Memorandum 94-32

Miscellaneous Debtor-Creditor Issues

The Commission has received several suggestions for revision of creditors' remedies statutes not directly related to the study of exemption amounts or attachment — the subjects specifically required to be reviewed this year. If the Commission sponsors a debtor-creditor bill in the 1995 legislative session, it would be an appropriate vehicle for dealing with any other issues approved by the Commission. It would also be possible to find another bill, such as a committee omnibus bill, as a vehicle for minor and technical amendments.

PERIOD OF ENFORCEABILITY AND RENEWALS OF FAMILY CODE JUDGMENTS

The following issues concerning enforceability of judgments under the Family Code were presented in Memorandum 94-25, considered in part at the May meeting, but were continued for further consideration.

Background

Frieda Gordon, a Los Angeles attorney who assisted the Commission during the Family Code project, has raised an issue that is bothering the family law bar. The sections involved were enacted on Commission recommendation, so Commission attention to the matter is appropriate, although the problem derives from other amendments made in recent years by other interests.

When the Enforcement of Judgments Law was enacted in 1982, it established a 10-year period of enforcement for money judgments and judgments for possession or sale of property. (See generally, Code Civ. Proc. §§ 683.010-683.620, as enacted by 1982 Cal. Stat. ch. 1634, § 2.) This 10-year period was not tolled for any reason and when it expired the judgment became unenforceable. However, the judgment was renewable by a simple procedure for filing an application for renewal with the court and giving notice and an opportunity to the debtor to petition to vacate or modify the renewal. In addition, the statute preserved the ancient right to bring an action on the judgment subject to the 10-year rule of Section 337.5 and its exceptions and tolling features.

In the case of money judgments payable in installments, the 10-year period of enforceability and the renewal scheme treated each installment as if it were a judgment entered on the date the installment fell due.

This structure was intended to provide certainty as a foundation for the various enforcement procedures. It was intended to eliminate the doubt about when a judgment or part thereof was enforceable and to regularize the process of determining how much was still owing on a judgment.

This scheme was not applied to judgments enforceable under the Family Law Act. (See Code Civ. Proc. § 683.310, as enacted by 1982 Cal. Stat. ch. 1634, § 2.) The Enforcement of Judgments Law did not affect the rule in family law that the court has discretion as to the manner of enforcement of judgments. (See former Civ. Code. § 4380). However, some of the benefits of the new scheme in the Enforcement of Judgments Law were extended to the Family Law Act by providing that judgments for child or spousal support were enforceable by a writ of execution without the need for a court order if the payments were not more than 10 years overdue. After 10 years, overdue support payments were enforceable only in the court's discretion, and lack of diligence was to be considered in determining whether to permit enforcement. (See former Civ. Code §§ 4383-4384, as enacted by 1982 Cal. Stat. ch. 497, §§ 15, 16.)

Revisions of the Original Scheme

In 1986, Section 4384.5 was added to the Civil Code providing that a judgment for child or spousal support could be renewed by application under the general procedures in the Enforcement of Judgments Law. This section, not sponsored by the Commission, created the situation whereby the Enforcement of Judgments Law provided that the general rules did not apply to the Family Law Act and the Family Law Act provided that they did apply to enforcement of child or spousal support.

In 1987, Civil Code Section 4383 was amended to permit enforcement of child or family support through execution without prior court approval until five years after the child reaches the age of majority and thereafter for amounts not more than 10 years overdue. The 10-year rule was retained for enforcement of spousal support by a writ of execution.

The Family Law Act had a hybrid system. The 10-year rule was no longer related to enforceability and renewal requirements, but only served as a limitation on the discretion of the court, making enforcement by writ of

execution a procedural right for amounts not more than 10-years overdue (or more in the case of a child and family support involving a child age 23 or less). Amounts more than 10-years overdue continued to be enforceable in the court's discretion without any renewal requirement.

It should also be noted that the renewal scheme in the Enforcement of Judgments Law as applied to judgments for possession or sale also did not apply to such judgments made under the Family Law Act.

The situation changed dramatically in 1992 when Civil Code Section 4384.5 was replaced by a new rule that judgments for child or spousal support or for arrearages are completely exempt from any renewal requirement and are enforceable until paid in full.

Current Law

The Commission took this law as it existed and reorganized it in the process of creating the Family Code. As the Commission will recall, the Family Code project was not directed toward substantive revision. The operative principal was to take existing rules into the new code structure, making only technical changes or necessary substantive revisions required to resolve inconsistencies.

The fundamental cross-reference provision in Code of Civil Procedure Section 683.310 was revised by the Commission to provide as follows:

> 683.310. Except as otherwise provided in Section 4502 of the Family Code, this chapter does not apply to a judgment or order made or entered pursuant to the Family Code.

Family Code Section 4502, as enacted in 1992, carried forward the then-existing version of Civil Code Section 4384.5:

> 4502. A party may renew a judgment for child, family, or spousal support as provided in Article 2 (commencing with Section 683.110) of Chapter 3 of Title 9 of Part 2 of the Code of Civil Procedure.

The special writ of execution rules from former Civil Code Section 4383, discussed above, were continued in Family Code Sections 5100-5104 without substantive change.

At the same time, confusing an already complicated situation, legislation sponsored by the Department of Social Services (DSS) amended many of these rules to eliminate the last vestige of the 10-year rule. (See 1992 Cal. Stat. ch. 718; 1993 Cal. Stat. ch. 876.) In an effort to coordinate the Family Code with the

ongoing revisions occurring around it, Family Code Section 4502 was amended in 1993 to pick up the 1992 amendments to Civil Code Section 4384.5. It now provides:

> 4502. Notwithstanding any other provision of law, a judgment for child, family, or spousal support, including a judgment for reimbursement or other arrearages, is exempt from any requirement that judgments be renewed. A judgment for child, family, or spousal support, including all lawful interest and penalties computed thereon, is enforceable until paid in full.

The writ of execution rules from former Civil Code Sections 4383 and 4384, as revised by the 1993 DSS bill, read as follows in their Family Code setting:

> **Fam. Code § 5100. Enforcement of child or family support without prior court approval**
>
> 5100. Notwithstanding Section 290, a child or family support order may be enforced by a writ of execution without prior court approval as long as the support order remains enforceable.
>
> **Staff Note.** Section 290 continues the general rule from former Civil Code Section 4380 that enforcement is subject to court discretion.
>
> **Fam. Code § 5101. Enforcement of spousal support without prior court approval**
>
> 5101. Notwithstanding Section 290, a spousal support order may be enforced by a writ of execution without prior court approval as long as the support order remains enforceable.
>
> **Fam. Code § 5102. Period for enforcement of installment payments**
>
> 5102. If a support order provides for the payment of support in installments, the period specified pursuant to this chapter runs as to each installment from the date the installment became due.
>
> **Staff Note.** This section is surplus since there is no longer any limitation on the period of enforceability of support.
>
> **Fam. Code § 5103. Enforcement of support against employee pension benefit plan**
>
> 5103. (a) Notwithstanding Section 2060, an order for the payment of child, family, or spousal support may be enforced against an employee pension benefit plan regardless of whether the plan has been joined as a party to the proceeding in which the support order was obtained.
>
> (b) Notwithstanding Section 697.710 of the Code of Civil Procedure, an execution lien created by a levy on the judgment debtor's right to payment of benefits from an employee pension benefit plan to enforce an order for the payment of child, family, or spousal support continues until the date the plan has withheld and paid over to the levying officer, as provided in Section 701.010 of the Code of Civil Procedure, the full amount specified

in the notice of levy, unless the plan is directed to stop withholding and paying over before that time by court order or by the levying officer.

(c) A writ of execution pursuant to which a levy is made on the judgment debtor's right to payment of benefits from an employee pension benefit plan under an order for the payment of child, family, or spousal support shall be returned not later than one year after the date the execution lien expires under subdivision (b).

Fam. Code § 5104. Application for writ

5104. (a) The application for a writ of execution shall be accompanied by an affidavit stating the total amount due and unpaid that is authorized to be enforced pursuant to Sections 5100 to 5103, inclusive, on the date of the application.

(b) If interest on the overdue installments is sought, the affidavit shall state the total amount of the interest and the amount of each due and unpaid installment and the date it became due.

(c) The affidavit shall be filed in the action and a copy shall be attached to the writ of execution delivered to the levying officer. The levying officer shall serve the copy of the affidavit on the judgment debtor when the writ of execution is first served on the judgment debtor pursuant to a levy under the writ.

Enforcement of Nonmoney Judgments in Family Law

A question has been raised about an apparent gap in existing law. Remember that the renewal scheme in the Enforcement of Judgments Law applies to judgments for possession or sale of property, as well as to money judgments. The various provisions tinkering with the relationship of this law to the enforcement of judgments under the Family Law Act, or now the Family Code, have focused on support and other monetary judgments. Apparently a case has arisen where the judge ruled that a judgment for sale under the Family Law Act could not be enforced after 10 years. But this seems contrary to Family Code Section 290, which continues former Civil Code Section 4380:

§ 290. Methods of enforcement

290. A judgment or order made or entered pursuant to this code may be enforced by the court by execution, the appointment of a receiver, or contempt, or by such other order as the court in its discretion determines from time to time to be necessary.

This section is not limited by any 10-year rule of Section 682.020 in the Enforcement of Judgments Law. Section 683.310 makes the general renewal

scheme inapplicable to Family Code judgments of all types, except as otherwise provided. Instead, the family law court has discretion as to when and how to enforce its orders, subject to some special rules for monetary judgments. Even if the 10-year rule of the Enforcement of Judgments Law applied somehow, the common law and Code of Civil Procedure Section 337.5 might give relief through an action on the judgment if the statute of limitations has been tolled.

Since the general renewal procedure has been made optional for support judgments, it might make sense to provide for optional renewal of judgments for possession and sale of property under the Family Code. Thus far, the blanket excuse from renewal has been applied only to money judgments for support and arrearages. Perhaps a better approach might be to apply the general Enforcement of Judgments Law renewal procedure to non-money judgments under the Family Code. Clarity on this issue would be better than an over-deferential approach that attempts to preserve the court's discretion under Family Code Section 290. This is particularly evident if the courts are refusing to accept that discretion.

Staff Recommendations

As a result of all of these amendments, Code of Civil Procedure Section 683.310 is misleading and adds to the confusion. The cross-reference to Family Code Section 4502 should have been removed in connection with the changes made to that section and its predecessor at the behest of DSS.

To help clear up some of the confusion, the staff recommends that Section 683.310 be amended as follows:

Code Civ. Proc. § 683.310. Time for filing renewal application

683.310. Except as otherwise provided ~~in Section 4502 of the Family Code~~, this chapter does not apply to a judgment or order made or entered pursuant to the Family Code.

Comment. Section 683.310 is amended for consistency with Family Code Section 4502, as revised in 1993. See 1993 Cal. Stat. ch. 219, §§ 142-143; 1992 Cal. Stat. ch. 162, § 10. This is a technical, nonsubstantive change. For a specific provision in this chapter applicable to enforcement under the Family Code, see Section 683.130.

Family Code Section 5102, discussed above, should be repealed since there is no longer a limited period of enforceability.

The procedure for renewing judgments for possession or sale should be extended to judgments under the Family Code. Analogous to the former procedure for money judgments under the Family Law Act, enforcement of

judgments for possession or sale could be made discretionary after the 10-year period had expired without renewal.

Comment Revisions

If the Commission approves the proposed revision, the staff would also like to make revisions in the language of related Comments to eliminate another source of confusion for practitioners. The staff will prepare a report on revised comments for consideration along with the 1994 Annual Report, depending on Commission action on the proposed amendments.

Staff Note

At the May meeting, the question arose concerning a recent case that might bear on these issues. The staff has searched for any such relevant case, and it appears that reference was being made to Marriage of Damico, ____ Cal. 4th ____, 872 P.2d 126, 29 Cal. Rptr. 2d 787 (1994). This case relates to estoppel of a custodial parent seeking to enforce long overdue support in a situation where it is alleged that the child had been concealed. The technical issues discussed above did not enter into the case.

HOMESTEAD EXEMPTION ISSUES

Background

A number of issues have been raised concerning the homestead exemption — Code Civ. Proc. §§ 704.710-704.995. These are outlined below, but the staff has not presented a detailed analysis because we do not believe that piecemeal revision of the homestead exemption is beneficial. The homestead exemption statutes were exhaustively studied when the Commission prepared the recommendation proposing the Enforcement of Judgments Law. The statute that emerged from the legislative process varied in several significant respects from what the Commission had originally recommended. See *Tentative Recommendation Proposing the Enforcement of Judgments Law,* 15 Cal. L. Revision Comm'n Reports 2001 (1980). Most importantly, the Commission had recommended the abolition of the declared homestead in favor of the automatic homestead.

The staff believes that the existing homestead statute is seriously in need of reform and would recommend the Commission's 1980 recommendation as a starting point. The remnants of the declared homestead that survive in the

Enforcement of Judgments law have been a continuing source of confusion to many who encounter them, including the bench and the bar. If the Commission is interested in pursuing this matter, then the subject needs to be considered in a comprehensive manner. The staff does not believe that the problems can be solved without a comprehensive review of the homestead statute.

Elimination of Distinction Between Automatic and Declared Homesteads

The State Bar Legal Services Section has proposed that the homestead statutes be amended to eliminate the distinction between the automatic homestead protection and the declared homestead. (See letter from Robin Leonard on behalf of the Section, attached to Memorandum 94-25, Exhibit p. 65, considered at the May meeting.) Specifically, the Legal Services Section writes:

> The distinction serves little purpose. Implicit in the creation of the automatic exemption was the recognition that a homeowner should not have to file a piece of paper to safeguard a homestead from a forced sale. There is no reason to restrict the benefit of a declared homestead (an exemption on the proceeds of a voluntary sale and no judgment lien on the house) to those who file a piece of paper.
>
> Clearly, borrowers/homeowners can obtain the additional protection by filing a homestead declaration, but many (perhaps most) borrowers/homeowners are not sophisticated and/or do not know about the additional protection that comes from filing a homestead declaration. Because few borrowers/homeowners gain any benefit from declared homesteads, there is no legal or logical justification for preserving them.

As discussed above, the staff is in agreement with the Section's position. Perhaps with the assistance and support of the Legal Services Section and the Debtor/Creditor Relations and Bankruptcy Committee of the Business Law Section, a new attempt to eliminate the redundant declared homestead procedure might be successful. In 1982, as the staff recalls, the reform effort failed in this respect because of opposition from lobbyists speaking on behalf of debtors.

Revise Homestead Sale Procedure in Light of Case Law

The State Bar Legal Services Section has proposed amending Section 704.780 in light of Abbett Electric Corp. v. Storek, 22 Cal. App. 4th 1460, 27 Cal. Rptr. 2d 845 (1994), to preserve an existing practice. (See letter from Robin Leonard on behalf of the Section, attached to Memorandum 94-25, Exhibit p. 65, considered at the May meeting.) Specifically, the Legal Services Section writes:

The case requires a court to order a sale of a home even if the court's fair market value determination at the initial hearing indicates that the amount of liens plus the homestead exemption exceeds the estimated fair market value. This is a departure from the practice of most courts. The real risk is that creditors may harass or intimidate a debtor, particularly one who is unsophisticated, with the threatened loss of the debtor's home in order to extract some payment even when the creditor has reason to believe that the property will not actually be sold at auction because no bid will exceed the amount of liens plus the exemption.

The problem is with the language of Code of Civil Procedure §704.780. Given the language of the statute, *Abbett Electric* is not irrational. Given the *intent* of the statute, however, it is. *Abbett Electric* upsets the practice of many courts in denying a motion for an auction sale if the fair market value determination required at the hearing does not reasonably support the likelihood that a sale can be confirmed under the tests in §§704.800 (a) and (b).

The relevant statutory language is as follows [emphasis added]:

§ 704.780. Hearing

704.780. …

(b) The court shall determine whether the dwelling is exempt. If the court determines that the dwelling is exempt, the court shall determine the amount of the homestead exemption and the fair market value of the dwelling **and shall make an order for sale of the dwelling subject to the homestead exemption**. The order for sale of the dwelling subject to the homestead exemption shall specify the amount of the proceeds of the sale that is to be distributed to each person having a lien or encumbrance on the dwelling and shall include the name and address of each such person. Subject to the provisions of this article, the sale is governed by Article 6 (commencing with Section 701.510) of Chapter 3. If the court determines that the dwelling is not exempt, the court shall make an order for sale of the property in the manner provided in Article 6 (commencing with Section 701.510) of Chapter 3.

(c) The court clerk shall transmit a certified copy of the court order (1) to the levying officer and (2) if the court making the order is not the court in which the judgment was entered, to the clerk of the court in which the judgment was entered.

(d) The court may appoint a qualified appraiser to assist the court in determining the fair market value of the dwelling. If the court appoints an appraiser, the court shall fix the compensation of the appraiser in an amount determined by the court to be reasonable, not to exceed similar fees for similar services in the community where the dwelling is located.

Comment (1982). Section 704.780 supersedes former Civil Code Section 1247, a portion of former Civil Code Section 1250, and a portion of subdivision (c), subdivision (e), and a portion of subdivision (f) of former Code of Civil Procedure Section 690.31. Subject to the requirements of Section 704.790, if an order for sale is obtained, the dwelling may be sold as provided in Sections 701.510 *et seq.* Notice of sale provisions (Sections 701.540-701.560) apply to the sale as well as the general provisions governing the sale itself (subject to Sections 704.800-704.850).

Comment (1984). Subdivision (b) of Section 704.780 is amended to make clear that the court is not required to determine fair market value and the amount of liens to be satisfied where the dwelling is not an exempt homestead. These determinations are relevant only where the special minimum bid requirements provided by Section 704.800 apply — that is, where a dwelling has been found to qualify for a homestead exemption. The sale of a non-exempt dwelling is governed by the general procedures applicable to other types of property. It should be noted, however, that the special procedures of Section 704.790, applicable where the order for sale is obtained by default, continued to apply even though the property is found not to qualify for an exemption.

The amendment of subdivision (a)(1) is a technical correction that makes clear where the burden lies where there is neither a homeowner's nor a veteran's exemption.

§ 704.800. Minimum bid

704.800. (a) If no bid is received at a sale of a homestead pursuant to a court order for sale that exceeds the amount of the homestead exemption plus any additional amount necessary to satisfy all liens and encumbrances on the property, including but not limited to any attachment or judgment lien, the homestead shall not be sold and shall be released and is not thereafter subject to a court order for sale upon subsequent application by the same judgment creditor for a period of one year.

(b) If no bid is received at the sale of a homestead pursuant to a court order for sale that is 90 percent or more of the fair market value determined pursuant to Section 704.780, the homestead shall not be sold unless the court, upon motion of the judgment creditor, does one of the following:

(1) Grants permission to accept the highest bid that exceeds the amount of the minimum bid required by subdivision (a).

(2) Makes a new order for sale of the homestead.

Comment. Section 704.800 supersedes former Civil Code Sections 1253 and 1254. If the property levied upon is not sold, the judgment creditor may not recover costs. See Section 704.840. See also Section 704.850 (distribution of proceeds).

The Section reports an existing practice whereby most courts do not make an order for sale of the homestead if the sum of liens and the applicable homestead exemption is greater than the estimated fair market value. The Section argues that *Abbett* is irrational given the intent of the statute. However, *Abbett* reads Section 704.780(b) literally and applies it, bolstering its conclusion by quoting from the Commission's original recommendation:

> Under existing law, before a dwelling subject to the homestead exemption may be sold on execution, it must be determined that the judgment debtor's equity exceeds the amount of the exemption. [Footnote omitted.] This determination is unnecessary, since the market place is a better determinant of value and the property should not be sold unless the minimum bid equals or exceeds the amount of the homestead exemption. The proposed law eliminates the determination of the judgment debtor's equity. To help ensure that the judgment creditor does not attempt to force sale of property in which the equity is less than the exempt amount, the proposed law provides that if the a minimum bid at sale is not received, the judgment creditor is not entitled to recover the costs of the sale procedure …. In addition, the judgment creditor is precluded from again levying on the homestead for a period of one year.

[See *Tentative Recommendation Proposing the Enforcement of Judgments Law,* 15 Cal. L. Revision Comm'n Reports 2001, 2092-2093 (1980), quoted in *Abbett, supra,* at 851-52.] In quoting from the Commission's original report, the court in *Abbett* failed to notice that the scheme as proposed in 1980 dispensed with the need for determining the fair market value. The original procedure was intended to eliminate burdensome procedural details and relied on the execution sale process and the potential penalties for failing to obtain a sufficient sale price. The judgment creditor was liable for costs and attorney's fees if the sale price was inadequate to satisfy liens and the exemption. The Commission thus had abandoned the inefficient attempt to protect debtors through appraisals. However, the determination of fair market value was reinserted in the Legislature, along with the 90% rule in Section 704.800, and the liability for attorney's fees was omitted. The mandatory sale language at issue in *Abbett* was not eliminated, most likely due to an oversight, although it may have been the result of compromise in the heat of battle before a committee hearing.

Although issuance of an order for sale does not *require* that a sale take place, it does not appear efficient to order a sale where the fair market value is far below what can be expected to result from a sale. The staff cannot agree that the existing scheme is "irrational" as claimed by the Legal Services Section, but it could be improved by loosening the strict rule announced in *Abbett.* The staff recommends that the court be given discretion to refuse to order a sale where it determines that the sale is not likely to achieve a sufficient bid:

§ 704.780. Hearing

704.780. …

(b) The court shall determine whether the dwelling is exempt. If the court determines that the dwelling is exempt, the court shall determine the amount of the homestead exemption and the fair market value of the dwelling ~~and~~. *The court* shall make an order for sale of the dwelling subject to the homestead exemption, *unless the court, in its discretion, determines that a sale of the dwelling would not be likely to produce a sufficient bid*. The order for sale of the dwelling subject to the homestead exemption shall specify the amount of the proceeds of the sale that is to be distributed to each person having a lien or encumbrance on the dwelling and shall include the name and address of each such person. Subject to the provisions of this article, the sale is governed by Article 6 (commencing with Section 701.510) of Chapter 3. If the court determines that the dwelling is not exempt, the court shall make an order for sale of the property in the manner provided in Article 6 (commencing with Section 701.510) of Chapter 3.

Residence as Qualification for Declared Homestead

Bankruptcy Judge Alan M. Ahart suggests that "the statute should be amended to clearly state that a debtor cannot utilize the declared homestead exemption if the debtor no longer resides at the property named in the Declaration of Homestead. See *In re* Anderson, 824 F.2d 754 (9th Cir. 1987); and *In re* Yau, 115 BR 245 (BC CD Cal. 1990); but see *In re* Figy, 102 BR 785 (BC SD Cal. 1989)." (See letter attached to Memorandum 94-25, Exhibit pp. 53-54, considered at the May meeting.)

The staff believes this issue would be appropriate for review in the context of a comprehensive study of the homestead exemption, but would prefer not to attempt to revise only this aspect of the statute.

RETIREMENT PLAN EXEMPTION

Judge Ahart also suggests revising the retirement plan exemption:

> I believe that a one-person corporation should not be able to exempt funds held in a pension plan designed and used for retirement purposes without regard to the support limitation that applies to Keogh and other non-corporate pension plans. See *In re* Cheng, [943 F.2d 1114] (9th Cir. 1991) …; *In re* Bloom, 839 F.2d 1376 (9th Cir. 1988). If such a change is not made, there will continue to be an undue incentive for high-income individuals with one-person corporations, such as doctors, lawyers, and dentists, to file bankruptcy and shield hundreds of thousands of dollars from the claims of creditors.

The governing statute in Code of Civil Procedure Section 704.115 provides as follows:

§ 704.115. Private retirement and related benefits and contributions

704.115. (a) As used in this section, "private retirement plan" means:

(1) Private retirement plans, including, but not limited to, union retirement plans.

(2) Profit-sharing plans designed and used for retirement purposes.

(3) Self-employed retirement plans and individual retirement annuities or accounts provided for in the Internal Revenue Code of 1954 as amended, to the extent the amounts held in the plans, annuities, or accounts do not exceed the maximum amounts exempt from federal income taxation under that code.

(b) All amounts held, controlled, or in process of distribution by a private retirement plan, for the payment of benefits as an annuity, pension, retirement allowance, disability payment, or death benefit from a private retirement plan are exempt.

(c) Notwithstanding subdivision (b), where an amount described in subdivision (b) becomes payable to a person and is sought to be applied to the satisfaction of a judgment for child , family, or spousal support against that person:

(1) Except as provided in paragraph (2), the amount is exempt only to the extent that the court determines under subdivision (c) of Section 703.070.

(2) If the amount sought to be applied to the satisfaction of the judgment is payable periodically, the amount payable is subject to an earnings assignment order for support as defined in Section 706.011 or any other applicable enforcement procedure, but the amount to be withheld pursuant to the assignment order or other procedure shall not exceed the amount permitted to be withheld on an earnings withholding order for support under Section 706.052.

(d) After payment, the amounts described in subdivision (b) and all contributions and interest thereon returned to any member of a private retirement plan are exempt.

(e) Notwithstanding subdivisions (b) and (d), except as provided in subdivision (f), the amounts described in paragraph (3) of subdivision (a) are exempt only to the extent necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires. In determining the amount to be exempt under this subdivision, the court shall allow the judgment debtor such additional amount as is necessary to pay any federal and state income

taxes payable as a result of the applying of an amount described in paragraph (3) of subdivision (a) to the satisfaction of the money judgment.

(f) Where the amounts described in paragraph (3) of subdivision (a) are payable periodically, the amount of such periodic payment that may be applied to the satisfaction of a money judgment is the amount that may be withheld from a like amount of earnings under Chapter 5 (commencing with Section 706.010) (Wage Garnishment Law).

Comment. Section 704.115 supersedes subdivision (d) of former Section 690.18. Subdivision (c) governs the application of the exemption for payable but unpaid benefits against enforcement of child or spousal support. Subdivision (c)(1) applies the general rule governing exemptions in support cases. Subdivision (c)(2) recognizes that federal law requires the protection of periodic payments pursuant to a pension or retirement program to the same extent as wages. See Section 706.052 and the Comment thereto. The exemption provided in subdivision (d) applies whether money received by the judgment debtor is in the actual possession of the recipient or has been deposited. See Section 703.080 (tracing exempt funds). The general rule governing exemptions in support cases provided by Section 703.070 applies to benefits after they have been paid.

Subdivisions (e) and (f) are new. Subdivision (e) requires that the court consider all resources — such as social security payments and other income and assets — that are likely to be available to the judgment debtor when the judgment debtor retires. Accordingly, where it will be a number of years before the judgment debtor will retire, the court will take into account not only all the assets of the judgment debtor at the time the exemption claim is determined but also all the assets and income (including pension rights) that the judgment debtor is likely to acquire prior to retirement. Subdivision (f) recognizes that the federal law requires the protection of periodic payments pursuant to a retirement program. See 15 U.S.C. §§ 1672(a), 1673(a).

A number of bankruptcy cases have struggled to interpret this statute in situations involving one or two-person professional corporations. The section is intended to protect reasonable amounts of retirement assets. It is based on the assumption that private retirement plans will be in a reasonable amount and recognizing that individual plans — e.g., Keogh and IRA — are subject to necessary for support standard. However, a plan set up by a one-person professional corporation does not fall within the necessity exception of Section 704.115(e). Thus, substantial amounts may be shielded from creditors in judgment enforcement proceedings and in bankruptcy proceedings by this special class of debtors. This appears to be inconsistent with the statute as a whole, but the courts have felt bound by the language of the statute.

Judge Ahart recommends that this situation be remedied by applying the necessity standard to one-person corporation retirement plans. The staff is sympathetic to this suggestion. However, it does not appear to be a complete solution to the problem. In *In re Bloom (supra),* the court was faced with a two-doctor medical corporation in which the bankrupt had an interest valued at $475,000. The problem is just as great in this case as with a one-person

professional corporation, which was the situation in *In re Cheng (supra).* The court in *Cheng* recognized that

> [a]lthough the legislative history indicates that the policy behind section 704.115(e) is to limit the exemption for plans that are controlled by one person, the statute says what it says, and it was improper for the bankruptcy court to read beyond it. If the California legislature intended to treat closely held corporations differently than large corporations, it could have done so explicitly.
>
> The bankruptcy court's observations have immense practical significance, and probably constitute a *better* approach than the California statute. We recognize the odd result the statute creates — one-person medical corporations are treated the same as General Motors, creating the opportunity for shareholders of tiny corporations to abuse the exemption scheme — but we may not disregard the statute's language to address problems left to the legislature.
>
> We also fear that the bankruptcy court's approach creates an unnecessary ambiguity in the plain language of the statute.... If corporations with one shareholder are not really corporations, how about corporations with two shareholders? Or three? Or four? When would a closely held corporation become a "real" corporation for the purpose of California exemption law? We are not willing to open the floodgate for this sort of litigation....

The staff does not know whether the Ninth Circuit's fear of a floodgate of litigation is realistic, but the dangers inherent in a more flexible standard for determining the exemption could be limited by legislating some appropriate standard concerning the number of participants in the plan, the degree of control over the plan and the amount of contributions, and other factors that would give the courts more guidance.

The Commission should determine whether this issue should be pursued, with a view toward including appropriate amendments in the debtor-creditor bill to be introduced in the 1995 legislative session. If the Commission decides to proceed, the staff will draft statutory language for later consideration.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary