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**UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF CALIFORNIA**

In Re: )  
NORTH COAST VILLAGE, LTD., )  
a California limited partnership, )  
Debtor. )

Case No.: 90-04997-A11  
Add. Pro. No. 91-90102-A11

**MEMORANDUM DECISION**

NORTH COAST VILLAGE, LTD., a )  
California limited partnership, )  
Plaintiff, )  
vs. )  
JOHN R. PREWITT, an individual )  
Defendant. )

North Coast Village, Ltd., (“NCV, Ltd.” and “Debtor”) is back before this Court after reversal by the Ninth Circuit Court of Appeals in May 1997 of this Court’s 1991 grant of NCV, Ltd.’s motion for partial summary judgment. The Court of Appeals found that genuine issues of material fact existed concerning the Debtor’s dispute with John R. Prewitt (“Prewitt”), requiring that the matter be tried.

1 The trial of the complaint to avoid the Prewitt deed of trust under Section 544  
2 and objection to the Prewitt claim came on for hearing on October 27, 1997 and  
3 continued thereafter on November 4, 1997, November 17-18, 1997, November 20-21,  
4 1997 and January 21, 1998. Theodore W. Graham, Maria K. Pum and Jason D.  
5 Schauer of Brobeck, Phleger & Harrison, LLP, appeared on behalf of NCV, Ltd.,  
6 Plaintiff; Peter W. James and Andrew Durkovic of Baker & Hostetler, LLP, appeared  
7 on behalf of John R. Prewitt, *et al.*, Defendants.

8 Having heard the testimony, examined the evidence, considered the arguments  
9 advanced by the parties and review of the trial briefs submitted by each party, the Court  
10 makes the following findings of fact and conclusions of law:

### 11 ***FINDINGS OF FACT***

#### 12 ***Procedural History***

13 1. Plaintiff NCV, Ltd., was the developer of 550 stock cooperative  
14 units in Northern San Diego County. The Debtor filed a petition for Chapter 11 relief  
15 on June 15, 1990.

16 2. On February 22, 1991, NCV, Ltd., filed this complaint objecting to  
17 the secured claim of John R. Prewitt. The complaint seeks declaratory relief that the  
18 trust deed securing Prewitt's claim against NCV is unenforceable pursuant to  
19 Bankruptcy Code section 544(a), requiring reconveyance of the deed of trust. The  
20 complaint also seeks a determination that Prewitt has breached his fiduciary duties to  
21 the partnership and has breached a contract between himself and the Debtor regarding  
22 11 units transferred to Prewitt.

23 3. Prewitt's answer and counterclaim filed March 15, 1991 denies the  
24 allegations of NCV, Ltd.'s, complaint and requests a declaration that Prewitt has the  
25 claims against the Debtor which are asserted in his proof of claim (collectively the  
26 "Action").

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1           4.     NCV, Ltd., brought a motion for partial summary judgment solely  
2 on the issue of avoidability under Section 544 of the Bankruptcy Code of Prewitt's  
3 deed of trust. The Court determined that the Modified Land Note which was supposed  
4 to be secured by the deed of trust was never executed by the obligor(s) and for that  
5 reason, the deed of trust was avoidable. The summary judgment motion was granted in  
6 December 1991. Prewitt filed a motion seeking to appeal the interlocutory order to  
7 which NCV, Ltd., did not object (Appeal No. 1). The balance of the matters remaining  
8 to be tried was deferred at the parties' request until July 1994.

9           5.     Sometime in 1993, the adversary proceeding *Metropolitan Service*  
10 *Corporation vs. NCV, Ltd., Prewitt, et al.* was removed to this Court becoming  
11 adversary proceeding number 93-90838. Metropolitan's complaint was an interpleader  
12 action requesting judicial resolution of a dispute between NCV, Ltd., and Prewitt over  
13 the Pool C AITD proceeds. Prewitt contended that the Pool C AITD proceeds had  
14 been assigned to him absolutely; NCV, Ltd., contended that the proceeds were  
15 assigned as security for the contemplated Modified Land Note which was never signed  
16 by the obligor(s).

17                 On cross-motions for summary judgment by NCV, Ltd. and Prewitt,  
18 the Court granted summary judgment in favor of NCV, Ltd., and against Prewitt,  
19 making certain findings of fact and conclusions of law which were entered on June 15,  
20 1994 ("Metropolitan Findings"). Prewitt made an untimely appeal of the order and his  
21 appeal was dismissed by the Bankruptcy Appellate Panel on January 17, 1995. The  
22 orders and judgments in the *Metropolitan* case are now final.

23           6.     In July 1994 the Court held a trial on the allowability of Prewitt's  
24 proof of claim. Prewitt had filed a secured claim (Ex. 1) against the estate based on  
25 four documents attached to that claim. At the conclusion of Prewitt's evidence, NCV,  
26 Ltd. moved for judgment under FRCP 52(c) (FRBP 7052) which was granted. A  
27 judgment in the action was entered on November 16, 1994. It was appealed by  
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1                   Sometime in the early 1970's Prewitt and the Trustees leased 13-  
2 acres of the Oceanside parcel to CSW under the terms of a lease which is now lost.  
3 (R.T. 11/21/97 at 19-21.) NCV, Ltd. was formed to develop a condominium project on  
4 the property. CSW became the general partner and 75% owner of NCV, Ltd.; Prewitt  
5 individually and Murphy individually each owned 12½% as limited partners. (R.T.  
6 10/27/97 at 18-19; Ex. 16.)

7                   11. The development of the beach front property ran into difficulties  
8 when California voters passed restrictions on coastline development and established the  
9 Coastal Commission in 1972. To avoid restrictions on coastal development, NCV, Ltd.  
10 was required to change from a condominium development to a stock cooperative  
11 project. Construction was commenced after the entity obtained a construction loan  
12 from General Electric Credit Corporation (“GECC”). (R.T. 11/21/97 at 107-120.)

13                   12. Patrick J. Kilfoil (“Kilfoil”) was a CPA with Kenneth Leventhal &  
14 Company. Leventhal & Company had been performing accounting for CSW in the  
15 mid-'70's. CSW hired Kilfoil as vice-president in 1977. (R.T. 11/21/97 at 122.)  
16 Kilfoil was never an owner of any shares of CSW nor a holder of a partnership interest  
17 in NCV, Ltd. There is no evidence presented that Kilfoil has any economic stake in  
18 this dispute. His testimony is highly credible.

19                   13. The GECC construction loan of approximately \$14 million went  
20 into default in 1977. Unable to pay or refinance the defaulted loan, NCV, Ltd. filed a  
21 Chapter 11 bankruptcy. (R.T. 11/21/97 at 23-24.)

22                   The bankruptcy judge set a December 31, 1979 “drop dead” date by  
23 which NCV, Ltd. was to resolve its problems or he would permit GECC to foreclose.  
24 (R.T. 10/27/97 at 16-18; 11/21/97 at 24.)

25                   14. In order to solve its financial crisis and preserve substantial equity  
26 in the project, NCV, Ltd. simultaneously pursued two sources of new capital: taking  
27 additional partners and refinancing the GECC debt. Murphy and Prewitt located a  
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1 group of investors headed by Robert Ferrante (collectively “Ferrante”) who agreed to  
2 buy into NCV, Ltd. for approximately \$3 million in exchange for which they would get  
3 a 50% interest in the partnership. (R.T. 10/27/97 at 22-24.)

4 Ferrante arranged for a loan with Imperial Bank of \$17 million to  
5 pay off the GECC debt. (R.T. 10/27/97 at 27-28.) Imperial Bank insisted as a  
6 condition of making the loan to NCV, Ltd. that the title to the real property be in the  
7 Debtor. (R.T. 11/21/97 at 25-26.)

8 15. As the bankruptcy court’s deadline approached, the Ferrante  
9 interests dragged their feet on making their \$3 million contribution. When NCV, Ltd.  
10 threatened to terminate their agreement to take Ferrante as a partner, Ferrante  
11 threatened litigation. (R.T. 10/27/97 at 24-27.)

12 16. Since Imperial Bank was requiring NCV, Ltd. to hold a fee interest  
13 in the property, Prewitt proposed “selling” the property to the newly-constituted  
14 partnership at a very high price to avoid realizing ordinary income taxes on future  
15 condominium unit sales. There had been no appraisal of the property.

16 17. Initially Prewitt proposed a price of \$10 million which Kilfoil and  
17 Murphy strongly believed would wreck the deal with Ferrante. Kilfoil expressed his  
18 belief that there was no economic justification for the “price” Prewitt wanted for the  
19 sale of the land to NCV, Ltd. He was very concerned that the transaction was clearly a  
20 “sham” and would never pass muster with the IRS.<sup>1</sup> Prewitt was adamant in his tax  
21 avoidance scheme but after considerable discussion with Kilfoil and Murphy, agreed to  
22 reduce his demand to a \$5 million note executed by NCV, Ltd.  
23 (R.T. 10/27/97 at 30-39; 11/21/97 at 27-33 and 47-48.)

24 18. Because of Prewitt’s insistence of the \$5 million note as a means of  
25 transmuting ordinary income into capital gains, the profit structure of the new

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26 <sup>1</sup> During the trial of this Action, Prewitt did not offer testimony contraverting  
27 Kilfoil’s characterization of the note as a tax avoidance scheme.

1 partnership had to be drastically altered. Rather than a 50/50 division between Ferrante  
2 and the other partners of NCV, Ltd., the partnership was restructured. The new  
3 Ferrante-NCV, Ltd. (the “restated partnership”) partnership provided:

- 4 a. Prewitt and Murphy would withdraw as partners in NCV,  
5 Ltd.;
- 6 b. CSW’s interest was reduced from 75% to 5%;
- 7 c. Ferrante-NCV, Ltd. became a 5% general partner; and,
- 8 d. Robert Ferrante Enterprises became a 90% limited partner.

9 (R.T. 10/27/97 at 50-60.) As well, the restated partnership agreement reflected an  
10 unusual profit division to compensate Ferrante for the lopsided distribution of future  
11 partnership “profits” to the Prewitt/Murphy interests. (*See*, ¶ 4.1 of Ex. 28.)

12 Finally, in the continuing quest to avoid ordinary income  
13 taxes on subsequent sales, it appears from the restated partnership agreement that  
14 Ferrante is deemed to have purchased the general and limited partnership interest from  
15 CSW, Murphy and Prewitt for an aggregate of \$13,602,500.00 (*See*, Ex. 28 at ¶2.4(a)  
16 and R.T. 10/27/97 at 61-64; R.T. 11/21/97 at 44-46.)

17 The restated partnership transaction with Ferrante closed on  
18 or about December 31, 1979.

19 19. Ferrante had failed to make the full amount of the original \$3  
20 million capital contribution in cash by the time the restated partnership agreement of  
21 NCV, Ltd. was set to close. Instead Ferrante substituted various promissory notes  
22 payable to CSW which, under the restated partnership agreement, would cause a  
23 reallocation of the partnership interests upon default in payment. (Ex. 28 at ¶2.4.)

24 20. Concurrent with the closure of the restated partnership, NCV, Ltd.  
25 executed its option to purchase the land from Prewitt, Carol Prewitt Murphy and the  
26 Prewitt trustees, giving a promissory note to the sellers in the amount of \$5,355,000.00  
27 (the “Original Land Note”). The note was subordinate to the Imperial Bank \$17

1 million bridge loan and \$4 million second trust deed loan, had no due date and had no  
2 date for the commencement of interest. (Ex. B) The note was nonrecourse and  
3 provided that the makers would not be personally liable on the debt or subject to a  
4 deficiency judgment. (R.T. 10/27/97 at 68-69.) It was secured by a deed of trust on the  
5 leasehold interest of NCV, Ltd. in the stock cooperative units which was recorded on  
6 or about July 3, 1980. (Ex. C) There is no evidence that payments were ever made on  
7 this note by NCV, Ltd.

8           21. As a means of circumventing restrictions on condominium  
9 developments along the coastline, NCV, Ltd. created a stock cooperative project called  
10 NCV, Inc. NCV, Inc. was incorporated on February 15, 1979 with Prewitt, Murphy  
11 and Carol Prewitt Murphy as directors of this non-stock membership corporation.  
12 After the bankruptcy was dismissed and the restated partnership formed, NCV, Ltd.  
13 and NCV, Inc. entered into a master proprietary lease agreement (Ex. 22) by which  
14 NCV, Inc. became the owner of the property and improvements and NCV, Ltd. leased  
15 the units which were to be sold to the public. (R.T. 10/27/97 at 79-80; 11/21/97 at 95-  
16 101.) The agreement transferring the property to NCV, Inc. was recorded on or about  
17 July 3, 1980.

18           22. Sometime early in the new partnership relationship, Ferrante  
19 defaulted and CSW exercised the reallocation option which started the “Ferrante wars”  
20 (R.T. 10/27/97 at 71-74.) As well the relationship between Prewitt and Murphy began  
21 to deteriorate and Prewitt filed an action to dissolve CSW. Finally the two brothers-in-  
22 law and Carol Prewitt Murphy decided to divide all their business interests and assets  
23 held in common. (R.T. 10/27/97 at 81-89.)

24           23. Sometime in June 1983, Prewitt, Murphy and Carol Prewitt Murphy  
25 entered into a massive Settlement Agreement (Ex. A) (the “1983 Agreement”) for the  
26 purpose of severing their business relationships. NCV, Ltd. was not a party to this  
27 agreement. The 1983 Agreement provided, *inter alia*, for division of the various  
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1 Prewitt/Murphy business interests and appraisal of the CSW shares.

2 Paragraph 2.02(a) of the 1983 Agreement provides that Murphy or  
3 CSW was to purchase Prewitt's shares at a price to be determined after the appraisal  
4 and adjustment for the value of other assets being assigned to the respective parties.  
5 Murphy and Prewitt agreed to divide the \$5, 355,000.00 Original Land Note and assign  
6 percentages of that note to each of them in partial satisfaction of their debts to each  
7 other. (Ex. A, §3 at 14-19.) A new promissory note of \$3,012,187.50 payable to  
8 Prewitt was to be created (Ex. 1 to Ex. A) which would be secured by a deed of trust  
9 (Ex. 3 to Ex. A) encumbering the leasehold interest now owned by NCV, Ltd.

10 24. The 1983 Settlement Agreement went through a number of  
11 modifications. In the April 15, 1985 modification (Ex. CC) ("the 1985 Agreement")  
12 the parties changed the 1983 Agreement by dropping the requirement of an appraisal of  
13 the CSW shares, providing Murphy or CSW an option to purchase Prewitt's shares in  
14 CSW for \$1,300,000.00 and modifying the terms of that note to be created under the  
15 1983 Agreement. The 1985 Agreement spelled out different payment terms for what  
16 became described as the "Prewitt Land Note," providing for interest payments on a  
17 fixed schedule and a maturity date of March 1, 1987. Ex. CC offered by Prewitt is  
18 incomplete and missing exhibits (R.T. 11/20/97 at 31-36). Because of this the Court is  
19 unable to determine whether the security to be given for the "Prewitt Land Note"  
20 discussed in paragraph B.3 at page 5 of the 1985 Agreement is the same as that  
21 contemplated by the 1983 Agreement.

22 25. As set forth in the now-final *Metropolitan* Findings, the severance  
23 of Prewitt and Murphy's business ties with the Debtor and CSW was conditional upon  
24 the Debtor obtaining a resolution with Ferrante no less favorable to the Debtor than  
25 contemplated by Prewitt, Murphy and Carol Prewitt Murphy in the 1983 agreement.  
26 The 1983 Agreement was not to become operative as to those parties unless and until  
27 an agreement with Ferrante as described in the 1983 Agreement was achieved.



1 North Coast Village, Ltd. shall be deemed as  
2 their approval of all the terms and conditions  
3 contained therein.

3 30. Amended escrow instructions to Escrow No. 1874 dated July 24,  
4 1986 added paragraph 21 and deleted original paragraph 21. (Exhibit J) New  
5 paragraph 21 recited:

6 As a matter with which Escrow holder is not to  
7 be concerned Prewitt and Murphy agree that  
8 promptly following the closing of this Escrow,  
9 they shall enter into an agreement memorializing  
the transaction herein and which shall constitute  
a further amendment to the settlement agreement  
stated June 8, 1983.

10 NCV, Ltd. by CSW and Prewitt executed this amendment on or  
11 about July 24, 1986. It appears to have been delivered to escrow the following day.

12 31. The Deed of Trust (Ex. M) referenced in Escrow No. 1874 was  
13 signed by CSW as general partner of NCV, Ltd. on July 25, 1986 and delivered to  
14 escrow sometime before July 31, 1986. The Deed of Trust purports to create a lien in  
15 favor of Prewitt on the fee interest of NCV, Ltd. in the land underlying the stock  
16 cooperative units. Because of the transactions set forth in paragraph 19 and 20 above,  
17 NCV, Ltd. did not own a fee interest in the land in 1986. A trust deed rider recorded at  
18 the same time appears to amend to legal description to create a lien on NCV Ltd.'s  
19 leasehold interest in various units.

20 32. The simultaneous closure of the four escrows was chaotic. (R.T.  
21 11/04/97 at 21-22.) Negotiating Ferrante's withdrawal from NCV, Ltd. was  
22 complicated by Ferrante's internecine dispute among his investors and his ex-wife  
23 (R.T. 10/27/97 at 96-97) and the changing demands of Ferrante's "price" for releasing  
24 his interest in NCV, Ltd. (R.T. 01/21/98 at 30-34). The Unified Capital Corporation  
25 which was brokering the financing for the Ferrante buy-out (R.T. 11/04/97 at 79-81)  
26 was threatening to recall loan monies if escrow did not close; Ferrante was threatening  
27 to file an involuntary bankruptcy petition against the partnership and Prewitt was  
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1 threatening to join Ferrante if the escrows did not close by July 31, 1986. To  
2 compound matters, Escrow World was extremely concerned about the complexity of  
3 the transactions and the glacial pace of progress. (R.T. 11/04/97 at 28-30.)

4           33. Since the relationship between Murphy and Prewitt was strained,  
5 Kilfoil acted as a go-between for the two. On July 30, 1986 Murphy and Prewitt were  
6 still negotiating the terms of a note which would become effective once Ferrante was  
7 out of the partnership and Murphy owned all of CSW's shares. On that day at the  
8 escrow office Kilfoil had lengthy discussions with Prewitt about the terms of the  
9 Modified Land Note which Prewitt would receive when the transactions closed. He  
10 discussed with him why many of the provisions of the 1983 Agreement were  
11 unworkable from the Debtor's viewpoint based on changes in the transaction caused by  
12 Ferrante's demands and the reduced amount of capital available to NCV, Ltd. Kilfoil  
13 had the impression that Prewitt understood his objections and was willing to modify his  
14 demands. (R.T. 11/04/97 at 31-43; 51-67.)

15           34. While at the escrow company, Kilfoil retired to a small office to  
16 make changes or comments to the proposed Modified Land Note (Ex. L). Murphy  
17 took over from Kilfoil the negotiations with Prewitt over the terms of the Modified  
18 Land Note. He made numerous changes based on his and Kilfoil's concerns over  
19 NCV, Ltd.'s ability to perform under the note once escrow closed. Those changes are  
20 for the most part embodied in Exhibit XXXX. Murphy negotiated with Prewitt over  
21 many points (R.T. 11/21/97 at 65-91) but Prewitt was unwilling to agree to most of  
22 them. (R.T. 11/21/97 at 92.) Murphy told Prewitt he was unwilling to agree to the  
23 note in an unmodified form.

24           Prewitt left the office where the two were speaking, obtained  
25 another copy of Exhibit L, changed the due date to November 1, 1987 and stated,

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1 If you want to deal, I'm going along with these  
2 changes, made the changes, initialed them and  
3 said, 'This is the deal. If you want to close, this  
is the note. Execute it, we'll close this escrow'.

4 (R.T. 11/18/97 at 82.) Prewitt did not see Murphy execute the note and Murphy did  
5 not verbally agree to Prewitt's changes in Prewitt's presence (R.T. 11/18/97 at 79; 82-  
6 85.) Prewitt agrees he has never seen Murphy's signature on Prewitt's version of the  
7 Modified Land Note. (R.T. 11/18/97 at 85.)

8 35. After Prewitt left Escrow World, Murphy continued to make  
9 changes to the Modified Land Note which he believes are reflected for the most part in  
10 Exhibit XXXX. Murphy's many alterations to the note included a postponement of  
11 the interest rate start date from September 21, 1979 to July 30, 1986; a reduction in the  
12 interest rate from 12% compounded to 10% simple interest; a reduction in the  
13 installments from \$17,000 or 80% of Net AITD Income to \$12,500.00, and substantial  
14 revisions to the default provisions and release clauses. Murphy signed a version of the  
15 note similar to Exhibit XXXX. There is conflicting testimony whether Murphy left the  
16 revised note with Escrow World which subsequently lost it or the note was never  
17 delivered. Murphy testified that it was delivered to Escrow World. (R.T. 11/21/97 at  
18 90-92.) The Court finds it unnecessary to resolve whether delivery occurred to  
19 determine the legal effect of Murphy's failure to agree with Prewitt on the provisions of  
20 the Modified Land Note.

21 36. Escrow closed on July 31, 1986. It is undisputed that the Original  
22 Land Note was canceled and the deed of trust securing it (Ex. C) was reconveyed.

23 37. Prewitt discovered the Modified Land Note was missing  
24 approximately two weeks after escrow closed. (R.T. 11/20/97 at 9.) He claims he  
25 discussed the fact that the Note was missing with Murphy; Murphy denies recollection  
26 of that discussion. (R.T. 11/21/97 at 135.) After the closing, Kilfoil had a number of  
27 meetings with Prewitt and Murphy but was unsuccessful with resolving the differences  
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1 between the two over the terms of the Note which would sever the business interests of  
2 the two men. (R.T. 11/04/97 at 75-82.) Prewitt filed suit against NCV, Ltd.’s lender  
3 which caused numerous problems for the project and ultimately precipitated this  
4 Chapter 11 filing.

5 ***CONCLUSIONS OF LAW***

6 The Court having made the foregoing findings of fact, adopts the following  
7 conclusions of law:

8 1. The Action involves the Debtor’s “Complaint Objecting to Secured  
9 Claim of John R. Prewitt,” seeking a declaration that the Modified Land Note is  
10 unenforceable and avoidance of the Prewitt Trust Deed pursuant to 11 U.S.C. § 544(a);  
11 and Prewitt’s “First Amended Complaint for Specific Performance and Declaratory  
12 Relief,” seeking delivery of the Modified Land Note, or delivery of a duplicate into  
13 Escrow No. 1874f. The Court has jurisdiction over the subject matter of the Action  
14 pursuant to 28 U.S.C. §§ 1334 and 157(b)(1) and General Order No. 312-D of the  
15 United States District Court for the Southern District of California.

16 2. The Action is a core proceeding pursuant to 28 U.S.C. §§  
17 157(b)(2)(A)(B) (K) and (O) in which the Court is empowered to enter final judgment  
18 pursuant to 28 U.S.C. § 157(b)(1).

19 ***The Modified Land Note Is Unenforceable***

20 3. This Action turns on Prewitt’s ability to enforce the Modified Land  
21 Note. To create an enforceable contract, the parties must mutually consent to the  
22 essential terms of the contract. Civil Code §§ 1550 and 1565. The parties’ consent  
23 must be mutual and communicated to the other side. *Ellis v. Klaff*, 96 Cal. App. 2d  
24 471, 478 (1950).

25 4. Mutual consent requires a precise and unequivocal acceptance of the  
26 offer. A qualified acceptance, or an acceptance that adds new terms, terminates the  
27 offer and creates a new counteroffer. Civil Code § 1585; *Howard v. Chow*, 27 Cal.

1 App. 2d 755, 757 (1938). Moreover, although an acceptance can be “grumbling,” it  
2 must be precise and unequivocal. *Chicago Bridge & Iron Co. v. Industrial Accident*  
3 *Com’n*, 226 Cal. App. 2d 309, 316 (1964).

4           5. Prewitt and Murphy did not mutually consent to the essential terms of  
5 the Modified Land Note. That is, Prewitt left his proposed version of the Modified  
6 Land Note with Murphy on a “take it or leave it” basis without obtaining Murphy’s  
7 acceptance. [FF 34] Murphy did not sign this proposed version and instead continued  
8 to make substantial interlineations. He signed this substantially interlineated version  
9 and may have left it with Escrow World. Kilfoil’s testimony confirms Prewitt and  
10 Murphy never agreed upon the essential terms of the Modified Land Note. [FF ¶¶ 33,  
11 34 and 37; *see also* Pre-Trial Order at ¶¶ 3(b)(5)-(11)] Their failure to agree renders  
12 the Modified Land Note unenforceable.

13           6. An issue also exists concerning delivery of the Modified Land Note in  
14 that it was never located. Failure to deliver the Modified Land Note provides alternate  
15 grounds to invalidate the note. *Western Loan & Bldg. Co. v. Scheib*, 218 Cal. 386, 390  
16 (1933). Because the Court finds no mutual consent, the Court makes no ruling  
17 concerning delivery.

18           7. Additionally, the failure to achieve mutual consent precludes specific  
19 performance. This Court cannot specifically enforce a contract lacking mutual consent;  
20 nor can it enforce a contract where the essential terms are uncertain. Civil Code §  
21 3390; *In Magna Dev. Co. v. Reed*, 228 Cal. App. 2d 230, 235-36 (1964).

22           8. Prewitt requests reasonable attorneys’ fees based upon the Modified  
23 Land Note. Prewitt is not entitled to recover attorneys’ fees in the absence of a statute  
24 or enforceable contract. *In re Fobian*, 951 F.2d 1149, 1153 (9th Cir. 1991).  
25 Moreover, Prewitt presented no evidence concerning his attorneys’ fees incurred in this  
26 Action.

27 ////

1 *Prewitt Has No Enforceable Secured Claim*

2 9. A mortgage, or deed of trust, serves to secure the “performance of a  
3 debt.” Civil Code §§ 2872 and 2920. A deed of trust purporting to secure an  
4 unenforceable debt has no legal effect. *Western Loan & Bldg. Co. v. Scheib*, 218 Cal.  
5 386, 393 (1933)(“A mortgage is merely security for a debt, and if there is no debt there  
6 is no mortgage”).

7 10. Prewitt’s secured proof of claim indicates the Prewitt Trust Deed is  
8 founded upon a debt memorialized by three instruments: (i) the 1983 Settlement  
9 Agreement; (ii) the 1986 Settlement Agreement; and (iii) the Modified Land Note.  
10 [Pre-Trial Order at ¶ 3(a)(1)] None of these instruments creates a debt enforceable  
11 against the Debtor. The Debtor was not a party to the 1983 Agreement. [FF ¶ 23]  
12 Additionally, the 1983 Agreement is unenforceable because the terms of the 1986  
13 agreement “were not as beneficial to NCV, Ltd. as those contemplated by the 1983  
14 Agreement.” [FF ¶¶ 25 and 27]

15 Similarly, the 1986 Agreement does not create a debt enforceable against  
16 the Debtor. This Agreement distributes nothing to Mr. Prewitt and nowhere obligates  
17 the Debtor to Prewitt. [Pre-Trial Order at ¶ 3(a)(8)] The remaining agreement -- the  
18 Modified Land Note -- is unenforceable for the reasons above.

19 11. Alternatively, Prewitt contends the Prewitt Trust Deed secures pre-  
20 existing obligations under the Original Land Note. A deed of trust given to secure a  
21 pre-existing debt is valid between the parties even though there is no additional  
22 consideration. *Smitton v. McCullough*, 182 Cal. 530, 537-38 (1920). However, the  
23 deed of trust may not bind third parties. A deed of trust securing pre-existing  
24 obligations must sufficiently reference the obligations so that third parties, upon  
25 inspection of the record and reasonable diligence, can ascertain the full extent of the  
26 obligation. *D’Oyly v. Capp*, 99 Cal. 153, 157 (1893).

27 ////



1 (1925).

2 16. Whether a novation has occurred is a question of fact established by  
3 written agreement, implication or parol evidence. *Alexander v. Angel*, 37 Cal. 2d 856,  
4 860-63 (1951). The parties must clearly intend to extinguish rather than merely modify  
5 or renew the original contract. *Howard v. County of Amador*, 220 Cal. App. 3d 962,  
6 978 (1990).

7 17. Further, a novation requires that both the original contract and new  
8 contract are valid and enforceable. *California C.P.*, 76 Cal. App. at 18. If there is no  
9 novation, the original note is enforceable. *Columbia Casualty Co. v. Lewis*, 14 Cal.  
10 App. 2d 64, 71-72 (1936).

11 18. The Court concludes the parties intended to accomplish a novation.  
12 The parties changed the amount of the principal obligation, the identity of the “payor,”  
13 and reduced the number of potential “payees” as Prewitt and Ferrante were no longer  
14 indirectly liable on behalf of NCV, Ltd. The parties also changed the type of debt. The  
15 Original Land Note was designed to protect Prewitt’s projected profits on  
16 condominium sales from taxes [FF 16 and 17]; whereas Prewitt intended the Modified  
17 Land Note to evidence a true debt adjusting the obligations between himself and  
18 Murphy. [FF 23] Indeed, the Original Land Note is curiously undated and contains no  
19 express provisions for payment or commencement of interest; nor is there any evidence  
20 of any payment ever being made. [FF 20; Pre-Trial Order at ¶ 3(a)(10)]. Additionally,  
21 the escrow instructions and simultaneous closing of escrow severing the parties’  
22 business dealings evidence the parties’ intent to accomplish a novation. [FF 28 and 29]

23 19. The Court rejects Prewitt’s argument that the novation lacks  
24 consideration. The Modified Land Note’s designation of Prewitt as the sole payee and  
25 elimination of Prewitt’s involvement in NCV, Ltd. provide consideration for Prewitt to  
26 agree to a novation.

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1           20. Despite the parties' intent, the novation fails in that the Modified  
2 Land Note is unenforceable for the reasons set forth above. Although, Prewitt may  
3 seek to enforce the Original Land Note pursuant to its original terms, his claim, if any,  
4 is a general unsecured claim because the original trust deed securing the Original Land  
5 Note was reconveyed.

6           21. The Court deems it premature to rule on the enforceability of the  
7 Original Land Note. Prewitt did not assert his entitlement to a general unsecured claim  
8 in his secured proof of claim or the first amended complaint, and the bar date for filing  
9 general unsecured claims has passed. Notwithstanding, Prewitt receives an extension  
10 of the bar date to establish his unsecured claim if it arises as a result of the Debtor  
11 avoiding his interest in property. Fed. R. Bankr. P. 3003(c)(3).

12                           ***The Debtor Can Avoid The Prewitt Trust Deed***

13           22. Pursuant to section 544(a)(1), a trustee may avoid any security  
14 interest that would have been voidable by a judicial lien creditor as of the petition date,  
15 whether or not such a creditor exists. *In re Wind Power Systems*, 841 F.2d 288, 291-  
16 92 (9th Cir. 1988). Accordingly, the trustee can avoid any transfer unperfected under  
17 state law as of the petition date. *In re Pacific Express, Inc.*, 780 F.2d 1482, 1486 (9th  
18 Cir. 1986).

19           23. Additionally, pursuant to section 544(a)(3), a trustee may avoid any  
20 security interest that would have been voidable by a *bona fide* purchaser of real  
21 property as of the petition date, whether or not such purchaser actually exists. *In re*  
22 *Kim*, 161 B.R. 831, 837 (9th Cir. BAP 1993). The trustee's status as hypothetical *bona*  
23 *fide* purchaser is measured by state law. *Kim*, 161 B.R. at 834. However, actual  
24 knowledge must be disregarded; only constructive or inquiry notice will defeat the  
25 trustee's avoiding powers. *Id.* at 838.

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1           24. Section 1107(a) affords a debtor in possession the same rights as a  
2 trustee. Accordingly, in applying section 544(a) the Court must disregard the debtor in  
3 possession's actual knowledge of a prior unperfected lien. *Id.* at 838.

4           25. Because the Prewitt Trust Deed secures an unenforceable debt, it  
5 provides no constructive notice to a *bona fide* purchaser or judicial lien creditor. *See,*  
6 *Western Loan*, 218 Cal. at 393 (holding that mechanics liens take priority over an  
7 earlier recorded mortgage securing an unenforceable debt). The recorded Prewitt Trust  
8 Deed is comparable to recording a blank piece of paper. *City of Los Angeles v.*  
9 *Morgan*, 105 Cal. App. 2d 726, 733-34 (1951).

10           26. Alternatively, constructive notice arises from the duty to make a  
11 reasonable inquiry. The duty arises where the person has actual knowledge of  
12 circumstances sufficient to cause a reasonably prudent person to inquire into a possible  
13 competing interest. Civil Code § 19. As set forth in paragraph 13 above, the Court  
14 finds the contents of the Prewitt Trust Deed insufficient to trigger the duty to inquire,  
15 and a reasonable person would likely conclude the debt was paid.

16           27. The Court also considered its equitable power to reinstate the  
17 reconveyed trust deed securing the Original Land Note in its corresponding priority  
18 where the reconveyance was purportedly mistaken. The filing of bankruptcy precludes  
19 this remedy because the Debtor occupies the status of a hypothetical *bona fide*  
20 purchaser under Section 544(a)(3). *See, First Nationwide Savings v. Perry*, 11 Cal.  
21 App. 4th 1657, 1669 (1992) (recognizing a reconveyed trust deed cannot be reinstated  
22 to the detriment of a *bona fide* purchaser).

23           28. In the absence of evidence concerning the Debtor's claims of offset  
24 against Prewitt or the Debtor's attorneys' fees incurred in the Action, the Court  
25 declines to make an award on account of these claims.

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29. Any findings of facts which may be considered a conclusion of law shall be deemed a conclusion of law. Any conclusions of law which may considered a findings of fact shall be deemed a finding of facts. A separate judgment is filed concurrently with these findings.

DATED: December 15, 1998

LOUISE DeCARL ADLER, Chief Judge  
United States Bankruptcy Court

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UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF CALIFORNIA

In re Bankruptcy Case No(s). 90-04997-A11; 91-90102-A11  
Case Name: In re NORTH COAST VILLAGE, LTD.; NCV v. PREWITT

**CERTIFICATE OF MAILING**

The undersigned, a regularly appointed and qualified clerk in the Office of the United States Bankruptcy Court for the Southern District of California, at San Diego, hereby certifies that a true copy of the attached document, to-wit:

**MEMORANDUM DECISION**

was enclosed in a sealed envelope bearing the lawful meter of the Bankruptcy Judges and mailed to the following parties at their respective addresses listed below:

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The envelope(s) containing the above document was deposited in a regular United States mail box in the City of San Diego in said district on September 22, 1998.

DEBORAH A. HOLT, Deputy Clerk