

12/811

#39.240

11/24/76

First Supplement to Memorandum 76-72

Subject: Study 39.240 - Enforcement of Judgments (Third Party Claims)

We have received a memorandum from Professor Riesenfeld, the Commission's consultant on creditors' remedies, that deals with the staff draft of the third party claims procedures. The draft sections are attached to Memorandum 76-72 as Exhibit I. Professor Riesenfeld's memorandum is attached hereto as Exhibit 1. This supplementary memorandum proposes to revise several sections set forth in Exhibit I to Memorandum 76-72 in response to Professor Riesenfeld's memorandum.

§ 706.010 (c). Definition of "third person"

Professor Riesenfeld comments that subdivision (c) which defines "third person" is "somewhat meaningless." (Exhibit 1, p. 2.) The reason it is included is to emphasize the change from existing law which provides separate procedures for secured parties and other third persons. The definition could be omitted without serious consequence.

§ 706.110. Manner of making third party claim

Professor Riesenfeld states that this section is too broad and should be limited to third party claims asserting superior interests. (Exhibit 1, p. 2.) The staff agrees and would revise the first portion of Section 706.110 as follows:

706.110. A third person may claim an a superior interest in any personal property that has been levied upon under a writ of execution by serving upon the levying officer a verified written claim, together with a copy thereof, which contains all of the following:

.....

Comment. Section 706.110 is based on part of the first paragraph of former Section 689 and the first sentence of subdivision (2) of former Section 689b. Section 706.110 permits any person claiming an a superior interest in the personal property levied upon to use the procedure provided by this chapter. Under former Section 689, the claimant had to show title and right to possession. See Palmquist v. Palmquist, 228 Cal. App.2d 789, 39 Cal. Rptr. 871 (1964) (attaching creditor could not use third party claim procedure). Under Section 706.110, any interest that is

superior to that of the judgment creditor may be claimed, including title, right to possession, a security interest under a security agreement, and a judicial or statutory lien.

. . . .

§ 706.120. Demand to judgment creditor for undertaking or deposit

Professor Riesenfeld states that Section 706.120(a)(2) should be consistent with Section 706.110(b). To accomplish this, we propose to revise both provisions:

706.110. . . .

(b) A statement of the reasonable value of the interest claimed ~~or which~~, in the case of a security interest, a ~~statement of~~ is the total amount due to the secured party under the security agreement with interest to date of tender.

. . . .

706.120. (a) . . . .

(2) A demand ~~for either the amount of the that the judgment creditor elect either~~ (i) to pay the reasonable value of the interest ~~claimed~~ stated in the claim plus interest due to the date of tender or (ii) to give an undertaking as provided in Section 706.170.

. . . .

§§ 706.130(b), 706.160, 706.290, 706.410, 706.440

Professor Riesenfeld proposes several technical changes in these sections relating to release of levy and custody in which the staff concurs. (Exhibit 1, pp. 4 and 5.)

Determination and payment of amounts not yet due to a secured party

Professor Riesenfeld also recommends that the procedure permit the determination of the total outstanding indebtedness secured by the property, and that the judgment creditor be afforded the right to pay off the entire interest, subject to any prepayment penalties. (Exhibit 1, p. 4.)

The staff agrees that it would be useful for the claim to state the amount not yet due but to become due, if for no other reason than that the execution purchaser should be able to know what he is buying.

Providing the judgment creditor with the right to compel the secured party to accept payment for his entire interest appears more

complicated. We could provide that the judgment creditor could pay off the entire amount if the security agreement provides for prepayment. The judgment creditor would have to pay any prepayment penalties. But, in the absence of a stipulation (which the statute need not provide for) or a right to prepayment in the security agreement, it appears somewhat unfair to the secured party to set up a statutory procedure for discounting the obligation and forcing him to accept such amount. What discount rate would be used? Does the Commission wish to pursue this possibility?

Third party claims in examination proceedings

Professor Riesenfeld recommends that the third party claims procedure be extended to cover the situation where a third party claims superior rights in an examination proceeding. (Exhibit 1, pp. 2-3.) As presently drafted, Section 705.160 provides that, if the third person denies the debt or claims an interest in property adverse to the judgment debtor, the court may not determine the respective interests in the property in order to achieve an early resolution of the dispute. Instead, it is contemplated that, if the judgment creditor wishes to pursue the matter, he will bring a creditors' suit against the third person. As Professor Riesenfeld notes, several states permit the court to determine the respective interests in the property in the supplementary proceedings--even as to real property in some jurisdictions. The staff agrees that this would be a beneficial change. If the Commission approves, we will draft a provision that requires a third person who claims superior rights in examination proceedings to make the sort of specific third party claim prescribed by Section 706.110.

Respectfully submitted,

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Staff Counsel

EXHIBIT 1

Comment on Memorandum 76-72

(Third-Party Claims)

by

Stefan A. Riesenfeld

Consultant

The Third-Party claim procedure as currently part of California Law is in need of revision because the language of the controlling provisions as well as their rules are in part obsolete in view of the adoption of the U.C.C. which consolidates all consensual security interests in personal property and specifically provides for the involuntary transferability of the debtor's rights in collateral by attachment, garnishment or other judicial process under Cal. U.C.C. 9-311, subject to default provisions in the security agreement. Under the U.C.C. purchasers at execution sales are not buyers in the ordinary course of business, Cal. U.C.C. 9-201(9) and not protected by Cal. U.C.C. 9-307.

Although the third-party claims sections, C.C.P. §§689 and 689b, relate to levies under a writ of execution, they are applicable to levies of attachments under operating or suspended new statutes. See C.C.P. 549 and suspended §§488.090, 488.020c. Because of their checkered history, §§689 and 689b are subject to curious gaps, unnecessary burdens and doubts as to their effects.

I.

Scope: Need for Expansion

At present C.C.P. 689 applies to "claims of title and right of possession" and 689b to "claims of conditional sellers and chattel mortgages."

Claimants of priority under statutory liens or liens by judicial process cannot invoke the procedures under 689, Palmquist v. Palmquist, 228 C.A.2d 789, 39 Cal. Rptr. 871 (1964). This of course does not mean

that they have not other remedies such as injunctions, declaratory judgment proceedings, trover, etc. Even C.C.P. §689 does not require resort to it by claimants protected thereby but permits reliance on other remedies, Retailers' Credit Ass'n of Sacramento v. Superior Court of Glenn County, 19 C.A.2d 457, 65 P.2d 937 (1937), Commercial Credit Plan, Inc. 276 C.A.2d Supp. 831, 80 Cal. Rptr. 534 (Super. Ct. Alameda, App. Dep.).

A) I agree with the staff that the consolidation of Sections 689 and 689b, as well as their extension to statutory and judicial liens is desirable. I am not satisfied, however, with some of the proposed language.

Third-party claim procedure should be available to a party who claims superior rights in the personal property levied upon, such superior rights including superior rights to possession or to the sale and satisfaction from the proceeds of the property. §706.110 ("any interest in the personal property levied upon" seems too broad); §706.010(c) seems to be somewhat meaningless.

I would say in §706.110:

"A person may claim a superior interest in any personal property."

I would define superior interest as "including title or other right to possession, security interest under a security agreement and liens by judicial proceedings or applicable provision of law."

B) I would recommend consideration of the question whether the availability of the third party claim procedure should be extended to supplementary proceedings. §705.160 (Memorandum 76-72) does not envisage claims by third parties other than persons indebted to or holding property of the judgment debtor. Present law does not permit third party claims under §689 or 689b in supplementary proceedings because of constitutional doubts. Since the procedure has been upheld as constitutional in case of a levy, see Rauer's Law and Collection Co. v. Higgins, 95 C.A.2d 483, 213 P.2d 45 (1950), there are no reasons why similar steps should not be permitted if a third party chooses to claim superior rights in supplementary proceedings. If the supplementary proceedings

implement a post-judgment levy, §§689 and 689b are applicable by their very terms. Why should the same procedure not be applicable if the judicial lien is obtained by supplementary proceedings? A number of jurisdictions now permit such proceedings, see Riesenfeld, Creditors' Remedies and Debtors' Protection (2d ed. 1975) p. 277 fn. 9 and Note 1, p. 289 (Florida, Indiana, Maryland, Michigan, New York, Oklahoma, Washington).

## II

### Rights and Duties of Subordinate Creditor

If the interest claimed is ownership of the personal property levied upon or a right to possession under a lease or bailment, the creditor has no right to sell the property in defiance of such interest. If the property is leased to the third party claimant but not yet delivered, the judgment debtor's rights as lessor (which may be chattel paper if the property was inventory) should be subject to an execution sale.

If the claimed interest is a lien or security interest, the determination of the amount of the debt so secured will become material. Under the terms of C.C.P. §689b the claim must state "the sums due or to accrue, above set-offs with interest to date of tender" and upon payment of that amount (and only upon the payment of that amount) the property will be sold free of all liens and claims of the third party claimant, §689b(8). In other words, the creditor must pay the whole amount of the debt whether due or not. This goes beyond the redemption rights of lienors under CC §2904 which accrue only upon maturity of the secured debt. Moreover, it may be inconsistent with U.C.C. §9-311 and therefore repealed by implication.

The staff proposes that the levying creditor is only bound to pay what is due at the time of the making of the claim. While this may be the whole debt if the agreement contains an acceleration clause, difficulties may arise if no portion of the debt is in default and the levy does not constitute a default under the governing agreement. I agree with the proposal that the levying creditor should no longer be under a duty to pay what is not due but that still leaves two further issues:

(a) Should the creditor have a right to a determination in summary proceedings of the total outstanding indebtedness secured by the property?

(b) Should he have the right to pay it off in toto, subject to prepayment charges, if validly stipulated or discounted to the present in the absence of a governing agreement?

1) In my opinion the third party claim procedure, whether initiated by the third party (§706.110) or by the levying creditor (§706.310), should also determine the total amount secured since the execution purchaser has a legitimate interest in such determination. The reasonable value of the interest (equity) sold depends on the value of the remaining third party interest. (In my opinion §706.120(a)(2) is not properly drafted and should track with §706.110 b.)

2) I would even answer issue (b) in the affirmative.

There are other points which are bothersome. If the property secures a debt which is partly due and partly not due, what are the relative priorities after subrogation? §706.140(b) is not clear on that issue. Under former law this problem did not exist. Moreover the levying creditor should be entitled to pay off the debt and be subrogated to the portion of the debt paid and to the security if the value of the collateral exceeds the total debt. §706.140(b) is either too broad or misleading. Cf. Potter v. Solk, 161 C.A.2d 870 (Super. Ct. App. D. 1958).

### III

#### Effect of Non-Compliance

§706.130(b), §706.160 and §706.290 deal with release and relevy.

The current statutes use varying language. §689 par. 3 speaks of "release the property and the levy," §689 par. 8 speaks of release of "the property of the levy" and provides for "retake or levy," if the creditor ultimately prevails. §689b(4) refers only to "release of the property" and §689b(10) envisages "retaking" of the property under an extant writ or a new writ. The difference in language between §689 and §689b is due to the amendment in 1957 which extended the third party

claims procedure of §689 to levy on intangible property and apparently also meant to overrule the suggestion in a prior case to the effect that the release of the property taken still left it subject to an equitable lien effective against the debtor's trustee in bankruptcy.

I recommend (a) that §706.130(a) should use the words "release the levy and the custody of the property where it is not held under another levy," (b) that §706.160 should speak of "release of the custody of the property" and (c) that §706.290 should remain restricted to re-levying instead of re-taking (as proposed). (d) I recommend, however, that a new writ should always be required, if the return day has expired, provided we keep the present system that after return day a writ is functus officio. The present system of §§689 and 689b create an unnecessary exception.

§§706.410 and 706.440 should be changed to conform to the suggestions relating to §§706.130(b) and 706.190.