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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

BEDROCK FINANCIAL, INC., a California Corporation

Plaintiff,

v.

THE UNITED STATES OF AMERICA; and
Does 1 through 50, inclusive,

Defendants.

THE UNITED STATES OF AMERICA,

Counterclaimant,

v.

BEDROCK FINANCIAL, INC., a California Corporation,

Counterclaim Defendant.

CASE NO. 1:10-cv-01055-MJS

ORDER GRANTING BEDROCK FINANCIAL, INC.'S MOTION FOR SUMMARY JUDGMENT AND DENYING THE UNITED STATES OF AMERICA'S MOTION FOR SUMMARY JUDGMENT

(ECF Nos. 70, 77 & 78)

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PROCEDURAL BACKGROUND

This case arises from a dispute over priority of interests in property in Merced County California.

1 The case originated with an action filed May 3, 2010, by Bedrock Financial, Inc., a
2 California Corporation ("Bedrock"), against the United States Internal Revenue Service
3 ("IRS") in California Superior Court, Merced, case number CV001026. Bedrock, holder of
4 a deed of trust on the subject property, sought to be subrogated to an earlier mortgage on
5 the same property so as to establish priority over a federal tax lien which attached after the
6 mortgage but before Bedrock's deed of trust. The United States ("U.S.") appeared in the
7 action and removed it to this Court. Subsequently, the IRS was dismissed, leaving the
8 U.S. as the only defendant. The government answered and filed a third party complaint
9 against First American Title Insurance Company and a counter claim against Bedrock.
10 Apparently as a result of issues relating to Bedrock's corporate status and the fact that First
11 American Title Company is a separate corporate entity from the one initially named by the
12 U.S., the pleadings ultimately were amended and two actions morphed into a single
13 consolidated action captioned as above and reflecting a claim by Bedrock against the U.S.
14 and U.S. claims against both First American entities (hereinafter at times referred to jointly
15 as "First American") and Bedrock, all relating to priority of the IRS and Bedrock claims
16 against the property.

17 All parties have consented to the jurisdiction of the United States Magistrate Judge
18 for all purposes pursuant to 28 U.S.C. § 636 (c)(1).

19 Bedrock and the U.S. have filed cross-motions for summary judgment which have
20 been deemed submitted and are now before the undersigned for decision. (ECF Nos. 70,
21 77 & 78.)

22 Bedrock seeks the Court's finding and declaration that \$171,107 of its lien on the
23 property should be given priority over the government's tax lien and it seeks to foreclose
24 on its lien.

25 The U.S. seeks a declaration that the \$38,369 balance (as of July 16, 2012) due on
26 its federal tax lien maintains priority over the Bedrock lien. It too seeks to foreclose on its
27 lien. (Other claims by the government for conversion and injunctive relief have been
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1 dismissed.)

2 These competing claims arise out of the following series of facts and occurrences
3 which are not in dispute.

4 **II. FACTS**

5 The essential and undisputed facts¹ in this case are outlined chronologically as
6 follows:

7 The property at issue is located in Atwater, Merced County California and identified
8 as APN 004-110-005. In 2006, the property was owned by Jose and Irma Fuentes. In that
9 year the Fuenteses borrowed \$150,000 from R.K Lowe and secured repayment by giving
10 Lowe a first deed of trust on the property. The deed of trust was recorded in Merced
11 County in August 2006.

12 In September 2005, the U.S. Secretary of the Treasury created a statutory lien on
13 all property owned by the Fuenteses to secure a tax (plus penalties and interest)
14 assessment of approximately \$42, 021.

15 In July 2007, the U.S. recorded a Notice of Tax Lien against the Fuenteses in
16 Stanislaus County, California (not the county in which the subject property is located).

17 In October, 2007, the U.S. recorded its Notice of Tax Lien, then in the amount of
18 \$42,458, against the Fuenteses in Merced County, California, the county in which the
19 subject property sits.

20 In July, 2007, the creditor on the Lowe deed of trust, who was then owed a balance
21 of \$171,107, initiated foreclosure proceedings on the subject property. The Fuenteses
22 sought refinancing from Bedrock. At that time there were two recorded liens on the subject
23 property, the Lowe deed of trust and the above-referenced tax lien. The property was
24 appraised at \$427,000, i.e., \$213,436 over and above both liens.

25 First American created a preliminary title report on the subject property in
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27 ¹ Except as otherwise indicated, disputes as to the facts and objections to evidence submitted in
28 support of allegedly undisputed facts are found not to be material to resolution of the competing claims
and motions and will not be resolved here.

1 connection with the proposed refinance. First American's search in connection therewith
2 identified the 2007 tax lien on the property, but inexplicably did not report that the tax lien
3 applied to these debtors and this property or affirmatively disclose it on its title report.
4 There is no evidence First American made the tax lien known to Bedrock. Instead, its title
5 insurance policy ensured Bedrock its deed of trust would be and was the first lien on the
6 property.

7 Bedrock's files include a January 31, 2008 credit report reflecting a tax lien against
8 the Fuenteses in Stanislaus, but not Merced, County.

9 The U.S. did not try to collect on its lien at the time of the refinance or later when
10 Bedrock undertook to foreclose on its note and deed of trust on the property. There is a
11 dispute as to whether U.S. was given effective notice.

12 Notwithstanding the above referred-to credit report indicating the debtors had a tax
13 lien, Bedrock denies that it had actual knowledge of the tax lien on the property at the time
14 of the refinance. Its principal maintains under oath that it would not have made a refinance
15 loan had it known of the tax lien. It did grant the Fuenteses a loan in the principal amount
16 of \$243,000, \$171,107 of which was applied to pay off the Lowe note and deed of trust and
17 the costs of the transaction. The Bedrock loan and deed of trust on the property was
18 recorded in Merced County in February 2008.

19 By June 2009, Bedrock had become aware of the tax lien and its record priority over
20 the Bedrock refinancing deed of trust. It sought relief under a title insurance policy it had
21 purchased from First American. First American advised Bedrock that Bedrock was first
22 obligated to foreclose on the property. Bedrock, guided by attorneys hired by First
23 American, then initiated and completed nonjudicial foreclosure proceedings and became
24 the owner of the property in October 2009.

25 As of May, 2010 the appraised value of the property had plummeted to \$213,000.

26 According to the U.S., the account balance, plus accruals and less credits, on the
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1 Fuenteses' tax liability was \$38,369 as of July 16, 2012.²

2 **III. THE COMPETING CLAIMS**

3 Referencing the title history alone, Bedrock's lien sits in secondary position to that
4 of the U.S. on this property. Because of the intervening loss in property value, neither
5 party will be regain the positive financial position it held at the time of the Bedrock refinance
6 or would have had if the tax lien had been dealt with at the time of that refinance,
7 regardless of who prevails in this action. Given uncertainty as to the actual current value
8 of the property and costs of sale, it is not clear what precise net loss Bedrock or the U.S.
9 would suffer if the other were found to have priority. Nevertheless, under reasonable
10 assumptions, the relative loss amounts appear quite comparable.³

11 However, it appears clear that First American would be obligated to indemnify
12 Bedrock for any such loss. That, the U.S. argues, is why First American is causing and
13 paying for this action to be pursued and why granting the relief sought by Bedrock would
14 simply reward First American for its failure to disclose the tax lien on the property to
15 Bedrock.

16 As noted, Bedrock initiated this action by seeking a judicial declaration that it was
17 entitled, under Han v. United States, 944 F.2d 526, 530 (9th Cir. 1991) to an equitable lien
18 enabling it to step into the shoes of the loan which existed before the Bedrock refinance
19 and before the tax lien. It seeks to foreclose on the senior lien created thereby.

20 Conversely, the U.S. wants a declaration that its tax lien is senior to the Bedrock
21 lien, and it wants to foreclose on its lien. The U.S. bases its claim on the argument that
22 that Bedrock and First American both had notice of the IRS lien and negligently failed to

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24 ² As Bedrock notes, IRS officer Reynolds testified at the time of his deposition that the balance
25 was approximately \$28,000 plus accruals. The evidence supplied by the U.S. supports the more precise
26 \$38,369 figure.

27 ³ For example, if the property sold for \$200,000 and costs of sale were about \$10,000, Bedrock
28 would suffer a net loss of about \$19,000 if its lien were subordinate to that of IRS's; the loss to IRS would
be about the same if Bedrock were subrogated. The U.S. argument that its lien would be wiped out if
subordinated to Bedrock's is based on the mistaken, and since clarified, belief that Bedrock was seeking
priority as to the full amount of its \$243,000 loan. Bedrock has now made clear that it seeks subrogation
only as to the \$171,107 it applied to pay off the note underlying the deed of trust that predated the IRS
lien.

1 consider it and that granting Bedrock relief would result in an inappropriate windfall for First
2 American and prejudice the U.S.

3 **IV. ANALYSIS**

4 **A. Legal Standard for Summary Judgment**

5 Any party may move for summary judgment, and the Court shall grant summary
6 judgment if the movant shows that there is no genuine dispute as to any material fact and
7 the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a) (quotation
8 marks omitted); Washington Mutual Inc. v. U.S., 636 F.3d 1207, 1216 (9th Cir. 2011).
9 Each party's position, whether it be that a fact is disputed or undisputed, must be
10 supported by (1) citing to particular parts of materials in the record, including but not limited
11 to depositions, documents, declarations, or discovery; or (2) showing that the materials
12 cited do not establish the presence or absence of a genuine dispute or that the opposing
13 party cannot produce admissible evidence to support the fact. Fed. R. Civ. P. 56(c)(1)
14 (quotation marks omitted). While the Court *may* consider other materials in the record not
15 cited to by the parties, it is not required to do so. Fed. R. Civ. P. 56(c)(3); Carmen v. San
16 Francisco Unified School Dist., 237 F.3d 1026, 1031 (9th Cir. 2001).

17 In resolving cross-motions for summary judgment, the Court must consider each
18 party's evidence. Johnson v. Poway Unified School Dist., 658 F.3d 954, 960 (9th Cir.
19 2011). Plaintiff bears the burden of proof at trial, and to prevail on summary judgment, he
20 must affirmatively demonstrate that no reasonable trier of fact could find other than for him.
21 Soremekun v. Thrifty Payless, Inc., 509 F.3d 978, 984 (9th Cir. 2007). Defendants do not
22 bear the burden of proof at trial and in moving for summary judgment, they need only prove
23 an absence of evidence to support Plaintiff's case. In re Oracle Corp. Securities Litigation,
24 627 F.3d 376, 387 (9th Cir. 2010).

25 In judging the evidence at the summary judgment stage, the Court does not make
26 credibility determinations or weigh conflicting evidence, Soremekun, 509 F.3d at 984
27 (quotation marks and citation omitted), and it must draw all inferences in the light most
28 favorable to the nonmoving party and determine whether a genuine issue of material fact

1 precludes entry of judgment, *Comite de Jornaleros de Redondo Beach v. City of Redondo*
2 *Beach*, 657 F.3d 936, 942 (9th Cir. 2011) (quotation marks and citation omitted).

3 **B. Standard for Equitable Subrogation**

4 The Ninth Circuit case *Han v. United States*, 944 F. 2d 526 (9th Cir. 1991) provides
5 the framework for the analysis of the facts, law and equities in this case:

6 The Hans purchased a piece of property which their real estate agent knew, but the
7 Hans did not, was encumbered by a federal tax lien. When the IRS undertook to levy on
8 the property to satisfy the lien, the Hans filed suit seeking, among other relief, to be
9 equitably subrogated to the position of the lender whose loan had been superior to the IRS
10 liens but was paid off when the Hans purchased the property. If successful, the Hans
11 would recover, on IRS foreclosure on the property, the amount they paid into escrow when
12 they purchased the property and IRS would recoup the same amount as if the delinquent
13 taxpayer still owned the property. Otherwise, the Hans would end up having to pay a
14 portion of the sellers' delinquent taxes.

15 The Ninth Circuit found that the Hans were entitled to be equitably subrogated to the
16 first lien holder position previously held by the lender the Hans paid in full. Applying the
17 California Supreme Court test adopted in *Caito v. United Californian Bank*, 20 Cal. 3d. 694,
18 704 (1984) (quoting *Grant v. de Otte*, 122 Cal. App. 2d 724, 728 (1954), it declared
19 equitable subrogation to be appropriate where:

20 “(1) Payment [was] made by the subrogee to protect his own interest. (2) The
21 subrogee [has] not . . . acted as a volunteer. (3) The debt paid [was] one for which the
22 subrogee was not primarily liable. (4) The entire debt [has] been paid. (5) Subrogation
23 [would] not work any injustice to the rights of others.”

24 The *Han* court, adopting language in *Caito*, 20 Cal. 3d. at 704, added that equitable
25 subrogation was a broad equitable remedy granted liberally in California, not only when all
26 five of the above factors were met, but whenever “one person, not acting as a mere
27 volunteer or intruder, pays a debt for which another is primarily liable, and which in equity
28 and good conscience should have been discharged by the latter.”

1 The District Court in Han had found four of the five factors met, but denied equitable
2 subrogation on the ground that the Hans' real estate agent's actual notice of the IRS lien
3 at the time of the Hans purchase was imputed to the Hans. It noted that under Smith v.
4 State Savings & Loan Association 175 Cal. App. 3d 1092, 1098 (Cal. Ct. App. 1985),
5 actual knowledge of the existing encumbrance defeated equitable subrogation. The Ninth
6 Circuit reversed, holding that notice to the Hans' agent was imputed to the Hans as a
7 matter of law and, hence, by definition, constructive, not actual, and that all other criteria
8 for equitable subrogation were satisfied. Specifically, it found that having decided to
9 purchase the property without actual knowledge of the IRS lien, the Hans paid off the
10 senior lien to establish and protect their own interests, not to meddle in the lender's
11 relations with the seller. The Hans were not primarily liable on the sellers debt, the entire
12 debt was paid, and the IRS would not suffer any injustice if subrogation were granted but
13 instead would find itself in the same position as if the seller still owned the property. The
14 Hans were innocent parties lacking actual knowledge of the tax lien and, like any home
15 buyer, reasonably reliant upon their real estate agent to advise them of any such claim
16 against the property. There was no evidence the Hans themselves were delinquent in
17 failing to discover the IRS lien.

18 Applying the Han criteria, it is clear Bedrock had no liability in relationship to the
19 property or the taxpayers debt to IRS at the time it undertook to make the loan. There is
20 no reason to suspect that Bedrock undertook to make the loan for any reason other than
21 it believed it was in its best business interest to do so. Such a lender is not a volunteer.
22 (Smith, 175 Cal. App. 3d at 1099; Simon Newman Co., 206 Cal. at 146). Bedrock paid off
23 the entire loan. There is no reason to suspect Bedrock had any motivation to interfere in
24 the relationship between the IRS and the taxpayers.

25 Whether Bedrock had knowledge of the IRS lien and/or whether it was negligent in
26 failing to discover the IRS lien are issues not so easily resolved.

27 1. Knowledge

28 Bedrock insists that those involved in authorizing the loan had no actual knowledge

1 of the IRS lien and never would have made the loan had they been aware of it. These two
2 claims are not refuted from a factual standpoint, but the U.S. maintains that Bedrock, the
3 institution, had actual knowledge of the lien and owes its apparent failure to factor the lien
4 into its loan calculations to its own culpable negligence.

5 There being no evidence to the contrary, the Court concludes that those at Bedrock
6 involved in authorizing the refinance loan to the taxpayers had no actual knowledge of the
7 IRS lien and would not have made the loan if they had been aware of the lien. Yet, it is
8 clear from Exhibit B to the Declaration of Pete Bednarek that at the time the refinance loan
9 was made, there was in Bedrock's files a credit report showing the existence of the tax
10 debtors' tax lien, albeit with reference to property in another county. (Bednarek Decl. Ex.
11 B.) As the U.S. notes, Bedrock has not ruled out the possibility that some Bedrock
12 employee, e.g., the one who received the credit report and placed it in the file, had
13 knowledge of the IRS lien. As such it appears Bedrock the corporation did have actual
14 knowledge of the IRS lien. See, e.g., *Bank of New York v. Fremont General Corp.*, 523
15 F.3d 902, 911 (9th 2008) (citing *Meyer v. Glenmoor Homes, Inc.*, 54 Cal. Rptr. 786, 800-01
16 (Cal. Ct. App. 1966) ("Generally, the knowledge of a corporate officer within the scope of
17 his employment is the knowledge of the corporation"); *W.R. Grace & Co., Inc. v. Western*
18 *U.S. Industries, Inc.*, 608 F.2d 1214 (9th Cir. 1979) ("a corporate principal is considered to
19 know what its agents discover concerning those matters in which the agents have power
20 to bind the principal").

21 In this Court's view, such knowledge, however, is not the type that renders equitable
22 relief inappropriate. As noted in *Caito*, 20 Cal. 3d. at 704, equitable subrogation is a broad
23 and liberally granted remedy available not only when all listed criteria are met, but
24 whenever one, not acting as a mere volunteer or intruder, pays a debt for which another
25 is primarily liable and which in equity and good conscience should have been discharged
26 by the latter. The party seeking equitable relief must not have acted with "culpable and
27 inexcusable neglect". *Simon Newman Co.*, 206 Cal. at 145. This Court reads *Simon* and
28 the tenor of the other authorities to say that the type of notice that will defeat equitable

1 subrogation should be such as to suggest the person seeking relief knowingly or with
2 something approaching gross recklessness disregarded information and seeks to
3 capitalize on his own ignorance to the detriment of an innocent third party. The type of
4 apparently innocent, albeit arguably negligent, oversight here is not that which, standing
5 alone, should deprive Bedrock of equitable relief.

6 2. Real Party

7 The U.S. also argues that the real party seeking subrogation here is First American
8 and that its actual knowledge of the loan forecloses the equitable relief requested. As
9 noted, First American did indeed discover the existence of the IRS lien on the property
10 during its searches in connection with the Bedrock refinance and was aware of it at the
11 time the loan was made. It, apparently negligently, failed to report it to Bedrock. This
12 knowledge however is not imputable to Bedrock in a way that defeats equitable
13 subrogation. In the same way that the Hans' real estate agent's actual knowledge was not
14 deemed to be actual knowledge to the Hans, First American's knowledge is not actual
15 knowledge to Bedrock. Like most lenders, Bedrock relied upon its title company to advise
16 of claims on the property. First American failed to fully advise Bedrock.

17 That, however, is not the end of the inquiry. As noted, upon discovering the IRS
18 lien, Bedrock sought indemnification under the title insurance policy issued by First
19 American. Apparently First American is obligated under its title insurance policy to provide
20 Bedrock with a defense and indemnity against loss in this case. As such, if equitable
21 subrogation is denied, First American, not Bedrock, will suffer the financial loss; if equitable
22 subrogation is granted, First American, not Bedrock, will benefit and do so at the expense
23 of the U.S. Moreover, First American is exercising control and direction of Bedrock in this
24 litigation. Bedrock, dormant except as necessary to pursue this action, not only is a
25 disinterested party, but a reluctant one. The U.S. argues that the unique relationship
26 between the two is such as to make First American the real party in interest whose actual
27 knowledge of the IRS lien, and negligence in failing to advise of it, should foreclose the
28 equitable relief sought here.

1 Although, the Court views with considerable skepticism Bedrock's argument that
2 First American did not have actual knowledge of the tax lien and, to a lesser extent, the
3 assertion that first American was not guilty of culpable conduct, those issues need not be
4 resolved here. Controlling authority in this jurisdiction makes it clear not only that, as
5 noted, First American's knowledge is not imputable to Bedrock, but the relationship
6 between Bedrock and First American is not such as to defeat equitable subrogation.

7 The U.S. relies on a Seventh Circuit case to support its argument that equitable
8 relief should be denied under such facts as exist here. In First Federal Savings Bank of
9 Wabash v. United States, 118 F.3d 532 (7th Cir. 1997), a negligent title insurer directed
10 and financed a legal effort to obtain equitable subrogation and was the party who would
11 bear the loss if relief were denied. The court concluded that in such circumstances, similar
12 to those here, the relationship between the insurer and insured was sufficiently linked as
13 to be characterized as "collusive" and render equitable relief inappropriate.

14 The Ninth Circuit, applying what appears to be more liberal California law, is to the
15 contrary. In Mort v. United States, 86 F.3d 890 (9th Cir. 1996), as here, a title insurance
16 company overlooked an IRS lien and provided title insurance on a deed of trust to secure
17 a subsequent refinance loan on the property. The insurer funded the insured's suit for
18 equitable subrogation. The IRS urged denial of equitable relief because the insurer who
19 caused the loss was the one directing the litigation and IRS would suffer injustice if
20 subrogation were allowed. It cited to other cases denying such relief where the insurer was
21 itself pursuing the litigation in its own name. It distinguished Mort and similar cases from
22 those where the insured pursued the claim and suggested that nothing short of collusion
23 between the insurer and insured would lead to a different result. As Bedrock notes, In re
24 Tiffany, BAP Nos. NC-06-1256-SKuB, NC-06-1287-SKuB, 2007 WL 7541013, 11 (B.A.P.
25 9th Cir. Aug. 24, 2007), held that instigation and control of the litigation by the insurer is not
26 the sort of "collusion" as would defeat relief. Collusion requires an agreement to defraud
27 or obtain a result contrary to law. Here, as in In re Tiffany, the parties seek only to enforce
28 their contractual rights and obligations and obtain an equitable remedy authorized by law.

1 3. Injustice

2 Equitable subrogation is designed to leave the junior encumbrancer in the same
3 junior position. In re Tiffany, 342 F.App'x. 303, 305 (9th Cir. 2009). This Court also finds
4 that, as in Mort, no injustice will result if equitable subrogation is a granted. IRS will be in
5 the same relative secured position it would have been in if Bedrock had not made the
6 refinance loan. Katsivalis v.Serrano Reconveyance Co., 70 Cal. App. 3d. 200, 214-215
7 (Cal. Ct. App. 1977). The contrary is not true; if equitable subrogation is denied, the IRS
8 will indeed have a windfall in that part of its lien will effectively be paid by Bedrock.

9 **B. Conclusion**

10 For these reasons Bedrock's motion for summary judgement will be granted and
11 that of the U.S. denied. To the extent of its payoff of the \$171,701 Fuentes' loan, Bedrock
12 shall be subrogated to the position held by the Fuenteses before the IRS lien attached.
13 Bedrock has a \$171,106.85 equitable lien on the lot described as APN 004-110-005
14 Atwater, Merced County, California. That lien shall have priority over the IRS lien on the
15 property. Bedrock is entitled to foreclose judicially on its superior lien.

16 Bedrock is ORDERED to file and serve, on or before November 22, 2012, points
17 and authorities supporting its claim, if it does so claim, that it is entitled to any additional
18 specific order or intervention from this Court to effectuate this judgment, setting forth the
19 precise nature of the relief sought and the basis therefor, and including a proposed order
20 intended to accomplish same. The U.S shall have until November 29, 2012 to file
21 opposing points and authorities and to submit an alternative form of proposed order. No
22 reply shall be filed.

23 **V. ORDER**

24 The Court hereby ORDERS as follows:

- 25 1. Bedrock Financial, Inc.'s motion for summary judgment (ECF No. 70 & 78)
26 is GRANTED;
- 27 2. The United States of America's motion for summary judgment (ECF No. 77)
28 is DENIED;

- 1 3. Bedrock Financial, Inc. has an equitable lien on the property in Atwater,
- 2 Merced County California and identified as APN 004-110-005 in the amount
- 3 of \$171,106.85;
- 4 4. Bedrock Financial, Inc.'s lien has priority over the IRS's lien on the property
- 5 in Atwater, Merced County California and identified as APN 004-110-005;
- 6 5. Bedrock Financial, Inc. is entitled to foreclose judicially on its superior lien,
- 7 and
- 8 6. Further briefing on the issues discussed in the final paragraph of this Order
- 9 shall be filed by Bedrock Financial, Inc., on or before November 22, 2012,
- 10 with opposition, if any, by the United States of America to be filed no later
- 11 than November 29, 2012.

12
13 IT IS SO ORDERED.

14 Dated: November 11, 2012

Michael J. Seng
15 UNITED STATES MAGISTRATE JUDGE