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# Collection Matters, Part 1: Workouts and Litigation

PATRICIA Y. TRENDACOSTA AND PETER CSATO

*This article discusses how to handle collection matters from the pre-litigation stage through judgment and enforcement.<sup>1</sup>*

**L**itigation is not the first and best means of collecting a debt or recovering on a claim. Litigation consumes a client's time and emotional and financial resources. No matter how good the prospects for recovery may seem, the outcome of litigation is never absolutely certain. Obtaining a judgment is often only the first step in a protracted and potentially costly collection process. Therefore, at the initial stage of any new collection matter, it is essential for the attorney and client to analyze the options for collection of the claim other than through litigation, in addition to reviewing the underlying merits of the claim, potential defenses to recovery, the costs and risks of litigation, the ultimate collectibility of any judgment, and the likelihood and effect of a bankruptcy. This article discusses the stages of collection matters from pre-litigation, through judgment and enforcement.

## PRE-LITIGATION ISSUES AND TACTICS

### Initial Review, Planning, and Goal Setting

Evaluate why the debtor has not paid the debt. As part of the initial case review, it is important to determine why a debtor will not pay. There

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are an infinite number of reasons; some of the most common are:

- *A Joint Debtor* — The debtor may be waiting for a joint debtor to pay the obligation. (This problem may arise in partnership situations or in situations involving guarantors.)
- *No Reduction of Standard of Living* — The debtor refuses to reduce his or her standard of living in order to repay his debts.
- *Refusal to Refinance* — The debtor refuses to refinance his or her debt and expects the creditor to wait indefinitely.
- *Assertion of Defenses* — The debtor claims to have defenses to the merits of the claim, such as claims for defects in the goods or services provided; the debtor may dispute the calculation of the amounts owing; or, the debtor may claim that additional terms or conditions to the debt were agreed to that render the debt not due at this time.
- *Professional Discounter* — The debtor may be a “professional discounter” who is hoping that the creditor, by being made to wait for repayment, will be satisfied with only a portion of the debt.
- *Fraudulent Transaction* — The transaction was fraudulent from its inception, and the debtor never had any intention of repaying.
- *Temporary Financial Setback* — The debtor may intend to ultimately pay the debt but, because of a temporary financial setback or change in circumstances, cannot pay at this time.

Although the concept of determining why the debt has not been paid seems basic, this evaluation impacts the course of action recommended for the matter, the timetable for pursuing any workout prior to litigation and the goals that are set for recovery in the action. In some cases problems may exist with the credit that will cause the attorney to recommend delaying litigation until the problems can be resolved or fully evaluated. For example, the debtor may claim entitlement to a reduction or credit on the debt due to incorrect crediting of payments or other actions/inactions by the creditor.

### **Workout Strategies as An Alternative to Litigation**

As part of the workout process, the creditor should evaluate all poten-

tial sources of recovery on the claim, the ability of those sources to repay the debt and the likelihood of recovery against those sources voluntarily or through litigation. These other potential sources of recovery may include the following:

- the debtor itself;
- the realizable value of all collateral security of the debt, taking into account any problems associated with the liquidation or realization on the collateral;
- persons or entities who may have voluntarily assumed the debt;
- persons who promised the customer to provide funds to enable the customer to pay the debt (for example, credit, life, or disability insurance companies);
- in the situation of a corporate debtor, persons that may be alter egos of the corporation; or
- the spouse of the debtor (even if he/she did not sign the obligation) based upon community property liability.

There are costs and benefits to pursuing a workout prior to initiating litigation. The costs include the delay in beginning the litigation process, in a case where a workout seems unlikely, and where there is risk that the debtor's assets will be transferred out of the creditor's reach while the workout discussions are pending, whether voluntarily or through attachments or actions by other creditors.

The benefits, however, are multifold. First, a successful workout can put more money in the creditor's pocket sooner, by avoiding the time and expense of litigation and utilizing dollars the debtor might otherwise spend on attorneys' fees in defending the action toward payment of the creditor's claim. Where potential defenses to the claim exist, a workout may provide the creditor with more control and certainty in the outcome of the resolution of the claim. Workouts also provide the creditor with an opportunity to gather information that may be helpful in assessing the creditor's settlement and recovery options and, in any ensuing litigation, can provide insight with respect to the current value, lien status and loca-

tion of assets of the debtor and of guarantors, and of the potential defenses the debtor or guarantors may assert in the action. Where a creditor's case is weakened by missing documents, potential exoneration defenses by a guarantor, ambiguities in the terms and conditions of documents or allegations of post-documentation oral representations or agreements, the workout is invaluable. Most debtors will gladly trade additional time for payment of the obligation or reduced payments in the short term for releases and agreements which shore up documentation deficiencies and eliminate defenses to the underlying claim, paving a much smoother path for the creditor if litigation inevitably comes to pass. In all, a workout can be the best form of pre-litigation planning since it helps to narrow the issues and defenses for any future litigation and provides the creditor with an advance arsenal of more current information and evidence going into the litigation.

### **Workout Documentation Considerations**

A workout can, of course, take many forms, some of which may include litigation in the form of a stipulation for entry of judgment that is held unfiled so long as performance is made under the work out by the defendants. A workout may involve a simple acceptance of a single discounted payoff of the obligation, potentially through a payment by the debtor or through a refinance. A workout may involve a stipulated liquidation of collateral securing the debt either in full or partial satisfaction of the debt, or a modification of the interest rate, due date, or payment schedule.

Workout documentation should generally include the following:

- A written acknowledgment of the debt by the debtor, including an acknowledgment of the validity and enforceability of all of the loan documentation and the dollar amount owing on the debt as of the date of the workout agreement, and what constitutes the components of the debt as of that date, including any attorneys' fees and costs, late charges, default interest and audit fees that are typically a source of dispute when litigation to recover the debt is later instituted;

- A waiver by the debtor and guarantors of any applicable statute of limitations;
- Additional security, including securing a previously unsecured guaranty;
- Releases in favor of the creditor for any claims that were or could have been asserted up to the time of the workout, except those based on the terms and conditions of the workout itself;
- Where a debt is guaranteed, it is preferable that the guarantor execute the workout documentation and that the documentation include a reaffirmation and acknowledgment of the continuing validity and enforceability of any guaranties covering the debt. While California case law makes waivers of exoneration defenses based on modifications of the underlying loan documents enforceable,<sup>2</sup> having the guarantor acknowledge in writing the changes to the underlying loan transaction, accept and agree to those changes and reaffirm the continuing effectiveness of the guaranty notwithstanding the changes is obviously better than litigating over the effectiveness of the waivers in the earlier executed guaranty;
- Where the debt is secured, to the extent not already provided in the loan or contract documentation, the obligation to keep the creditor informed of the location, value and condition of the collateral and the right by the creditor to have access to the collateral on demand for the purposes of inspecting, appraising and/or auditing the collateral;
- “Clean up” documentation, by which any defenses the creditor has discovered are addressed and dealt with generally through the releases, where there is a stipulation as to the debt amount owing, and where any omissions or ambiguities in the original loan or contract documentation are addressed and resolved.

Additional provisions that the creditor may want to consider if a bankruptcy filing is looming on the horizon would include the following:

- A provision by which the debtor acknowledges having provided the creditor with a balance sheet and financial statements demonstrating

the debtor's solvency, together with a solvency representation and warranty. The evidence of solvency may help rebut the presumption of insolvency during the 90 days prior to bankruptcy if a bankruptcy is filed and a preference suit is instituted by the trustee to recover any payments made to the creditor during that period.

- A provision by which the debtor acknowledges the value of the collateral as being at least equal to the amount of the debt, in order to provide evidence the debt is fully secured for the purposes of a subsequent bankruptcy filing and to allow the debt to continue to accrue post-petition interest and attorneys' fees. Such a provision can also be useful as evidence if the debtor proposes a Chapter 11 cram-down plan that would reduce the amount of the creditor's lien to the value of the property securing it, and treat the balance as unsecured (which typically might entitle the creditor to only a minimal distribution over time on the unsecured portion of the debt).
- Advance waivers of the automatic stay. These waivers are typically not enforced, but they are enforceable in some courts and under some circumstances. These waivers are most likely to be enforced if the agreement contains agreed upon facts (admissions by the debtor) that would be sufficient to warrant termination of the stay if submitted as evidence to support a motion for relief from stay in the bankruptcy case (facts such as the debtor's attempts to reorganize and rehabilitate its business that have failed, the limited options available for reorganization or rehabilitation, the fact that the collateral securing the debt is not needed by the debtor for its business or for a reorganization, the fact that the value of the collateral is declining, etc.) Creditors are cautioned that a relief from stay waiver has almost uniformly been deemed not effective automatically and not without the creditor obtaining a bankruptcy court order "validating" the waiver and terminating the stay based on the waiver.

If there is collateral securing the claim, in most cases, the creditor can proceed against that collateral without litigation, and then after liquidation of the collateral, determine what, if any, action can or should be taken to pursue any unpaid deficiency on the debt. If the creditor holds real prop-

erty security, in most instances the creditor has no choice but to resort to the liquidation of the real property collateral prior to pursuing an action on the note or other debt instrument to impose personal liability for the debt or any deficiency. The antideficiency judgment statutes have to be evaluated carefully, in the context of real property collateral, and contain a myriad of pitfalls for the unwary. (*See* discussion hereinafter.)

To the extent the debtor is willing to stipulate to liquidation of all or a portion of the collateral securing the claim through a workout, the workout documentation should, to the greatest extent possible, contain express consent by the debtor as to the timing, method and manner of the creditor's intended disposition of the collateral, and an express waiver of any objections or the right to assert defenses to the creditor's claim for any deficiency based on the timing, method or manner of the creditor's liquidation of the collateral.

In negotiating workout terms and documentation, the creditor needs to consider how to treat the payments received under the workout documentation. In some instances, the workout is documented merely as a forbearance, with the default remaining in existence and uncured despite the workout. Where the debt is secured by real property and a notice of default has been recorded, a forbearance agreement may be preferable to allow the notice of default to remain of record and the 90-day time period under California law before which the notice of sale cannot be published to pass while the parties are operating under the workout. In that case, the workout documentation needs to express clearly the above-concept that all payments received under the workout are being applied to the accelerated debt, and that the debt has not been, and will not be, cured by those payments.

In other instances, the creditor may for other business reasons, or because the debtor will not agree to a mere forbearance, allow the workout to modify the loan or contract terms and reinstate the loan or contract, eliminating the default. How the workout is documented will affect whether a new notice of the default (whether under the real property laws or under the terms of the loan or contract providing for notice of default to be given) will need to be issued prior to pursuing a claim on the debt as modified, and what amounts can be demanded. For example, late charges and default interest may not be able to be charged until the new notice of default has been issued and the debtor fails to cure the debt as modified.

## **Payments Made After the Case Is Assigned to Litigation**

Occasionally, the customer may make or tender a post-default payment on his obligation after you have accelerated the debt and made the decision to sue but before judgment is entered. If you accept such payments without taking steps to preserve your rights, you might be waiving the default and your right to proceed with the litigation.

For example, the customer may claim that he spoke with someone within your organization who told him that, if he started making his monthly payments or brought the account current, “nothing more would happen” or “the default would be forgiven and the loan reinstated in good standing.” The customer may also claim that he would never have paid the money to bring the account current except to avoid litigation.

Once the debt is in default and you have, in accordance with the terms of the loan documents, accelerated the due date of the remaining outstanding balance, you have the right to accept late payments and apply them to the total indebtedness without reinstating the loan. However, to avoid claims of the type described in the preceding paragraph, be sure to notify the customer in writing if there has been no reinstatement of the loan and no forgiveness or waiver of the default or acceleration.

## **LITIGATION**

### **Jurisdiction and Venue**

#### ***Where to Sue: This State or Another State?***

- If the debt was incurred in California or if the debtor is residing in California at the time the creditor files the lawsuit (regardless of where the debt was incurred), the creditor may sue the debtor in California.
- When the debtor resides outside California at the time the creditor is to file the lawsuit but the debt was incurred in California, the creditor may sue the debtor either in California or in the state of his residence at the time the lawsuit is filed, whichever is more practical for the creditor.

### ***Where to Sue: State or Federal Court?***

Whether to sue in state or federal court can be a significant decision for a creditor with ramifications beyond the particular case. Unlike state courts with general jurisdiction, federal courts are courts of limited jurisdiction whose basis for hearing and determining claims is subject to constitutional and statutory restrictions. The general jurisdiction statutes grant the federal courts jurisdiction to hear (a) cases and controversies subject to “federal question” jurisdiction, defined generally as actions arising under or based upon the federal constitution or federal statutes, laws or regulations, and (b) “diversity” cases where citizens of different states are involved and where the claim or controversy meets the minimum amount in dispute of \$75,000, exclusive of interest and costs. To qualify for diversity jurisdiction, which would typically be the only basis for federal court jurisdiction in a traditional collection action or contract dispute, there must be complete diversity of citizenship among the parties, such that none of the plaintiffs are citizens of any state in which any defendant is a citizen.

As a strategic matter, unless there is a clear basis for federal jurisdiction and specific reasons to proceed in federal court under the facts or circumstances of a given case, proceeding in federal court may not be as advantageous as it might have once been, prior to implementation of the trial delay reduction act in most of the major county courts in California.

With the trial delay reduction act in effect, the long-term delays that used to be experienced by creditors in trying to get to trial in state court have been minimized, if not eliminated entirely. The expedited processing of cases was one reason creditors found federal court litigation more attractive in many cases and would seek ways to file their action in federal court when possible. The federal rules and local rules and procedures in most federal district courts in California now require an early meeting of counsel and impose fairly burdensome and expensive pre-trial procedures on the parties from the outset of the case. In some cases, those procedures may help bring the debtor to the table to avoid the cost and time consumption associated with compliance; in other cases, where the collect ability of the judgment is uncertain and other factors may make the creditor reluctant to incur substantial attorneys’ fees and costs early in the litigation, in the hopes of either reaching an early settlement or in the face of a potential

bankruptcy filing by the debtor, those federal procedures may pose a distinct disadvantage to the creditor.

In addition, “forcing” federal jurisdiction where the basis for federal jurisdiction is not totally clear may be a risk not worth taking in most collection actions. Lack of subject matter jurisdiction is a defense that can be raised at any time in an action, including by an appellate court *sua sponte*. As a result, if subject matter jurisdiction in the federal court is tenuous and the district court or an appellate court later determines that subject matter jurisdiction is lacking, the creditor is faced with starting the litigation over again in the state court, a significant price to pay for the marginal benefit of applying federal rather than state court procedures and timing in the action. These and numerous other factors need to be assessed by the creditor in determining whether the state or federal court forum is preferable if federal court jurisdiction exists.

### ***Where to Sue: Venue of Actions***

Venue is the place for trial of the action, the particular county in the state for the superior courts or the district for the federal district courts. Unlike improper subject matter jurisdiction, improper venue can be waived if not timely asserted. Venue requirements vary according to the kind of obligation sued upon. Usually, the debtor may be sued in the county where the debt was entered into, where one of the debtors resides or where the obligation is to be performed. If the lawsuit includes a claim to title of real property it should be filed in the county in which the real property is located.

Many loan documents and contracts, including workout documents, contain forum selection clauses and stipulated venue provisions. A forum selection clause is generally an agreement by the parties as to the *state* in which any litigation concerning the agreement should be commenced. These clauses are generally enforced. Under federal law, they are presumptively valid unless the party challenging the clause can show the clause was the product of fraud or overreaching, or the clause should not be enforced because enforcement would make trial of the action in the selected forum “seriously inconvenient” or would violate a strong public policy of the forum in which suit is brought.<sup>3</sup>

In contrast, a venue selection clause in a contract or agreement under California law, by which the parties agree in advance that the action should be commenced in a particular county or district, is generally declared illegal and void.<sup>4</sup> Agreements purporting to waive certain statutes providing for venue of actions in a particular site also are declared void by statute.<sup>5</sup>

## **Timing of Lawsuit**

### ***Statute of Limitations Periods***

The statute of limitations periods most applicable to commercial litigation are:

- *On a Written Contract*: Four years from the date of breach or last payment. If the debtor or guarantor waives the statute of limitations in writing, the statute may be extended for an additional four years.
- *Account Stated in Writing*: Four years from the last statement of the account.
- *Book Account*: Four years from the date of last payment.
- *Breach of an Oral Agreement*: Two years from the breach or date of last payment.
- *Common Counts Not Based on a Writing (e.g., Money Had and Received)*: Two years from the date the cause of action arises (e.g., from the date on which the debtor received the money).

### ***The Tolling of the Statute of Limitations***

The statute of limitations may be tolled, or extended, under certain circumstances (for example, if defendant leaves the state, petitions for relief in bankruptcy, or otherwise is unable to be sued or served with process). For some claims the statute of limitations does not begin to run (and therefore is in a manner tolled) until certain events have occurred. For example, the statute of limitations on fraud claims (three years under California Code of Civil Procedure Section 338(d)) does not begin to run until

the plaintiff discovered or should have discovered the facts giving rise to the claim. The statute of limitations on a legal malpractice claim typically does not begin to run until the later of (a) the date the attorney ceases representing the client in connection with the matter out of which the claim arises, and (2) the client suffers damage as a result of the malpractice.

### ***Waivers of the Statute of Limitations***

Under California Code of Civil Procedure Section 360.5, a party may waive the statute of limitations for a period not to exceed four years from (a) the date the original limitations period was to have expired, in the case of a waiver signed prior to the expiration of the original statute of limitations, and (b) the date of the execution of the waiver in the case of a waiver of the statute of limitations made after the expiration of the original statute of limitations. Statute of limitations waivers may be renewed for successive four-year periods under California Code of Civil Procedure Section 360.5. There is little case law construing this statute and in particular, what will be sufficient to meet the standard of the waiver being “in writing and signed by the person obligated.” For example, a problem may arise when the statute of limitations waiver is contained in one of several documents forming a single transaction, but the document containing the waiver is not itself signed by the “person obligated.” Since the statutory language is very similar to the language of California Code of Civil Procedure Section 1856 governing the statute of frauds, cases under that statute may provide analogous authority for determining the sufficiency of the writing and the signature of the party obligated.

## **Arbitration and Mediation**

### ***Mandatory Arbitration***

- *When Is a Case Subject to Mandatory Arbitration?* In an attempt to relieve some of the court congestion, a Mandatory Arbitration Program has been introduced in superior courts that have 10 or more judges and in other superior courts and municipal courts that have chosen to participate. The cases pending in superior courts that are subject to mandatory

arbitration are those in which the court determines the amount actually in controversy is \$50,000.00 or less, regardless of what the plaintiff asks for in his complaint. A plaintiff can also demand mandatory arbitration if he is willing to limit his award to a maximum of \$50,000.00. While awaiting arbitration, the creditor can go forward with discovery.

- *The Arbitration Hearing.* If a case is subject to mandatory arbitration, it will be heard in front of an arbitrator (who is usually an attorney or a retired judge). The arbitration hearing is, in essence, an informal trial.
- *Trial de Novo.* After the arbitration award, either party can demand a trial de novo (that is, a regular court trial) and the case is treated as though there had been no arbitration. There are limited sanctions against a party that demands a trial de novo and does not better his position as a result of the trial.
- *Advantages and Disadvantages of Mandatory Arbitration.* The benefits of mandatory arbitration are that declarations can sometimes be used in place of a personal appearance by the witness. The arbitration can also be used to flush out defenses, thereby serving as a discovery tool or as a prelude to a settlement.

On the other hand, the Mandatory Arbitration Program may require the parties to incur the expenses of preparing for trial and trying the case twice, once at the arbitration hearing and again at the trial de novo.

### ***Contractual (Binding) Arbitration***

Contractual arbitration arises where the parties to a contract or agreement have agreed to have any disputes arising under the agreement (or specified types of disputes or issues) resolved through arbitration. Arbitration in this instance is binding, and is subject only to limited judicial review and oversight. Arbitration agreements are strongly favored under California law and policy and will be enforced absent fraud or other grounds that would render a contract invalid or unenforceable. (California Code of Civil Procedure Section 1281). Under a California Supreme Court ruling, a party does not waive the right to demand the controversy be determined by arbitration merely by filing a lawsuit in court.<sup>6</sup>

The Arbitration Act is located at Section 1280 *et seq.* of the California Code of Civil Procedure. California Code of Civil Procedure, Section 1282 *et seq.* governs the conduct of arbitration proceedings. Unlike judicial arbitration, contractual arbitration proceedings are governed by broad and loose principles aimed at the arbitrator making an award based not only on legal principles, but also on “broad principles of justice and equity.”<sup>7</sup>

Consistent with the arbitrator’s broad equitable instruction and absent contrary agreement of the parties, the arbitrator may make his award based not only on information presented in the arbitration, but also on information obtained by him independently, so long as the arbitrator discloses the information that is outside the record and provides the parties an opportunity to respond to it.<sup>8</sup>

Subject to the parties’ right to agree to different rules or procedures, the arbitration proceeding is not subject to the usual right to conduct discovery in civil actions. There are specific provisions in the Arbitration Act governing the ordering of depositions (California Code of Civil Procedure Section 1283) and enforcing discovery obligations (California Code of Civil Procedure Section 1283.05). For example, in the absence of a contrary agreement of the parties, and except in personal injury tort claims, depositions can only be conducted with the approval of, and upon an order of, the arbitrator. The arbitrator and the parties have substantial freedom to determine how the arbitration proceeding will be conducted. The ordinary rules of evidence do not govern an arbitration, absent agreement of the parties to the contrary, just as ordinary judicial procedures for the conduct of trial are not applicable.<sup>9</sup>

An arbitration award has the effect of a contract between the parties until it is confirmed, corrected or vacated by a court order.<sup>10</sup> A party seeking confirmation of the award can file and serve a petition not less than 10 days, but not more than four years after the arbitration award is issued, and when confirmed, a judgment is entered that has the same force and effect as a judgment entered in any civil action.<sup>11</sup>

An arbitrator’s award is generally final and cannot be corrected or vacated unless the party seeking to vacate or correct the award can show one of the statutory grounds set forth in California Code of Civil Procedure Section 1286.2, including fraud, corruption, misconduct of the arbitrator or an award exceeding the arbitrator’s power. Two recent companion cas-

es decided by the California Supreme Court illustrate that even in the face of an error of law or fact that appears on the face of an arbitration award, the arbitrator's award is final and cannot be disturbed by the court.<sup>12</sup>

Although the trend for many financial institutions and others is to include mandatory binding arbitration provisions in their contracts, there are advantages and disadvantages to contractual arbitration. The sweeping and largely unbridled scope of information which the arbitrator can consider in reaching the result, the fact that the award need not necessarily be consistent with the outcome based on legal principles alone, and the fact that the rules of evidence and discovery are largely suspended in arbitration proceedings can create substantial risks of an award issued to meet the arbitrator's sense of "justice" under the circumstances, an outcome which might otherwise be outside the bounds of legal precedent. On the other hand, arbitration tends to be less costly, produces a more rapid remedy than traditional litigation through trial, and avoids the right to a jury trial, all of which can increase the expense, time consumption and risks associated with litigation.

### ***Mediation***

More and more courts are developing mediation programs by which neutral, third parties attempt to facilitate communication among the parties to assist them in reaching a consensual resolution of their disputes. Mediation may be particularly useful when the parties have an ongoing business relationship which they desire to continue. By statute, statements made during mediation and documents generated for the purpose of mediation are deemed confidential and cannot be disclosed in litigation or otherwise. Mediation can be an effective tool to resolve disputes without litigation or after litigation is commenced, particularly where both sides have a genuine desire to reach a settlement without trial and are receptive to "hearing" the other side's position through the mechanism of the mediator.

### **Jury Trial Issues**

#### ***Cost and Additional Pleadings Required***

In most cases, trial by jury is significantly more expensive because of the additional time required to select a jury, the additional fees incurred

to pay for the jury, the additional attorneys' fees incurred with respect to motions in limine and preparation of, and resolution of disputes over, jury instructions. Although motions in limine still may be filed in a court trial, those motions take on added significance with a jury because the jury is less able to disregard irrelevant evidence or evidence with limited legal significance in the scheme of the case than the judge.

### ***Effect on Order of Trial***

The right to a jury trial, the effect of a jury trial on the claims to be pled, and how the action might actually be tried should be considered by the party prior to filing litigation. When equitable and legal claims are joined together in one action, the equitable claims typically are not triable by a jury. Depending on the nature of the claims and the proof required, the court may determine to try the equitable, non-jury issues first, which may or may not be to the plaintiff's advantage, as it could be dispositive of the issues in the case. If the plaintiff wants to avoid a trial by jury and if there is a legitimate basis to include declaratory relief or other similar claim in the action, it may be to the creditor's advantage to include a declaratory relief cause of action and attempt to have that claim tried prior to the remainder of the suit.

### ***Waiver of Jury Trial***

On August 4, 2005, the California Supreme Court in *Grafton Partners v. Superior Court*<sup>13</sup> held that pre-dispute jury trial waivers are not authorized by statute and are therefore unenforceable under California law. The California Supreme Court based its decision on California statutory construction (Section 631 of the California Code of Civil Procedure) and a strict interpretation of Article 1, Section 16 of the California Constitution which provides a constitutional right to a jury trial. The California Supreme Court concluded that the Constitution permits jury trial waivers only when they are expressly prescribed by statute and that California Code of Civil Procedure Section 631 does not expressly authorize a jury trial waiver before the parties have submitted their controversy to a court of law. Prior to *Grafton*, such pre-dispute jury trial waivers were considered generally enforceable so

long as there was a knowing and voluntary waiver.<sup>14</sup>

As an alternative, many companies in California are utilizing the state's judicial reference procedure. Pursuant to California Code of Civil Procedure Section 638, it is provided that, among other circumstances, judicial reference is authorized "upon the motion of a party to a written contract or lease that provides that any controversy arising therefrom" a dispute can be "heard by referee if the Court finds that a reference agreement exists between the parties..." A judicial reference proceeding is, in substance, a court proceeding that will result in a binding judicial decision. The parties will give the referee the powers of a judge and the California Code of Civil Procedure and rules of evidence will apply. The judgment entered by the judge as a result of the referee's decision is fully subject to appellate review like any other judicial decision.

Whether an arbitration or a judicial reference applies, remedies such as writs of attachment, writs of possession (replevin), injunctive relief, appointments of a receiver will typically be carved out of the judicial reference or arbitration provision so that pre-judgment remedies can be awarded by a court since they will not be awarded by an arbitrator or referee.

## **PREJUDGMENT REMEDIES**

In certain situations the law provides a plaintiff with a means of tying up specific assets of a defendant prior to judgment in order to assure that those assets will be available to satisfy any judgment that may be entered. Such procedures, described herein, are attachment, writ of possession, and the appointment of a receiver.

### **Attachment**

Attachment is a method of placing a lien on the defendant's property prior to judgment. This method is a practice widely used in California, but not often permitted in other states. This is distinguished from an *execution*, which takes place *subsequent* to judgment. In certain instances a writ of attachment requires the property to be turned over to the sheriff during the proceedings so that there will be funds or property available for execution once judgment is obtained.

### ***The Requirements for Attachment***

Attachments are available against corporations and general and limited partnerships. They are also available against individuals but only on a claim that arises out of the conduct by the individual of a trade, business, or profession. Exactly what constitutes a “trade or business” is quite technical. A guarantor may or may not be subject to attachment depending upon the involvement of the guarantor in the particular business entity.

Attachment cannot be used on a claim against an individual for a debt incurred primarily for personal, family, or household purposes.

The only exception to the above rules is when the defendant on a claim for money is a non-resident; the defendant then may be subject to a special non-resident attachment procedure.

The requirements for attachment are:

- *Amount of the Debt:* The debt sued upon must be for a readily ascertainable sum over \$500 (exclusive of interest, attorneys’ fees, and court costs).
- *Nature of the Action:* The action against the defendant must be for breach of a contract, for money lent, for services rendered, or for some other breach of an express or implied contractual obligation.
- *Lack or Inadequacy of Security:* You may utilize the attachment remedy on a debt if it is unsecured at the time you attach, if the debt is secured, the attachment lien will be in the amount of the difference between the amount of the claim and the value of the security.
- *Real Property Security:* Likewise, you may also utilize the attachment remedy when the obligation was originally secured by real property when the real property has become valueless or decreased in value.
- *Property Subject to Attachment:* All corporate or partnership property is subject to attachment. For individuals engaged in a trade or business, a writ of attachment is restricted to inventory; accounts receivable, chattel paper and general intangibles arising out of a trade, business or profession in excess of \$150 each; bank accounts (with certain restrictions), securities; negotiable documents of title and in-

struments; equipment; final money judgments arising out of a trade, business or profession; and real estate. The defendant, however, can have the property released if he can convince the court that the attached property is necessary for his support and the support of his family or that it is exempt.

- *Bond (Undertaking)*: Before issuance of a writ of attachment or a temporary protective order, the plaintiff shall file an undertaking to pay the defendant any amount the defendant may recover for any wrongful attachment by the plaintiff in the action. The amount of the bond that the attaching plaintiff must file depends upon whether or not the attachment is sought in the superior court (presently a \$10,000 bond). Also, a defendant may make a motion to increase the amount of the bond if he feels his potential damage from any wrongful attachment may be greater than the statutory amounts.

#### ***Procedure for Obtaining an Attachment***

- *Noticed Hearing*: The normal procedure for prejudgment attachment is to notice a hearing on the application for attachment. This procedure is used when there is little demonstrative likelihood that the defendant will try to hide, conceal, or transfer his property between the time he is served with the notice of the hearing and the date of the hearing (normally 16 court days plus any extra time for service).
- *Attachment Without Notice (Ex Parte)*: It is always more desirable to obtain an immediate writ without notice, but that is very difficult unless the creditor can show that there is a substantial probability of sustaining great or irreparable injury because:
  - property is being concealed;
  - property is being substantially impaired in value;
  - a bulk sale notice is being published;
  - property is about to be conveyed; or
  - the defendant is not paying its bona fide undisputed debts as they become due.

- *Temporary Protective Order*: If an immediate writ of attachment cannot be obtained, the next alternative is a temporary protective order (“TPO”) restraining transfer of the property pending the hearing on the application for a writ of attachment.
- The TPO allows the defendant to continue his usual business and protects the creditor’s right to attach the defendant’s property if a writ of attachment is obtained at the noticed hearing. The service of the TPO creates a lien upon the property described in the order. However, the debtor can still transfer certain property in the ordinary course of business on a C.O.D. basis. But a TPO may impose appropriate restrictions on the disposition of the proceeds (the cash receipts) from such transfer. In addition to transferring property in the ordinary course of business, the defendant may still issue checks for C.O.D. goods, taxes, payroll, and legal fees.
- After the TPO is obtained it has to be served on the defendant and/or recorded on the property to obtain the restrictions imposed by the TPO. It is effective for 40 days after issuance of the Order unless the court makes a different ruling. In order for the lien to be valid, the hearing on the writ of attachment must take place before the TPO expires and the application for the writ of attachment has to be granted. Otherwise the TPO is dissolved and is of no force or effect. If the writ of attachment is granted, then its lien priority will relate back to the date of the levy of the TPO.

### ***Election of Remedies***

As noted above, attachment is available only in an action for breach of an express or implied contract. It is not uncommon for a complaint stating such a claim to also state an alternative claim for fraud. In such a situation, use of the prejudgment attachment procedures may result in a waiver of the fraud claim. The rationale is that the contract claim and the fraud claim are “inconsistent remedies” and the plaintiff can recover on only one of them. By obtaining a writ of attachment, available only on the contract claim, the moving party may be deemed to have “elected” to pursue the contract remedy and to have waived the fraud remedy.

If a writ of attachment is not obtained, both inconsistent remedies may be pursued. An election between the inconsistent remedies will not be required until it is time for judgment to be entered. Depending on the nature of the fraud cause of action, there may or may not be an election of remedies.

### ***Practical Applications and Problems***

- The remedy of attachment should not be used without knowledge of specific assets to attach and such assets are not exempt from attachment.
- The defendant always has the right to post a bond to prevent the writ of attachment from being levied. In essence, the bond replaces the attached property as a source of funds to satisfy any judgment that may be obtained.
- It is important to note that very few classes of property may be attached in an action against individuals engaged in a trade or business. (For example, automobiles and boats of an individual engaged in a trade or business are not attachable unless it can be shown that the vehicle or boat is actually used in the trade or business. Also, certain “tools of trade” are exempt.)
- The amount sought to be attached in an application for writ of attachment may be reduced by the court in an amount equal to any indebtedness that the defendant claims against the plaintiff in a cross-complaint or affirmative defense if the defendant’s claim is also one upon which an attachment could have been issued and the defendant has proven each element of the cross-complaint or the affirmative defense. Thus, in cases in which the defendant has a legitimate defense and/or claim against you, the amount sought in the application for writ of attachment may be reduced.
- After a writ of attachment has been issued against a corporation or partnership, it is possible to place a keeper in that business. A keeper should be considered particularly when the defendant has a retail business.

### ***Wrongful Attachment***

If the creditor fails to recover judgment against the defendant, he or she will be liable for any damages the defendant suffered as a result of the attachment. Therefore, careful consideration should be given before seeking a writ of attachment in a case in which the defendant has meritorious defenses.

Also, wrongful attachment could result from placing a lien on property that has a value greatly in excess of the amount due. Remember, the purpose of attachment is to assure the plaintiff that a source of funds will be available to satisfy the judgment, not to place undue hardship or pressure on the defendant.

### **Writ of Possession**

A secured creditor entitled to possession of property held by another may bring an action for recovery of the property and, to prevent the defendant from concealing or using the property, may request a prejudgment writ of possession. The cause of action in the lawsuit is known as Claim and Delivery and in most states other than in California it is called Replevin.

A writ of possession differs from a writ of attachment in that it allows a secured creditor to recover specific property that it either owns or has a lien on, while a writ of attachment places a lien on all the defendant's property which may be subject to an attachment and is not exempt.

### ***Obtaining the Writ of Possession***

- *Application:* The plaintiff must first apply for a writ of possession and support the application by declarations. The application must show the plaintiff's right to possession and the defendant's wrongful detention of the property. Also, it must describe how the defendant came into possession of the property, the location of the property, and, if in a private location, that there is probable cause to believe the property is at that location. The property must also not have been taken for a tax, fine or assessment or levied under a writ of execution.
- *Hearing on the Application:* Prior to the hearing, the defendant must

be served with a copy of the summons and complaint, a notice of application and hearing, and a copy of the application and any supporting declarations.

If the defendant opposes the plaintiff's application, he or she must either file a declaration that gives evidence sufficient to disprove the plaintiff's right to possession or post a bond to insure plaintiff's recovery in the event the plaintiff is awarded a judgment. The court bases its ruling on the application upon the pleadings and other documents in the record. Generally there is no oral testimony at such a hearing.

- *Writ of Possession Before the Noticed Hearing (Ex Parte)*: In “extraordinary circumstances” the court may issue a writ that entitles the plaintiff to immediate possession at anytime after the complaint is filed without a noticed hearing. The plaintiff must establish that (1) the defendant gained possession by felonious taking, such as theft (fraud or embezzlement is not enough); or (2) the property is a credit card; or (3) the property was acquired in the ordinary course of defendant's business and the property is in immediate danger of becoming either unavailable for levy, concealed, removed from the state or substantially impaired in value and is not necessary for the support of the defendant or his family.

It is difficult to obtain a writ of possession before the noticed hearing on the application.

- *Temporary Restraining Order*: Alternative protection to the secured creditor is a temporary restraining order (“TRO”) to restrain the defendant from transferring or concealing the property, or impairing its value, pending the hearing on the application for a writ of possession. A TRO will be granted without a noticed hearing if the plaintiff can establish the probable validity of its claim to possession and the probability that the property may become unavailable to levy or that it may be substantially impaired in value before the hearing.

The TRO fills the gap between the application for a writ of possession and the noticed hearing on that application (like the TPO in the attachment statutes).

It is easier to obtain a TRO than an ex parte writ, but the TRO is effective only if it is served on the debtor (although deliberate disobedience of the TRO may subject the defendant to being held in contempt of court).

- *Bond*: With an application for a writ of possession or a TRO, the plaintiff must provide a bond for twice the value of the defendant's interest in the property for which possession is sought. This is to protect the defendant if the plaintiff fails to obtain a judgment for possession of the property. If the defendant seeks to retain possession of the property, he or she may post a bond (redelivery bond) in the same amount as the plaintiff was required to post. The debt due to the plaintiff, however, constitutes a lien for bond purposes. Therefore, if the plaintiff is owed \$100,000 and the property has a value of \$50,000, since plaintiff is owed more than the value of the collateral, it will not have to post a bond. The redelivery bond for the defendant, however, must still be no less than \$50,000.

### ***Enforcement of the Writ of Possession***

- *Turnover Order*: After the hearing, if the court grants the application, it will issue a writ directing the levying officer to take possession of the property. The court may also issue an order directing the defendant to transfer possession to the plaintiff. This order informs the defendant that failure to turn over possession to plaintiff may subject defendant to being held in contempt of court. This order is used when the creditor knows the defendant has the property but does not know where it is located.
- *Levy and Custody*: On receipt of the writ of possession, the levying officer (a sheriff or marshal) must take custody of the property if it is in the possession of defendant or his or her agent. The levying officer, however, may not enter private premises unless that is specified in the writ. The levying officer may be a private process server appointed by the sheriff or marshal.
- *Possession Following Levy*: After the officer takes possession, he or she must keep the property in a secure place. The defendant may get

the property back by giving notice to the officer within 10 days after the levy that he or she has filed a redelivery bond. If the defendant does not file such an undertaking, the officer must deliver the property to the plaintiff upon payment of the fees for taking and keeping the property.

- *Order for Sale:* It is generally the rule that a plaintiff who gains possession under a writ of possession must keep the property for possible return to the defendant should the defendant ultimately prevail at trial. An exception is made if the plaintiff can show that the interests of both parties will best be served by immediate sale (e.g., when property is perishable or would greatly deteriorate or depreciate in value).

If the security agreement permits the creditor to sell the collateral by private action (and almost all security agreements have this type of provision), the creditor can immediately proceed to dispose of the collateral by a commercially reasonable method. If plaintiff is the owner of the property (for example with an equipment lease) then it also can dispose of the property.

### ***Liability If Plaintiff Fails to Obtain Judgment for Possession***

If the creditor fails to recover judgment, it must redeliver the property to the defendant and will be liable to the defendant for any damages the defendant suffered as a result of the levy of the writ or the loss of possession of the property.

### ***Problems with Writ of Possession***

If the plaintiff cannot describe specific property, then the sheriff or marshal will not levy on it. Therefore, if, for example, the plaintiff has a lien on all accounts or all inventory, this is not specific enough and the sheriff or marshal will not levy on this property.

Sometimes the levy takes a long time. Once the writ of possession is obtained the plaintiff is at the mercy of the levying officer to levy the writ of possession and it can take weeks to get the levy done. By that time, the property could be sold, transferred, concealed, or destroyed.

## **Business Receiver**

In certain situations, the court may appoint a receiver to take possession of a defendant's property. Depending on the circumstances of the case, the appointment of a receiver can be more effective than a writ of possession in protecting your collateral and may be less severe for a defendant than an order to turn over his equipment, inventory, or machinery pursuant to a writ of possession. Receivers may be used to go onto the premises to protect the property of the creditor where inventory, work in process, supplies, and/or equipment are being diverted or are about to be transferred, hidden, or sold. In addition, a receiver may continue to operate the collateral or encumbered property and secure the income generated by the operation or use of such property. A receiver may also be used to collect your accounts receivable collateral. A writ of possession is not effective to obtain accounts receivable or inventory and equipment that cannot be described.

### ***Availability of Remedy of the Appointment of a Receiver***

The availability of a prejudgment appointment of a receiver is governed by statute. The receiver may be appointed only in those situations specified in Section 564 of the Code of Civil Procedure. When the security agreement provides for the appointment of a receiver in the event of the debtor's default, the creditor may obtain the appointment of a receiver by making a claim for specific performance of that provision of the security agreement.

### ***Procedure for the Appointment of a Receiver***

The procedure for obtaining the prejudgment appointment of a receiver is similar to the procedure for obtaining a prejudgment writ of possession. The receiver may be appointed either upon ex parte application (without noticed hearing) or upon a noticed hearing. To obtain the appointment of a receiver upon an ex parte application, the creditor must show (by appropriate declarations) that if a receiver is not appointed immediately, there is a substantial danger that the defendant's assets will be depleted,

damaged, destroyed, or concealed before a noticed hearing can be held. Obtaining the appointment of a receiver ex parte (like the obtaining of any other prejudgment remedy ex parte) is difficult and requires a strong showing that some irreparable loss or injury will occur if the receiver is not appointed immediately.

If the ex parte application for the appointment of a receiver is granted, all the defendants must be served, and another hearing will be set for confirmation of the appointment of the receiver.

An alternative to the ex parte appointment of a receiver is the obtaining of a temporary restraining order upon an ex parte application, prohibiting the customer from transferring or concealing the property pending the noticed hearing on the application for the appointment of a receiver.

### ***Duties of the Receiver***

The receiver can do such acts with respect to the property as the court authorizes, including running the customer's business, opening mail, collecting accounts receivable, purchasing necessary insurance, etc. The receiver advises the post office to send all mail to him or her and makes reports to the court regarding the debtor's assets. Occasionally a receiver is used to aid in a foreclosure involving improved real property.

Because the receivership proceeding can be expensive, it should be thoroughly analyzed before it is instituted. In any case in which a secured creditor has significant collateral and believes that its collateral is endangered, however, the appointment of a receiver should be seriously considered as the most useful remedy available to protect the collateral.

## **POST-LITIGATION SETTLEMENTS**

### ***Stipulation for Entry of Judgment***

A stipulation for entry of judgment can also be an effective device to work out a defaulted obligation while providing the creditor an added measure of protection. Since the creditor already has commenced the action, judgment can be rendered forthwith if the debtor fails to abide by the stipulation. Typically, these stipulations provide that they will be held

unfiled pending default by the debtor in its performance under the stipulation, but that upon default, without cure, the creditor can file the stipulation and obtain judgment.

One issue that has been the subject of some controversy for creditors is the enforceability of “waive down” provisions versus “penalty” provisions in these stipulations. For example, a creditor may be willing to accept a lesser sum than is owed if it receives timely payments over a limited period of time but wants to preserve its right to recover the full debt if there is a default. The better drafting approach is to have the debtor stipulate to entry of judgment for the full amount due but provide that if the debtor performs under the payment plan, the creditor will deem the debt satisfied. An alternative approach, providing that the parties agree the debtor is to pay a lesser sum that will be increased *if* the debtor defaults, is more likely to be interpreted as an unenforceable penalty.

The stipulation for entry of judgment is a useful tool for documenting a stipulation reached after litigation has commenced.

The objective in negotiating stipulations for judgment is to include all, or as much as possible, of the principal, interest, costs, and attorneys' fees. Generally, a stipulation for judgment will contain the following kinds of provisions:

- A down payment (for as large a sum as can be negotiated).
- A payment plan for the balance of the obligation, with regular (preferably monthly) payments. The amount and frequency of the payments may correspond to the amount and frequency of the payments called for in the original obligation. But if the payment schedule is made too harsh, the defendant may default for the same reasons it defaulted on the original obligation.
- If the defendant defaults on the stipulation, the creditor can obtain an immediate entry of judgment without further defense and delay, and then execute on the judgment.
- Once the defendant has complied with all the terms of the stipulation, the complaint will be dismissed “with prejudice.”
- Interest on the outstanding obligation during the payment period

should be at least equal to the contract rate of the original note.

- Naturally, the precise terms of any stipulation for entry of judgment will depend on the circumstances of each case and will be arrived at by negotiation among the parties and/or their attorneys.

### ***Advantages of the Stipulation for Entry of Judgment***

- It reduces the costs and attorneys' fees that would otherwise be incurred in protracted litigation.
- It provides a mechanism for either the immediate entry of judgment or the prompt entry of judgment if the defendant should default on the agreed-upon payment plan.
- It puts an end to the litigation, which often may include a cross-complaint against the creditor.
- The delay of trial is avoided.
- The settlement and stipulation for entry of judgment give the defendant a fair and reasonable way of gaining credibility, maintaining credit ratings or avoiding bankruptcy.

## **SELECTED POST-JUDGMENT ENFORCEMENT ISSUES AND PROCEDURES**

Once the creditor has obtained a judgment, the problem becomes finding and executing on assets of the judgment debtor to satisfy the judgment.

### ***The Money Judgment***

The judgment should clearly and accurately reflect identified and all known dba's for judgment debtors. Payment terms (e.g., whether the judgment is joint and several) should also be spelled out. Los Angeles County Local Rules 3.0 contain specific guidelines regarding the preparation, submission and entry of judgments. Judgments should be drafted to avoid a double recovery. For example, if A and B owe \$50,000 jointly and severally, and B separately owes \$25,000, the judgment should not be

against A for \$50,000 and against B for \$75,000. This constitutes a double recovery. Judgment should be against A and B for \$50,000 and against B alone for \$25,000.

Judgments have a duration of 10 years, but are subject to extension for successive 10 year periods under Code of Civil Procedure Section 683.120.

### ***Obtaining a Writ of Execution***

A writ of execution issued by the court and directed to the levying officer is required for commencement of the levy process on a money judgment. Creditors must file with the clerk of the court a separate application for issuance of a writ of execution, including an affidavit regarding interest in order to obtain issuance of a writ of execution.

### ***Perfecting Judgment and Other Enforcement Liens***

A lien on certain types of personal property, such as accounts receivables, equipment and inventory, may be immediately perfected by filing a "J-1," Notice of Judgment Lien form with the secretary of state.<sup>15</sup> The judgment lien so created is valid for five years and may be renewed for successive five year periods.

An immediate lien on all real property interests of the judgment debtor in a particular county (i.e., fee, leasehold, easement or other real property interest) may be created and perfected by recording an abstract of judgment in the county recorder's office. The abstract should be recorded in any county where the judgment debtor owns real property, resides, does business, or is otherwise present. The judgment lien on real property is valid for 10 years but may be renewed.

Other types of judgment liens are created by various other means. For example, a lien on all personal property of the judgment debtor is created by the service of an order to appear at a judgment debtor exam.<sup>16</sup> In *In re Hilde*,<sup>17</sup> the Ninth Circuit held that the ORAP lien created by service of the judgment debtor examination order requires no further "perfection" steps to establish the creditor's lien priority on all nonexempt personal property of the judgment debtor. The lien is effective for one year from date of service.

Another type of lien, an "execution lien," is created by execution under

a writ of execution. Enforcement liens are cumulative in nature, that is, they relate back for priority purposes to the earliest lien perfected which is still in effect on a particular type of property. For example, an execution lien on a particular piece of personal property will relate back to the filing of a “J-1” with the secretary of state, which, in turn, will relate back to any earlier attachment lien (or even a temporary protective order lien) still in effect.

### ***Sales of Dwellings***

Because the potential displacement of a person from his or her home is at stake, special — and often cumbersome — procedures apply with regard to the sale of a dwelling. The term “dwelling” is defined to be: “A place where a person resides,” including but not limited to a “house,” “mobile home,” “boat,” “condominium.”<sup>18</sup> The purpose of these special procedures is to ascertain whether the dwelling is subject to a homestead exemption, and, if so, a special sale order must issue. Promptly after the dwelling is levied on, the judgment creditor must apply to the court for an order of sale. The contents of the application are specified in California Code of Civil Procedure Section 704.760.

### ***Securities***

If the securities are “certificated” and in the judgment debtor’s possession, the levying officer will take the securities into custody. Other certificated securities are levied on by service of a writ of execution and notice of levy on third person (i.e., broker or financial institution) in possession of the securities.<sup>19</sup> If the securities are “uncertificated,” a garnishment levy effected by service on the party in whose name the security is registered (e.g., judgment debtor, broker, escrow holder, etc.) is the proper enforcement mechanism.<sup>20</sup>

### ***Wage Garnishments***

The Wage Garnishment Law is the exclusive judicial method for compelling an employer to withhold an employee’s earnings to satisfy a non-support judgment.<sup>21</sup> The service of an earnings withholding order

creates a lien upon the judgment debtor's earnings required to be withheld during the withholding period, and all the employer's property is subject to enforcement of a money judgment in an amount equal to the amount that has been withheld. The duration of the lien continues for one year from the date the judgment debtor's earnings became payable.

In addition to levying on the judgment debtor's wages, an earnings withholding order may also be issued against the judgment debtor's spouse; however, an order will only be granted upon noticed motion.

The maximum amount that may be withheld by the employer for any work week may not exceed the lesser of 25 percent of the employee's disposable earnings for that week, or the amount by which the disposable earnings for the week exceeds 30 times the federal minimum hourly wage. Notwithstanding the fact that the withholding may not exceed the maximum of 25 percent of an employee's disposable income, the debtor may file a claim of exemption, claiming that all or a portion of the withheld funds be released to him on the basis that the employee's earnings are necessary for the support of the judgment debtor or his or her family.<sup>22</sup>

### ***Claims of Exemption***

As indicated above, an employee's earnings necessary for the support of the judgment debtor or his or her family are exempt from an earnings withholding order. To obtain the benefit of this exemption, the judgment debtor must file a timely claim of exemption with the levying officer. If the judgment creditor fails to oppose the claim of exemption, the exemption is automatically granted and the earnings must be released. Necessaries of life are defined as essentials commonly required by all persons for the sustenance of life, whatever their employment status.

### ***Charging Orders***

Charging orders are obtained by making a motion to the court. Charging orders are used by the judgment creditor to allow a creditor to reach a judgment debtor's interest in a partnership or limited liability company. When granted and properly served on an appropriate managing agent for the partnership or limited liability company, the charging order entitles the

creditor, subject to any claims of exemption, to receive all distributions of assets of the partnership or limited liability company to which the judgment debtor is entitled. The procedure is an enforcement procedure, but is not considered an execution procedure.

Charging orders may be combined with a motion for appointment of receiver to collect judgment debtor's share of partnership proceeds.

The service of a motion for charging order creates a lien on the judgment debtor's interest in the partnership which is the subject of the motion. The charging order does not result in a sale or liquidation of the partnership, but merely creates a right of collection of all distributions attributable to judgment debtor's partnership interest. If monies collected are insufficient, however, the creditor may apply for an order for sale of judgment debtor's partnership or limited liability company interest.

### ***Judgment Debtor Examinations***

In order to assist a judgment creditor in identifying and locating assets possibly subject to levy, the California Code of Civil Procedure provides a full panoply of discovery rights to a judgment creditor, including oral depositions, inspection rights, and written interrogatories.

Service of the examination order creates a blanket lien on all non-exempt personal property of judgment debtor. The judgment debtor examination is generally held in the court where judgment was issued.

An order for examination is obtained by submission of a written application (on ex parte basis if necessary) to the court which issued the judgment. Judgment debtor examinations may not be taken more frequently than once every 120 days, although the court has discretion to permit an earlier examination based on a showing of "good cause."

The judgment creditor may also examine third persons who possess or control property of the judgment debtor or who owe a debt to the judgment debtor in excess of \$250.

### ***Keeper***

- *What Is a Keeper?* A keeper is an individual deputized by the sheriff or marshal and authorized to take custody and control of the defendant's assets and/or personal property.

- *When Is a Keeper Used?* To levy upon tangible personal property of a going business, the judgment creditor may have the sheriff or marshal take immediate possession of that personal property. Alternatively, the judgment creditor also has the right to request the sheriff or marshal install a keeper in the business while the business continues to operate. The creditor has one objective in mind by installing a keeper in a place of business: to get paid off. If the defendant owns a “going concern,” the chances are that once he sees the keeper he will make immediate arrangements to pay off his obligation to the creditor. The longer the keeper remains, the greater the expenses incurred by the debtor.
- *Operation of Business Under Levy:* When a keeper has been placed in charge of a business under execution, the defendant-owner must be permitted to continue to operate in the ordinary course of business, at its own expense, provided that all sales are for cash or its equivalent and the full proceeds are given to the keeper for the purposes of the levy, unless otherwise authorized by the creditor. The cash and/or proceeds are subsequently turned over to the plaintiff by the sheriff/marshal as payment on the judgment.

When a judgment debtor continues to operate while the keeper remains at its place of business, monies received by the keeper may not be used to pay the wages of the debtor’s employees. Also, any reordering of materials or supplies cannot be paid for from the monies received by the keeper.

When a keeper is placed in a going business, the keeper should immediately take a detailed inventory of the property executed upon, including a detailed inventory as to fixtures, furniture, equipment, machinery, etc. Inquiry should be made of the debtor or someone familiar with the business as to whether any of the above are covered by security agreements or contracts, in which case the name of the secured creditor should be obtained, if possible. A general inventory should be taken as to stock-in-trade, supplies, finished goods, etc. If property is to be moved to storage or sold, a detailed inventory should be taken at that time. As soon as the first inventory is taken, a copy is mailed to the creditor’s attorney.

- *Levy on Place of Business:* After the keeper has been in charge of the property for no more than 10 days, the levying officer is required to take the property into his immediate possession.

### ***Other Miscellaneous Remedies for Collection of a Judgment***

- *Motions for Turnover Orders:* If the creditor is aware that the creditor judgment debtor has a valuable piece of personal property which the creditor would like to execute on but is unable to locate because the property is being hidden, the creditor may make a motion to the court for an order that the judgment debtor turn over the property to the marshal and/or sheriff for levy. In addition, the creditor also has the right to apply to the court for an order that the sheriff and/or marshal be given authority to enter a building or a private place in order to obtain possession of property.
- *Obtaining a Lien on a Lawsuit Which the Judgment Debtor Has Filed Against a Third Party:* If the creditor is aware that the creditor judgment debtor has filed a lawsuit against a third party which may result in a money recovery to the judgment debtor, the creditor can obtain a lien on that lawsuit preventing the judgment debtor from compromising, dismissing, or settling the pending action without prior court order or creditor-written consent by filing and serving a Notice of Lien in the lawsuit, along with a certified copy of the creditor judgment against the judgment debtor.
- *Assignment Orders:* Certain types of income of a judgment debtor are very difficult to levy on using a writ of execution. These include rents, commissions, royalties, payments due from patents, copyrights, or wages due from the federal government. If the creditor is aware that the creditor judgment debtor is receiving income of this type, the creditor can make a motion for an order requiring the judgment debtor to turn over that income to the creditor when and if it is received. This motion is also an ideal procedure to collect judgments where the judgment debtor does not receive wages on a regular basis from his or her employer.

- *Reaching the Judgment Debtor's Interest in a Trust:* If the creditor is aware that the creditor judgment debtor has an interest in a trust, the creditor may apply to the court administering the trust for an order authorizing the judgment debtor's interest in the trust to be applied in satisfaction of the creditor judgment. The court is given broad power to fashion an appropriate method for satisfaction of the creditor judgment in this situation. Please note, however, that this motion procedure does not affect the validity of a spendthrift provision in a trust instrument. If the judgment debtor retains the power to revoke the trust, the creditor may also seek an order from the court directing the sheriff and/or marshal to execute on property standing in the trust's name.

In addition, the creditor may also apply to the court for an order applying the contingent remainder interest, executory interest, or any other interest of the judgment debtor in property that is not vested in the judgment debtor in partial satisfaction of the creditor judgment. The court is also given broad power to fashion an appropriate order in this situation.

### ***Debts Secured by Collateral Other Than Real Property***

- *Summary of Rights to a Deficiency Judgment:* When a debt is secured by collateral other than real property (i.e., personal property), the creditor may repossess and sell its collateral and still obtain a deficiency judgment against the debtor and any guarantor if the following conditions are met:
  - The debt is not a consumer retail installment contract account, and
  - The collateral is sold in a commercially reasonable manner, in strict compliance with the notice provisions of the applicable laws.
- *Sale of Collateral Under the California Commercial Code:* The sale of repossessed collateral not subject to the Unruh Act or the Rees-Levering Act is governed by Division 9 of the California Commercial Code. Under the California Commercial Code, the creditor may sell

repossessed collateral at either a private sale or a public sale, provided that the following conditions are met:

- Notice of Sale. Proper written notice of the sale must be sent to all persons liable on the obligation (including the debtors, co-signers, and guarantors) and to all persons who have informed the creditor that they are claiming a security interest in the collateral. Notification requirements are set out in California Commercial Code §9611.
- Commercial Reasonableness of Sale. The creditor's sale of the repossessed collateral must be made in good faith and in a commercially reasonable manner. A commercially reasonable manner means that the creditor obtains genuine bids, accepts the highest bona fide bid, and conducts the sale fairly under the circumstances. The creditor may advance costs prior to the sale to repair or preserve the collateral, if it is reasonably anticipated that the advances are likely to increase the amount received for the collateral upon sale in an amount higher than the amount of the advances. If such advances are made, the creditor may recover the amount of such advances from the sale proceeds.

The fact that a better price could have been obtained by sale at a different time or place, or by a different method of sale, is not, by itself, sufficient to establish that the sale was not made in a commercially reasonable manner. Also, a sale that is approved by any judicial authority is conclusively presumed to have been commercially reasonable.

## NOTES

<sup>1</sup> The substance of this article is based in part on California law and may be different in other jurisdictions.

<sup>2</sup> See generally, *Bloom v. Bender* (1947) 48 Cal. 2d 793).

<sup>3</sup> See *Jones v. GNC Franchising, Inc.* (2000) 211 F.3d 295.

<sup>4</sup> *General Acceptance Corp. v. Robinson* (1929) 207 Cal. 285 (but see *Smith, Valentino & Smith, Inc. v. Superior Court of Los Angeles County* (1976) 17

Cal. 3d 491, criticizing *General Acceptance Corp. v. Robinson*).

<sup>5</sup> See California Code of Civil Procedure (“CCP”) Section 395(d).

<sup>6</sup> *Doers v. Golden Gate Bridge, Highway & Trans. Dist.* (1979) 23 Cal. 3d 180.

<sup>7</sup> *Noguiero v. Kaiser Foundation Hosp.* (1988) 203 Cal. App. 3d 1192.

<sup>8</sup> Code of Civil Procedure Section 1282.2(g).

<sup>9</sup> Code of Civil Procedure Section 1282.2.

<sup>10</sup> Code of Civil Procedure Section 1287.6.

<sup>11</sup> Code of Civil Procedure Sections 1288, 1288.4, 1287.4.

<sup>12</sup> See *Moshonov v. Walsh* (2000) 22 Cal. 4th 771 (in which the arbitration award did not award attorneys’ fees to the prevailing parties despite the undisputed existence of applicable contractual attorneys’ fees provisions).

<sup>13</sup> 36 Cal. 4th 944 (2005).

<sup>14</sup> See *Trizec Properties, Inc. v. Superior Court* (1991) 229 Cal.App.3d 1616).

<sup>15</sup> Code of Civil Procedure Section 697.530.

<sup>16</sup> Code of Civil Procedure Section 708.110(d).

<sup>17</sup> 120 F.3d 950 (9th Cir. 1997).

<sup>18</sup> Code of Civil Procedure Section 704.710.

<sup>19</sup> Commercial Code Section 8317.

<sup>20</sup> Commercial Code Section 8317.

<sup>21</sup> Code of Civil Procedure Section 706.020.

<sup>22</sup> Code of Civil Procedure Section 706.051(a)(b)(c) *infra*.