11 U.S.C. § 105(a)
11 U.S.C. § 541(a)(6)
11 U.S.C. § 542(a)
C.C.P. § 741
Equitable lien
Equitable subrogation
Unjust enrichment

Paul Lansdowne, Inc. v. Marko et al., Adv. No. 687-5025 (In re Cox), Consolidated Case Nos. 684-08459, 08496-98

2/5/91 PSH unpublished

Under § 542(a), the trustee was entitled to recover the value of rental property located near Santa Cruz, California, less certain offsets. A quitclaim deed conveying the subject property from the debtors Cox, to Marko, the girlfriend of Cardinal, had been forged. Cardinal had the deed recorded immediately prior to the filing of the debtors' involuntary bankruptcies while the debtors were fugitives from justice. Marko/Cardinal later sold the property to the Ertas who refused to return it to the trustee as they had made considerable improvements which allowed them to raise rents and accordingly increased the property's market value (however, property values in general had also appreciated significantly).

The court held the trustee was entitled to recover the value of the property, rather than the property itself, plus net rents. As the Ertas' improvement costs and operating expenses had exceeded their rental income as of the date of turnover, the trustee was limited to turnover of the present value of the property. However, the estate would be unjustly enriched if the Ertas were not given credit for paying off encumbrances the trustee would have been subject to upon liquidation of the property. The Ertas were also entitled, as good faith improvers under California Code of Civil Procedure § 741, to setoff the amount by which any increase in the property's market value was attributable to their improvements. To reach this conclusion the court also ruled the trustee was not guilty of laches and was not equitably estopped from recovery; the Ertas had no standing to raise the affirmative defense of a resulting trust on behalf of Cardinal; the Ertas were not entitled to an equitable lien as they had an adequate remedy under CCP § 741; and the Ertas' mortgage holder was not entitled to an equitable lien either, but would be entitled to equitable subrogation if the Ertas could not pay the trustee the value of the property and were forced to return the property instead. All claims for relief against Marko, Cardinal, and the Ertas' mortgagees were dismissed.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

IN RE	)	
	)	
S.D. COX INVESTMENTS, INC.; STEPHEN D. COX; DEBORAH M. COX; EUGENE R. RICHMOND,	)	Case Nos. 684-08459-W7 684-08496-W7 684-08497-W7 684-08498-W7
Debtors.	)	
	)	
PAUL LANSDOWNE, INC., Trustee,	)	
	)	
Plaintiff,	)	
vs.	)	
	)	
TAMARA MARKO; JAMES CARDINAL; RAY W. ERTA; LINDA S. ERTA; PORTOLA INVESTMENT CORPORATION; and WATSONVILLE FEDERAL SAVINGS AND LOAN ASSOCIATION,	)	Adversary No. 687-5025-W
	)	FINDINGS OF FACT AND
Defendants.	)	CONCLUSIONS OF LAW

FINDINGS OF FACT

The trustee is attempting to regain certain real property located in Watsonville, California, and the rental income therefrom for the benefit of the estate under a variety of alternative legal

theories. These include a claim for turnover of the property under 11 U.S.C. § 542[1], a claim to avoid an unperfected transfer under § 544(a)(3), a claim to avoid the transfer under § 547 as preferential, and a claim to avoid the transfer as fraudulent under either § 544(b) or § 548, with accompanying § 550 claims against the ultimate transferees of the property regarding the latter four claims.[2]

The trustee alleges that a quitclaim deed conveying the subject property from the debtors, Steven Cox and Deborah Cox, to Tamara Marko, the girlfriend of James Cardinal, was forged, and that Mr. Cardinal had the deed recorded immediately prior to the filing of the debtors' involuntary bankruptcies while the debtors were fugitives from justice. Marko/Cardinal later sold the property to Ray and Linda Erta who allege they purchased it in good faith without knowledge of the bankruptcies or any prior claims and refuse to return it to the trustee.

In their third amended answer the defendants Ray Erta, Linda Erta, Watsonville Federal Savings and Loan Association (hereinafter "Watsonville"), and Portola Investment Company (hereinafter "Portola") raised five affirmative defenses under California law: (1) equitable estoppel; (2) the existence of a resulting trust; (3) an equitable lien theory; (4) a statutory good

---

[1] All references hereinafter are to the Bankruptcy Code, 11 U.S.C. § 101 et seq., unless otherwise specified.

[2] At trial the trustee withdrew his claim under § 549.

faith improver setoff; and (5) the doctrine of equitable subrogation. They further assert laches against the trustee and Code defenses under § 549(c) and § 550(d) and ask the court to restrict turnover under § 542, if any, to the value of the property.

If the court finds the deed was forged, the trustee's claims under §§ 547, 548 and 544(b) must fail, and its claim under § 544(a)(3) is only relevant to the extent the court enforces a resulting trust as prayed for by the defendants Erta. If the court finds the deed was not forged, then the trustee's claim under § 542 must fail.

The court denied with prejudice the trustee's pretrial motion to strike or dismiss all affirmative defenses on the ground that defendants failed to assert them in earlier pleadings, and denied the remainder of the motion made on other grounds without prejudice to reassert it at trial. At trial the trustee renewed its motion to strike or dismiss all the defendants' affirmative defenses on the bases either that certain of them were time barred or that they were unavailable as a legal defense under either California or bankruptcy law. This court ruled that the affirmative defenses of setoff available to good faith improvers under § 741 of the California Code of Civil Procedure (hereinafter "CCP"), equitable lien, and equitable estoppel were not time barred. This court declined to rule on the balance of the motion

pending presentation of the evidence. The court will address the legal validity of these defenses in its conclusions of law.

The defendants Tamara Marko (hereinafter "Marko") and James Cardinal (hereinafter "Cardinal") appeared pro se throughout the proceedings. Prior to trial the Ertas, Watsonville and Portola dismissed cross-claims they had earlier filed against Marko and Cardinal. Neither Marko nor Cardinal filed any counterclaims or cross-claims. This court took the matter under advisement after a two week trial. Although this court labored mightily through numerous pretrial hearings to get the parties to stipulate to a number of facts and narrow the issues of law, it was largely unsuccessful primarily due to the presence of pro se defendants and the immediate and intense dislike between counsel for the trustee and the Ertas. The parties were unable to agree upon the contents of a comprehensive pretrial order. Pursuant to court order the attorneys filed trial and post-trial briefs. Cardinal testified at trial and his deposition became part of the record. This court found him to be a completely noncredible witness. After the court had a chance to analyze all of the evidence, review all of the legal arguments and case law, and was substantially ready to enter its opinion in this case, it held another evidentiary hearing to determine any change in the present value of the property since trial, the amount of rents collected by the Ertas and expenses incurred by them since trial, and what, if any, portion of the

increase in the property's market value during the Ertas' possession is due to their improvements.

The court takes judicial notice of the following facts:

1. An involuntary Chapter 7 petition was filed against S.D. Cox Investments, Inc. on October 18, 1984. An order of relief was entered on November 26, 1984.

2. An involuntary Chapter 7 petition was filed against Steven D. Cox on October 29, 1984. An order of relief was entered on March 13, 1985.

3. An involuntary Chapter 7 petition was filed against Deborah M. Cox, Steven Cox's wife at that time, on October 29, 1984. An order of relief was entered on March 13, 1985.

4. An involuntary Chapter 7 petition was filed against Eugene ("Bud") Richmond, Steven Cox's business partner at that time, on October 29, 1984. An order of relief was entered on December 17, 1984.

5. On February 16, 1988, this court entered on order substantively consolidating these four estates.

This court entered a limited pre-trial order, after hearing, which addressed certain questions which arose in this adversary proceeding as a result of the entry of the order of substantive consolidation. This order, dated June 30, 1989, directs that the order of substantive consolidation is binding on all the defendants in this adversary proceeding. It further directs that for purposes of this adversary proceeding all assets

of the four estates are to be treated as assets of one consolidated estate for the purpose of any proof of ownership of assets required by the trustee; that any prepetition transfers of property by any of the debtors to third parties shall be treated as transfers of property from one consolidated debtor; that liabilities of the separate estates shall be treated as liabilities of one consolidated debtor; and that for purposes of exercise of the trustee's avoiding powers, the petition date for all estates is deemed to be October 18, 1984.

The parties have consented to this court entering a final order in this case.

The court has reviewed the third amended complaint and the defendants' answers filed thereto and has found that all the defendants have stipulated to the following facts:

6. The court has jurisdiction over the parties and the subject matter.

7. The plaintiff is the duly qualified and acting trustee in the Cox bankruptcies.

8. On January 28, 1983, the debtor Steven D. Cox (hereinafter referred to as "Cox") acquired legal title to a certain parcel of real property (the subject property) located at 416 Riverside Drive, Watsonville, Santa Cruz County, California by means of a grant deed from Barry J. Nottoli. This deed was recorded on February 28, 1983 in the Official Records of Santa Cruz County.

9. Ray Erta and Linda Erta claim an interest in the subject property by reason of a grant deed dated December 26, 1985, signed by defendant Tamara Marko.

10. Defendants Portola Investment Corporation, as trustee, and Watsonville Federal Savings and Loan Association, as beneficiary, claim some interest in the subject property by reason of a deed of trust dated December 19, 1985, granted by Ray Erta and Linda Erta.

11. Transfer of the subject property was made to Marko within one year of the filing of the bankruptcy petitions in the related Cox bankruptcy cases.

12. The related debtors were all insolvent within 90 days of their bankruptcy filings.

Defendants Marko and Cardinal have stipulated to the fact, and the court finds, that neither of them paid any consideration to the debtors Cox for any transfer of the subject property from the Coxes to Marko. Marko has stipulated, and the court finds, that she did not authorize any third party to receive delivery on her behalf of the deed which was executed to her as transferee on the subject property.

The trustee and defendants Erta, Watsonville and Portola have stipulated to the following facts, which the court finds:

13. On or about January 6, 1983, Mary Riley Tomasello executed a certain grant deed granting Barry J. Nottoli her interest in the subject property. The grant deed was recorded at

the request of Penniman Title Company in the Official Records of Santa Cruz County, California, on January 6, 1983 at Book 3521, Page 343. After recordation the grant deed was mailed to Barry J. Nottoli at P.O. Box 1390 in Aptos, California.

14. On or about January 6, 1983, Barry J. Nottoli executed a note secured by deed of trust in favor of Mary Riley Tomasello in the amount of $87,500. The deed of trust was executed by Barry J. Nottoli on or about January 6, 1983, and was recorded in the Official Records of Santa Cruz County, California, on January 6, 1983 at Book 3521, Page 347.

15. On or about January 10, 1983, an assignment of deed of trust was executed by Mary Riley Tomasello, as assignor, to transfer to Elaine Little, as assignee, her beneficial interest in the trust deed, dated January 6, 1983, executed by Barry J. Nottoli, trustor, in favor of Mary Tomasello, which trust deed secured payment on a debt incurred for the purchase of the subject property. The assignment was recorded in the Official Records of Santa Cruz County, California, on January 11, 1983, at Book 3522, Page 250.

16. On or about February 1, 1983, Barry J. Nottoli executed a deed of trust and assignment of rents, for the subject property in favor of N.C.I., Inc., securing a promissory note in the amount of $2,000.00. The deed of trust and assignment of rents was recorded in the Official Records of Santa Cruz County, California, on or about February 9, 1983, at Book 3532, Page 744 et seq.

17. N.C.I., Inc. was previously a corporation wholly owned by Barry J. Nottoli.

18. On or about March 16, 1984, Steven D. Cox and Deborah Cox purportedly executed a quitclaim deed granting to Tamara Marko their interest, if any, in the subject property. The quitclaim deed indicates that it was witnessed by James Cardinal, on March 16, 1984. On or about October 3, 1984, the quitclaim deed was recorded at the request of James Cardinal in the Official Records of Santa Cruz County, California, at Book 3762, page 807. After recordation the quitclaim deed was mailed by the Santa Cruz County Recorder to James Cardinal at P.O. Box 1390, Aptos, California 95003.

19. On or about December 26, 1985, Tamara Marko executed a grant deed granting to Ray W. Erta and Linda S. Erta her interest, if any, in the subject property. The grant deed was recorded in the Official Records of Santa Cruz County, California, on December 31, 1985, at Book 3926, Page 935 et seq.

20. On or about December 30, 1985, Ray W. Erta and Linda S. Erta executed a deed of trust for the subject property securing a promissory note in the amount of $92,000 to Portola Investment Corporation, as trustee, and to Watsonville Federal Savings and Loan Association, as beneficiary. The deed of trust was recorded in the real property records of Santa Cruz County, California, on December 31, 1985, at Book 3926, Page 938 et seq.

21. In connection with the Ertas' purchase of the subject property certain funds were placed in escrow with Penniman Title and Escrow Company. As part of the closing of the sale, Penniman Title and Escrow made certain disbursements, including payment of the following: $88,258.42 to Elaine Little, to pay off the Barry J. Nottoli promissory note and trust deed of Mary Riley Tomasello (assigned to Elaine Little); $7,700 to N.C.I., Inc.; $3,250.03 in payment of real property taxes; and $43,679.98 by check payable to Tamara Marko.

22. On or about January 13, 1986, Elaine Little executed a substitution of trustee and reconveyance by substituted trustee, which granted to the "present holders of the equitable title, without warranty, all of the estate and interest derived by the said trustee under said deed of trust", in the subject property. The substitution of trustee and reconveyance by substituted trustee was recorded in the Official Records of Santa Cruz County, California, on or about January 22, 1986, at Book 3933, Page 756.

23. On or about September 15, 1986, Ray W. Erta and Linda S. Erta executed a deed of trust and assignment of rents in favor of the City of Watsonville, California, for the subject property, in the amount of $8,750. The deed of trust and assignment of rents was recorded in the Official Records of Santa Cruz County, California, on or about October 2, 1986 at Book 4045, Page 933. The deed of trust and assignment of rents secured payment of a H.U.D. loan intended to improve the subject property.

24. For purposes of § 547(b)(4)(A), the quitclaim deed purportedly from the debtors Cox to Tamara Marko was recorded within 90 days of the bankruptcy filing of the consolidated debtors.

25. For purposes of § 548(a), the execution and recordation of the quitclaim deed purportedly from the Coxes to Tamara Marko occurred within one year of the bankruptcy filing of the consolidated debtors.

26. The quitclaim deed, dated March 16, 1984, purportedly executed by Steven D. Cox and Deborah M. Cox to Tamara Marko, was never physically delivered to Tamara Marko.

27. Ray and Linda Erta received $60,237.23 in the form of rents off the subject property during the period from January 1, 1986 through July 31, 1989. They received $16,082 of this $60,237.23 from January 1, 1986 through March 3, 1987 (the date the complaint in this adversary proceeding was filed).

After reviewing the witnesses' live and deposition testimony, and exhibits the court makes the following additional findings of fact:

28. There will be less than 100% distribution of assets to unsecured creditors of the consolidated estate.

29. James Cardinal had many business transactions with Steven Cox from 1979 through September, 1984. During this period of time Cardinal had a mailing address in California. These transactions generally were discussed in person or by phone and the parties

prepared no written documentation of them other than brief notes jotted by Cox in personal notebooks. This lack of documentation was contrary to the custom and practice of the Cox investment businesses when dealing with the investments of others. During these years Cardinal also used the names of Don Whitmore or James Whitmore for purposes of these transactions. Mr. Cardinal invested many hundreds of thousands of dollars with Steven Cox over these years. The investments were always made in cash and were in a variety of forms, including stocks, diamonds, cars, gold, and gold commodity contracts. Diamonds were regularly shipped between the parties with Cox sometimes purchasing diamonds from Cardinal. Cardinal also obtained cars and registered them with S.D. Cox Investments, Inc. in Oregon and then sold or leased them.

30. In 1982, at Cardinal's request, Cox took out several hundred thousand dollars of life insurance on his own life. Cardinal designated the beneficiaries on the policies. The beneficiaries were friends and relatives of Cardinal.

31. In late 1982, Cardinal learned of the subject property from his friend, Barry Nottoli. He wished to own an interest in the property. Cardinal reached an oral agreement with Cox that they would purchase the property from Nottoli as 50-50 partners and the legal title to the property would be placed in Cox's name.

32. On January 28, 1983, Nottoli executed a grant deed to the property to Steven Cox. This took place in Nottoli's office. The deed was acknowledged at that time by Carla Spears, Nottoli's

secretary. Cox and Cardinal were present. Simultaneously, Cox gave Nottoli a check in the amount of $25,017.00 for the down payment. Around this time, not necessarily the same day, Cardinal gave Cox cash for 50% of the down payment on the property. The only parties directly involved in the transfer of the title to Cox were Cox, Nottoli, and Cardinal. All three agree that Cardinal was to have an equitable interest in the property. They disagree as to percentage of that interest. There was conflicting testimony from Cardinal and Nottoli as to the timing, amount and form of Cardinal's contribution to the down payment. However, Cox has stated that Cardinal contributed 50% of the down payment and agreed to provide 50% towards the expenses on the property. Absent any proof to the contrary, and absent proof of any bias by Cox on this testimony, this court believes that there is sufficient proof of the amount of Cardinal's contribution toward the purchase of the property.

33. Nottoli kept the deed to Cox. Before he had it recorded he had a deed of trust placed on the property in favor of N.C.I., Inc., his solely owned corporation, securing a note for $2,000. This was done without the knowledge of Cox. He had the deed recorded on February 28, 1983 and the deed was then returned to Cox. Nottoli also saw that information regarding insurance coverage he had placed on the property was sent to Cox.

34. Cox Property Management, an entity run by Cox to manage his numerous real property holdings (which entity is part of the

consolidated bankruptcy estates), took over management of the property shortly after Cox received legal title. This management continued until the Coxes fled the Medford, Oregon area in September, 1984 as fugitives from justice. During a short period of time after Cox received legal title, Nottoli continued to receive the rental payments from the property while control over the income and expenses was being straightened out. All rentals began to come to Cox Property Management around the middle of 1983 and continued thereafter without interruption until October, 1984. Cox directed that a variety of forms of insurance placed on the property by Nottoli be continued in the name of either Steven Cox or S.D. Cox Investments Inc., and Cox Property Management paid the insurance premiums from transfer of the property to Cox through 1984. Insurance coverage for fire loss, flood and earthquake damage remained in the Cox name up through the bankruptcy filings.

After the transfer to Cox, Cox Property Management paid $875 per month on the underlying trust deed in favor of Tomasello without interruption through September, 1984, first to Wells Fargo Bank, in Watsonville, California, and then to San Francisco Federal Savings and Loan Association, also in Watsonville. Cox Property Management also paid some city and county real property taxes on the property during this time but was delinquent as of mid-1984. Cox Property Management also paid some amounts for maintenance of the property. It collected $800 per month rent off the property in 1983, taking in $9,600 total income that year and paying out total

expenses of $9,254.94, for a net profit of $345.06. In 1984 it received between $300 and $550 per month rent from the property, and as of August 31, 1984, took in $4,150 while paying out $7,000 in expenses, for a loss of $2,850. This is an accurate or close to accurate accounting of the income and expenses of this property during this period. Any monthly shortfall between income off the property and property expenses was made up by a deposit into the Cox Property Management account from S.D. Cox Investments, Inc. or Steven Cox individually.

35. Cox and Cardinal agreed that Cardinal would pay one half the expenses on the property. They knew that there would be insufficient income off the property to pay the expenses associated with the property. Cox kept track of the expenses in an informal way in a personal notebook. Cardinal made a contribution of at least $10,000 cash to Cox for the expenses prior to the bankruptcy filings. Neither Cox nor Cardinal kept a written record of the amount of these contributions. No written record indicates how these funds were in fact applied and Cox had no recollection on this point.

36. On September 24, 1984, Cox and his wife fled the Medford, Oregon area. Cox took with him a large quantity of cash, bullion, diamonds and other assets of the various Cox businesses. Some of the diamonds he took belonged to Cardinal. At this time the Cox business entities were on the verge of collapse and were under investigation by the securities division of the state of Oregon.

At this time Cox owed Cardinal anywhere from $300,000 to $1 million on business deals other than that involving the subject property. These debts carried interest at 40% per annum. Cox remained hidden, his whereabouts unknown to the trustee, until apprehended by the F.B.I. in December, 1988.

37. Cardinal knew of Cox's flight very soon thereafter and attempted to get in touch with Cox by leaving messages requesting a call with Cox's relatives. Cox was afraid of Cardinal and did not return his calls.

38. On September 25, 1984, Penniman Title Company, a title insurance company in Santa Cruz County, California, received a request for a preliminary title report on the subject real property. This request was represented as coming from the office of Barry Nottoli. The title report, issued the same day, showed the record title to be in Cox's name.

39. On September 28, 1984, Penniman Title Company received another call represented as coming from Barry Nottoli. The caller ordered a new title report on the subject property.

40. On October 3, 1984, Cardinal appeared before Adrienne Pelker, a notary public who was working for a bailbond company in Santa Cruz, California. With him he had the quitclaim deed on the subject property from Deborah Cox and Steven Cox to Tamara Marko. Cardinal swore before Ms. Pelker that he had witnessed the debtors Cox execute and deliver the subject deed on March 16, 1984. Ms. Pelker notarized that Cardinal made this declaration to her and

acknowledged his own signature as witness. This acknowledgment procedure is sanctioned by California law but rarely used.

41. On October 3, 1984, Cardinal took the quitclaim deed to the recorder for Santa Cruz County and caused it to be recorded. After recording, the deed was mailed to Cardinal at P.O. Box 1390, Aptos, California, pursuant to instructions on the deed. This address was the business mailing address of the offices of Barry Nottoli and N.C.I., Inc.

42. Penniman Title Company received another call represented as coming from Barry Nottoli on October 9, 1984 wherein the caller notified Penniman that the report should reflect vesting of the property in Tamara Marko. On October 9, 1984, Penniman Title Company issued an amended preliminary title report on the subject property showing that title was now vested in Tamara Marko. The change in ownership was the result of the recordation of the quitclaim deed to Tamara Marko on October 3, 1984. At this time Tamara Marko was Cardinal's girlfriend.

43. Sometime after the sale of the property to Cox, Cardinal removed from Nottoli's office the file set up and kept there on the subject property which contained the original quitclaim deed from the Coxes to Marko.

44. In 1983, Cox discussed with Cardinal listing the subject property for sale in the $200,000 to $225,000 price range. Thereafter Cardinal, through Barry Nottoli's office, listed the property for sale with a realtor, William A. Burgstrom, Inc.

(hereinafter "Burgstrom"). The agreement authorizing an exclusive right to sell, dated October 15, 1983, was purportedly signed by S.D. Cox as owner. Cox did not sign this document nor did he specifically authorize anyone to sign it for him. He did, however, know the property was placed for sale. S.D. Cox never dealt directly with Burgstrom nor had any indirect dealings with it. The property did not sell and Cardinal, through Nottoli, eventually withdrew it from the market.

45. After he recorded the quitclaim deed to Marko, Cardinal took steps to re-list the property for sale. He did this through the auspices of Barry Nottoli's office. On October 31, 1984 he signed Marko's name, without her authority, to an exclusive contract to sell the subject property with Burgstrom for $175,000. The property was on the market a year without an offer.

46. Ray Erta learned about the listing on the property from a neighbor. He had not been actively looking for investment property but had some funds in an account from the sale of other property which he needed to reinvest by the end of 1985 to offset a capital gain. He had previous experience in buying properties. He went into Burgstrom's and inquired about the subject property. At that time Burgstrom was not looking for property on Ray or Linda Erta's behalf. At the broker's office Ray Erta first dealt with William Burgstrom and then he dealt with Glenn Kramer.

47. Ray Erta made an offer on the property to Burgstrom. Mr. Kramer then called Cardinal and told him about it. He knew

Cardinal as "James Whitmore". He met Cardinal in the parking lot of Nottoli's office after hours with Ray Erta's offer and a blank counteroffer form. Later he met Cardinal again in Nottoli's parking lot to pick up the counteroffer allegedly signed by Tamara Marko.

At the time Burgstrom received Ray Erta's offer on the property, Nottoli's office told Mr. Kramer that "James Whitmore" was the "true owner" of the property, that Marko was holding the title for him, and that "Whitmore" was the man with whom Mr. Kramer needed to speak regarding any matters involving the sale of the property to the Ertas. The note that Mr. Kramer wrote to himself upon hearing this information states: "Per Carla [Carla Spears, Nottoli's secretary], S.D. Cox was a partner with Whitmore. Then Cox deeded to Whitmore. Then Whitmore deeded to Marko for reasons known only to Whitmore."

Mr. Kramer told Ray Erta about Marko's counteroffer. Its unclear whether Ray Erta actually saw the written counteroffer allegedly signed by Marko. On November 4, 1985 Ray Erta signed a real estate purchase contract for a purchase price of $150,000 and paid Burgstrom a deposit of $500. At the time he signed this contract Marko's name was not on it. Later Cardinal signed Marko's name, without her authority, to this real estate purchase contract and receipt for deposit form also signed by Ray Erta. Ray Erta did initial some changes on the contract which had already been

initialed by "T.M." Cardinal and Ray and Linda Erta did not meet during the process of the sale of the property.

Linda Erta had no dealings with the realtors. Glenn Kramer handled the day-to-day discussions with all parties while the sale of the property was pending. He had had direct contact in 1983 with Nottoli's office regarding the listing at that time. He had signed the 1983 listing agreement for Burgstrom that was allegedly signed by Cox. He never had any personal contact with Cox. Mr. Kramer never met or talked to Marko, nor prior to this transaction did he know James Cardinal by any name.

48. After signing the sale agreement, Ray and Linda Erta went to Watsonville Federal Savings and Loan to arrange financing for the property. Linda Erta handled the day to day paperwork with Watsonville to get the loan processed. The Ertas eventually borrowed $92,000 from Watsonville, secured by a first trust deed on the property, which was applied to pay off the Tomasello/Little encumbrance, the N.C.I., Inc. encumbrance and a real property tax encumbrance. The note to Watsonville carried a six-month adjustable interest rate with the rate at that time at 12 1/2% per annum. Ray and Linda Erta have kept the payments on this loan current.

49. Watsonville, through Mr. Meidl, followed its regular procedure in reviewing and eventually approving the loan application. Mr. Meidl sent a letter to the title company with the lending institution's requirements for closing. They included

ordering a copy of the preliminary title report, a credit report, an appraisal for loan purposes, placement of fire and flood insurance on the property at time of closing, and the issuance of an American Land Title Association Loan Form Policy of Title Insurance. An ALTA policy covers off-record matters, such as construction in progress, mechanics and materialmens' liens, easements and encroachments; that is, matters that would be discovered by a physical inspection of the property. As part of the procedure prior to the issuance of ALTA insurance, the property to be insured undergoes a physical inspection. Mr. Meidl ordered such an inspection and relied on employees of Penniman to carry it out. This is also normal operating procedure. Principals of Watsonville reviewed the preliminary title report and noted nothing out of the ordinary. They did not review the chain of title. In the preliminary report title was shown in Tamara Marko.

An appraiser was retained by Penniman which charged Watsonville a fee for the appraiser's services. The appraiser valued the property at $127,600 "as is" and $148,600 in restored condition. Watsonville paid their loan proceeds check directly to Penniman Title Company. According to standard operating procedure, Penniman deducted its fee from the loan proceeds before transferring the balance to escrow.

Portola is a subsidiary of Watsonville established to serve as trustee on deeds of trust on which Watsonville is beneficiary.

Principals of Watsonville and Portola never had contact with Burgstrom with regard to this property. Principals of Watsonville and Portola never had any knowledge of any ownership interest Cardinal may have claimed in the property. In December, 1985 principals of Watsonville and Portola had no previous knowledge of Tamara Marko. Principals of Watsonville and Portola had no discussions with Ray and Linda Erta about the ownership of the property. Principals of Watsonville and Portola had no knowledge of any claim on the property by Cox until served with the complaint in this proceeding.

50. Ray and Linda Erta hired Penniman Title Company to provide a title report and title insurance on the property, and to act as escrow agent. As escrow agent it collected the funds from Watsonville and the Ertas, paid off the lienholders and saw to it that the related legal documents were recorded. Penniman Title had previously been retained by the office of Barry Nottoli to do two title reports in the fall of 1984 when title was allegedly transferred from the Coxes to Tamara Marko. The employee who handled the Erta escrow was Jack Coffey. In 1985 Mr. Coffey made a physical inspection of the property but did not talk to the tenants. The employee who prepared the title reports on this property in both 1984 and 1985 was Mr. Griffith. Mr. Griffith reviewed the chain of title and documents involved therein including the quitclaim deed from the Coxes to Marko. Mr. Coffey

did not know a man by the name of James Cardinal, James Whitmore or Don Whitmore.

51. Prior to closing the sale from Marko to the Ertas, Mr. Kramer told Ray Erta that a James Whitmore was the "true owner" of the property. Ray Erta conveyed this information to his wife. They also knew that this "James" was managing the property, including collecting the rents. Ray Erta was present on inspection of the property with Mr. Kramer when one of the tenants mentioned that "James Whitmore" collected the rents on the property. Linda Erta asked Mr. Kramer to talk to "James" about handling any security deposits and prorates of rents through the escrow.

52. At least one tenant, Camille Hopper, lived continuously at the subject property prior to 1980 and through September, 1988. In March, 1983 she met James Cardinal for the first time when he visited the property with two other men and informed her that the three of them were the new landlords. He said his name was "Don Whitmore". She could not identify the other two men. Thereafter, from March, 1983 through July, 1983, she mailed her rent checks payable to Barry Nottoli in Aptos, California. From July, 1983 through September, 1984 she mailed her rent checks payable to S.D. Cox Investments in Medford, Oregon. Her October, 1984 rent check was returned from Oregon as undeliverable. On October 4, 1984, "Don Whitmore" came by to pick up the rent check. He told her he was the new owner and would be picking up the rent checks every month. He did this every month

until December, 1985. Ms. Hopper was under the impression that "Don Whitmore" changed his name to "James Whitmore" in May, 1985 and at his instruction made out her checks accordingly. She had never heard of a James Cardinal or a Tamara Marko. As Cardinal received the rent checks from the property from October, 1984 to December, 1985 he saw to it that the payments on the underlying Tomasello/Little encumbrance were made.

53. Ray Erta and Linda Erta were not told anything about Cox. There is insufficient proof to find that they personally knew before or at closing that the title owner to the property was Marko. Prior to closing Ray Erta received a copy of the preliminary title report but didn't pay much attention to it. It showed Tamara Marko as the title owner. Ray and Linda Erta did not themselves investigate the state of the title to the property at the courthouse. They had no expectation of any services on their behalf from the realtors. They relied on the services of Penniman Title Co. to assure them good title and relied on the title insurance to protect them from any problems with the title. They did not tell Penniman Title or Watsonville Federal Savings and Loan that they had heard "James Whitmore" was the owner of the property. At closing they received copies of the escrow documents which showed Tamara Marko as the title owner. This court believes they didn't notice who the owner was at that time as they did not see a deed at that time.

54. After closing, the Ertas received a grant deed to the property. They noticed for the first time that Tamara Marko was the grantor but made no effort to contact the title company or realtor to ask about this. After the sale transaction they had no contact with either Marko or Cardinal. They first learned of Cox and the trustee's claim on the property when they were served with the complaint in these proceedings. It has only been in these proceedings that they have seen the quitclaim deed from the Coxes to Marko.

55. The real estate contract which the parties signed states that the seller has employed Burgstrom as broker and agrees to pay it $5,500 for its services. Marko and Cardinal paid Burgstrom's commission for the sales transaction.

56. In the fall of 1984, Cardinal told Marko he had put some Watsonville property in her name. He did not tell her why he had done this. He did not intend to give her any benefits from the property. She never saw the property and did not receive any of the rents off the property. She did not know of the existence of the quitclaim deed purportedly from the Coxes to herself. She had no dealings with the sale of the property until she went to the Penniman Title Co. at Cardinal's direction to sign the deed to Ray and Linda Erta and to pick up the sale proceeds. She never met the buyers nor had any contact with them, nor did she have any contact at any time with Watsonville or Portola. At the direction of, and accompanied by, Cardinal she took the sales proceeds check for

$43,679.98 to a bank, endorsed it, and asked for and received two checks, one made out to Larry Segarini, Cardinal's friend, for something less than $43,679.98 and a check for the balance made out to either James Whitmore or Don Whitmore. She gave these checks to Cardinal.

57. In addition to their $500 earnest money deposit, Ray and Linda Erta provided $60,912.82 of their own funds toward the purchase of the property. In addition to payment of the purchase price, these funds went to payment of the following: Credit Report--$30; Appraisal--$200; Tax Service--$54; Loan Fee--$1,840; Interest--$30.67; Fire Insurance--$328; Flood Insurance--$192.50; Title Insurance--$494.40; Escrow Fee--$184.25; Recording Fee--$24; Monument Tax--$10.

58. When Ray and Linda Erta purchased the property at the end of 1985, it consisted of 3/4 acre with a three bedroom main house, a studio over a garage and a smaller back house. All the buildings were in bad condition. In the main house the roof leaked; there were water stains inside; the electrical system was 40 years old and had wires exposed with broken switches and outlets; the carpet was old with holes; the doors were broken; the bathroom shower was rotten, affecting the subfloor; the windows were dry-rotted; the interior paint was gone; the outside paint was gone; the door to the porch was rotted away and there was no stove.

The front side of the studio was weakened and sagging; the shower was rotted out and inhabited by rats; the electrical system consisted of a bare line running from the main house; there were no doors or heat; the ceiling was covered with grease from cooking; the roof leaked; the outside paint was gone.

The back house had a bad roof; the electrical system was substandard; there was no heat; the windows were rotten and broken; the door was split and had been nailed shut; the bathroom floors were dry-rotted.

The grounds were covered with weeds.

59. After closing on the property Ray and Linda Erta applied for a loan from the City of Watsonville in July, 1986 under a rental unit rehabilitation program it conducted with the federal Housing and Urban Development Agency. The city eventually lent them a total of $8,750. This loan was secured by a second trust deed on the property and bears interest at 3% per annum. Ray and Linda Erta only participated in the program with regard to the main house. As part of the program, the city verified that Ray and Linda Erta expended at least $19,721.54 on rehabilitating the main house. Ray and Linda Erta used their own funds to finance the rehabilitation in excess of the amount they borrowed from the city. They intended to apply for another loan from the city for rehabilitation of the other units but were unable to do so due to this litigation. Ray and Linda Erta have kept the payments on this loan current.

60. Between the time the Ertas purchased the property in December, 1985 and the time of trial in July, 1989, they spent $43,086.29 in rehabilitating, improving and maintaining the property. Most of the improvements were completed by the time the trustee commenced this lawsuit in March, 1987. The improvements substantially rehabilitated the property. They included: regrading under the house and other foundation repairs; replacing some subflooring; replacing several doors and windows; remodeling interiors, including rewiring electrical systems and extensive drywall and carpentry work; new heat systems; fresh paint inside and out; new bathrooms, linoleum, carpets, window coverings and light fixtures; new appliances including a range and three refrigerators; two new roofs; and weeding and mowing the yard.

This amount is slightly more than the $42,600.86 the Ertas claim to have spent according to exhibit K7, to which the trustee made numerous objections. Exhibit K7 consists of four pages with a total of 187 entries designated by line number. The court notes the following discrepancies, by page and line number, between defendants' claimed improvements and the court's calculations:

Page 1, line 3 - $220.80 dumpster fee allowed, reducing 9/30/86 utility bill to -0-

Page 1, line 7 - $1,924.42 was actually paid for electrical work, not $1,954.42

Page 1, line 16 - $220 dumpster fee allowed, reducing utility bill for 11/3/86 to $72.70

Page 1, line 37 - $98 allowed for hauling debris from bathroom, reducing 1/2/87 utility bill to $73.15

Page 1, line 43 -	$558.44 payment to Monument Lumber Co. allowed, reducing utilities by same amount
Page 2, line 20 -	$89.14 disallowed - this entry is a duplicate of page 2, lines 10 and 13
Page 2, line 23 -	$97.46 disallowed - parts for power tool
Page 2, line 30 -	$147.37 disallowed - purchase of power tool
Page 2, line 37 -	$81.44 disallowed - power tool repair
Page 3, line 1 -	only $104.74 of $360.57 bill allowed - the other $255.83 was allowed at page 2, line 19
Page 3, line 9 -	$29.71 disallowed - already credited at page 1, line 15
Page 3, line 49 -	$15.88 disallowed - classified ad
Page 4, line 32 -	$132.02 in repairs from burglary allowed, reducing utilities by same amount

Funds spent improving the property include the $8,750 borrowed under the City of Watsonville's HUD program. As a result of the Ertas' rehabilitation and maintenance efforts, they were able to raise the rents on the three units from a total of $800 per month in early 1986 to $1,673 per month as of the date of trial. They have steadily increased the rents since trial at 8% per year and presently collect $1,895 per month. The Ertas have taken in a total of $89,307.23 in gross rents off the property from January, 1986 through January, 1991.

Since trial the Ertas have spent an additional $9,596.50 on improvements and maintenance, including a new roof on one unit not replaced in the original rehabilitation effort. They also fenced the yard and repaired extensive semi-automatic weapon's damage to the interior of one unit and other waste committed by a tenant before he was evicted. This $9,596.50 plus the $43,086.29 spent

pretrial equals $52,682.79 in total rehabilitation, improvements and maintenance. While in possession of the property, the Ertas also paid a total of $58,207.54 on the Watsonville bank loan, at least $630.38 in interest on the HUD loan, $9,727.28 in property taxes, $3,280.30 in insurance, $2,699.57 in utilities (paid on the tenants' behalf), $448 in legal fees for the eviction, and $62.68 on classified advertising. They thus spent a total of $127,738.54 in order to collect $89,307.23 in gross rents, for a net operating loss to date of $38,431.31, not including closing and other costs of sale.

61. At trial the court was provided with two appraisals on the property. The trustee's appraiser concluded that the market value of the property was $174,000 in December, 1985 and $238,000 in July, 1988 (he did not provide a fair market value for the property as of the date of the trial, July, 1989). He further concluded that rents in the area had risen steadily at about 1% per month since 1980 and he assumed they would continue to rise at least at that rate into the future, and seems to have assumed that the market value would also continue to rise proportionately through July, 1989. Thus the trustee argued that the market value as of the time of trial was over $280,000. In contrast, the defendants' appraiser concluded that the market value was $140,000 in December, 1985 and $245,000 at trial.

The trustee's appraiser used three methods in determining a value as of July, 1988; the defendants' appraiser used

substantially the same three methods in determining a value as of July, 1989. Those methods were a cost approach, an income approach and a comparable sales approach. The defendants' appraiser also used the income approach and comparable sales approach, also called the market approach, in determining the December, 1985 value. However, the trustee's appraiser only used the income approach in determining the December, 1985 value, and gave greater weight to the income approach in determining the July, 1988 value. The trustee relied on that approach also in estimating the July, 1989 market value.

The income approach to value has two components: the gross rent multiplier (hereinafter "GRM") and estimated gross rents (based on average rents collected off comparable rental properties). The GRM is a ratio of the area's average value of rental property typical of the subject property divided by the average rental income off such property. The trustee's appraiser used a GRM of 133.5 and rents of $1,300 per month to calculate the $174,000 value for December, 1985. However, the defendants' appraiser used a lower GRM and rents to calculate a December, 1985 value of $140,000. He used a GRM of 125 and rents of $1,005 per month to calculate a $125,625 value under the income approach, but then weighed this against a $157,220 value from his comparable sales analysis to arrive at the $140,000 value. There was testimony that actual rents on the three units as of January, 1986 was $800. Therefore both appraisers' calculation of value was

based on average rents significantly higher than those actually collected off the subject property.

Fair market value "is the price which a reasonable seller who desires to sell but is not required to sell would demand for the property and the price which a reasonable buyer who desired to buy but was not required to buy would pay for the same, assuming a reasonable time for negotiations and explorations of alternatives." United States v. 429.59 Acres of Land, 612 F.2d 459, 462 (9th Cir. 1980). The sale from Marko/Cardinal to the Ertas comports with this definition. Considering this and the methods by which the appraisers reached their conclusions, this court believes that the fair market value of the property as of December 31, 1985, the date of the sale to the Ertas, was $150,000, the actual sales price.

62. At a January 24, 1991 hearing held by the court, the parties submitted updated appraisals. The trustee's appraiser valued the property at $275,000 as of January 13, 1991; the defendants' appraiser determined the present value to be $228,000. The court has determined that the present market value of the property is $245,000, for the following reasons.

The trustee's appraiser still used a 133.5 GRM and used an average comparable rent of $2,200 per month to calculate a value of $293,700. He then looked at comparable sales and concluded that the market was generally softer than the rapidly appreciating market of 1985 through June, 1989. This softening market indicated a selling range of $265,000 to $295,000 was appropriate and that

the fair market value would therefore be $279,000. He then compensated for some earthquake damage to the property from the October 17, 1989 disaster, indicating that insurance estimates of $4,000 for one unit and $14,000 for the others, in order to repair some foundation cracks and two toppled chimneys, were reasonable (the actual estimates were $7,320 and $15,989.32, respectively). However, he concluded that it is not necessary to replace the chimneys in order to ensure the stream of rental income, and that sufficient repairs could be made for about $4,000. Thus the $279,000 figure was rounded down to $275,000, the most probable selling price in his opinion if the property was placed on the open market for three to six months.

The defendants' updated appraisal was not performed by the same appraiser as the one at trial. Instead it was submitted by the appraiser who appraised the property for Watsonville Bank in December, 1985 for loan purposes. This appraiser concluded that the present value of the property is $228,000 after considering three valuation methods: the cost approach, land value per square foot (the value of the bare unimproved land -- as the subject property is located in an industrial area); and market approach (a combination of income approach and comparable sales approach). He concluded that the market approach yielded the highest and most accurate value and thus relied solely on the market approach. The market approach entails analyzing four factors gleaned from comparable sales. Each factor is given equal weight. They are:

price per unit; price per room; price per square foot; and GRM. This appraiser used a GRM of 120 and rents of $1,895 (actual). He did not consider any earthquake damage.

The two appraisals of present value are $47,000 apart. Coincidentally, these same two appraisers were $46,400 apart in their December, 1985 values. The trustee's appraiser said the property was worth $174,000 at that time, while the appraiser for Watsonville said the value was $127,600 "as is" or $148,600 if commensurate repairs were completed. Each appraiser has added around $101,000 to their values as of December, 1985. This court has held the actual value at that time was $150,000, the sales price. It is tempting for the court to just add $101,000 to its $150,000 figure to arrive at the present value. However, this court believes the defendants' appraiser made more reliable assumptions regarding the actual GRM and rents used. First, he considered that although this property was substantially rehabilitated by the Ertas, they were unable to complete their remodeling plans due to this lawsuit. Consequently, the property still requires deferred maintenance which is reflected in below average rents. He thus used a GRM that reflected the ratio of selling prices to rents obtained from rental properties in comparable condition in the Watsonville area, while the trustee's appraiser used a GRM which apparently was not based on substantially comparable sales and did not reflect the generally "softer" market. Second, the defendants' appraiser used actual

rents in calculating the income approach factor of his market approach analysis, while the trustee's appraiser used average or above average rents in calculating his income approach value. The resulting income approach value was crucial to the rest of the trustee's appraiser's analysis. Accordingly, the court gives greater weight to the defendants' appraiser's estimate of present value bearing in mind, however, that this appraiser has been historically conservative in his estimates.

Another factor the court has considered is the July, 1989 appraisal performed for the defendants. In the court's opinion that appraiser made reasonable assumptions in arriving at both his December, 1985 value of $140,000 and July, 1989 value of $245,000. It thus finds that the value at trial was most likely $245,000, given a "heated" market that was just beginning to level off. There was testimony from all the appraisers that the market may have risen slightly after trial but has definitely cooled since the earthquake in October, 1989 and subsequent recession throughout the California real estate market. However, there has been no testimony that actual market values have dipped significantly, if at all, below July, 1989 levels. Considering all these factors, the court finds that the present value is still $245,000.

63. At the request of the court the appraisers estimated the increase in the value of the property as a result of improvements made, for purposes of applying CCP § 741. Both of the appraisers at trial agreed that the value of the property increased

from 1985 through July, 1989 and that part of that increase was attributable to the improvements made to the property by the Ertas. They are in disagreement as to the actual percentage to be attributed to the improvements. Part of that variance arises from different appraisal methods, different assumptions within their respective application of the income appraisal method, and different assumptions on the amount expended on improvements. The trustee's appraiser at trial assumed $17,172 was spent on improvements and that there was no more than a dollar for dollar increase in the value of the property for the improvements made. On the other hand, the defendants' appraiser at trial assumed $45,000 was spent on improvements and that all the increase in the market value of this property from December, 1985 to July, 1989, over what he states is the local overall percentage in the increase in this type of property in the community, must be attributed to the improvements.

The trustee's appraiser at trial used a GRM of 133.5 to calculate both the value of the property and the dollar amount of any increase in the property attributable to expenses. He used estimated rents of $1,785 in July, 1988, when they were actually somewhere between $1,586 and $1,673 per month, and assumed they would continue to rise 1% per month to approximately $2,000 per month by July, 1989, when they were actually $1,673. Apparently the GRM had remained somewhat consistent as an average for some time in this area, which means that the value of the property and

the rents moved up proportionately over that period of time. But on our subject property that appears not to have been the case. The rents on the three units as of January, 1986 was $800. However, there was testimony that after all improvements were completed in mid-1987 the rents were $776 per month for the front house, $400 for the studio and $410 for the back house for a total of $1,586 per month. The rents nearly doubled from January, 1986 to mid-1987 while property values in general increased by only 10.5 to 14% in a year and a half (depending on whether you assume a 7% per year increase in value, as the defendants' appraiser did, or a 9.5% per year increase in value, as the trustee's appraiser did, for that time period).

By dividing the GRM into the amount of improvements assumed by the trustee's appraiser as being made by the Ertas, the trustee's appraiser at trial came out with an increase in rents on the property of $128.63 per month. This is far below what was actually obtained off this property after the improvements were made. As the system of using an average GRM doesn't reflect in fact the significant rate of increase in the rents resulting from the improvements, this court rejects that approach.

The court likewise rejects that appraiser's conclusion in his updated appraisal for the trustee that all of the increase in value to date is due solely to market appreciation. He contends that the average landlord's cost of maintaining an average rental unit is $250 per month; since the subject property has three units, the

average yearly maintenance cost would be around $9,000. Thus routine maintenance would have cost them $45,000 over five years, and their expenditures are just slightly above average. This court believes the improvements in fact constituted a major physical rehabilitation of the property, after which the rents were substantially increased to a level just below average rents for the area. Logically some portion of the increase in rents, and thus the proportionate increase in the property's market value, must be attributed to the improvements.

Alternatively, the defendants' updated appraisal calculates the increase in market value due to the improvements by estimating the value of the property today had the improvements not been made. The appraiser uses the "as is" value of $127,600 found in his December, 1985 appraisal and increases it by 45% to arrive at a hypothetical present value of $185,000 had the property remained unimproved. The 45% increase in value is based on paired sales of comparable rental properties in Watsonville between January, 1986 and mid-1990 (paired sales are resales of the same property within the desired time frame). The 45% figure is also supported by Santa Cruz County Multiple Listing Service's cumulative averages of the increase in all types of properties in general over the last 60 months, adjusted by the appraiser to reflect the hypothetical unimproved status of this particular property. He then subtracts this $185,000 unimproved value from his $228,000 present value to arrive at a $43,000 figure representing the increase in market

value attributable to the Ertas' improvements. This figure would represent the amount of the Ertas' setoff under CCP § 741, if applicable. If the court plugs its findings into this formula, however, a significantly lower amount results ($150,000 plus 45% equals a $217,500 hypothetical unimproved value which when subtracted from the $245,000 present value equals a $27,500 setoff). The court is a little uneasy finding that only $27,500 of the $95,000 increase in market value is due to the improvements. However, the court notes that under this formula for every dollar the present value is increased over $217,500 the Ertas receive one dollar setoff against the trustee's potential recovery. In the absence of any other reasonable alternative approach offered by the parties, this formula will be used by the court. This court therefore finds for the purposes of CCP § 741 that $27,500 of the increase in the value of the property from December, 1985 to the present is attributable to the Ertas' improvements.

64. The signature of Deborah Cox on the quitclaim deed to Tamara Marko, dated March 16, 1984, is forged. (The court defines a "forgery" as a writing which falsely purports to be the writing of another.) All handwriting experts agreed on this. Both Coxes agreed on this. Deborah Cox did not authorize her signature to be placed on the subject deed. Cardinal did not witness Deborah Cox sign the deed as he stated he did to the notary public.

65. The signature of Steven Cox on the quitclaim deed to Tamara Marko is forged. I have reached this ultimate conclusion of

fact based on the following intermediate conclusions of fact. I have reviewed the testimony of Steven Cox, Deborah Cox, Bud Richmond (Cox's business partner), James Cardinal and Dorothy Lehman (defendants' handwriting expert), as well as Cardinal's deposition and the handwriting reports of Lehman, and Bergen and Sterling (trustee's handwriting experts). The handwriting experts were all well qualified. All experts commented that their analysis was made more difficult because of their inability to examine the original document, which is missing. All agreed that Cox routinely varied his signature greatly which also made the analysis more difficult.

The court has spent a great deal of time on the exemplar signatures. One can find in the signatures at least one example of a number of variations mentioned by the experts. Ms. Lehman did not emphasize any one signature trait as indicative of Cox's signature. Rather, she relied on an overall impression of all salient features which she believes are the hallmark of signatures. Mr. Sterling and Ms. Bergen (essentially one report) stressed certain specific differences which they believed indicated a forgery. Unlike Lehman, they limited their comparison signatures to those executed on checks around the date on the subject quitclaim deed. Cox and Bud Richmond both testified that Cox often signed checks differently because he signed them more hurriedly. Further, Cox testified that in 1984 he was under additional stress

and was required to sign even more documents than usual. He believed his signature reflected his haste by being more "thready".

I've examined the exemplars prepared by Ms. Lehman, marked by exhibit number and date in her expert report. I have compared the questioned signature with exemplars other than checks for around March 16, 1984, specifically: instructions to title company dated 7-13-83 (Exhibit #003); promissory note dated 1-12-84 (Exhibit #099); promissory note dated 2-9-84 (Exhibit #098); memorandum of contract dated 2-21-84 (Exhibit #DL EX 2); trust deed dated 7-18-84 (Exhibit #018); tax return, dated 9-14-84 (Exhibit #191); bargain and sale deed dated 10-23-84 (Exhibit #026); and payroll account (undated - Exhibit #132). On these documents there are many "t" bar cross strokes which connect with the "D". On many the "D" is open. On many the first "e" of Steven is evident. All of this is contrary to the questioned signature. They largely appear hurried, unlike the questioned signature. The signatures from 1980 to 1981 appear less hurried including the one check signature, check # 1338, dated 1-29-81. Cox almost always wrote his name obviously above any line given, contrary to the questioned signature. I found no exemplars where the "D" was higher than the "C" as in the questioned signature. Ms. Lehman's explanation that this depended on the baseline of the letters was not an adequate explanation as the baseline of other "D"s in exemplars varies from the baseline for "C"s but the "D" is never higher. The "t" bar is

rarely crossed so high. The "even" almost always does not slope down as in the questioned signature.

We do not know who forged Deborah Cox's name to the subject deed. However, it is clear on review of known forgeries (from other related adversary proceedings and information supplied to the trustee by Deborah Cox) of her signature on bank cards, etc., most likely executed in Medford, Oregon, that the person who signed her name to those cards did not sign her name to the subject deed. The signatures are quite visibly different. The author of all these forgeries is unknown. But if we assume that Cox signed his wife's name to the cards rather than anyone else, which is a logical assumption considering the number of forgeries involved and his access to the bank cards, then he likely did not sign her name to the subject deed. This is more evidence that his signature is forged.

There is other nonforensic, circumstantial evidence that supports my finding that Steven Cox's signature was forged. Deborah Cox rarely, if ever, signed any document "Deborah Cox" and it is doubtful that her husband, who knew this, would so sign her name. The deed form is a California form. Cardinal swore he witnessed Deborah Cox signing the subject deed. All experts agreed her signature was forged. Therefore, Cardinal's sworn statement when recording the deed was not true. This is some evidence that his sworn statement that he saw Steven Cox sign the deed was also not true.

The legal description on the subject deed is a copy of the legal description from the N.C.I., Inc. trust deed. This court believes that until trial Cox did not know of the N.C.I., Inc. trust deed and never had possession of it. This suggests someone else prepared the subject deed. The original trust deed to N.C.I., Inc. was to be returned after recording to Barry Nottoli's office.

Cardinal had possession of the subject quitclaim deed until recording and it was sent, at his request, to him at Barry Nottoli's office. Cardinal admitted that he took the file on the subject property from Nottoli's office. Yet he could not produce the original quitclaim deed and could give no explanation where it was. This is some evidence he did not want the original to be examined too closely.

The timing of the recordation of the subject deed in relation to the Coxes' flight from Medford, Oregon raises some question about the validity of the deed. There was no convincing explanation as to why the deed was not recorded around the alleged execution date of March 16, 1984.

A number of documents typical of those Cox would have signed in Medford, Oregon in his daily business operations were dated contemporaneously with the subject deed and signed by Cox. These along with Cox's testimony of his customary business practice have convinced me that Mr. Cox was in Medford, Oregon on March 16, 1984 taking care of daily business. This conclusion is supported by the lack of proof that the Coxes were elsewhere on that date and

lack of proof as to where Cardinal, who supposedly witnessed the signatures, was on that date.

Cardinal stated he could not remember where the deed had been signed. Cardinal had a very selective memory. His presence at any location where he may have sworn he witnessed the Cox signatures on the deed could be checked.

Both Coxes testified that they did not know the name "Tamara Marko" until preparing for trial. The court believes this testimony. Tamara Marko testified she did not know the Coxes and had never met them.

After Cox fled Medford, Oregon he went to Hawaii. While there, late in 1984 and knowing that Cardinal was looking for him and that he owed Cardinal a great deal of money, he executed a deed on the subject property to Cardinal. This action plus the contents of the note which he prepared and which was to accompany it by mail is strong evidence that Cox did not know of and did not sign the subject deed in March, 1984. Further, Cox had prepared financial statements for himself in 1984 showing the property as an asset and he prepared bankruptcy schedules which included the subject property as an asset shortly after the involuntary petition was filed in October, 1984.

66. Steven Cox did not authorize his signature to be placed on the subject deed.

67. Michael Grassmueck was appointed interim trustee in all the consolidated Cox cases. At the time these cases were filed

the debtors Cox had fled the Medford, Oregon area. The police and the state of Oregon had possession of the records found at the corporate offices. It was difficult for the trustee to gain possession of any records. After a few weeks he obtained some records from the police and found reference therein to the subject property. He went to California to look at the property. The property was occupied by tenants some of whom, at least, spoke only Spanish. The trustee did not speak Spanish and was not able to locate a person on site with whom he could speak. As is customary, he retained an employee to review the loan-to-value status of the property. This person told him the estate was not the title owner and sent him a copy of the deed to Tamara Marko. He viewed the deed as suspicious and thus viewed the property as a potential asset. He took no other action regarding the subject property other than turning over to counsel the information he had obtained.

68. Mr. Grassmueck was succeeded as trustee of the four related Cox estates by Paul Lansdowne, Inc. on March 23, 1985 and April 1, 1985. When it became trustee, Paul Lansdowne, Inc. became aware of the subject property as a potential asset of the estate. The trustee knew the title was in a third party and therefore believed the estate was not entitled at that time to the rents off the property. At that time it made no attempt to find out where the rents were going.

In 1985 the trustee learned from the police that Tamara Marko was James Cardinal's girlfriend. It also learned that Mr. Cardinal

was a friend of Cox's. The trustee was reviewing a number of potential assets involving Cardinal and Cox, including autos and collectibles. The police had informed the trustee that they thought Cardinal had taken a diamond pendant from Cox which they believed the Coxes had removed from their business when they fled Medford, Oregon. The trustee knew the police were investigating Cardinal for threats he'd allegedly made on Cox's life. Because of this information the trustee was concerned that if it approached Marko or Cardinal directly about any assets, some might disappear.

The trustee had seen the subject deed to Marko early on and had believed it was suspicious because Deborah Cox's signature did not look genuine. In addition, the trustee believed it was suspicious that the deed had been recorded around the time the Coxes fled Medford, Oregon. However, the trustee believed it did not have sufficient information at that time to file a lawsuit on the property. It instructed its counsel to file a notice of the bankruptcy in the California office of real property records. Trustee's counsel filed notice in January, 1986, but mistakenly filed it in Santa Clara County instead of Santa Cruz County. The trustee believed it, and counsel, needed to further examine the legal relationships between Cardinal and Cox, and Marko and Cardinal.

Cox was a fugitive from justice until apprehended by the F.B.I. in December, 1988. When these consolidated bankruptcies were filed, the trustee had no records of the Cox creditors.

Rather, they had to be reconstructed from creditors' records and bank records. The trustee decided to subpoena and review records from over twenty of the debtors' bank accounts. This took around a year.

In 1986, Deborah Cox returned to Medford, Oregon. In connection with her discharge trial and after reviewing the subject deed, she notified the trustee in September, 1986 that her signature was forged. In early 1987, the trustee ordered an updated title report on the subject property. Only then did the trustee learn that title to the subject property had been transferred to the Ertas. This lawsuit was filed March 3, 1987.

CONCLUSIONS OF LAW

Summary

Due to the forgery of the quitclaim deed from the Coxes to Marko, the trustee is entitled to recover damages in the amount of the present value of the property pursuant to its § 542 claim. It is also entitled to recover the net rents generated from the property during the period of time the Ertas were wrongfully in possession. However, in order to prevent the estate from being unjustly enriched, the Ertas will be given credit against the value of the property for paying off all encumbrances the trustee would have had to pay upon liquidation of the property. The Ertas are also entitled, as good faith improvers under California law, to setoff the award of damages to the trustee by an amount equal to

the increase in the property's market value that is attributable to their improvements. The court's reasoning is detailed below.

CLAIMS

The real property and rents accruing therefrom are property of the estate

1. Under § 542(a), an entity in possession of property that the trustee may use, sell or lease under § 363 is required to deliver that property, or the value of such property, to the trustee. Section 363 recites that the trustee may use, sell or lease property of the estate. Section 541 defines property of the estate. It includes all legal interests of the debtor in property as of the commencement of the case. The extent of the debtor's interest in property is determined under state law. The § 541 definition of property of the estate also includes rents or profits of or from property of the estate. Thus, pursuant to § 542, an entity in possession of property of the estate is required to turn over to the trustee the property, or its value, and, in addition, all rents or profits obtained from that property. The court believes the duty to turn over property of the estate is absolute once the entity in possession is aware of the bankruptcy. This duty is not conditioned upon demand being made for the property.

There is no statutory limitation on the time within which a trustee may bring an action for turnover of property of the estate. However, this court believes it has inherent power as a court of

equity and pursuant to the provisions of 11 U.S.C. § 105 to apply the doctrine of laches to deny relief under § 542 to a trustee who, with knowledge of his rights and without good cause, has failed to pursue property of the estate within a reasonable period of time to the detriment of a defendant.

2. California law governs all state law issues as California is the situs of the real estate at issue. Matter of Torrez, 63 Bankr. 751, 754 (9th Cir. BAP 1986), aff'd, In re Torrez, 827 F.2d 1299 (9th Cir. 1987), citing In re Rogal, 112 F. Supp. 712, 716 (S.D. Cal. 1953). Under California law, a forged document is void ab initio and constitutes a nullity; as such it cannot provide the basis for a superior title as against the original grantor. Wutzke v. Bill Reid Painting Service, Inc., 151 Cal. App. 3d 36, 198 Cal. Rptr. 418, 423 (1984). The validity of the title of a subsequent purchaser or encumbrancer depends upon the validity of his grantor's title. Id.

3. Where the conveying instrument is void for such reasons as forgery or lack of delivery, it does not gain efficacy by recordation even in favor of an alleged party taking in good faith, for value and without notice.

4. This court has found the quitclaim deed from the Coxes to Marko was forged. The quitclaim deed is void and did not pass title to Marko. As Marko had no title to pass, she could not transfer title to Ray and Linda Erta. The Ertas, having no interest in the property, could not grant a valid encumbrance on

the property in favor of Watsonville Federal Savings and Loan or the City of Watsonville. Recordation of the deed did not change these results. The real property and rents flowing from it after October 18, 1984 are property of the estate, and, absent equitable considerations, must be turned over to the trustee pursuant to § 542(a). Based on Findings of Fact numbers 67 and 68, as addressed in more detail in the discussion of the defense of equitable estoppel, this court finds there is no basis to deny relief to the trustee under § 542(a) through imposition of the defense of laches against him under 11 U.S.C. § 105.

5. Ray and Linda Erta assert they may choose to turn over the value of the property rather than the property itself in satisfaction of the requirements of § 542(a). The language of § 542(a) indicates the entity in possession of estate property shall deliver the property or the value of the property to the trustee. Unlike similar language in § 550, the statute does not direct that the decision as to the form of the property to be delivered lies with the judge. Nor is there any legislative history for § 542 on this point to guide this court. I have turned to the history and commentary on § 550 for direction. I believe I must determine, first, with whom this option rests. Second, if the option rests with the court, I must determine under what circumstances the value of the property, as opposed to the property itself, should be turned over to the trustee. Third, if I allow the value of the property to be turned over, I must determine at what point in time

the value should be determined and the calculation, under the facts, by which that amount is reached.

Clearly the decision as to the form of the property to be turned over should lie with the judge, not either party. I believe the decision must be based on the equities of the case and the judge is the proper person to weigh those equities. Under these facts -- where the plaintiff as trustee would liquidate the property immediately for the benefit of the creditors, where defendants have in good faith put significant time and money into the property and wish to keep it as an investment, and where two entities were granted liens on the property in good faith -- this court believes no additional benefit would inure to the trustee, and additional inconvenience would result as to the defendants Erta, in requiring Ray and Linda Erta to turn over the property to the trustee.

The trustee had the right to possess the real property and receive rents therefrom from October 18, 1984 forward. In light of this continuing right and in the absence of such possession, and as the property has increased in value in the interim, the increase should inure to the benefit of the estate. Any other conclusion would result in a windfall to those wrongfully in possession. Consequently, Ray and Linda Erta must turn over to the trustee the value of the property as of the date the court orders the turnover. In fairness, however, and to prevent the trustee's unjust enrichment, the court will exercise its § 105 equitable powers to

grant the Ertas credit for paying off all prior encumbrances on the property the trustee would have had to pay off in order to liquidate the property. Therefore, the Ertas will be ordered to turn over the value of the property ($245,000 -- see Finding of Fact number 62) less the amounts they paid at escrow to satisfy property taxes and the Tomasello/Little and N.C.I., Inc. encumbrances ($99,208.45 -- see Finding of Fact number 21).

In addition to turning over the value of the property, the Ertas must turn over to the trustee all net rents obtained off the property subject to any recognized offsets. The court believes that Ray and Linda Erta should not be required to turn over to the trustee the gross rents they have obtained from the property. If the trustee had possession of the property in October, 1984 it would have had expenses for the maintenance of the property and would not have been able to collect the enhanced rents the Ertas have received without making similar payments for improvements and upkeep. Thus Ray and Linda Erta should turn over the rents after subtracting all expenses they reasonably and necessarily incurred. As the court has determined in Finding of Fact number 60 that the Ertas have actually suffered a net loss from the rental property, they are not obligated to turn over any net rents to the trustee.

6. The existence of a legal remedy against one of several obligors cannot relieve another obligor of his equitable responsibility. Katsivalis v. Serrano Reconveyance Co., 70 Cal. App. 3d 200, 138 Cal. Rptr. 620, 627 (1977), citing Barr v.

Roderick, 11 F.2d 984, 986 (N.D. Cal. 1925). The fact that the defendants Erta may have a legal cause of action against the other defendants or against their title insurance company does not prevent them from obtaining any appropriate relief against the trustee.

7. In its third amended complaint the trustee seeks no specific relief against Cardinal. However, in its post-trial memorandum the trustee requests that in the event the court does not award it the property that Cardinal be ordered to pay into the estate the sum of $64,204.98, which represents $12,825 in rents he collected from October, 1984 to December, 1985, the $7,700 paid to N.C.I., Inc. and the $43,679.98 paid to Cardinal by Marko at the closing on the sale of the property to the Ertas in December, 1985. The court cannot award any relief from Cardinal to the trustee. All claims against parties must be set out in formal pleadings with sufficient specificity to allow the party to respond knowledgeably, and such pleadings must be served on those parties. See Fed.R.Civ.P. 8(a). Such pleadings do not include a post-trial memorandum. See Fed.R.Civ.P. 7.

The trustee's demand would fail in any event. First, the trustee presented no facts or legal argument to support its entitlement to an award of the $7,700 admittedly paid not to Cardinal but to Barry Nottoli, a third party, through N.C.I., Inc. (Mr. Nottoli testified that the amount owing N.C.I., Inc. from Cox had increased from the $2,000 secured by the trust deed he had

placed on the property to $7,700 due to interest on the $2,000, plus the payoff of a $5,000 loan made by Nottoli to Cardinal sometime between 1983 and 1985. Penniman Title Co. apparently paid that amount to N.C.I., Inc. on Cardinal's oral assertions without more.) Second, the trustee did not support its claim for $12,825 in rents with evidence of the amount collected by Cardinal. $12,825 works out to $1,068.75 per month for the 15 months Cardinal collected the rents between October, 1984 and December, 1985. The only evidence on record shows that no more than $800 per month was ever collected by Cox and that this amount had dipped to between $300 to $500 per month by the time Cardinal took over collecting the rents. The trustee further ignored the fact that during this period of time Cardinal paid the $875 per month due on the underlying Tomasello/Little encumbrance, which most likely exceeded the amount of rents he collected. Finally, the trustee is not entitled to both the property, or its value, plus partial proceeds from its sale in 1985. To allow such recovery would be to allow a partial double recovery resulting in the trustee's unjust enrichment. Any claim for the $43,679.98 paid to Cardinal from the sale to the Ertas would more properly lie with the Ertas who thought they were purchasing good title with those funds.

8. Marko was an innocent party to the described proceedings. The trustee has made no claim for recovery against Marko and the court orders none.

AFFIRMATIVE DEFENSES

The doctrine of equitable estoppel is not applicable under the facts

9. Under California law the doctrine of equitable estoppel may be invoked by an innocent purchaser of real property taking by forged document in spite of the fact that ordinarily a forged instrument cannot carry title. The owner of property cannot be divested thereof by a forged instrument, but his conduct may estop him from denying its validity. Wutzke, 198 Cal. Rptr. at 424.

In order to bring about an estoppel against assertion of ownership of real property, four conditions against the owner of real property are necessary: (1) the party to be estopped was apprised of the true state of his own title; (2) he made an admission with intent to deceive or with such culpable negligence as to amount to constructive fraud; (3) the other party was not only destitute of knowledge of the state of the title, but also of the means of acquiring knowledge; and (4) the other party relied on the admission to his damage. Marks v. Bunker, 165 Cal. App. 2d 695, 332 P.2d 340, 343 (1958).

Generally speaking, mere silence on the part of a party will not create an estoppel unless he was under some obligation to speak, and a party invoking such estoppel must show that it was the duty of the other to speak, and that he had not only been induced to act by reason of such silence, but that the other had reasonable

cause to believe that he would so act. Johnson v. Johnson, 179 Cal. App. 2d 575, 3 Cal. Rptr. 575, 577 (1960).

A party invoking the doctrine of estoppel must be ignorant of the true facts and must have sustained injury in reliance upon the representation or conduct of the party to be estopped. Marks v. Bunker, 332 P.2d at 344. When evidence is not in conflict and is susceptible of only one reasonable inference, existence of an estoppel is a question of law. Driscoll v. City of Los Angeles, 67 Cal. 2d 297, 61 Cal. Rptr. 661, 431 P.2d 245, 250 (1967).

Defendants Erta assert that the trustee is equitably estopped to claim the rents flowing from the property for the years 1985 and 1986 because it knew from early 1985 that the estate might have an interest in the subject property and yet did not notify the defendants Erta of its potential claim. (The Ertas do not assert the doctrine as a defense to turnover of the property itself. The court further notes that Cardinal in fact received the rents in 1985 and he has not raised this defense.) The court questions whether the doctrine applies to personal property. Even assuming it does, the uncontested facts do not support the application of the doctrine. The facts demonstrate that the trustee was not able to obtain the information required to make an informed and knowledgeable claim for the subject property until the beginning of 1987. This was due to the significant delay in obtaining information about the background on the Cox ownership and subsequent transfer of this property and the existence of any

debtor-creditor relationship between Cox and Cardinal due to the lack of bankruptcy schedules, business records, and the disappearance of the Coxes. Moreover, the trustee was receiving bizarre information from third parties regarding Cardinal's "business" affairs with Cox and his alleged threat against Cox's life, which prevented the trustee from contacting Cardinal personally.

The trustee was dealing with a confusing and complex situation for an extended period of time, none of which was of its making and much of which was out of its control. For the trustee to assert a claim under § 542 would require proof of forgery which it had no reason to seriously believe until Deborah Cox indicated this in September, 1986. For it to assert a claim under §§ 544, 547 or 548 would require detailed information about the business relationship between Cardinal, Marko and Cox and the exact circumstances under which the property was transferred. The trustee had no business records of Cox-Cardinal dealings because they intentionally kept their written records at a minimum. The trustee could not question Steven Cox until he was apprehended in December, 1988. Deborah Cox knew nothing about the property, very little about Cardinal and nothing about Marko. The trustee could not ask Cardinal and Marko about the property because it had reason to believe from law enforcement people investigating the circumstances surrounding the Coxes' disappearance -- which this court believes was the best information available at that time --

that any direct questioning of Cardinal or Marko could result in the disappearance of other estate assets. Although the trustee may have had some suspicions about the state of the subject deed, it simply did not know of any substantive claim it might have on this property until late 1986. Until then it had no reason to incur estate expense in asking for an updated title report. Thus it had no reason to know of the defendant Ertas' interest in the property. Under these facts the trustee had no duty to notify the Ertas or others through recording of any interest it might have had in the property. Nor did it have reasonable cause to believe that the defendants Erta would be induced to act as a result of its failure to notify them of any interest it might have had in the property. While it is unfortunate that trustee's attorney recorded the notice of the Coxes bankruptcy in the wrong place, such inadvertence does not rise to the level of acts required to support the doctrine of estoppel.

The Ertas may not assert the §549(c) defense under the facts

10. The purpose of § 549(c) is to protect a good faith purchaser against a fraudulent debtor selling real property postpetition. In re Walker, 861 F.2d 597, 599-600 (9th Cir. 1986). It is a strictly statutory affirmative defense available only in conjunction with an adversary proceeding brought by the trustee under § 549(a). Because the trustee dropped its § 549(a) claim, § 549 (c) is unavailable as a defense to the defendants.

The Ertas may not assert the §550(d) defense under the facts

11. Any § 550(d) lien otherwise available to the Ertas is only available in connection with a recovery by the trustee under one of the Code sections mentioned in § 550(d). None of those sections applies under the facts as found by the court. Therefore that statutory lien is not available to the defendants Erta.

The Ertas do not have standing to assert a resulting trust defense.

12. Under § 541(d), where the debtor possesses only a legal and not an equitable interest in property, the equitable interest does not become part of the estate. Torrez, 63 Bankr. at 753; In re Gurs, 34 Bankr. 755, 757, rehearing denied, 34 Bankr. 755 (9th Cir. BAP 1983); In re Wilder, 42 Bankr. 6, 8 (Bankr. D. Or. 1983). Whether a third party has an equitable interest in property is determined under state law.

Under California law an equitable interest arising from a resulting trust is recognized and the trust enforced by the court under certain circumstances. See Torrez, supra at 754 (and cases cited therein). The party alleging the existence of the trust must do so by clear, satisfactory, unambiguous and convincing evidence. Carr v. Yokohama Specie Bank, Limited, 99 F. Supp. 4, 7 (N.D. Cal. 1951), aff'd, 200 F.2d 251 (9th Cir. 1952).

There is a presumption that the holder of title to property is the owner thereof. Baskett v. Crook, 86 Cal. App. 2d 355, 195 P.2d 39, 44 (1948). However, a resulting trust is implied by

operation of law whenever a party pays the purchase price for a parcel of land and places the title to that land in the name of another. Torrez, 63 Bankr. at 754.

A resulting trust is often called an "intention-enforcing" trust. It arises by implication of law to enforce the inferred intent of the parties to a transaction. It is a creature of equity and need not be evidenced by a writing or even by an express declaration. Calistoga Civic Club v. City of Calistoga, 143 Cal. App. 3d 111, 191 Cal. Rptr. 571, 577 (1983). The Statute of Frauds has no applicability to an action to enforce a resulting trust. Jones v. Gore, 141 Cal. App. 2d 667, 673, 297 P.2d 474, 477 (1956).

Although partial payment of the consideration for property may give rise to a resulting trust to the extent of the payment, the burden is on the party who asserts a pro tanto trust to establish with definiteness and specificity the proportional amount contributed. Lloyds Bank California v. Wells Fargo Bank, 187 Cal. App. 3d 1038, 232 Cal. Rptr. 339, 342 (1986), rev. denied (1987). Where two persons allegedly contribute money to the purchase of land, it is not a condition of the enforcement of the trust that the beneficiary of the alleged resulting trust actually pay his portion of the consideration at or before the execution of the conveyance. Viner v. Untrecht, 26 Cal. 2d 261, 158 P.2d 3, 7 (1945).

The defendants Erta have raised the claim of a resulting trust as an affirmative defense on their own behalf. The trustee has

asserted that they did not have standing to raise such a defense. Prior to trial this court ruled against the trustee on this issue. The court has reconsidered its position. One of the elements of the standing inquiry that the Ertas must satisfy is that they are asserting their own legal rights and interests, and are not resting their claim to relief on the legal rights or interests of third parties. Secretary of State of Md. v. J.H. Munson Co., 467 U.S. 947, 955, 104 S.Ct. 2839, 81 L.Ed.2d 786 (1984). There is an exception to this rule. Where it is shown that practical obstacles prevent a party from asserting rights on behalf of itself, the court will recognize the doctrine of jus tertii standing. Id., 467 U.S. at 956; In re Umpqua Shopping Center, Inc., 113 Bankr. 303, 305 (9th Cir. BAP 1990) (and cases cited therein).

The court finds that the Ertas are resting their claim to relief under the resulting trust theory on the rights and interest of Cardinal and his monetary contribution to the purchase of the subject real property. During this adversary proceeding both the trustee and the defendants Erta have analyzed the resulting trust claim as well as the equitable defenses thereto raised by the trustee within the context of the facts which were alleged to have existed as between Cox and Cardinal. Further, the defendants Erta have not shown that there was any practical obstacle to prevent Cardinal from asserting the resulting trust defense in his own right. On the contrary, the record shows that he had every opportunity to do so and chose not to assert the defense. The

court concludes that the defendants Erta have no standing to raise the affirmative defense of a resulting trust.

The defendant Cardinal has waived any defense of a resulting trust

13. Federal Rule of Civil Procedure 8(c), which is incorporated by Bankruptcy Rule 7008(a), requires that a party set forth its affirmative defenses in a responsive pleading. This court believes that the claim of a resulting trust is an affirmative defense. See 5 Wright & Miller, FEDERAL PRACTICE AND PROCEDURE § 1270, at 411 (1990). Cardinal did not plead a claim of resulting trust as an affirmative defense; nor did he seek to amend his pleadings to include this defense at trial. At trial he did not attempt to present any evidence to support such an affirmative defense. Failure to plead an affirmative defense generally results in its waiver. See U.S. v. Continental Illinois Nat. Bank and Trust, 889 F.2d 1248, 1253 (2nd Cir. 1989). Under the Federal Rules of Civil Procedure and these facts, the court will not enforce such a trust on his behalf. Even if the court could impose a resulting trust on Cardinal's behalf, it would decline to do so under the facts here. Cardinal's conduct does not warrant such extraordinary equitable relief.

Ray and Linda Erta are not entitled to an equitable lien on the property for the amount of the improvements

14. Ray and Linda Erta assert under general equitable principles of California law the right to an equitable lien on the

subject property in the amount of the value of the improvements, repairs and the cost of insurance, taxes and utilities they expended on the property.

California statutes provide three alternative remedies for good faith improvement of property. Recognition of the common law right to a setoff for good faith improvement of property was first allowed in California by statute in 1851. That statute was reenacted in 1872 as CCP § 741.

As an addition to the setoff remedy, a 1953 amendment to the Civil Code provided that the improver had the right to remove his improvements upon payment of the damages caused by the affixing and removal. See CCP § 1013.5.

In 1968 the legislature enacted a third remedy for the improver. CCP §§ 871.1-871.7 provide the improver with the right to bring an original action based upon his improvements. Under these sections relief will not be granted if the court determines that he has an adequate remedy by setoff or by removal of the improvement. Under these sections the court is granted broad authority to grant a remedy which is equitable under the particular circumstances. This remedy may consist of granting the improver an equitable lien on the improved property. Okuda v. Superior Court of Riverside County, 144 Cal. App. 3d 135, 192 Cal. Rptr. 388 (1983).

Ray and Linda Erta have requested relief as good faith improvers under California law under CCP § 741. They have also

requested an equitable lien, presumably under California common law. There appears to be a split in California as to whether CCP §§ 741 and 871.1 et seq. provide the exclusive remedy for good faith improvers. In Taliaferro v. Colasso, 139 Cal. App. 2d 903, 294 P.2d 774, 777 (1956), the court held that it may not impress an equitable lien on property as an alternative remedy to the statutory remedy available through CCP § 741. In contrast, in Lesny Development Co. v. Kendall, 164 Cal. App. 3d 1010, 210 Cal. Rptr. 890 (1988), where the owner received no damages for wrongful withholding and CCP § 741 was not invoked by the improver, the improver received the value of his services (not the value by which the property was enhanced) in the form of a money judgment under the equitable principles of restitution. This court believes that the better rule is that where the value of improvements on another's property is sought by the holder of the property who has acted in good faith, CCP §§ 741 or 871.1 et seq. provide the exclusive remedy. "Rules of equity cannot be intruded in matters that are plain and fully covered by positive statute . . . ." Katsivalis, 138 Cal. Rptr. at 626. Pursuant to CCP § 871.4, relief may not be granted under CCP § 871.1 et seq. if CCP § 741 provides an adequate remedy. Ray Erta and Linda Erta have an adequate remedy under CCP § 741 (discussed infra), and are therefore limited to that remedy for their improvements. Therefore they are not entitled to an equitable lien.

The parties have addressed the case of Trout v. Taylor, 220 Cal. 652, 32 P.2d 968 (1934) at length in their briefs on the issue of whether this court may impose an equitable lien under the facts before it. Under circumstances where either through mistake or the fraudulent acts of a third party a defendant has obtained what he innocently believed to be an interest in real property, California courts have refused to impress an equitable lien on the property for any losses the defendant may have incurred if the plaintiff, as true owner and innocent party, has not been enriched thereby. Id.; Bryce v. O'Brien, 5 Cal. 2d 615, 55 P.2d 488 (1936). Trout v. Taylor is cited by the trustee in support of its argument that an equitable lien on behalf of the Ertas does not lie. Trout v. Taylor is distinguishable. In Trout v. Taylor unlike the case at bar the purchaser had made no improvements; further, the true owner was not enriched by defendant's expenditures.

California courts will impress an equitable lien where it is found the plaintiff and defendant had intended an equitable lien be created. Under these circumstances an equitable lien serves the same purpose as a resulting trust. Holder v. Williams, 167 Cal. App. 2d 313, 334 P.2d 291 (1959). The facts do not support a finding that the Ertas and the trustee intended an equitable lien be created against the property.

Ray and Linda Erta are entitled to a setoff under CCP § 741

15. Under certain circumstances CCP § 741 allows a defendant who has improved the property of another to offset the amount by which the improvements enhance the value of the property against damages awarded the owner.[3] The setoff is only allowed to the extent damages are actually awarded to a landowner for wrongful withholding of possession. See Taliaferro, 294 P.2d 774. The statute was amended in 1968 in two ways. The requirement that the improver claim the property under color of title was eliminated. The measure of the offset was changed to that amount by which the improvements have increased the market value of the land. This is clarified in the Law Revision Commission Comment of CCP § 741:

> The amendment also substitutes "the amount by which such improvements enhance the value of the land" for "the value of such improvements." The new language clarifies the former wording and assures that the value of the improvement, for purposes of setoff, will be measured by the extent to which the improvement has increased the market value of the land.

CCP § 741 encompasses the definition of a "good faith improver" found at CCP § 871.1:

§ 871.1. Good faith improver defined

---

[3] Section 741 of the CCP states:

> **§ 741. Damages for withholding property**
> (a) **Good faith improver defined**
> (a) As used in this section, "good faith improver" has the meaning given that term by Section 871.1.
> (b) **Value of improvements as set-off**
> (b) When damages are claimed for withholding the property recovered, and improvements have been made on the property by a defendant or his predecessor in interest as a good faith improver, the amount by which such improvements enhance the value of the land must be allowed as a setoff against such damages.

> As used in this chapter, "good faith improver" means:
>
> (a) A person who makes an improvement to land in good faith and under the erroneous belief, because of a mistake of law or fact, that he is the owner of the land.
>
> (b) A successor in interest of a person described in subdivision (a).

The comments to CCP § 871.1 make it clear that a person cannot be a "good faith improver" as to any improvement made after he becomes aware of facts that preclude him from acting in good faith.

> Under this section, a person is not a "good faith improver" as to any improvement made after he becomes aware of facts that preclude him from acting in good faith. For example, a person who builds a house on a lot owned by another may obtain relief under this chapter if he acted in good faith under the erroneous belief, because of a mistake of law or fact, that he was the owner of the land. However, if the same person makes an additional improvement after he has discovered that he is not the owner of the land, he would not be entitled to relief under this chapter with respect to the additional improvement.

Law Revision Commission Comment, 1968 Enactment, CCP § 871.1; (see also Brown Derby Hollywood Corp. v. Hatton, 40 Cal. Rptr. 848, 395 P.2d 896 (1964), for a general discussion of notice as an element of lack of good faith improvements on another's property.)

16. This court has noted no cases addressing the question as to what is to be included in the statutory definition of "improvements". This is unnecessary. The statutory offset is measured by the value of the property in the hands of the owner as enhanced by the improvements. The court need not determine the exact amount of the improvements or whether they are categorized as capital improvements or routine repairs. It need only find that

improvements were made to the property and that the market value was increased thereby. The cost of the improvements do not necessarily translate to an increase in value dollar for dollar.

17. Sections 741 and 871.1 et seq. provide the improver with separate remedies, but the remedies are for the same form of loss. Section 741 stands alone; it does not contain any statutory guidelines for the court regarding burdens of proof or the adjustment of the rights and interests of the parties. In contrast, CCP § 871.3, added in 1968, makes it clear the good faith improver has the burden of proving his right to setoff. Further, and for the first time, that statute requires the court also to consider the good faith improver's degree of negligence as a factor in determining the extent of relief granted, if any. Thus the court must consider not only the improver's honesty and lack of fraudulent intent but also his degree of care. Raab v. Casper, 51 Cal. App. 3d 866, 124 Cal. Rptr. 590 (1975). Finally, § 871.5, added in 1968, enumerates specific guidelines the court should follow in exercising its equitable powers to protect the rights and interests of the parties. This court believes that the legislative guidelines provided in conjunction with the equitable remedy available to improvers through § 871.1 et seq. are likewise suitable for application in determining the parameters of the equitable right to setoff available under § 741. This court has followed those guidelines in its analysis of Ray and Linda Erta's right to a § 741 setoff under our facts.

18. The trustee asserts that Ray and Linda Erta are not "good faith improvers" because they became aware of facts prior to making improvements on the property, either directly or through their agents Penniman Title or Burgstrom Realty, which, with further investigation, could have led them to discover that they were not the true owners of the property. The trustee seems to want to transplant the same standards for good faith improver that the law requires of a good faith purchaser. These standards would necessarily encompass the concept of constructive notice. Constructive notice is defined by California Civil Code § 19 (hereinafter "CCC") as follows: "Every person who has actual notice of circumstances sufficient to put a prudent man upon inquiry as to a particular fact, has constructive notice of the fact itself in all cases in which, by prosecuting such inquiry, he might have learned such fact."

This court knows of no California cases under either CCP §§ 741 or 871.1 which have denied the status of a "good faith improver" to one who has improved property under the mistaken belief that he owned it, on the basis that the improver had constructive notice of the fact that he was not the true owner of the property. The court does not believe that a "good faith improver" within the meaning of CCP § 871.1 must necessarily satisfy these standards of constructive notice established through common law for a "good faith purchaser." The definition of constructive notice found in CCC § 19 does not allow for degrees of

negligence to be taken into consideration by a court of equity. Yet CCP § 871.3 states: ". . . the degree of negligence of the good faith improver should be taken into account by the court in determining whether the improver acted in good faith and in determining the relief, if any, that is consistent with substantial justice to the parties under the circumstances of the particular case." Moreover, CCC § 19's definition does not allow for a complete balancing of the equities of the individual case. Yet CCP § 871.5 states:

> **§ 871.5. Adjustment of rights, equities and interests of parties**
>
> When an action or cross-complaint is brought pursuant to Section 871.3, the court may, subject to Section 871.4, effect such an adjustment of the rights, equities, and interests of the good faith improver, the owner of the land, and other interested parties (including, but not limited to, lessees, lienholders, and encumbrancers) as is consistent with substantial justice to the parties under the circumstances of the particular case. The relief granted shall protect the owner of the land upon which the improvement was constructed against any pecuniary loss but shall avoid, insofar as possible, enriching him unjustly at the expense of the good faith improver. In protecting the owner of the land against pecuniary loss, the court shall take into consideration the expenses the owner of the land has incurred in the action in which relief under this chapter is sought, including but not limited to reasonable attorney fees. In determining the appropriate form of relief under this section, the court shall take into consideration any plans the owner of the land may have for the use or development of the land upon which the improvement was made and his need for the land upon which the improvement was made in connection with the use or development of other property owned by him.

In construing § 871.3 in light of the balancing of equities which is directed by § 871.5, the court in Powell v. Mayo, 123 Cal. App. 3d 994, 177 Cal. Rptr. 66 (1981), stated:

> Negligence on the part of the improver does not necessarily preclude all relief. The degree of negligence is a factor which should be taken into account in determining whether the improver acted in good faith and in determining the relief that is consistent with substantial justice. (Emphasis in original)

Id., 177 Cal. Rptr. at 68. The court went on to state: " . . . even if plaintiff was negligent, the [trial] court was entitled to grant her relief under the circumstances." Id.

19. The trustee alleges that through its service as escrow agent, title examiner and title insurer, Penniman Title Co. had knowledge of a series of highly unusual facts with regard to the title to the property which "required a reasonably prudent title insurer to inquire further, or, at a minimum, disclose these strange facts to the defendants Erta." (Plaintiff's Trial Brief, at 74.) The trustee further asserts that Penniman was an agent of Ray and Linda Erta; knowledge of these unusual facts was therefore imputed to Ray and Linda Erta. The facts the trustee believes Penniman had notice of, which it believes were highly unusual and which should have led the title company to investigate the legitimacy of the quitclaim deed were:

A. The existence of the quitclaim deed from Cox to Marko.

B. The existence of the rare "subscribing witness" acknowledgment on the quitclaim deed.

C. The fact that the quitclaim deed was recorded six months after its execution.

D. The fact of the recordation of the quitclaim deed by a third party (Cardinal).

E. The return of the quitclaim deed to Cardinal after recording.

F. The fact there was a request for a preliminary title report in late September, 1984 followed by the recordation on October 3, 1984 of the quitclaim deed and the request for a rush title report thereafter by Nottoli.

G. The fact that Cardinal accompanied Marko to pick up the proceeds check at the closing.

H. The fact no consideration was paid for the quitclaim deed.

I. The fact there is a different recordation stamp number on each sheet of the quitclaim deed.

J. The fact that "James Whitmore" was collecting the rent checks on the property before closing.

(The record indicates that Penniman, through Mr. Coffey and Mr. Griffith, did have knowledge of facts A, B, C, E, F, G, H and I. There is no evidence it had knowledge of facts D or J, and the court finds it did not.) Further, the trustee asserts that Penniman was negligent in not investigating the legitimacy of the signature of either Steven or Deborah Cox on the quitclaim deed.

20. When a title company is hired <u>solely</u> to provide title insurance, a contractual relationship arises. Thus, the title

company does not act as the agent of its employer but instead is an independent contractor. Rice v. Taylor, 220 Cal. 629, 32 P.2d 381 (1934). However, when a title company acts as a title searcher, it has an accompanying duty to report its findings to its employer and thus becomes the agent of the employer for this purpose. Id., 32 P.2d at 383.

An escrow holder is the agent of all the parties to the escrow at all times prior to performance of the conditions of the escrow, bears a fiduciary relationship to each of them and owes an obligation to each, measured by an application of the ordinary principles of agency. Spaziani v. Millar, 215 Cal. App. 2d 667, 30 Cal. Rptr. 658, 666 (1963). Under ordinary principles of agency law, knowledge of the agent is imputed to the principal if the agent has a duty to supply information to the principal relevant to the matters entrusted to him. RESTATEMENT (SECOND) OF AGENCY § 381, at 182 (1958).

Penniman Title Company was retained by Ray and Linda Erta. It was not retained by Watsonville or by Portola. It provided a copy of the preliminary title report and a lender's title insurance policy to Watsonville on its request, but charges for this service were included in Watsonville's fees which were paid by Ray and Linda Erta. The title company was not the agent of Watsonville or Portola. As escrow holder and title examiner, it was the agent of Ray and Linda Erta. Any knowledge that Penniman Title Co. obtained, which dealt with the state of the title and with the

execution of the escrow, should have been supplied to Ray and Linda Erta. If it was not disclosed, it could be imputed to them. It could not be imputed to Watsonville or Portola.

21. Even if this court were to accept the application of the legal concept of constructive notice for purposes of determining the right to a setoff against damages under § 741, the trustee's argument must fail on the evidence presented. The trustee offered neither oral testimony nor documentary evidence that a reasonably prudent title company armed with knowledge of the known listed facts would have prosecuted further inquiry into the legitimacy of the quitclaim deed to Marko, including an examination of the Cox signatures. Therefore this court cannot conclude that Penniman Title Company, and Ray and Linda Erta through imputation, had constructive notice of the true ownership of the property. The court notes that even the transferee of a quitclaim deed can take as a "good faith purchaser". See 54 Cal. Jur. 3d, Real Estate Sales § 328 (1979); Sabo v. Horvath, 559 P.2d 1038 (Alaska, 1976). Certainly the court cannot find, as the trustee seems to be suggesting, that the existence of a quitclaim deed in a chain of title gives notice to all subsequent transferees of possible title defects.

22. The trustee asserts that Burgstrom as realtor for the sale had knowledge of a series of highly unusual facts with regard to the title to the property which required a reasonably prudent realtor to inquire further into the state of the title. It further

asserts that the realtor was the agent for Ray and Linda Erta, the buyers, and as such its knowledge is imputed to the Ertas. Thus through this imputed knowledge, the Ertas had constructive notice of other claims to the property and cannot be "good faith improvers."

Normally the broker is the agent of the party first employing him. See Stephen v. Ahrens, 179 Cal. 743, 178 P. 863, 864 (1919). However, within the context of a transaction such as the one before the court, where there are two principals and only one broker, it is possible that the broker may be the agent for the seller for certain purposes and the agent for the buyer for other purposes. Bonaccorso v. Kaplan, 218 Cal. App. 2d 63, 32 Cal. Rptr. 69, 72 (1963). When one party has retained the broker, an agency relationship between the broker and the other party may arise from the broker's acceptance of duties and responsibilities to that party. See Wright v. Lowe, 140 Cal. App. 2d 891, 296 P.2d 34, 37 (1956). An agency relationship is established by a factual determination of the particular sales transaction. Wolf v. Price, 244 Cal. App. 2d 165, 52 Cal. Rptr. 889, 894 (1966).

One of the factors to look at is the party who pays the broker's commission. Burgstrom was hired to market this property in October, 1984 by Barry Nottoli's office on behalf of Cardinal. Marko/Cardinal paid Burgstrom's commission arising out of the Erta sale. Burgstrom of necessity had to speak to Ray Erta on occasion about the progress of the transaction. But the trustee has not

been able to point to any evidence which would support a finding that Burgstrom acted as the agent for Ray and Linda Erta for any purpose. This court concludes that Burgstrom did not act as agent for Ray and Linda Erta. Therefore, any knowledge the realtor held cannot be imputed to Ray and Linda Erta.

23. The trustee asserts that prior to the closing of the sales transaction on the subject property, Ray and Linda Erta obtained direct knowledge which would have led a prudent purchaser to make further inquiry into the state of the title. In its post-trial brief, at pp. 102-03, the trustee states:

> " . . . the purported knowledge held by the defendants Erta (i.e., that `James Cardinal' held title to the property) was entirely inconsistent with the record title. The defendants Erta were thus reasonably required to make inquiry of the prior parties in the chain of title, as to their interests, and the nature of the unrecorded title interests of `James Cardinal', whom the defendants Erta believed held title."

The court has summarized its findings as to the extent of Ray and Linda Erta's actual knowledge of the title in Findings of Fact numbers 46, 47, 51, 53 and 54. Consistent with the proof presented at trial by the trustee, it has found that Ray and Linda Erta knew that a James Whitmore, not a James Cardinal, claimed title to the property. The court found the Ertas did not know the name of the title owner until after closing. Further, the trustee put on no evidence to support a finding that a reasonable person who knew that one who was not in the chain of title (i.e., Whitmore/Cardinal) claimed ownership of the property would make

further inquiry as a result of that knowledge. This court can conceive of circumstances where it is likely that a reasonable person would not be concerned about such a claim if they were assured by a title examiner that the person from whom they were to receive title (i.e., Marko) was able to transfer marketable title. The court finds that Ray and Linda Erta were not negligent in any way in their dealings with regard to this property prior to their placing improvements on it. The court further finds that in placing improvements on the property they acted in good faith in the mistaken belief that they were the owners of the property. They qualify as good faith improvers under § 741 and should receive a setoff of $27,500, as calculated in Finding of Fact number 63, against damages awarded to the trustee in the form of the present market value of the property.

Watsonville Savings and Loan is not entitled to an equitable lien on the property

24. A lender which has provided funds which have been spent for improvements on real property and which has no record lien may receive an equitable lien on the property in the owner's hands. Jones v. Sacramento Savings and Loan Ass'n, 248 Cal. App. 2d 522, 56 Cal. Rptr. 741 (1967). Equity creates the lien to prevent unjust enrichment. The amount of the lien may be the value of the improvements. Id. at 746. The judgment is not a money judgment

but simply establishes a charge on the property and does not bear interest. Id. at 747.

The Jones court distinguished the circumstances under which CCP § 741 would apply from the facts before it by finding "the statute applied to one who makes improvements while `holding' the land, not to one who has supplied services to its acknowledged owner or lent him money in reliance upon a security." Id. at 748. This court notes that since Jones was published, the language of CCP § 741 has been amended. It no longer refers to a defendant "holding under color of title . . . ." However this court believes that the distinction made in Jones is still valid. The legislative comments to the 1968 amendments of CCP § 741 state that the quoted language was deleted so that a defendant may receive protection from the statute when he builds on another's property by mistake and not under color of ownership. There was no intent by the amendment to shift the focus of the statute to claimants improving the property while not physically in control of it.

However, Jones is not precedent for Watsonville. Ray and Linda Erta did not use the funds provided by Watsonville to finance improvements to the subject property. Rather those funds went to pay off the existing encumbrances. Jones is distinguishable on the facts. Watsonville has not demonstrated that under California law they are entitled to an equitable lien for the funds they provided to pay off the existing encumbrances.

Watsonville Federal Savings and Loan qualifies for application of the doctrine of equitable subrogation

25. Watsonville asks the court to apply the doctrine of equitable subrogation on its behalf. The doctrine of equitable subrogation is recognized by California courts and may be stated as follows:

> "One who advances money to pay off an encumbrance on realty at the instance of either the owner of the property or the holder of the encumbrance, either on the express understanding, or under circumstances from which an understanding will be implied, that the advance made is to be secured by a first lien on the property, is not a mere volunteer; and in the event the new security is for any reason not a first lien on the property, the holder of such security, if not chargeable with culpable and inexcusable neglect, will be subrogated to the rights of the prior encumbrancer under the security held by him, unless the superior or equal equities of others would be prejudiced thereby, and to this end equity will set aside a cancellation of such security, and revive the same for his benefit."

Katsivalis, 138 Cal. Rptr. at 625.

As the lender is treated in equity as the assignee of the debt and subrogated to its assignor's rights, the lender is entitled to an equitable lien on the property in the amount of the prior encumbrance discharged.

A lender who provides refinancing at the request of the debtor "with the understanding that the advance will be secured by a first trust deed . . . 'is not a mere volunteer' [within the meaning of the statute]." Smith v. State Savings and Loan Ass'n, 175 Cal. App. 3d 1092, 223 Cal. Rptr. 298, 302 (1985), rev. denied (1986), quoting Katsivalis, supra at 625.

One of the purposes of the doctrine is to prevent unjust enrichment. Thus the measure of the enrichment is the benefit to the owner, not the amount expended by the creditor. Katsivalis, supra at 625.

The uncontested facts here demonstrate that Ray and Linda Erta asked Watsonville Federal Savings and Loan to provide financing to pay off the existing encumbrances on the property. Watsonville was not a volunteer. Ray and Linda Erta were to be shown on the title as the owners. They agreed with Watsonville that it would have a first lien on the property upon release of the prior encumbrances.

The trustee argues that Watsonville knew or should have known that Steven Cox may have had an interest in the property which precluded title from vesting in Ray and Linda Erta; and that Watsonville is therefore chargeable with culpable and inexcusable neglect and is not entitled to relief under the doctrine of equitable subrogation.

This court has entered relevant findings on this point at Finding of Fact number 49. It found that Watsonville followed its standard operating procedure in processing this loan application; that it had no contact with Burgstrom about this property; that it had no knowledge of any ownership interest Cardinal may have claimed in the property; that it did not know Tamara Marko; that it had no discussions with Ray and Linda Erta about the prior ownership of the property; that although it received a copy of the preliminary title report on the property, it did not review the

chain of title to the property; and that it had no actual knowledge of the Cox claim to the property until served with the complaint in this lawsuit. The trustee has not demonstrated that Watsonville neglected some duty that it had which would have led to its discovery of a possible claim to the property by Cox or Cardinal. Nor has the trustee pointed to any theory which, under the facts as found, would impute to Watsonville any knowledge held by others about these claims. Watsonville was neither the principal nor agent for either Burgstrom or Penniman Title Co. in dealing with this property transaction. Watsonville may have been Ray and Linda Erta's agent for the narrow purpose of providing financing to pay off the prior encumbrances on the property. But even if this court were to find that the Ertas knew or had reason to know of the Cox interest in the subject property prior to the sale closing, it is unaware of any authority for the proposition that the knowledge of a principal is imputed to its agent. An agent is subject to the control of its principal and has a duty to convey material information to its principal when dealing with third parties on the principal's behalf. The law thus assumes that this duty is performed and consequently imputes such knowledge to the principal. The inverse is not necessarily true, as principals are not generally subject to control by their agents.

There are no facts to support denial of the benefit of the doctrine of equitable subrogation to Watsonville on the basis of culpable and inexcusable neglect. However, if the property remains

in the possession of Ray and Linda Erta it will not be necessary for the court to order the application of the doctrine on behalf of Watsonville. If Ray and Linda Erta are unable to retain the property under the conditions imposed by the court and the property reverts to the possession of the trustee, the court will order the application of the doctrine to prevent unjust enrichment to the estate. According to Katsivalis, supra at 625, the measure of the enrichment is the benefit to the owner, not the amount expended by the creditor. The estate would be enriched by the payoff of encumbrances by the Ertas with funds lent by Watsonville. The amount of the encumbrances paid off is $99,208.45 ($3,250.03 in property taxes + $88,258.42 on the Tomasello/Little deed of trust + $7,700 on the N.C.I., Inc. deed of trust). Watsonville lent $92,000 to the Ertas for payment of these encumbrances. Since this amount is less than the amount of encumbrances paid off, Watsonville should be subrogated for the full amount lent.

CONCLUSION

The Ertas are required to turn over to the trustee net rents generated off the property while they were wrongfully in possession, which is equal to $0. They must also turn over the value of the property as of the date of this order, which is $245,000, less $99,208.45 credit for paying off the Tomasello/Little, N.C.I., Inc. encumbrances and property taxes ($88,258.42, $7,700 and $3,250.03, respectively). From these damages they may also setoff $27,500 under CCP § 741, representing

the increase in the market value of the property over the period of their wrongful possession that is attributable to their improvements. Thus the net recovery for the trustee is $118,291.55.

This Memorandum Opinion contains the court's findings of fact and conclusions of law and pursuant to Bankruptcy Rule 7052 they will not be separately stated.

An order consistent herewith shall be entered. The parties shall submit a stipulated judgment within 20 days of this order providing for post-judgment interest at the rate of 6.62% per annum until paid. The judgment should also quiet title to the property in favor of Ray and Linda Erta.

POLLY S. HIGDON
Bankruptcy Judge