

First Supplement to Memorandum 99-76

Homestead Issues: Comments from Brian Holman

Attached to this supplement are some further comments from Brian Holman on the homestead exemption proposals, amplifying his earlier comments (attached to Memorandum 99-76).

Code Civ. Proc. § 704.850. Distribution of proceeds of sale of homestead

Mr. Holman notes the inconsistencies between the general section governing distribution of sale proceeds (Section 701.810) and the special homestead rule (Section 704.850). He correctly points out that the general rule would not protect junior lienholders who do not deliver a writ because the rule in Section 701.810(g) doesn't apply to homesteads.

We have not gone back to trace the history of the development of these two rules, but it is likely that the reason for the special homestead rule is the artifact in Section 704.850(a)(1) (see page 17 of the draft attached to the main memorandum), which requires satisfaction of *all* liens and encumbrances at a homestead sale. The Commission's proposed revisions would conform this part of the homestead statute to the general rule requiring satisfaction only of superior liens. Hence, Sections 704.850 and 701.810 would have the same approach on this point.

If the reason for Section 704.850 is the "all liens" language that we would change, then it would be best to eliminate Section 704.850 and rely on the general rule. This would eliminate the other inconsistencies between the two. Accordingly, the staff recommends repealing Section 704.850 and relying on the general rule, which is more highly developed and integrated into other levy sale procedures:

701.810. Except as otherwise provided by statute, the levying officer shall distribute the proceeds of sale or collection in the following order:

(a) To persons having preferred labor claims that are required by Section 1206 to be satisfied from the proceeds, in the amounts required by Section 1206 to be satisfied.

(b) To the state department or agency having a state tax lien (as defined in Section 7162 of the Government Code) that is superior to the judgment creditor's lien, in the amount of the lien.

(c) If a deposit has been made pursuant to Section 720.260 and the purchaser at the sale is not the judgment creditor, to the judgment creditor in the amount required to repay the deposit with interest thereon at the rate on money judgments from the date of the deposit.

(d) To the judgment debtor in the amount of any applicable exemption of proceeds pursuant to Section 704.010 (motor vehicle), 704.020 (household furnishings and other personal effects), or 704.060 (tools of trade), except that such proceeds shall be used to satisfy all of the following in the order of their respective priorities:

(1) Any consensual liens and encumbrances, and any liens for labor or materials, that are subordinate to the judgment creditor's lien.

(2) Subject to Section 688.030, any state tax lien (as defined in Section 7162 of the Government Code) on the property sold if the notice of state tax lien on the property has been recorded or filed pursuant to Section 7171 of the Government Code prior to the time the levying officer received the proceeds of the sale or collection.

(e) To the levying officer for the reimbursement of the levying officer's costs for which an advance has not been made.

(f) To the judgment creditor to satisfy the following:

(1) First, costs and interest accruing after issuance of the writ pursuant to which the sale or collection is conducted.

(2) Second, the amount due on the judgment with costs and interest, as entered on the writ.

(g) To any other judgment creditors who have delivered writs to the levying officer, accompanied by instructions to levy upon the judgment debtor's property or the proceeds of its sale or collection, or any other persons actually known by the levying officer to have a claim, lien, or other interest subordinate to the judgment creditor's lien that is extinguished by the sale and that is not otherwise satisfied pursuant to this section, in the amounts to which they are entitled in order of their respective priorities.

(h) To the judgment debtor in the amount remaining.

Section 704.850 would be repealed:

~~704.850. (a) The levying officer shall distribute the proceeds of sale of a homestead in the following order:~~

~~(1) To the discharge of all liens and encumbrances, if any, on the property.~~

~~(2) To the judgment debtor in the amount of any applicable exemption of proceeds pursuant to Section 704.720.~~

~~(3) To the levying officer for the reimbursement of the levying officer's costs for which an advance has not been made.~~

~~(4) To the judgment creditor to satisfy the following:~~

~~(A) First, costs and interest accruing after issuance of the writ pursuant to which the sale is conducted.~~

~~(B) Second, the amount due on the judgment with costs and interest, as entered on the writ.~~

~~(5) To the judgment debtor in the amount remaining.~~

~~(b) Sections 701.820 and 701.830 apply to distribution of proceeds under this section.~~

Comment. Section 704.850 is repealed. Distribution of proceeds from an execution sale are governed by the general rules in Section 701.810 *et seq.*

Code Civ. Proc. § 704.720. Homestead exemption

Mr. Holman is also concerned about the handling of proceeds of a *voluntary* sale, which is quite different from the rules just discussed concerning execution sales. He is concerned with preserving the rights of junior lienholders in a voluntary sale situation. Draft Section 704.720(e) refers to “the judgment creditor.” While the singular includes the plural (Section 17), and so would cover all judgment creditors with liens on the property, the draft does not really develop the procedure. However, subdivision (e) could be expanded to make clear that the proceeds are to be applied in the manner provided for execution sales under Section 701.810. The staff thinks this should work, but it will require further analysis before we can be sure.

Mr. Holman is also concerned about where the proceeds are held during the six-month exemption period. He suggests deposit in court, which would be consistent with the rule governing disputed proceeds following an execution sale. See Section 701.830. An earlier version of the draft, when the Commission first considered it a few years ago, provided for deposit with the court, but this was changed to the rule based on agreement of the parties because of a concern that money deposited with the court could be lost in bankruptcy or otherwise difficult to retrieve. The funds can't be held by the levying officer, because there is no officer involved in holding voluntary sale proceeds under the proposed scheme. Mr. Holman would like to see a lot more guidance on this issue in the statute, whereas our approach has been to leave it to the parties, although the statute may not be clear on who the parties are. This approach was inspired by current practice where homesteads are voluntarily sold. As far as the staff knows,

statutes do not govern what sellers, buyers, real estate brokers, title companies, and creditors do about the judgment debtor's statutory homestead rights when a homestead is sought to be sold.

Considerations

These complications, and others discussed in Memorandum 99-76 and yet to be discovered, suggest that on balance the best solution may be to repeal the declared homestead procedure and let the ineffective proceeds exemption fade away. This approach solves most of the problems discussed in the draft recommendation, as we have recognized in the past. Whatever rights people had gained by recording declarations would be preserved, but no new recordings would be permitted. Other than the potential for a mad rush at the recorders' offices throughout the state in the last weeks before the repeal would become operative, the practical effect of this approach on concrete debtor's rights would probably not be noticeable.

Respectfully submitted,

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Subject: Memorandum 99-76; Homestead Issues

I disagree with certain of Mr. Ulrich's responses to my comments on the Tentative Recommendation on the Homestead Exemption.

My comment that "properly perfected lien creditors should not lose their place in line" was directed to proposed C.C.P. § 704.850, which governs distributions of the proceeds of the judicial sale of a homestead. My point was that a properly perfected judgment lien creditor (such as one who has duly recorded an abstract of judgment or duly levied on the property) should not have to deliver a writ of execution to the levying officer in order to preserve its right to share in any surplus proceeds of sale.

Mr. Ulrich suggests that a junior creditor may bid at the sale or redeem the senior lien. This is true, but the junior creditor cannot credit bid and may not have the cash to bid or redeem. A junior creditor should not lose its lien priority because it has no cash.

Mr. Ulrich then notes that, under C.C.P. § 701.810(g), the levying officer distributes the proceeds of an execution sale to creditors who have delivered writs to the levying officer and "to any other persons actually known by the levying officer to have a claim, lien or other interest subordinate to the judgment debtor's lien" (Note that, pursuant to C.C.P. § 701.540, the levying officer should have notice of all abstracts of judgment and notices of levy recorded as of the date of the levying judgment creditor's levy).

Section 701.810(g), however, will not apply to the distribution of the proceeds of the judicial sale of a homestead, because section 701.810 will be displaced by proposed section 704.850. Section 701.810 provides, "Except as otherwise provided by statute," Proposed section 704.850 will exclusively govern the distribution of the proceeds of the judicial sale of a homestead. Perhaps the additional language in section 701.810(g) should be added to proposed section 704.850(a)(5).

My comment that the liens of junior creditors should attach to the exempt proceeds of a sale of a homestead was directed at proposed C.C.P. § 705.720 (e), which provides a levying judgment creditor's lien, but not other creditors' liens, to attach to the exempt proceeds of sale. Mr. Ulrich again suggests that section 701.810(g) may preserve the rights of judgment lien creditors.

Proposed section 705.720(e), however, exclusively governs the distribution of the exempt proceeds, and provides for distribution of any proceeds not applied toward the purchase of a replacement dwelling only to the satisfaction of the levying creditor's judgment. So again, the provisions of section 701.810(g) will not protect any other judgment lien creditors, even those who actually delivered a writ to the levying officer. Arguably, in the case of a voluntary sale where there is no levying judgment creditor, no judgment lien creditors at all will have any rights in the exempt proceeds.

I note that proposed section 705.720(e) does not describe in whose name the "controlled deposit account" is maintained, who pays the fees for the account, whether the account must be maintained at a federally insured bank, whether the funds may earn interest, who exercises the control, etc. Perhaps instead the funds should be held by the levying officer or, in the case of a voluntary sale, deposited with the clerk of court, in each case subjecting the funds to judicial supervision.

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