

First Supplement to Memorandum 96-9

**Homestead Exemption: Proceeds Exemption
(Letters Commenting on Recommendation)**

We have just received two letters commenting on the homestead proceeds exemption, which are attached as exhibits.

Sargis Letter

Ronald H. Sargis of Hefner, Stark, and Marois, writes on behalf of the California Association of Collectors (or so the staff understands). (See Exhibit pp. 1-2.) Mr. Sargis is concerned that the statute should not be taken to impair the judgment lien in any way. His letter works through a number of general provisions and raises a concern with the language of proposed Section 704.720(a) (see Memorandum 96-9, p. 2). The error in the chain of logic comes between steps 3 and 4. Under the Enforcement of Judgments Law property that is "non subject to enforcement" is a special category of property that may never be applied to the satisfaction of a judgment by any procedure. The question of "exemption from enforcement" does not generally arise unless the property is *subject to enforcement*. In other words, exemption from enforcement is not relevant where the property is categorically not subject to enforcement. The letter erroneously equates property not subject to enforcement in step 3 with exempt property in step 4.

Exemptions are provided for property that otherwise could be applied to satisfaction of a money judgment to protect minimal necessities of life so that the debtor will not be driven to the wall but will have some ability to be self-supporting and to support dependents. Property that is exempt from enforcement generally requires that some procedure be followed to claim and determine the exemption. The potential of an exemption claim does not prevent the creditor from obtaining a lien on the property by levy, recording, or filing under the appropriate procedure. On the other hand, if property is "not subject to enforcement" no levy, recording, or filing can possibly work to create a lien or achieve application of the property to the judgment. But this is not the case with most property, including dwellings. All of the exemption statutes in the series following Section 7094.010 provide that the property is "exempt" under certain

conditions or in certain amounts. There is no tenable argument that by so providing, these exemption statutes have made motor vehicles, tools of a trade, jewelry, household furnishings, deposit accounts, etc., "not subject to enforcement" and thus unreachable by creditors. Nor should the addition of this language in Section 704.720(a) lead to that conclusion.

The reason the language has been added is to be consistent with all the other exemption statutes and to avoid the misinterpretation that occurred in a bankruptcy case where the court focused on the "exempt from sale" language. In addition, as proposed to be revised, the statute says that a "homestead is exempt from enforcement of a money judgment *as provided in this article*" — and the article makes clear what conditions must be met to qualify for the exemption. That said, it should be made clear that addition of this language is not a necessity, and it could be removed or altered if the concerns expressed by Mr. Sargis cannot be met.

Mr. Sargis also expresses some concerns about making sure judgment lien rights are not impaired. Section 704.720(e) provides that the judgment creditor's lien continues on the proceeds and the Comment states that the judgment creditor's lien priority is preserved. As the concern expressed by Mr. Sargis is developed, we can determine whether additional statutory language is needed.

Lazo Letter

Ignacio J. Lazo is chair of the Post-Judgment Remedies Subcommittee of the State Bar Business Law Section Debtor-Creditor Relations Committee. However, his letter represents a collection of individual views of subcommittee members. (See Exhibit pp. 3-5.) In sum, lawyers of both the debtor and creditor persuasions found the recommendation to be "ill-advised." It is not clear from the letter how much the subcommittee members understood about the details of the recommendation, its history, or justification for reform. The subcommittee members apparently did not offer any suggestions for reform, nor are their opinions of the existing scheme apparent from the letter. The staff has urged that someone representing the subcommittee can attend the February 22 meeting.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

Law Revision Commission
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File: _____

February 16, 1996



Mr. Stan Ulrich
California Law Revision Commission
7000 Middlefield Rd., Ste. D-2
Palo Alto, CA 94303-4739

Archie Hefner
(1922-1988)

Re: Item D-352--Homestead Exemption

Dear Stan:

In reviewing the proposed amendments to the automatic and declared homestead exemptions I identified several concerns. One deals with the substantive problem that my client has to make sure that the changes do not impair the existing situation with respect to the validity of their abstracts. I will need to address this point in a subsequent correspondence. I have also identified an unintended potential interpretation of the statute based upon adding the language the homestead is exempt from "enforcement of a money judgment." After reviewing the various CCP sections, this could be interpreted as not allowing an abstract to attach to the homestead property. The analysis is as follows:

1. CCP §697.340 provides that a judgment lien attaches to all real property that is subject to enforcement of a money judgment as provided in §§695.010 et seq.
2. CCP §695.010 provides that all property of the judgment debtor is subject to enforcement of a money judgment, except as otherwise provided by law.
3. CCP §695.040 provides that Property that is not subject to enforcement of a money judgment may not be levied upon or in any other manner applied to the satisfaction of a money judgment.
4. Therefore, if the homestead itself is exempt from enforcement of a money judgment, the judgment lien only attaches to real property that is subject to enforcement of a money judgment, and that property not subject to enforcement of a money judgment is excepted out from the general enforcement provisions of CCP §695.010, then it could be argued that the abstract could not attach and that the creditor could never conduct a sale of the homestead property irrespective of the value.

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Kenneth R. Stone
Timothy D. Taron
Todd A. Murray
Timothy M. Cronan
Joel S. Levy
Robert P. Biegler
Ronald H. Sargis
Martin B. Steiner
Janice L. Thurston
Howard S. Nevins
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Given that this was not the intention of the Law Revision Commission in drafting the proposed changes, I suggest the following with respect to this point to modify that portion of the proposed amendments:

(a) A homestead ~~is exempt for enforcement of a money judgment as provided in this article and~~ is exempt from sale under this division to the extent provided in Section 704.800.

This would maintain the existing language for this section. I tried several variations, but they did not help to make the provisions any clearer. It says what is intended, that the homestead will not be sold unless the minimum financial requirements are met under §704.800.

With respect to the other issue, preservation of the abstract of judgment lien rights, I will be in touch with you on Tuesday morning due to commitments I have this afternoon. Please be advised that my client's concerns run to making sure that the statute is clear on its face that the lien rights are not impair to avoid a situation where a court may make a rouge interpretation, as in the recent homestead case in federal court, that will have severe consequences to creditors.

Very truly yours,

HEFNER, STARK & MAROIS, LLP

By


Ronald H. Sargis

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February 16, 1996

Mr. Stan Ulrich
Assistant Executive Secretary
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Re: Proposed changes to homestead exemption revision bill (SB 1368).

Dear Mr. Ulrich:

As you may recall, I am a member of the Debtor-Creditor Relations Committee of the Business Law Section of the State Bar of California (the "DCRC"). I am the chair of its Post-Judgment Remedies Subcommittee. I have just received the minutes of the California Law Revision Commission's January 19, 1996 meeting. Because there appears to be insufficient time for the DCRC to pass formal recommendations up through the appropriate channels of the State Bar hierarchy before SB 1368 receives further consideration, I am writing to you in my individual capacity to pass along the personal sentiments and anecdotal experiences of those members of the DCRC who attended its regular meeting on January 24, 1996.

At that time, I reported on the amendments to SB 1368 that the CLRC had been scheduled to consider at its January 19, 1996 meeting. I advised those DCRC members who were present (approximately fifteen seasoned lawyers) that the bill would mandate that sale proceeds be deposited with the court and allow an exemption only if the proceeds were actually applied to the purchase of another dwelling in California during the six-month exemption period. I opined that the ostensible purpose was to preclude any possibility that the proceeds might be dissipated, transferred out of the state, or otherwise rendered unavailable to pay the just obligations of recalcitrant judgment debtors.

Those DCRC members present who specialized in representing debtors objected to this proposed procedure. In the current economic climate, some felt, a "downsized" debtor might well need to use the sale proceeds to purchase tools of the trade or a commercial vehicle in order to rehabilitate himself financially. Debtors might also need the use of the moneys to pay basic living expenses (such as rent, clothing, and groceries) once they and their families are dispossessed of their homes. Denying them the use of exempt proceeds to pay basic living expenses would be likely to place even greater strains on the public fisc. Moreover, Debtors presently have the right to convert nonexempt assets into exempt property or to convert one form of exempt property into another (as long as they do not act so egregiously as to run afoul of the

Uniform Fraudulent Transfer Act). The proposed revision would restrict the ability to use or convert this one particular form of exempt property for no principled reason.

Interestingly, those DCRC members present who specialized in representing both secured and unsecured creditors also objected to this proposed impound procedure. In their view, the revision would actually render judgment creditors far less likely to secure the use of sale proceeds to satisfy outstanding judgments. In their experience, many judgment debtors will either neglect to roll over the sale proceeds or will spend them on such articles such as new cars or other nonexempt assets (which the judgment creditor can then seize and liquidate).

They opined that the proposed deposit procedure would inspire a "use it or lose it" mentality, prompting judgment debtors to go to extraordinary lengths to preserve the value of their homestead exemption. Judgment debtors would be unlikely to qualify for new mortgages and there are few freeholds available that one could purchase for \$50,000 in cash. A whole new cottage industry could arise among the same persons who currently solicit business by scrutinizing the judgment rolls. Instead of giving bankruptcy advice, they would collect commissions for giving referrals to the owners of mobile homes (double-wide), budget suburban condominiums, and ramshackle rural properties. The judgment creditor would be the last person ever to receive the benefit of the sale proceeds.

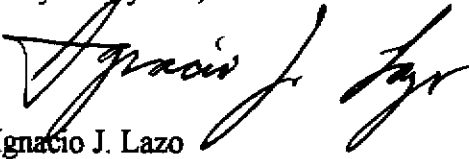
While acknowledging that some judgment debtors might try to squirrel away sales proceeds, creditors' counsel felt that most such individuals were too unsophisticated to do so effectively. Cases of actual fraudulent transfers could always be pursued if enough money were at stake. The current system at least gives judgment creditors some shot at the money.

Following animated discussion, each and every member present at the meeting (debtors' counsel and creditors' counsel alike) concurred in the conclusion that the proposed change to SB 1368 was ill-advised. They also authorized me to forward this letter summarizing our personal, unofficial opinions. Whitney Rimel, the chair of the DCRC circulated a draft copy of this letter privately among the members of the committee two weeks ago soliciting their

Stan Ulrich, Assistant Executive Secretary
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comments, if any. None of the members have contacted me to identify any proposed objections or revisions.

Very truly yours,

A handwritten signature in black ink, appearing to read "Ignacio J. Lazo". The signature is fluid and cursive, with the first name "Ignacio" being more prominent and the last name "Lazo" written in a more compact, stylized manner.

Ignacio J. Lazo

IJL/wp
cc: Debtor-Creditor Relations Committee