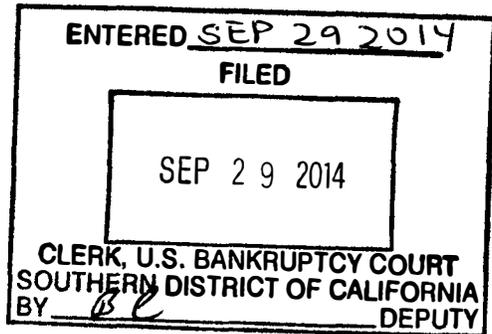


1 WRITTEN DECISION - NOT FOR PUBLICATION



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6 UNITED STATES BANKRUPTCY COURT
7 SOUTHERN DISTRICT OF CALIFORNIA

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11 In re) Case No. 10-22356-PB7
12) Adv. No. 11-90154-PB
13 CURTIS L. and STEPHANIE A.)
14 FARBER,) ORDER ON DEFENDANT'S
15) RENEWED MOTION FOR
16) PARTIAL SUMMARY
17) JUDGMENT
18)
19)
20)
21)
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23)
24)
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26)
CHRISTOPHER J. and WENDY W.)
PHILCOX,)
Plaintiffs,)
v.)
CURTIS L. and STEPHANIE A.)
FARBER,)
Defendants.)

23 Defendants' previous motion for partial summary judgment was
24 denied with respect to Plaintiffs' § 523(a)(2)(A) and §
25 523(a)(2)(B) claims. The § 523(a)(2)(A) is based upon
26 Plaintiffs' reconveyance of a second priority deed of trust. In

1 this renewed motion, Defendants have added evidence of the value
2 of the subject property as of the date of the reconveyance in an
3 effort to establish that the reconveyed deed of trust had no
4 value. The Court afforded Plaintiffs an additional opportunity
5 to obtain their own evidence of value. Plaintiffs submitted
6 appraisal reports which had been prepared prepetition at the
7 request of Defendants' prepetition lender. The Court held an
8 evidentiary hearing at which both appraisers testified. Having
9 considered all of the evidence the Court finds that the most
10 reasonable and accurate appraisal report establishes that as of
11 the date of the reconveyance the property was worth less than the
12 amount of the debt secured by the first priority deed of trust
13 and thus the second priority deed of trust reconveyed by the
14 Plaintiffs was valueless. Defendants' motion is therefore
15 granted on the § 523(a)(2)(A) claim.

16 **BACKGROUND**

17 As of the beginning of 2006, after a series of transactions,
18 Christopher and Wendy Philcox (Plaintiffs) held a promissory note
19 in the amount of \$1.5 million signed by Defendants' wholly owned
20 corporation, Pacific Liberty, Inc., (PL Note). The PL Note was
21 secured by a second priority deed of trust on Defendants' real
22 property at Las Flores Drive in Carlsbad, California (Las Flores
23 Property). The Las Flores Property was, at the time, under
24 construction. It is now "an 11-unit luxury residential
25 condominium complex." See Appraisal Report of Kenneth A. Keagy
26 (Keagy Report) at page vi. The Las Flores Property was at all

1 times relevant hereto subject to a first priority deed of trust
2 held by construction lender Temecula Valley Bank (TVB). At the
3 time of the reconveyance the amount owing TVB was between
4 \$5,549,613.08 (as of September 19, 2006) and \$5,597,561.22 (as of
5 September 28, 2006).

6 On September 27, 2006, at the request of Defendant Curtis
7 Farber, Plaintiffs reconveyed their second priority deed of trust
8 on the Las Flores Property, ostensibly in order to enable
9 Defendants to negotiate an extension with TVB. Plaintiffs
10 contend that they agreed to reconvey the deed of trust based upon
11 Curtis' assurance that the deed of trust would be promptly re-
12 recorded. Indeed, the copy of the Reconveyance provided by
13 Plaintiffs includes a notation "we've signed the form to put it
14 right back on." Plaintiffs allege other misrepresentations, but
15 this is the only misrepresentation at issue in the present
16 motion.

17 For reasons which are not relevant to this decision,
18 Plaintiffs' deed of trust was not re-recorded. On April 22,
19 2008, TVB foreclosed on the Las Flores Property. TVB credit bid
20 the full amount of its senior claim, and Plaintiffs have received
21 nothing on the PL Note since Defendants stopped making payments
22 in May, 2008.

23 Plaintiffs filed a complaint seeking to have their claims
24 excepted from Defendants' discharge on several theories. Two of
25 the theories were challenged in the prior motion for summary
26 judgment - sections 523(a)(2)(A) and (B). In a prior order the

1 Court denied summary judgment with respect to the § 523(a)(2)(B)
2 claim, which was based upon a separate alleged misrepresentation.

3 In support of the current motion Defendants rely upon the
4 appraisal report of Kenneth Keagy in which he opines that the
5 Property was worth \$4,500,000 as of the date the Plaintiffs
6 reconveyed their deed of trust. Plaintiffs have now provided a
7 copy of an appraisal report prepared by James P. Leahy, MAI, and
8 his associate dated August 18, 2006 (the Leahy Report) in which
9 he opined that the "as is" was \$8,221,611 as of August 9, 2006,
10 shortly before the reconveyance. On February 20, 2014, the Court
11 conducted an evidentiary hearing to determine the value of the
12 Property as of September 27, 2006, the date of the reconveyance.
13 Mr. Leahy appeared and testified at the evidentiary hearing as
14 did Defendants' appraiser Mr. Keagy. The Court took the matter
15 under submission.

16 DISCUSSION

17 As discussed above, Plaintiffs contend that Defendant Curtis
18 Farber induced them to reconvey their deed of trust on the Las
19 Flores Property by misrepresenting his intent to immediately re-
20 record the deed of trust. Section 523(a)(2)(A) excepts from
21 discharge "any debt" "(2) for money, property, services, or an
22 extension, renewal, or refinancing of credit, to the extent
23 obtained by-- (A) false pretenses, a false representation, or
24 actual fraud, other than a statement respecting the debtor's or
25 an insider's financial condition."

26 Claims under § 523(a)(2)(A) typically stand or fall on

1 whether the representation was false, whether it was material
2 and/or whether the debtor justifiably relied thereon. However,
3 before getting to those issues, the Court must determine whether
4 there is a "debt" and whether debtor "obtained" any "money,
5 property, services, or an extension, renewal, or refinancing of
6 credit," in the first place.

7 In this case what Defendants "obtained" was a reconveyance
8 of Plaintiffs' deed of trust. The reconveyed deed of trust is
9 clearly not money, services, nor an extension, renewal or
10 refinancing of credit. The only other option is that it is
11 property. Property is not defined in § 523 or anywhere else in
12 the Code. In a Supreme Court case applying the predecessor to §
13 523 under the Act, the court concluded that legal services were
14 not property, describing the limitations of the concept of
15 property:

16 At most [property] denotes something subject to
17 ownership, transfer, or exclusive possession and
18 enjoyment, which may be brought within the dominion and
19 control of a court through some recognized process.
20 This is certainly the full extent of the word's meaning
as employed in ordinary speech and business, and the
same significance attaches to it in many carefully
prepared writings.

21 Gleason v. Thaw, 236 U.S. 558, 561 (1915).

22 The Court finds that in general, the reconveyance of a deed
23 of trust would fit within this parameter and would amount to
24 obtaining property. It is generally accepted that granting a
25 security interest in property is a transfer of property. It
26 stands to reason then that return of such an interest is a

1 transfer of property.

2 The issue raised by Defendants' renewed motion is whether
3 the security interest reconveyed had any value. If it did not,
4 Defendants' theory is that no "debt" would have resulted based
5 upon the reconveyance. Another way to state the same argument,
6 is that the alleged fraud and reconveyance would have resulted in
7 no damages. See In re Siriani, 967 F.2d 302, 304 (9th Cir.
8 1992), in which the court set out the elements of § 523(a)(2)(A),
9 which included "(7) that damage proximately resulted from the
10 misrepresentation."

11 In support of the prior motion Defendants had submitted the
12 declaration of appraiser Kenneth Keagy, in which he opined on the
13 value of the Las Flores Property as of April 22, 2008, the date
14 TVB foreclosed. In support of the renewed motion Defendants
15 submitted the Supplemental Appraisal Report of appraiser Keagy,
16 in which he opines that as of September 27, 2006, the date the
17 Las Flores deed of trust was reconveyed, the Las Flores Property
18 was worth \$4,500,00, which is less than what was owed to TVB at
19 that time - \$5,549,613.80 as of September 19, 2006. Based upon
20 these numbers, the reconveyed deed of trust would have had no
21 value, and thus no debt would have arisen based thereon.
22 Further, Defendants would have received no property.

23 At the prior hearing, Plaintiffs requested a continuance in
24 order to obtain a competing appraisal, showing that the
25 reconveyed deed of trust had some value. The Court had
26 misgivings, because, as counsel for the Defendants explained at

1 the hearing, Plaintiffs had notice of the hearing and ample
2 opportunity to obtain a competing appraisal. Nevertheless, upon
3 reflection the Court decided to allow the Plaintiffs such an
4 opportunity.

5 Plaintiffs did not obtain a new appraisal. Rather, they
6 rely upon two appraisal reports previously prepared by James P.
7 Leahy at the request of TVB. The Leahy Reports were dated August
8 18, 2006 and February 8, 2008 and provided an "As Is" value as of
9 August 9, 2006 and February 4, 2008 respectively.

10 The parties have stipulated that as of the September 27,
11 2006 reconveyance date, the amount owing to TVB secured by its
12 first priority deed of trust was approximately \$5,549,613.80.
13 Thus, the issue of fact before the Court is whether the Property
14 was worth more or less than \$5,549,613.80 on September 27, 2006.

15 **Keagy Report**

16 In his Supplemental Appraisal Report Mr. Keagy noted that as
17 of September 2006 "construction was still less than half
18 complete," and opined that the market value of the Property as of
19 September 27, 2006 was \$4,500,000. Mr. Keagy explained the
20 methodology used to arrive at this number:

21 Discounted Cash Flow analysis was used to value
22 the Subject Property. The Discounted Cash Flow
23 analysis first required the appraiser to estimate the
24 prospective market value of each individual Subject
25 condominium units as if completed. For the September
26 2006 date of value, a 6-month construction period was
assumed with a completion date of about April 1,
2007.... Then a cash flow model was created by
projecting remaining construction costs, sales
absorption rate, sales costs, holding costs and
selecting a discount rate to be applied to the periodic

1 cash flows. Because no remaining construction cost
2 estimate was available for the two dates of value, the
3 actual subsequent amounts of Temecula Valley Bank
4 construction loan disbursements from October 1, 2006
5 and October 1, 2007 were applied as a reasonable
6 approximations of remaining construction costs (see
7 loan disbursement schedule page 38).

8 He also explained that "cost to complete construction was assumed
9 to be \$3,070,631 based upon TVB loan disbursements from October
10 1, 2006 through January 30, 2008." He also warned that to the
11 extent the developer contributed additional equity funds not
12 included on the TVB loan disbursement schedule to complete
13 construction, or if construction was not 100% complete as of
14 January 30, 2008, the assumed cost to complete construction in
15 this report would be understated and, as a result, the market
16 value estimates herein would be overstated." On cross-
17 examination counsel for the Plaintiffs raised no real errors or
18 omissions in the methodology used in or creation of the Keagy
19 Report.

20 **Leahy Report**

21 In his Report dated August 18, 2006 (the Leahy Report) Mr.
22 Leahy provided four separate valuations. Three of those are
23 irrelevant to the current dispute as they are as of January 1,
24 2007 - the estimated date of completion of the condominium
25 project. The fourth, dated as of August 9, 2006, is the one of
26 interest to the Court:

Our opinion of the Market Value 'As is' of the fee
simple interest for the subject property, based upon
information contained in this report, as of August 9,
2006 is [\$8,221,611].

1 Leahy Report at page 3. In the report, and at the hearing, Mr.
2 Leahy explained that he arrived at this value using the "cost
3 approach," which was defined twice in the report:

4 Cost Approach: A value approach through which an
5 appraiser derives a value indication of the fee simple
6 interest in a property by estimating the current cost
7 to construct a reproduction of or a replacement for the
8 existing structure, deducting for all evidence of
9 accrued depreciation from the cost new of the
10 reproduction or replacement structure, and adding the
11 estimated land value plus an entrepreneurial profit.

12 Leahy Report at 15. A more succinct definition was provided
13 further on:

14 The Cost Approach to value consists of adding the land
15 value to the estimated reproduction (or replacement)
16 cost new of all improvements less accrued depreciation
17 from all causes.

18 Leahy Report at 53.

19 At the hearing Mr. Leahy confirmed that the \$8,221,611
20 figure was arrived at by adding the estimated land value of
21 \$3,300,000 at page 58 of the report to the "direct cost
22 (incremental value) [which was] reported by Temecula Valley Bank
23 to be \$4,921,611," at page 16. These figures do indeed total the
24 \$8,221,611 figure found at page 3.

25 At the hearing several problems with the Leahy Report were
26 raised. First, when discussing the costs, the report also
provides the "Construction at the subject property commenced 12
months ago.... The subject property has experienced numerous
delays and cost overruns." Leahy Report at 16. At the hearing
Mr. Leahy admitted that he did not know the extent to which the

1 \$4,921,611 direct cost expense number provided by TVB included
2 expenses due to the delay and cost overruns, such as interest
3 carry. The report provided "The developer of the subject
4 property has provided an itemized cost breakdown for the subject
5 property along with a component cost detail. Further, a complete
6 specification list was provided for review. All are contained in
7 the addendum to the report." Leahy Report at 53. However, no
8 such addendum was attached, and Mr. Leahy had no specific
9 recollection of such a report. At the hearing Mr. Leahy conceded
10 that interest carry and such costs should not properly be
11 included in the cost approach since they would not have enhanced
12 the value of the project. Thus, the appropriateness of the
13 \$4,921,611 figure is suspect.

14 That figure for direct costs to date is also called into
15 question by the fact that the estimated "Total Direct Costs" for
16 the completed project are only \$4,433,474 - which is less than
17 the "direct costs" as of the date of the report for the
18 incomplete project. See Leahy Report at 55 and 59. This might
19 simply be an error in the report using the term "direct costs" at
20 page 16 to include what are referred to as "direct" and
21 "indirect" costs at page 59. Or perhaps it is an indication that
22 the \$4,921,611 "direct cost" used in the "as is" value includes a
23 great deal of interest carry and other non-improving expenses.

24 Finally there is the question of what to do with the figure
25 in the footnote to the "as is" value which provides:

26 Land Value plus the contributory value of the

1 improvements completed as of the effective date of
2 valuation. Contributory value (% disbursed) as
3 reported by the Temecula Valley Bank amounts to
4 \$2,238,613.

5 Leahy Report at 3, Fn. (**). Counsel for the Defendants raised
6 the possibility that this was the real figure for direct costs
7 with interest and the like backed out. Mr. Leahy could not
8 recall.

9 There was at least one factual error in the Leahy Report
10 that was raised at the hearing. It incorrectly stated that "the
11 subterranean parking garage was in place and the primary
12 structures have been framed. Subflooring is also in place at the
13 subject property." As pointed out in the Keagy Report, this
14 description is inconsistent with the photograph at page 6 of the
15 Leahy Report which clearly shows incomplete framing. The Court
16 agrees that the projected completion schedule of 4 months August
17 2006 to January 2007) in the Leahy Report was aggressive. Keagy
18 Report's six month projection is more reasonable. However, since
19 Mr. Leahy's "as is" value was based upon disbursements to date,
20 not projected, the error would not have impacted Mr. Leahy's
21 conclusions.

22 **Analysis**

23 The Leahy Report simply contains insufficient support for
24 the \$8,221,611 "as is" valuation. Based upon the language of the
25 report, the direct costs used appear to include at least some
26 costs such as interest carry which should not be included for a
valuation. On the other hand, the Court finds no serious

1 objection to the Keagy Report.

2 More importantly, of the two valuation approaches, the Court
3 finds the market value approach used by Mr. Keagy to be more
4 likely to arrive at accurate valuation than the cost approach
5 used by Mr. Leahy. In the view of the Court, the cost approach
6 has at least two shortcomings. First, as a matter of
7 application, it can only be accurately applied if the true costs
8 are known. As discussed above, Mr. Leahy admitted that he did
9 not know what, if any, portion of the funds dispersed by TVB and
10 used as the "direct costs" was attributable to interest carry or
11 late fees and the like. To the extent the cost were due to costs
12 not attributable to the improvements, they should not have been
13 included.

14 Second, as a matter of common sense, what someone is likely
15 to spend on a partially completed project (the market value
16 approach used by Mr. Keagy), is a much better indicator of value
17 than what had been spent to date. As Mr. Keagy explained at the
18 hearing, the aggregate cost approach used by Mr. Leahy (adding
19 land value and costs) was not reliable because it does not
20 account for overruns, delay and market turndown. The Court
21 agrees with Mr. Keagy that it is best used, if at all, as a
22 secondary check of value. Having considered the opinions of the
23 two experts the Court concludes that the best approach is the one
24 used by Mr. Keagy.

25 The Court's conclusion is buttressed by Mr. Leahy's own
26 report (Ex. 1), in which he arrives at his "Market Value 'As

1 is.'" At p. 13 of the same report, he tells us the then "current
2 economic definition of market value" was:

3 "The most profitable price which a property should
4 bring in a competitive and open market under all
5 conditions requisite to a fair sale, the buyer and
6 seller each acting prudently and knowledgeably, and
7 assuming the price is not affected by undue stimulus.
8 Implicit in this definition is the consummation of a
9 sale as a specified date and the passing of title from
10 seller to buyer under conditions whereby:

11 (1) Buyer and seller are typically motivated;

12 (2) Both parties are well-informed or well-
13 advised, and acting in what they consider their own
14 best interests;

15 (3) A reasonable time is allowed for exposure in
16 the open market;

17 (4) Payment is made in terms of cash in U.S.
18 dollars or in terms of financial arrangements
19 comparable thereto; and

20 (5) The price represents the normal consideration
21 for the property sold unaffected by special or creative
22 financing or sales concessions granted by anyone
23 associated with the sale."

24 In contrast, on the next page, Mr. Leahy provides his
25 definition of "Market Value 'As is.'" It provides:

26 The current value estimate of the subject property in
its present physical and economic state without
hypothetical conditions, assumptions or qualifications
are of the date of value. In purposes of this
appraised analysis, the Market Value "As is" estimate
consists of the Aggregate Retail Proceeds less any and
all costs associated with the marketing and sales of
the subject property as individual "for sale"
condominiums.

Based on the testimony taken at the hearing, it appears
there are inconsistencies between the foregoing definition of
"Market Value 'As is'", and the assumptions made to arrive at any
sort of value. Most troubling to the Court is the idea that one
arrive at any sort of value by adding land costs and lender

1 disbursements (whatever they might include, such as cost overruns
2 and prolonged interest carry because of delays), without regard
3 to what the defined Market Value might be.

4 To be fair to Mr. Leahy, he was not hired by either of the
5 parties to opine on market value. Rather, he was hired by the
6 construction lender back in 2006 for mortgage finance purposes.
7 He was subpoenaed to testify about an appraisal he made 7-1/2
8 years before, and made for different purposes. Nevertheless, the
9 Court concludes that it is of significantly less usefulness for
10 present purposes than the appraisal of Mr. Keagy.

11 For the foregoing reasons, the Court adopts the valuation
12 provided in the Keagy Report, and rejects that of the Leahy
13 Report. With a value of \$4,500,000 as of September 27, 2006,
14 compared to the stipulated senior lien of TVB of \$5,549,613.80,
15 the Court concludes that the deed of trust reconveyed on
16 September 27, 2006, was of no value. Regardless of whether the
17 market value of the property is determined as of September 27,
18 2006, when the reconveyance was made, or September 2007, when Mr.
19 Philcox learned the junior trust deed had not been re-recorded,
20 or April 22, 2008 when foreclosure by TVB occurred, it is clear
21 that the senior debt owed to TVB always significantly exceeded
22 the market value of the property on each corresponding date.
23 Hence, there was no property obtained by Defendants by virtue of
24 the alleged fraud and no damages flowing from the alleged
25 misrepresentations.

26 Finally, the Philcoxes also assert that they were damaged by

1 the loss to foreclosure of rights they would have had as junior
2 lien creditors (if the trust deed had been re-recorded).
3 However, it is established in this Court that an otherwise
4 secured creditor who claims such rights must prove that at the
5 time of, for example, forbearance "it had valuable collection
6 remedies." *Cho-Hung Bank v. Kim*, 163 B.R. 157, 161 (9th Cir. BAP
7 1994), aff'd and adopted 62 F.3d 1511 (9th Cir. 1995); see also
8 *In re Sirian*, 967 F.2d 302, 305 (9th Cir. 1992). In short, so
9 far as the record in this case reflects, at no relevant point in
10 time would the Philcoxes have had any equity value to which their
11 junior lien would have attached assuming the trust deed
12 purporting to secure the debt had been re-recorded.

13 **CONCLUSION**

14 For the foregoing reasons, the Court grants Defendants'
15 motion for summary judgment on the § 523(a)(2)(A) claim at this
16 time. The Court has already denied the motion with respect to the
17 § 523(a)(2)(B) claim.

18 IT IS SO ORDERED.

19
20 DATED: September 29, 2014

21 

22 PETER W. BOWIE, Judge
23 United States Bankruptcy Court
24
25
26

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
325 West F Street, San Diego, California 92101-6991

In re Bankruptcy Case Name: Curtis & Stephanie Farber
Adversary Name: Christopher & Wendy Philcox v. Curtis & Stehanie Farger

Case No.: 10-22356-PB7
Adversary No.: 11-90154-PB

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:

ORDER ON DEFENDANT'S RENEWED MOTION FOR PARTIAL SUMMARY JUDGMENT

was enclosed in a sealed envelope bearing the lawful frank of the bankruptcy judges and mailed to each of the parties at their respective addresses listed below:

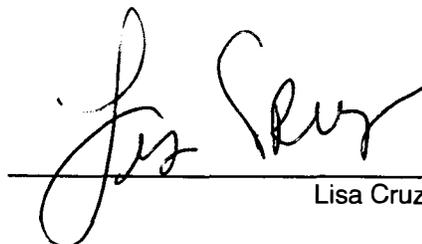
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Said envelope(s) containing such document was deposited by me in a regular United States Mail Box in the City of San Diego, in said District on September 29, 2014.



Lisa Cruz, Deputy Clerk