4th Civil No. G026984

IN THE COURT OF APPEAL
STATE OF CALIFORNIA
FOURTH APPELLATE DISTRICT
DIVISION THREE

VALLELY INVESTMENTS, L.P.,
a California limited partnership,

Plaintiff/Appellant,

vs.

BANCAMERICA COMMERCIAL CORPORATION,
a Pennsylvania corporation; and DOES 1 through 50, inclusive,

Defendant/Respondent.

APPELLANT'S REPLY BRIEF

Appeal from the Orange County Superior Court
Honorable Robert D. Monarch, Judge
Case No. 792718

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INTRODUCTION

BACC is a self-described sophisticated business entity. (Joint Appendix ["JA"] 590.) If, during the Balboa workout, it was trying to invent some new breed of property conveyance, it had a team of talented lawyers at its disposal to figure out how to name it and how to specify its limitations.

Instead, BACC and its lawyers settled on an entirely conventional, long-established form of conveyance—"Assignment." (JA 113.) An assignment is "the transfer by the tenant of his entire interest in all of the demised premises for the full unexpired term of the original lease, without reservation of a reversionary interest." (6 Miller & Starr, California Real Estate (2d ed. 1989) § 18:52, p. 109.) That was exactly what the assigning tenant, Balboa, wanted and needed. (See JA 407 ["Assignor now desires to assign to Assignee all of Assignor's right, title and interest in and to the Ground Lease"].) There is not a shred of evidence that Balboa intended anything else.

The Lease required an assignee to assume all Lease obligations. (JA 66, 76.) That is exactly what the Stipulation describes. (JA 397, 407.) That is what BACC did. (JA 114.)

Since there can be no genuine doubt that BACC took an assignment and assumed the Lease obligations, BACC is left arguing that the Assignment was extinguished by RECMC's foreclosure on its trust deed. But BACC's sole authority—*Dover Mobile Estates*—does not apply, because it involved the narrow question of whether a purchaser of a fee interest at a trustee's sale could, at its option, keep alive a subordinated lease that otherwise would have been extinguished. Here, by contrast, there is no question about whether the Lease survived RECMC's foreclosure. Nor is there any question about RECMC's right to the entire leasehold interest as the purchaser at the trustee's sale. The key question, neither raised nor considered in *Dover*, is the survivability of the dispossessed lessee's obligations to *a different party*—here, BACC's lessor, Vallely—under the existing Lease.

The answer lies in the fundamental landlord/tenant principle of privity of contract, which is simply another way of saying that a lease binds all tenant-assignees who assume the lease obligations. Applying this principle leads to the inescapable conclusion that while BACC's privity of estate terminated with RECMC's foreclosure, its privity of contract with Vallely survived as a function of its express assumption of the Lease. Accordingly, BACC is liable on its promise to fulfill the Lease covenants.

As a fallback, BACC argues that the Lease was terminated by Edgewater's deemed rejection of it in federal bankruptcy proceedings. But the dated federal authority on which BACC relies has been thoroughly distinguished and repudiated. Both the current federal bankruptcy view and the longstanding common-law view is that a tenant's bankruptcy or insolvency can never extinguish the landlord's right to seek indemnity from a prior, nondebtor tenant.

As for BACC's remaining arguments, they have been largely anticipated and countered in Vallely's Opening Brief, and we add only a few additional comments when they are needed to correct BACC's distortions of the record or the law.

The summary judgment in favor of BACC must be reversed and the trial court directed to grant summary judgment to Vallely.

ARGUMENT

I.

THE ASSIGNMENT WAS EXACTLY WHAT IT PURPORTED TO BE—A COMPLETE TRANSFER OF BALBOA'S LEASEHOLD INTEREST TO BACC, UNDER WHICH BACC UNQUALIFIEDLY BOUND ITSELF TO FULFILL THE LEASE COVENANTS.

A. BACC Took An Assignment Of The Lease.

1. The Assignment describes a conventional assignment/assumption agreement, which was what Balboa and the Lease required.

To the extent this case seems complicated, it is only because BACC is asking the Court to view what actually happened through a fractured, revisionist lens. Here is what the record shows:

Balboa could not repay its debt to its lender, RECMC. It knew its leasehold interest was worth "substantially less" than what it owed RECMC (JA 395), and it presumably did not want to be liable for a deficiency judgment. When RECMC started to foreclose, Balboa petitioned for bankruptcy, triggering an automatic stay. (JA 397.) This made RECMC concerned that the property would fall into disrepair. (JA 892.) With this leverage, Balboa saw an opportunity to cut a deal.

Balboa offered to assign the Lease to RECMC. However, RECMC did not want to take the Lease by a direct assignment, because the property might remain subject to mechanic's liens. (JA 892-893; 4 Miller & Starr, *supra*, § 9:41, p. 112 ["when the beneficiary accepts a deed from the trustor in lieu of foreclosure, he is a successor of the grantor, and his title may be subject to the junior liens if there is a merger of the senior lien"].)

Someone proposed this solution: Balboa would sell for $25,000 "all of [its] right, title and interest as lessee in and to the Ground Lease" to a

third party, BACC. (JA 114, 397.) At that point, Balboa was free to go its separate way, while RECMC conducted a non-judicial foreclosure on its trust deed.

The catch, however, was that BACC was left holding the bag—BACC was in a position where it had unqualifiedly agreed to "observe, perform and fulfill all of" the Lease obligations. (JA 114.) There are two possibilities: (1) BACC knew this, and that is why it kept the Assignment secret from Vallely; or (2) BACC did not realize its exposure until Vallely sought to enforce its rights. Neither matters. BACC is bound by its actions. (See, e.g., *Berman v. Bromberg* (1997) 56 Cal.App.4th 936, 947 [plaintiff's intent upon cashing a check was "immaterial to whether such a sale in fact occurred" and "in no way changed the fundamental character of that transaction"]; Appellant's Opening Brief ["AOB"] 25-26.)

Now, a decade after the fact, BACC has conjured up a third possibility: Despite explicit language crafted by experienced counsel, it never really took an assignment from Balboa after all. Instead, it claims to have taken something that has no settled name in real estate law. BACC calls it, at various times, a sublease (Respondent's Brief ["RB"] at p. 15, fn. 3), a "temporally limited leasehold assignment" (RB at p. 19), and a "sub-set" of Balboa's interest under the Ground Lease (RB at p. 19).

None of these labels sticks. The document recorded in 1989, signed by BACC, is entitled "Assignment of Leasehold Interests." (JA 113.) It describes a conventional assignment:

> For valuable consideration, receipt of which is hereby acknowledged, Assignor [Balboa] does hereby sell, assign, transfer and set over to Assignee [BACC] (i) *all* of Assignor's right, title and interest as lessee in and to the Ground Lease; [description of other interests (ii) and (iii)]; (iv) and *all other right, title or interest held by Assignor in and to the Property*; to have and to hold the same together with all rights, easements, privileges and appurtenances thereunto belonging or appertaining or held and enjoyed therewith, *for and during the full respective unexpired terms of the Ground Lease*[.]

(JA 114, emphasis added.)

That describes an assignment to a "T": The transfer of a tenant's "*entire interest* in all of the demised premises for *the full unexpired term of the original lease*, without reservation of a reversionary interest." (6 Miller & Starr, *supra*, § 18:52, p. 109, emphasis added.)

Indeed, from Balboa's perspective at the time of its bankruptcy, conveying a lesser interest like a sublease would have made no sense. Balboa wanted to completely divest itself of the property. (JA 407 ["Assignor now desires to assign to Assignee all of Assignor's right, title and interest in and to the Ground Lease"].) By assigning the Lease, Balboa was relieved under bankruptcy law from liability for any later breach of the Lease by BACC. (11 U.S.C. § 365, subd. (k); 3 Collier on Bankruptcy (15th ed. rev. 1999) ¶ 365.08[4], p. 365-72.) There is absolutely no evidence that Balboa intended to forego this absolution by remaining a sublessor or retaining any other interest in the property. (6 Miller & Starr, *supra*, § 18:52, p. 110 ["under a sublease, the tenant-sublessor is the landlord of the subtenant"].)

Likewise, BACC is wrong when it argues that the Assignment must be a sublease because it "'creates a new cause of termination,'" that is, foreclosure. (RB at p. 15, fn. 3.) Foreclosure was already a ground for terminating Balboa's right to possession. By taking the Assignment, BACC stepped into Balboa's shoes, and became, just as Balboa was, vulnerable to dispossession by foreclosure. Nothing in the Assignment suggests Balboa intended to or did retain the right to re-enter on any condition, including the termination of BACC's right to possession. (6 Miller & Starr, *supra*, § 18:52, p. 110 ["[a] transferor who reserves a right of re-entry for breach of conditions has a contingent reversionary interest that prevents his transfer from operating as an assignment of the whole of the unexpired term; therefore, his transfer is a sublease"].)[1]

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[1] In fact, there is no evidence at all of Balboa's intent, other than the Assignment itself. That fact underscores why, as we explain in Section III.A.1.b below, BACC's one-sided extrinsic evidence of its own intent is irrelevant.

Nor could BACC have accepted such a novel thing as a "temporally limited" assignment, because the Lease itself *requires* an assignee to "accept and assume all of the terms and covenants in this lease." (JA 66, 76.) Since a limited assignment would have been less than that, it would not be authorized by the Lease. The bankruptcy court does not have the power to approve a lease transfer in violation of an express lease provision.[2] (See, e.g., *In re Washington Capital Aviation & Leasing* (Bankr. E.D.Va. 1993) 156 B.R. 167, 174-175 [debtor-lessor could not assume lease and assign to third party under terms that would violate lease provision requiring named individual to control lessor company]; *In re Pin Oaks Apartments* (Bankr. S.D.Tex. 1980) 7 B.R. 364, 372-373 [trustee could not assume lease and then sublease to third party where lease prohibited sublease without lessor's consent and lessor did not consent].)

2. The "subject to" language describes BACC's relation to the lender and has no effect on BACC's duties to Vallely.

BACC's entire "proof" of its alleged limited Lease interest is the Assignment's "subject to" language. But BACC takes the phrase completely out of context.

The Assignment is composed of three substantive paragraphs. Paragraph 1 is entitled "Assignment" and describes the transfer of "all of" Balboa's "right, title and interest as lessee in and to the Ground Lease" to BACC. (JA 114.) Paragraph 2 is entitled "Acceptance" and describes BACC's acceptance of the Assignment and its agreement with Balboa "to faithfully observe, perform and fulfill all of the terms, covenants and

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[2] The only exception is for a lease provision whose "primary purpose appears to be to restrict the assignability of the contract or lease or to deny to the trustee all or part of the economic benefits of the assignment." (3 Collier on Bankruptcy, *supra*, ¶ 365.08[3], p. 365-71; 11 U.S.C. § 365, subd. (f).) That exception does not apply here, where the Lease allows free assignability.

conditions and obligations required to be observed, performed and fulfilled by [Balboa] as lessee under the Ground Lease." (JA 114.) Paragraph 3 is entitled "Encumbrances":

> 3. Encumbrances. The within assignment is made expressly subject to the lien of [the construction deed of trust]. This assignment shall in no way impair or alter any rights or remedies provided to BA Mortgage and International Realty Corporation [now RECMC], as beneficiary under such Deed of Trust.

(JA 114.)

In other words, Paragraph 3 only addresses BACC's relationship with *RECMC*. It says nothing about the relationship between BACC and *Vallely*, which was created in Paragraph 2 when BACC agreed to fulfill the Lease covenants. That relationship is not conditioned on BACC's continued possession, and thus there is absolutely no reason why the obligations created by that relationship would have to terminate when RECMC exercised its lender's rights.[3] Accordingly, the "subject to" language can only be reasonably interpreted as having its ordinary real estate meaning: BACC agreed to assume the Lease, but not Balboa's debt to RECMC. (AOB 21-23.)

In sum, BACC took exactly what its attorneys negotiated and what the Lease required: A complete assignment of Balboa's leasehold interest, with the corresponding assumption of Balboa's duties to Vallely. A decade later, BACC cannot undo the legal consequences of that act.

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[3] At one point, BACC seems to be arguing that Paragraph 3's "subject to" language was intended to alter the priorities to make the trust deed senior to the Assignment. (RB at p. 15, referring to the effectiveness of "private agreements regarding the priorities of competing claims to real estate.") It is not clear what BACC means by this. Since the Assignment was recorded after the trust deed, there was nothing to reorder, so this reading would render the "subject to" language surplusage.

B. The Foreclosure Wiped Out Only BACC's Possessory Interest, Not Its Contractual Obligations.

1. California's priority rules only affect the lender's rights, not the non-competing contractual rights and duties of third parties like Vallely and BACC.

BACC's argument concerning the effect of foreclosure on the Assignment boils down to a mantra-like repetition of its position that a foreclosure extinguishes junior "interests." (See, e.g., RB at pp. 1, 16-18, 21.) But the actual rule is not so broad:

> Title to real property which is conveyed after foreclosure by a trustee's deed relates back to the date the trust deed was executed. The title passed is that held by the trustor at the time of execution. Liens which attached after the foreclosed trust deed was executed are extinguished and the purchaser takes title free of those junior or subordinate liens.

(*Principal Mutual Life Ins. Co. v. Vars, Pave, McCord & Freedman* (1998) 65 Cal.App.4th 1469, 1478.)

Stated in full, it is clear the rule governs only the *creditor's* relationship *to the property*. The rule explains what happened to RECMC. At the trustee's sale, RECMC acquired what it bargained for when the trust deed was executed: clear title to the lessee's interest in the ground lease, unencumbered by any tenancy or lien rights. But the rule says nothing about the dispossessed lessee's continuing contractual obligations *to the lessor*. The discussion in *Dover Mobile Estates v. Fiber Form Products, Inc.* (1990) 220 Cal.App.3d 1494, does not come anywhere close to this issue, and so provides no guidance. In contrast, *P.S.G. Limited Partnership v. August Income/Growth Fund VII* (1993) 115 N.M. 579 [855 P.2d 1043], discussed at pages 17-18 of the Opening Brief, comes very close—demonstrating how a lessor's contractual rights to liquidated damages survived foreclosure of a senior lien. *P.S.G.* also contains a detailed discussion of the critical distinction between the property

components and contract components of a lease—a distinction that BACC never meaningfully discusses.[4]

Strader v. Sunstates Corp. (N.C.App. 1998) 129 N.C.App. 562 [500 S.E.2d 752] is even closer. There, a landlord subordinated his fee interest so that his ground lease tenant could obtain a development loan. The tenant defaulted, and the lender foreclosed, causing the landlord to lose the property. The landlord then sued the tenant for breach of the lease's implied covenant to preserve the landlord's reversionary interest. The tenant defended by arguing the lease was terminated by foreclosure and any other conclusion would "disturb the settled rule that the foreclosure of a senior lien extinguishes junior property interests." (500 S.E.2d at p. 758.) The North Carolina Court of Appeals easily recognized the overstatement. Distinguishing between the lease's property and contractual components, the court concluded that while the landlord's property interest in the land was lost at foreclosure, the landlord "may still seek damages based on his contractual rights." (*Id.* at pp. 756-758.) Consequently, the court affirmed the judgment awarding the landlord, among other damages, the present value of rent for the remaining lease term. (*Id.* at pp. 756-758.)

Similarly, Vallely maintains its contractual rights against BACC even after RECMC's foreclosure. In fact, *Strader* shows how, but for Balboa's bankruptcy, Balboa would also have been liable under the Lease to Vallely. That is because a lender's foreclosure on a lease interest does not affect the contractual obligations that run between the landlord and

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[4] It is difficult to make out what BACC means when it argues that *P.S.G.* is "distinguishable" because "the subordination at issue in *P.S.G.* did not apply to the claims asserted in the lawsuit." (RB at p. 22.) PSG's predecessor subordinated its fee and lessor interests to a leasehold mortgage. (*P.S.G.*, *supra*, 115 N.M. at p. 580.) That gave the lender the right to take over the property upon foreclosure. PSG's predecessor, however, excepted the right to rental payments. Thus, PSG, as the successor lessor, had the right to enforce its tenants' rental obligations even after it and the tenants had been dispossessed by foreclosure. Vallely (which never subordinated its fee interest) was always in a position to enforce its lessees' covenants after foreclosure on their leasehold interest. PSG's exception simply makes it *more* like Vallely in that respect.

tenant—even when the tenant is dispossessed and broke. Since, by taking the Lease and assuming its obligations, BACC became Balboa's substitute, BACC's contractual lessee duties are enforceable by Vallely even after RECMC's foreclosure.

2. California cases confirm the rule that contractual obligations that do not compete with the lender's rights survive foreclosure.

Even without referring to out-of-state authority, the California decisions in *Principal Mutual Life Ins. Co. v. Vars, Pave, McCord & Freedman, supra*, 65 Cal.App.4th 1469 and *Miscione v. Barton Development Co.* (1997) 52 Cal.App.4th 1320 show how contractual components of leases can survive foreclosure. In both decisions, the landlords and tenants agreed the tenants would attorn to any new landlord, and they documented their agreements in subordinated leases.[5] In both cases, the attornment agreements survived foreclosure of the trust deeds that extinguished the leases. And in *Principal Mutual Life*, the court specifically recognized that the new landlord could enforce the attornment agreement as a third party beneficiary. (65 Cal.App.4th at pp. 1486-1487.)

If BACC's view of the effect of foreclosure on a tenant's lease obligations were correct, neither *Principal Mutual Life* nor *Miscione* could have been decided as they were. By BACC's reasoning, the attornment agreements would have been extinguished when the leases in which they were contained were extinguished. Indeed, that was exactly the tenants' position in *Miscione* (52 Cal.App.4th at p. 1329) and *Principal Mutual Life* (65 Cal.App.4th at p. 1486). They lost that battle, because *Dover*'s priority rule simply did not apply to their contract issues. (*Principal Mutual Life*,

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[5] In *Miscione*, the trust deed was prior in time and therefore senior to the lease by operation of law. (52 Cal.App.4th at p. 1326.) In *Principal Mutual Life*, the trust deed was recorded after the lease, but the lease contained a subordination clause that made the trust deed senior to the lease as a matter of contract. (65 Cal.App.4th at pp. 1476-1477.)

supra, 65 Cal.App.4th at p. 1483 ["*Dover's* failure to discuss and consider the effect of an attornment clause on the status of a subordinate lease after foreclosure by a senior encumbrancer renders *Dover* inapplicable here"]; *Miscione*, *supra*, 4 Cal.App.4th at p. 1329 ["*Dover* is distinguishable for the simple reason that the court in that case did not discuss whether the lease contained an attornment clause or what the effect of such a clause would be"].)

Here, BACC's agreement to assume the Lease covenants is contained in the Assignment. Upon RECMC's foreclosure, BACC's right to possession was terminated. But BACC's promise to fulfill the Lease covenants independently binds it—just as the *Principal Mutual Life* and *Miscione* tenants were independently bound by their promise to attorn to their new landlord. Vallely, like the *Principal Mutual Life* landlord, is a third party beneficiary of its tenant's agreement and may therefore enforce its tenant's independent obligations to it, the lessor.

BACC is incorrect in stating that an assignment is wiped out by foreclosure on a senior interest. (RB at pp. 19, 21.) *R-Ranch Markets #2 v. Old Stone Bank* (1993) 16 Cal.App.4th 1323 shows why. There, the landlord entered into a lease with the original tenant. A new landlord purchased the property with the help of a loan secured by a trust deed. (*Id.* at p. 1326.) The *R-Ranch* tenant took by assignment from a successor to the original tenant *after* the trust deed was recorded. When the lender later foreclosed, it attempted to evict the tenant-assignee on the ground BACC advocates here—that the assignment, which was after the trust deed, was extinguished. (*Id.* at pp. 1326, 1329-1330.) The court disagreed, upholding the tenancy because the original lease was prior in time to the trust deed. (*Id.* at p. 1330.) Had the court adopted BACC's view, however, the tenancy would have been extinguished automatically.

In sum, as we explained in the Opening Brief (page 14), elementary principles of property law establish that foreclosure does not eliminate contractual obligations that do not affect the senior lienholder's interest. That is why *Principal Mutual Life*, *Miscione*, *R-Ranch, P.S.G.*, and

Strader were decided as they were. That is why BACC is liable on its contractual obligations to Vallely here.

3. Why *Dover Mobile Estates* doesn't apply.

BACC hangs its entire foreclosure argument on *Dover Mobile Estates*, but the case simply cannot bear the weight. *Dover* addressed a specific lending question: May a purchaser at a foreclosure sale, at its option, elect to keep alive a subordinate lease? That is not our question, nor is the court's negative answer one that has been universally accepted.

Dover involved a lease that was subordinated to a trust deed by the lease's express terms but also allowed the lender to reverse the subordination at its election. In practice, that meant that in the event of impending foreclosure, the lender could elect to preserve the lease or let it be extinguished. In *Dover*, the lender foreclosed without notifying the lessee that it intended to treat the lease as senior to the trust deed. (200 Cal.App.3d at p. 1499.) Dover Mobile Estates, which purchased the property at the trustee's sale, knew of the lease before the sale. (*Id.* at p. 1497.) It nevertheless attempted to enforce the lease after purchase, arguing it should have the option of terminating it or not. (*Id.* at p. 1500.) The tenant contended that the foreclosure extinguished the lease. (*Id.* at p. 1497.) The court sided with the lessee, concluding that it would be unfair to allow the foreclosure purchaser to elect whether to subordinate the lease on the basis of its profitability while ignoring the tenant's concerns. (*Id.* at p. 1500.) The court saw itself as fulfilling the tenant's expectation when it executed the lease that, unless it were notified otherwise, the lease would be wiped out as a junior encumbrance upon foreclosure.[6] (*Ibid.*)

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[6] *Dover* has been "criticized by many mortgagee supporters as denying the mortgagee the right to carry out a scheme that was the probable intent of the documentation," although the case has also been defended by those sympathetic to the plight of a tenant who is left hanging "until after the foreclosure takes away any ability for the tenant to prepare to leave or prepare to stay." (September 16, 1998 Daily Development from the

(continued...)

For multiple reasons, none of this has anything to do with our issues:

1. Our case does not require the Court to construe the beneficiary/purchaser's rights. Here, everyone agrees that, on foreclosure, RECMC received what it bargained for in its trust deed—title to the Lease, free and clear of anyone else's competing interests. BACC's Lease obligations are not a competing interest; they flow outside of the chain of RECMC's title, and *Dover* is of no help in analyzing them.

2. Our case, unlike *Dover*, involves an unsubordinated ground lease, not a subordinated lease. The Lease is itself the security for RECMC's loan, and thus the *subject of*, not subordinate to, the trust deed.

3. At the end of *Dover*, the court noted that the tenant could have contracted for a different result: "[T]he tenant under a subordinate lease can obtain some protection by requiring the landlord to obtain from its lender a non-disturbance agreement in favor of the tenant." (*Id.* at p. 1500.) Thus, the court recognized that, even in a subordinated lease context, contractual rights and duties could survive foreclosure.

4. The lessee and lessor's expectations in an unsubordinated ground lease context are completely different from those in the subordinated lease context of *Dover Mobile Estate*. Tenant-developers expect to be able to use their leasehold interest as security for a development loan. The Lease's Article 12 allows that. (JA 66.) They also expect, as Balboa did here, to make money by improving the land and subletting the building space, profiting from the income stream generated from the subleases. (JA 65 [permitting subleasing]; Harper, Ground Leases

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[6] (...continued)
Quarterly Report on Developments in Real Estate Law, published by the ABA Section on Real Property, Probate & Trust Law, available on the internet as http://cctr.umkc.edu/dept/dirt/dd98/dd091698.htm.) *Dover*'s limited view of a foreclosure-purchaser's rights, however, is the minority one. The majority rule in the United States "gives the beneficiary (or any other purchaser at the foreclosure sale) the option of terminating the lease," which is not automatically terminated. (Dunaway, The Law of Distressed Real Estate (1997-1999 West Group) § 7.04[3] [discussing *Dover*], available on Westlaw as "LAWDRE s 7.04".)

and Land Acquisition Contracts (1999) § 2.01[1], p. 2-8.4.) Tenant-developers can also make money by improving the land, then selling their interest for a substantial profit. (*Id.* at § 2.01[5], p. 2-8.36.) For this reason, they may "insist that their lease liability be limited to the leasehold estate created by the ground lease." (*Id.* at § 2.01[1], p. 2-8.5.)

As for the lessor's expectation, "[I]t doesn't take a rocket scientist to understand the landowner's fundamental objectives":

> Landowners are usually risk adverse. They don't want to lose what they have. They don't want to invest money in land improvements or construction. They are attracted by the prospect of a steady and safe income stream. When they execute development-oriented unsubordinated ground leases, they expect to get a regular and uninterruptible stream of rent payments. They also expect to own the tenant-developer's buildings and other improvements when the lease term ends.

(*Id.* at § 2.01[2], p. 2-8.10.)

Being risk adverse, unsubordinated ground lessors are concerned that the property stay in the hands of responsible lessees. This means they are generally reluctant to allow a tenant-developer to assign the lease at its pleasure. (*Id.* at § 2.01[5], p. 2-8.46 ["Giving the tenant-developer complete freedom to assign the leasehold estate before the buildings and other improvements are completed is not much different from giving the tenant-developer complete freedom to speculate on the value of the demised premises"].)

Here, the Lease reaches a compromise between free assignability and tenant responsibility. On one hand, there is no exculpation clause for assigning lessees.[7] On the other hand, Article 12 permits all lessees to freely assign the Lease without obtaining the lessor's consent, as long as the assignors "assume all of the terms and covenants in this lease." (JA 65-66.)

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[7] Underscoring the significance of this omission, there is an express exculpation clause for lenders. (JA 70.) BACC is not the lender, nor the agent of the lender, as shown in Vallely's Opening Brief at pages 38-39 and below in Section II.C.

Here, BACC benefitted from the Lease's free-assignability provision when it accepted the Assignment from Balboa without seeking Vallely's consent. BACC must accept the corresponding burden of assuming the Lease obligations, because that is the very essence of the bargain that lies at the heart of the Lease.[8]

5. Bankruptcy law, not a factor in *Dover Mobil Estates*, also requires that BACC be liable under the Lease. Section 365, subdivision (k) of the Bankruptcy Code provides that once Balboa assumed the unexpired Lease and assigned it to a third party (BACC), then Balboa was relieved of any further liability, and BACC became fully liable under the Lease. (*In re Pin Oaks Apartments*, *supra*, 7 B.R. at p. 367 [under bankruptcy law, "the debtor is granted the rights to assign a lease to a third party who becomes fully liable thereunder"]; 11 U.S.C. § 365, subds. (k), (f).) In this way, bankruptcy law allows for the lease's continuation, with the new lessee substituted in the debtor's place, taking on the debtor's rights and duties. If BACC now escapes liability, BACC will have misused the bankruptcy process to destroy the lessor rights both the bankruptcy code and Lease are designed to protect.

In sum, BACC's efforts to make *Dover Mobile Estates* a kind of procrustean bed for all lease foreclosure situations fails. Our case won't fit unless BACC hacks off key distinguishing facts (like the fact that the Lease, as the security for RECMC's loan, survives foreclosure, or the fact of the parties' differing expectations), or stretches the truth about assignments (i.e., that they are *per se* extinguished by foreclosure), or simply ignores the

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[8] BACC argues that since Vallely was not a party to the Stipulation, it cannot "have formed any expectation that the foreclosure would inure to its benefit." (RB at p. 2.) But that turns the issue on its head. Vallely's expectation was and is that each lessee be fully liable under the Lease covenants for the entire Lease term. If BACC wanted to be excused from that requirement, it was incumbent on it to *seek Vallely's permission* and attempt to negotiate an exculpatory agreement. Because BACC did not do this, it assumed the Lease as drafted. Accordingly, it is bound just as any other lessee would be.

body of California property law that holds a tenant liable on its promise to assume a lease for the full lease term.

This case snugly fits the privity of contract cases discussed in the Opening Brief (pages 11-18) and the cases discussed above. They establish that while foreclosure wiped out BACC's junior *possessory* interest in the Lease, thus allowing RECMC to control the leasehold estate upon purchasing it at the trustee's sale, foreclosure had no effect on BACC's *contractual* obligations to Vallely, which are a function of its assuming the Lease and all its covenants when it executed the Assignment.

C. Vallely Has Not Received And Will Not Receive A "Windfall"—Only The Rents Due And Owing Under The Lease.

When Vallely and Balboa executed the Lease, Vallely bargained for rents on the property that Balboa promised to improve and sublease, and it bargained to own the improvements. (JA 16-26, 32-39, 76-78.) When Balboa defaulted, BACC opted to step into the Lease and pay the rent. BACC complains, without evidentiary support, that the rents at that time were "above-market" (RB at p. 48)—as if Vallely had any say in BACC's decision to become its tenant, or any control over the rental market. BACC, of its own choice, took the Lease as it found it.

When RECMC foreclosed, it decided the leasehold estate was worth purchasing at the trustee's sale. Any difficulties it experienced in selling the Lease cannot be laid at Vallely's doorstep.

Where is the supposed "windfall" that BACC complains of? Vallely seeks nothing more than its contractual due. A "sophisticated business entit[y]" (JA 590), represented by experienced counsel, BACC made an unequivocal promise to fulfill the Lease covenants. There is no windfall in the performance of its promise.

II.

NONE OF BACC'S REMAINING ARGUMENTS SUPPORTS ITS SUMMARY JUDGMENT.

Besides foreclosure, BACC argues three other grounds for affirming its summary judgment: (a) suretyship's exoneration defense; (b) Edgewater's rejection of the Lease in bankruptcy; and (c) Article 13(e)'s lender-exculpation provision. (RB at pp. 23-36.) None has any merit.

A. BACC Is Not A Surety, Nor Is It Entitled To Any Suretyship Defenses.

Only a few points are required here, since the Opening Brief anticipated and addressed most of BACC's arguments. (See AOB 26-31.)

First, contrary to BACC's assertion (RB at p. 34, fn. 11), Vallely has never conceded BACC's surety status.

Second, BACC contends that the California Supreme Court overruled *DeHart v. Allen* (1945) 26 Cal.2d 829 in the later decision *Kendall v. Ernest Pestana, Inc.* (1985) 40 Cal.3d 488 (RB at p. 33, fn. 10). But it is not the Court's practice to overrule its leading cases sub silentio. (See, e.g., *San Francisco Unified School Dist. v. W.R. Grace & Co.* (1995) 37 Cal.App.4th 1318, 1332 ["If the California Supreme Court intended to overrule these cases, it is unlikely that it would do so—especially a landmark case such as [Supreme Court decision] *Seely*—sub silentio"].)

Third, as we explain in the Opening Brief, there is no conflict between *DeHart* and *Kendall*. In *Kendall*, the Court did not consider the nature of an assignor's continuing liability to the lessor, but merely stated it as a fact in support of its conclusion on a different issue. Nothing in *Kendall* suggests that an assignor's surety-like, continuing liability precludes it from being, in the *DeHart* sense, a primary obligor who is not entitled to suretyship defenses. BACC's quotation from Miller & Starr says no more. (RB at p. 33.) Indeed, later in the same section from which BACC quotes, Miller & Starr clarify that the assignor "is not exonerated,

and remains liable on the lease even though the landlord grants unauthorized extensions of time to the assignee, or permits the assignee to alter the premises." (6 Miller & Starr, *supra*, § 18:54, p. 114; see also *Meredith v. Dardarian* (1978) 83 Cal.App.3d 248, 252 [original tenants "not entitled to the defense of exoneration of a surety"].) In other words, the assignor is *not* a surety in the sense that it is entitled to suretyship defenses. The *Kendall* Court did not face that issue and did not purport to decide it. BACC "cannot find shelter under a rule announced in a decision that is inapplicable to a different factual situation in his own case." (*Harris v. Capital Growth Investors XIV* (1991) 52 Cal.3d 1142, 1157.) *DeHart*, therefore, controls.

Fourth, even if BACC were a true surety, it would not be entitled to the surety defense of lack of notice, because Vallely did not learn of the assignment to BACC until May 1996—after executing the Addendum. (JA 439, 725, 789.) BACC argues that Vallely actually did have constructive notice because the Assignment was recorded (RB at p. 34, fn. 11), but that argument fails for two reasons:

(a) It is the lessee's responsibility to deliver a copy of the recorded Assignment to Vallely. (JA 65-66 [Article 12.2].) BACC cannot fail to comply with its notice duty and then fault Vallely for not knowing.

(b) The doctrine of constructive notice does not apply here. "The purpose of the recording statutes is to give notice to *prospective purchasers or mortgagees* of land of all existing and outstanding estates, titles or interest, whether valid or invalid, that may affect their rights as bona fide purchasers." (*Domarad v. Fisher & Burke, Inc.* (1969) 270 Cal.App.2d 543, 544, emphasis added.) Vallely was not a prospective purchaser—it already owned the property when BACC recorded the Assignment. A property owner is not placed on either inquiry notice or constructive notice of an interest recorded after its own. (*R-Ranch Market #2, Inc. v. Old Stone Bank*, *supra*, 16 Cal.App.4th at p. 1329, fn. 2.)

Fifth, the one-year, monthly payment accommodation that Vallely made to Edgewater was immaterial for the reasons given in the Opening Brief at pages 30-31. BACC has not made any showing that it was

prejudiced in any way by the trivial modification. And even if the modification were not material, BACC was, at most, exonerated for only the 1996 rent. (AOB 31.) Since BACC does not address this point, the Court may conclude that it is conceded.

B. Edgewater's Rejection Of The Lease Had No Effect On BACC's Continuing Lease Obligations.

BACC's only authorities for its rejection defense are *Ilkhchooyi v. Best* (1995) 37 Cal.App.4th 395, *366-388 Geary St., L.P. v. Superior Court* (1990) 219 Cal.App.3d 1186, and a handful of federal cases out of courts in the Ninth Circuit decided in the 1980s. (RB at pp. 24-28.) But the Opening Brief demonstrated why *Ilkhchooyi* is distinguishable. (AOB 36-37.) The federal cases are superseded by later cases and, in any event, not on point, as we explain below. And since *366-388 Geary* relies on the same outdated federal cases, it, too, is not controlling. In any event, its facts are inapposite.

As shown in our Opening Brief, the question of whether Edgewater's bankruptcy "terminated" the Lease is academic. (AOB 34-35.) California upholds the longstanding common-law rule that a tenant's bankruptcy or insolvency cannot dissolve the relationship between the nondebtor lessee-assignor and the lessor. (*Tsemetzin v. Coast Federal Savings & Loan Assn.* (1997) 57 Cal.App.4th 1334.) BACC seems to think that this rule does not apply in the specific context of Chapter 11 bankruptcy (RB at p. 24), but it offers no reason why a *nondebtor*'s rights against *another nondebtor* should hinge on the debtor's federal forum for resolving its debts.

In any event, the current view in federal bankruptcy courts, including two courts in the Ninth Circuit, is that rejection does *not* diminish the rights of third parties with rights in the leasehold estate. (3 Collier on Bankruptcy, *supra*, ¶ 365.09[3], pp. 365-74-365-75; AOB 36 [collecting authority, including *In re Bergt* (Bankr. D.Alaska 1999) 241 B.R. 17, 25 and *In re Locke* (Bankr. C.D.Cal. 1995) 180 B.R. 245]; see also *Medical*

Malpractice Ins. Ass'n v. Hirsch (In re Lavigne) (2d Cir. 1997) 114 F.3d 379, 386-387 ["While rejection is treated as a breach, it does not completely terminate the contract"]; *Chateau Communities, Inc. v. Miller* (E.D.Mich. 2000) 2000 U.S. Dist. LEXIS 12545, *7-8.) Accordingly, the rights of nondebtors with lease interests (such as lessors) are enforceable against other nondebtors with lease interests (such as co-tenants and guarantors). (See, e.g., *In re Locke*, *supra*, 180 B.R. at pp. 260-261 [debtor-lessee's rejection of lease did not terminate lease as to nondebtor cotenants, and thus did not terminate their liability on judgment lien]; *In re Modern Textile, Inc.* (8th Cir. 1990) 900 F.2d 1184, 1191 ["the lessor's claim for breach survives the Trustee's rejection; thus, the lessor can still look to the person or entity that guaranteed the debtor's lease obligations"].) Contrary to BACC's position (RB at p. 24), this is entirely consistent with 11 U.S.C. § 365, subdivision (d)(4), which requires a debtor-lessee to immediately surrender the property to the lessor once the lease is deemed rejected: "[T]he debtor's right to possession of the premises is extinguished but the leasehold itself is not." (3 Collier on Bankruptcy, *supra*, ¶ 365.09[3], p. 365-75.)

It is true that in the past, some bankruptcy courts categorically stated that a lessee-debtor's rejection of its lease terminated the lease. These are the cases on which BACC relies. They fall into two categories:

(1) *Debtor-lessees' interests.* In these bankruptcy court decisions (*Sea Harvest Corp. v. Riviera Land Co.* (9th Cir. 1989) 868 F.2d 1077; *In re Southwest Aircraft Services, Inc.* (Bankr. C.D. Cal. 1985) 53 B.R. 805, aff'd, (9th Cir. BAP 1986) 66 B.R. 121, rev. on other grounds, 831 F.2d 848 (9th Cir. 1987)), the courts only considered the effect of rejection on the *debtor-in-possession's* interest, and the cases are not authority for situations where a nondebtor's property or contract rights in property of the estate are at issue. (*In re Locke*, *supra*, 180 B.R. at pp. 252-255 [explaining these decisions]; cf. *Tsemetzin*, *supra*, 57 Cal.App.4th at p. 1346 [rejecting cases that did not deal with the precise question of the liability of an original lessee under a rejected lease].)

(2) *Creditors' interests.* In these cases, the courts concluded that the debtor's rejection extinguished all security interests taken in the debtor's lease interest. (*In re Gillis* (Bankr. D. Haw. 1988) 92 B.R. 461; *In re Bernard* (Bankr. D. Haw. 1986) 69 B.R. 13; *In re Hawaii Dimensions, Inc.* (D. Haw. 1985) 47 B.R. 425.) This conclusion has been thoroughly repudiated in later bankruptcy decisions. (*In re Austin Development Co.* (5th Cir. 1994)19 F.3d 1077, 1081 [decisions such as *Gillis* and *In re Hawaii Dimensions* are "[f]lawed by their failure to analyze § 365(d)(4) in harmony with the rest of § 365 and applicable statutory antecedents" and "have worked needless and perhaps unconstitutional forfeitures of security interests"]; *In re Bergt, supra*, 241 B.R. at p. 31 ["[t]he [*Gillis*] court completely disregarded the bank's rights in the collateral"]; *In re Locke, supra*, 180 B.R. at pp. 256-257 [*Hawaii Dimensions, Bernard,* and *Gillis* "failed to provide a persuasive rationale" for their conclusions]; 3 Collier on Bankruptcy, *supra*, ¶ 365.09[a], p. 365-75.)

366-388 Geary St., L.P. v. Superior Court falls in the second category. There, the issue was whether the leasehold mortgagee could revive the lease after the tenant rejected it in bankruptcy. The court expressly relied on the discredited *In re Gillis* and *In re Bernard* decisions for its conclusion that the mortgagee's security interest was extinguished by the rejection. (219 Cal.App.3d at pp. 1197-1198.)

In any event, all the creditor cases are factually inapposite, because they are concerned with the issue of the lease as the creditor's security for the debtor's performance. Here, the Lease is not security for anything owing to Vallely. *BACC* is Valley's security. BACC's direct, contractual obligation to Vallely would not be extinguished even if the Lease were.

Finally, *Ilkhochooyi v. Best*, though distinguishable for the reasons discussed in the Opening Brief, is no longer current to the extent it suggests that sublessees' interests are automatically terminated upon a tenant-sublessor's rejection of the lease in bankruptcy. (37 Cal.App.4th at p. 404.) Insofar as the suggestion is derived from *366-388 Geary* and federal bankruptcy decisions from the 1980s (*ibid.*), its foundation has collapsed. A sublessee's rights and duties are controlled by state property and contract

law. They are not terminated by federal bankruptcy law. (*Block Properties Co., Inc. v. American Nat. Ins. Co.* (Mo.App. 1999) 998 S.W.2d 168, 175-177 [lessee's rejection of master lease did not result in termination of lease under federal or state law or terms of master lease and sublease; sublessee therefore entitled to continued possession]; 3 Collier on Bankruptcy, *supra*, § 365.09[3][a], p. 365-75 ["recognition that rejection of the lease does not terminate all rights under the lease leaves it open to the sublessee or leasehold mortgagee to prove that under nonbankruptcy law it is entitled to retain its interest even if the debtor-lessee breached the lease"].)[9]

In sum, nothing in federal bankruptcy law preempts the application of California's privity of contract principles to two nondebtors (BACC and Vallely) with lease interests. For these and all the reasons set forth in the Opening Brief, there is no merit to BACC's rejection argument.[10]

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[9] In dictum, Division Six of the Second Appellate District recently stated that the Ninth Circuit "take[s] the position that an immediate surrender order extinguishes the lease entirely and may terminate the rights of third parties which arise from the interest of the bankrupt." (*George v. County of San Luis Obispo* (2000) 78 Cal.App.4th 1048, 1053.) The issue in *George*, however, was whether a sheriff was immune from civil liability for evicting nondebtor co-tenants, pursuant to a federal bankruptcy court order, when the debtor-tenants had rejected their lease in bankruptcy. For the purposes of resolving the civil suit, the court did not need to reach the question of whether the order exceeded the bankruptcy court's powers. Its discussion of the Ninth Circuit's law was dictum, and, in any case, inaccurate and incomplete. The court failed to mention two contrary, recent decisions out of bankruptcy courts in the Ninth Circuit, *In re Bergt, supra*, and *In re Locke, supra* (the latter expressly involving the status of nondebtor co-tenants). Moreover, each of the four cases that *George* cited (78 Cal.App.4th at p. 1053) either falls into one of the two categories described above, or is otherwise factually distinguishable.

[10] Buried in a footnote in its Statement of Issues section, BACC suggests that the trial court's denial of BACC's first summary judgment motion (where it first raised the rejection issue) was "improper" because it was rendered more than 60 days after Vallely's new trial motion. (RB at p. 11, fn. 2.) The point is irrelevant, since Vallely has assumed this Court will reach the issue on the merits. In any event, BACC is wrong. The trial

(continued...)

C. BACC Is Not RECMC's Agent And Therefore Not Entitled To The Lease's Lender Protections.

In response to Vallely's discussion of why BACC is not RECMC's agent as a matter of California law (see AOB 38-39), BACC simply pronounces, *ipse dixit*, that it is an agent. (RB at p. 31.) That is not enough to establish, as a matter of fact or law, the existence of an agency relationship.

BACC's focus on the Lease's Article 13(e) (RB at pp. 30-31) is irrelevant. That provision provides that lenders who become owners of the leasehold estate "by foreclosure or by assignment in lieu of foreclosures" are liable only for the term of their possession. (JA 70.) But since BACC is not the lender, Article 13(e) does not apply.

BACC sees some kind of concession in Vallely's argument that the Assignment was part of a legitimate lending transaction. (RB at p. 31; see AOB 41.) Not so. Vallely made that point to demonstrate that RECMC would not be acting ultra vires in setting up the Assignment transaction. But even if one assumes (there is no evidence of this) that RECMC masterminded the transaction, that does not make BACC its agent, and it certainly does not make BACC the lender.

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[10] (...continued)
court, recognizing that the new trial deadline had lapsed, instead reconsidered and corrected an erroneous ruling on its own motion. (RT 40-41.) As this Court has held, the trial court has broad discretion to reconsider an erroneous order prior to the entry of judgment. (*Gailing v. Rose, Klein & Marias* (4th Dist., Div. 3, 1996) 43 Cal.App.4th 1570, 1579; see also *Darling, Hall & Rae v. Kritt* (2nd Dist., Div. 7, 1999) 75 Cal.App.4th 1148, 1157 [judicial resources "would be wasted if the court could not, on its own motion, review and change its interim rulings"]; *Nave v. Taggart* (Fifth Dist., 1995) 34 Cal.App.4th 1173, 1177 ["Until entry of judgment, the court retains complete power to change its decision as the court may determine"]; *Phillips v. Phillips* (1953) 41 Cal.2d 869, 874; but see *City and County of San Francisco v. Tijerino* (First Dist., Div. 2, 2000) 82 Cal.App.4th 160, 168 [court may not reconsider prior rulings except as specified by Code of Civil Procedure, section 1008].)

Almost as an afterthought, BACC points to one hearsay memo, in which RECMC thanks BACC for its cooperation and purports to reimburse it for rent and other money paid (JA 913). Even accepting the memo as admissible (but see AOB 23-25 and section III.A.2 below [objections to evidence]), that does not establish any of the three legal elements of an agency. (See *Lewis v. Superior Court* (1994) 30 Cal.App.4th 1850, 1868-1869; AOB 38.) On the other hand, the evidence that BACC signed the Assignment as "Assignee" (JA 116) and that it informed Balboa's tenants that it was the new owner (JA 721) show that BACC acted as an independent entity (AOB 38).

III.

BACC CONCEDES THAT ITS REMAINING ISSUES ARE NOT GROUNDS FOR AFFIRMING THE JUDGMENT, AND IT HAS NOT IDENTIFIED ANY TRIABLE ISSUES OF MATERIAL FACT.

The remaining issues are: (a) BACC's intent; (b) ultra vires; and (c) novation. In the Respondent's Brief, BACC appears to retreat from its trial court position that these three grounds justify summary judgment in its favor.[11] BACC now relegates them to the last section of its brief, which argues that reversal should not direct judgment for Vallely, because there are supposedly triable issues of material fact. (RB at pp. 37-47.)

BACC contends that the trial court found there was a factual dispute about these issues (RB at p. 38), but it is wrong. The trial court never reached those issues, because it concluded, erroneously, that BACC's interest in the Lease terminated upon RECMC's foreclosure. (JA 1038.) In

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[11] BACC raised the first two issues in response to Vallely's motion for summary judgment (JA 592-600), but then argued them in support of its own summary judgment motion (JA 899-900, 1000-1001). BACC raised novation as a ground for affirming the trial court's original judgment in favor of BACC on the rejection issue. (JA 278-280.)

any event, as we show below, BACC's "evidence" does not create a triable issue that justifies denial of summary judgment for Vallely.

A. BACC's Intention Is Irrelevant.

1. The extrinsic evidence does not create a triable issue of fact.

a. The extrinsic evidence is legally irrelevant because the Assignment is not reasonably susceptible to any meaning other than that BACC assumed the Lease for the full Lease term.

Vallely does not dispute, at least for the purposes of this appeal, that BACC expected to possess the Lease only for the time it took RECMC to conduct a non-judicial foreclosure. At best, the Stipulation and declarations (which are, in any case, inadmissible, see AOB at pp. 23-26 and below) establish no more. But BACC's possessory expectation has no bearing on the question of the term of its contractual Lease obligations to Vallely. That question is settled by state property law. By signing an unqualified agreement assuming the Lease, BACC became bound to the Lease by privity of contract. (See AOB at pp. 11-13.) The Assignment is not reasonably susceptible to any other meaning, and BACC cannot now introduce extrinsic evidence to try to show it did not mean to do what it did. The bank in *Tahoe National Bank v. Phillips* (1971) 4 Cal.3d 11 tried a similar tactic—and lost.

In *Tahoe National Bank*, the defendant borrowed money from a bank for a business venture and executed an instrument entitled "Assignment of Rents and Agreement Not to Sell or Encumber Real Property." The property described was the defendant's residence, which remained unencumbered until she recorded a declaration of homestead. The bank then sued and sought foreclosure. The bank attempted to introduce

extrinsic evidence to show that it actually meant to create an equitable mortgage, and pointed to the word "security" in the assignment's preamble as evidence that the instrument supported its interpretation (because, it argued, "security" signified a right of foreclosure). (*Id.* at pp. 19-20.) The Court was unsympathetic: "[W]e are not dealing with homemade security instruments in which the parties labor to produce a mortgage but fall short of the legal requirements and must be rescued by a court of equity." (*Id.* at p. 18.) Rather, the plaintiff was, like BACC, a sophisticated bank. (*Ibid.*) "[H]aving selected a form for 'assignment of rents and agreement not to sell or encumber real property,'" the bank was "bound by the terms of that agreement." (*Ibid.*) It could not turn the assignment into a mortgage by "legal alchemy." (*Id.* at p. 20.) The bank's extrinsic evidence was therefore legally irrelevant and could not support the judgment in the bank's favor, which the Court reversed. (*Id.* at pp. 23-24; see also *Commerce & Industry Ins. Co. v. Chubb Custom Ins. Co.* (1999) 75 Cal.App.4th 739, 746 [a "few scattered references to 'contingent property' and 'contingent coverage'" in insurance policy "will not suffice to transmute what is obviously a policy for primary coverage"; extrinsic evidence of insurance company's intent irrelevant].)

Here, too, the Assignment is a conventional assignment. In Paragraph 1, BACC received all of Balboa's interest in the Lease. (JA 114.) In Paragraph 2, BACC assumed the entire Lease and all its obligations. (*Ibid.*) BACC, with all its financial sophistication, cannot transform this conventional assignment into some kind of exotic breed of conveyance transferring limited lease rights under special conditions.[12]

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[12] Moreover, BACC's decision to express its understanding of its rights and duties in a conventional instrument was undoubtedly deliberate. When Balboa filed for bankruptcy, triggering an automatic stay, RECMC became anxious to take immediate control of the property. (JA 892.) By structuring the deal as a conventional assignment/assumption, RECMC and BACC avoided sticky questions from the bankruptcy court about the rights of an absent lessor who might be prejudiced if BACC refused to assume the Lease for the full Lease term. (See, e.g., *In re Pin Oaks Apartments, supra*, 7 B.R. at p. 371 [if assignee is unwilling to accept the lease "as is," then he

(continued...)

b. There is no evidence that Balboa intended anything other than a conventional assignment.

Even assuming that it were meaningful to establish by extrinsic evidence whether BACC actually intended to receive from Balboa only some kind of a short-term, limited interest in the Lease, there is still no evidence that BACC's intention was conveyed *to Balboa.* On that score, the Assignment is clear: Balboa transferred to BACC its entire Lease interest. (JA 407 ["Assignor now desires to assign to Assignee all of Assignor's right, title and interest in and to the Ground Lease"].) Without evidence that Balboa intended to transfer some lesser interest, BACC's one-sided evidence of what it intended by making the Assignment "subject to" the trust deed is irrelevant. (*Commerce & Industry Ins. Co.*, *supra*, 75 Cal.App. 4th at p. 746 [extrinsic evidence "cannot be used to substantiate unexpressed intention and thereby vary clear and explicit contract provisions"]; *Shaw v. Regents of University of California* (1997) 58 Cal.App.4th 44, 55 ["The true intent of a contracting party is irrelevant if it remains unexpressed"]; *Tahoe National Bank v. Phillips*, *supra*, 4 Cal.3d at p. 19, fn. 11 ["The bank, however, cannot create an ambiguity by the device of adding to the note a private code designation which is unexplained to the borrower"].)

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[12] (...continued)
cannot circumvent it by taking a lesser interest that would jeopardize the landlord].) BACC cannot now take advantage of its subtle drafting to defeat the unqualified obligations that appear on the face of the Assignment. (*Tahoe National Bank*, *supra*, 4 Cal.3d at p. 19 ["If ambiguity there is, that ambiguity may be deliberate," since assignments such as the one at issue were designed "to afford the lender the option of being a secured or an unsecured creditor at the time of the debtor's default"].)

c. BACC cannot be released from its Lease obligations without Vallely's consent.

No exculpation provision in the Lease released BACC after losing possession; nor did BACC, Balboa, and RECMC have any power to release BACC without Vallely's consent. BACC's extrinsic evidence is not admissible to vary the Lease's terms and create an implied exculpation clause where there is none. (2 Witkin, Cal. Evidence (3d ed. 1986) Documentary Evidence, § 960, p. 908.)

In sum, all this Court needs to review is the Assignment. Everything else is legally irrelevant extrinsic evidence. The Assignment is not reasonably susceptible to any meaning other than that BACC is bound as a matter of law to fulfill the Lease covenants.

2. The Granoff and Forsberg declarations are inadmissible.

In the Opening Brief, we demonstrated why the Granoff and Forsberg declarations are inadmissible. (AOB at pp. 23-26.) We show above why their admissibility does not matter. Only a few other points are in order.

First, summary judgment affidavits must "show *affirmatively* that the affiant is competent to testify to the matters stated." (Code. Civ. Proc., § 437c, subd. (d), emphasis added.) That standard is obviously not met by BACC editorializing on why it "seems" to it that Granoff spoke and acted on behalf of BACC and RECMC. (RB at p. 42, fn. 13.) There is no "seems" in the affidavit standard. Granoff supplies no facts to show that he ever spoke with BACC or RECMC officers, let alone that he had the authority to speak and act on their behalf. (JA 696, 794-795.)

Second, BACC's contention that Granoff's statements are admissible as statements against interest (RB at p. 42, fn. 13) is nearly incomprehensible. Although BACC ominously hints at suing Granoff for malpractice because of his role in counseling BACC to accept the

Assignment (RB at p. 42, fn. 13), Granoff's statements are not a declaration against his interest in the evidentiary sense. (Evid. Code, § 1230.) That hearsay exception applies when the declarant is unavailable as a witness and the statement, when made,

> was so far contrary to the declarant's pecuniary or proprietary interest, or so far subjected him to the risk of civil or criminal liability, or so far tended to render invalid a claim by him against another, or created such a risk of making him an object of hatred, ridicule, or social disgrace in the community, that a reasonable man in his position would not have made the statement unless he believed it to be true.

(*Ibid.*)

Granoff is an available witness, and his declaration, if anything, is motivated by a desire to *avoid* later liability by injecting into this trial an irrelevant intent issue in the hope of saving BACC's case. In that respect, his declaration is most assuredly *in*, not against, his interest.

Third, as for Forsberg's declaration, Vallely first objected to it under Code of Civil Procedure section 2023 on the ground that BACC had abused discovery—because earlier BACC had objected to Vallely's deposition notice claiming that no person knowledgeable about the Balboa workout existed. (JA 925.) In the same "Objections" document, however, Vallely also stated that in the event BACC maintained that Forsberg did not represent BACC, then Vallely objected "on foundational grounds." (JA 925.) Since Forsberg does not represent BACC, but purports to represent Bank of America, and since BACC argued that Forsberg was not offered as BACC or RECMC's representative in the Balboa workout, but was simply a "custodian of records" (RT 72), Vallely's incompetency and business records objections are proper. (See AOB 24-25.)

3. BACC's assumption of the Lease obligations was not ultra vires.

In its last attempt to create a triable issue over its irrelevant intent, BACC points to federal lending law—arguing, in essence, that the Court should infer that BACC could not possibly have intended to violate that law. If that were the legal standard, every civil and criminal defendant would walk free.

Even assuming BACC could not, as a matter of federal lending law, hold the Lease for more than five years, BACC divested itself of its possessory interest when it lost the property through RECMC's foreclosure. BACC does not cite a single case, treatise, practice guide, or Comptroller opinion to show that it could not still be bound by privity of contract. BACC's silence is the most convincing evidence that no authority supports its position.

In sum, there is no triable issue of fact as to BACC's intent, nor—contrary to BACC's assertion (RB at p. 40, fn. 12)—has Vallely ever argued that there was. The only question for this Court is the legal effect of the Assignment language. And that, as we have shown, is to bind BACC to its Lease obligations.

B. There Was No Novation.

BACC's interpretation of *Wells Fargo Bank v. Bank of America* (1995) 32 Cal.App.4th 424 distorts the case nearly beyond recognition. *Wells Fargo* unequivocally holds that "to constitute a novation, rather than a mere assignment, in the context of a new debtor, the former debtor must be released of his obligation by consent of the former debtor *as well as the creditor.*" (*Id.* at p. 432, emphasis added.) BACC has not produced a shred of evidence in the Lease or elsewhere suggesting that *Vallely* intended to release BACC from liability upon its assignment of the Lease. To the contrary, the Lease is permeated with the notion that *all*

lessees, apart from RECMC, owe Vallely a nonextinguishable payment obligation.

The only "fact" BACC relies on to urge that there is factual dispute about Vallely's intent is that Vallely brought this action against BACC in April 1998. (RB at p. 47.) According to BACC, this fact supposedly raises a jury question as to whether Vallely may have intended to release BACC. (*Ibid.*) BACC ignores the dispositive fact that in July 1996 (i.e., two months after Edgewater defaulted on its rent), Vallely sued Edgewater *and* BACC for past due rents. (JA 4-5.) That case was removed to federal bankruptcy court when Edgewater filed its bankruptcy case. (JA 5.) Pursuant to a February 1998 settlement agreement between BACC and Vallely, BACC paid Vallely the outstanding rent, and Vallely reserved its rights to sue BACC in state court for future rents. (JA 5.) Vallely brought the present suit a little more than a month later. (JA 1.) Thus, there is absolutely no basis in these facts to support BACC's novation theory.

CONCLUSION

BACC puts all its eggs in *Dover Mobile Estates'* basket, but the basket has too many holes. There is an overwhelming number of reasons why the case does not apply. BACC does not seriously address any of them. That is because the whole logic of the law of privity of estate and contract (to which BACC devotes exactly one paragraph (RB at p. 14)) compels the conclusion that BACC is a true assignee, currently bound to the Lease.

All BACC's remaining arguments are makeshift plugs, which do not hold for all the reasons set forth above and in the Opening Brief. The judgment must be reversed, and the Court should direct entry of judgment in favor of Vallely.

September 21, 2000

Respectfully submitted,

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