

Memorandum 2002-54

**Exemptions from Enforcement of Money Judgments:
Second Decennial Review
(Comments on Discussion Draft)**

BACKGROUND

During the fall of 2002 the Commission circulated for comment its Discussion Draft on exemptions from enforcement of a money judgment. The Commission's proposal would make three changes to California's exemption scheme:

(1) It would generally increase existing dollar-based exemptions by 20% to recognize the effect of inflation since the last decennial review.

(2) It would add to the law a cost of living escalator, so that in the future inflation is adjusted for automatically, without the need for periodic legislation.

(3) It would double the amount of the exemptions allowed to a recipient of public aid in an action by the county for reimbursement.

COMMENTS

We have received a comment from the California Association of Collectors opposed to adding an automatic cost of living adjustment provision to the exemption statutes. See Exhibit p. 1. The Collectors note that they have interests in common with all plaintiffs in the judicial process, and they believe their comments reflect interests of judgment creditors in general.

We have also received an informal communication from the Insolvency Law Committee of the State Bar indicating their support for the proposal as written.

We have directed the attention of the California Association of Counties to our proposal to double the exemptions from enforcement of public aid reimbursement. However, we have had no response from that organization.

AUTOMATIC COLA PROPOSAL

Position of Collectors

In opposition to an automatic cost of living adjustment for exemptions, the Collectors argue that it would imbalance plaintiff/defendant rights by

addressing only a portion of the exemption process. They explain that inflation affects all concerned — plaintiffs as well as defendants — and that plaintiff costs and fees rise just as do defendant costs of living. The exemptions reflect a balance, which may be examined periodically and adjusted. However, an automatic COLA applied only to one side of the equation will upset the balance of interests.

The Collectors do not find persuasive the Commission's argument that applying an automatic COLA to exemptions from enforcement of judgments will keep the exemption scheme in line with exemptions available in bankruptcy. They view the two schemes of exemptions as serving different and unrelated purposes — the enforcement exemptions are part of a scheme of creditors' remedies, whereas the bankruptcy exemptions are part of a scheme of debtors' protections.

Staff Critique

Upsetting the Debtor/Creditor Balance

Would an automatic exemption COLA upset the current balance between creditor and debtor interests? In order to answer that question, we must ask another — is it correct that exemptions represent a balance of interests? Or do they represent a legislative determination of the minimum amount necessary to keep a person from becoming destitute? If so, the exemptions must be viewed by a creditor as a cost of doing business that is subject to inflation, just as other costs of running the creditor's business are subject to inflation.

As a practical matter and regardless of theory, the exempt amounts in California historically have represented a tug of war between debtor and creditor interests. To that extent they may be said to represent a balance between those interests that reflects the political perspective of the Legislature at the time the matter was last considered.

It must certainly be true that as the cost of living increases for a debtor, the cost of doing business increases for a creditor. Of course, many of the creditor's direct costs of collection from a particular debtor will be reimbursable — filing fees, costs of service, etc. — so that inflation of those costs will not adversely impact the creditor (assuming full collection). Indirect costs — compensation of personnel involved in form preparation and court appearances, office overhead, etc. — would affect the creditor's bottom line.

To some extent the creditor may be in a position to control costs. A collector could, for example, take a deeper discount on an assignment of a creditor's claim, or increase the amount charged a creditor for collection services. Of course that would come out of the pocket of the creditor. A contract creditor may be able to control its loss exposure by various devices, but a tort creditor would not have this option available.

An increase in the exempt amounts may mean that a creditor who wishes to collect the full amount due, rather than compromising it out, must wait longer for satisfaction of the debt. But then, the legal rate of interest on a judgment is 10% — not a bad rate of return these days.

Relation to Bankruptcy Exemptions

Bankruptcy exemptions are subject to a triennial COLA. Is it a problem if the enforcement of judgment exemptions fall too far behind the bankruptcy exemptions?

The Collectors argue that it's not a problem. They make the point that the two systems serve different functions. Bankruptcy is designed to assemble all assets, discharge all debts, and leave the debtor with enough for a fresh start. In that regime, the exemptions are designed to stabilize a debtor's financial situation and help the debtor become a productive and self-supporting member of society.

Thus the exemption level in bankruptcy is determined by policy considerations unrelated to the exemption level for enforcement of judgments. The enforcement of judgments process is designed to allow a creditor to reach specific assets of a solvent debtor. It may well be appropriate that the exemption level for those assets in that circumstance differs substantially from the exemption level for the same type of asset in bankruptcy.

In California, this line of argument founders on the fact that the law permits a debtor in bankruptcy to choose either the enforcement of judgment exemptions or a special set of exemptions applicable only in bankruptcy. Thus the California enforcement exemptions live in two worlds and serve a dual role. The counterargument, of course, is that it is unnecessary for enforcement exemptions to keep pace with bankruptcy exemptions since the special bankruptcy exemptions are always available to a debtor in bankruptcy.

If the bankruptcy exemptions get too far out of line with the enforcement of judgment exemptions, will there be an incentive for a debtor to file for

bankruptcy? If so, that would hurt creditors, whose debts are discharged. A creditor would prefer to keep the debtor solvent.

The concern about making bankruptcy too attractive appears to be more theoretical than real. Most debtors wish to avoid bankruptcy, and in fact only a small percentage resort to it, despite substantial debt. The fact that exemptions may be more liberal in bankruptcy does not appear to be a significant factor in the decisionmaking process of many debtors.

Bottom Line

Realistically, the automatic COLA debate comes down to the question of whether the Legislature ought to be involved each time there is a change in exempt amounts. The practical effect of requiring legislative involvement is that exemptions will be adjusted less frequently and, when they are, as a result of political compromise they will not necessarily be fully adjusted for inflation.

At least in California there is a mechanism for ensuring that, absent an automatic COLA, things do not get too far out of whack. That mechanism is the statutory mandate that the Law Revision Commission decennially review exemptions and recommend revisions.

The current scheme is a compromise that resulted from the Commission's study of creditors' remedies law in the late '70s. At that time the Commission tentatively recommended an automatic COLA for exempt amounts, but the final recommendation was for a quinquennial review by the Commission. Out of the legislative process emerged the decennial review.

The question for the Commission is, do we want to travel that road again?

CONCLUSION

Our objective at this meeting is to make the decisions that will enable us to finalize a recommendation on exemptions. The next Commission meeting at which this could be taken up is in March. If the Commission is unable to reach a conclusion until then, it would be difficult, but not impossible, to achieve legislation on the matter in 2003, by means of a spot bill or other device.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary



LAW OFFICES
ESTABLISHED 1896

2150 RIVER PLAZA DRIVE
SUITE 450
SACRAMENTO, CA
95833-3883
TEL: (916) 925-6620
FAX: (916) 925-1127

RONALD H. SARGIS
EMAIL: R.SARGIS@HSMLAW.COM

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VIA FACSIMILE
(650) 494-1827

Stan Ulrich, Esq.
California Law Revision Commission
4000 Middlefield Rd., Rm. D-1
Palo Alto, CA 94303-4739

Re: Tentative Recommendation D-355 Comments
Exemptions From Enforcement of Judgments

Dear Mr. Ulrich

On behalf of the California Association of Collectors, Inc., I am submitting the following comments concerning Discussion Draft #D-355, Exemptions from Enforcement of Judgments. As you are aware, the Association's members have interests in common with all plaintiffs in the judicial process, and believe that these comments reflect interests of judgment creditors in general.

The Draft Recommendation makes suggestions to increase specified exemptions in specific amounts. With respect to the enumerated exemptions in the Recommendation, the Association does not make any comment. As provided under current law, the Commission and staff have considered the changes in the California economy since the last adjustment and provided for increases as it has determined appropriate.

The second part of the Draft Recommendation is to enact an automatic cost of living CPI increase, as well as the Decennial Review by the Commission. The Draft Recommendation lists several arguments in support of automatically increasing the exemptions, including COLAs which are scattered in various other provisions of law, conformity with the bankruptcy exemptions, and to relieve the burden on the Legislature. In considering the proposal and the arguments in support, the Association has reached different conclusions and concerns.

The present set of exemptions in California law is part of a comprehensive enforcement of judgments scheme, which itself is part of the larger judicial process. One of the original reasons for the Decennial Review and legislative adjustment of the exemptions is to provide for deliberate consideration of how the increases will impact the judicial process as a whole and the rights of the other parties in the process. COLAs are not provided (nor proposed) for the judicial process as a whole for plaintiffs in enforcing their rights in the court system, or to otherwise automatically address the rising costs and fees to plaintiffs.

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While the use of a COLA may be appropriate in some areas where the automatic increase applies to an entire area of economic issues, such as retirement benefits, welfare payments, taxes and campaign spending limits, it is not appropriate to use an automatic COLA to address only a portion of the economic issues in the judicial process. With the judicial system and the Enforcement of Judgments provisions, the exemption provisions (including amounts) are inexorably intertwined with the rights of plaintiffs and judgment creditors. Adjustment of only one part can properly be made only after deliberate consideration of the actual impact on the system as a whole and the rights of plaintiffs.


The argument is also made that the automatic COLA increases will merely bring California in conformity with the Bankruptcy Code (for which California chose to opt-out of the federal exemptions). The exemptions under the California Enforcement of Judgments provisions address issues separate and apart from the Bankruptcy Code. The exemptions are part of a dynamic system by which a plaintiff is attempting to enforce his or her rights against a defendant, including rights and benefits that are not found under the Bankruptcy Code.

In contrast, the Bankruptcy process is not a dynamic process for plaintiffs to enforce their rights (with limited exceptions relating to discharge of debts), but is a static process by which a debtor obtains a discharge of the indebtedness. In adopting a COLA for the Bankruptcy Code, Congress was implementing a federal policy which would be uniformly applied in all the states, irrespective of the specific interests and deliberative considerations of the individual states. If the present concern relates to bankruptcy debtors in California being able to utilize the COLA in the federal bankruptcy exemption scheme, the answer would be to amend California law to allow debtors to utilize either the Federal Bankruptcy Code exemptions (rather than the State opting-out) or the California exemptions.

Respectfully, the California Association of Collectors, Inc. submits these comments opposing adding an automatic COLA provision to the exemption portion of the judicial process. Creating such a provision would address only a portion of the process and work to put plaintiff - defendant rights out of balance.

Very truly yours,

HEFNER, STARK & MAROIS, LLP

By 
Ronald H. Sargis

RHS:dn

cc: CAC Executive Committee (c/o CAC)

Ms. Jan Stieger

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