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If You Are Unlucky Enough to Be a Judgment Creditor, At Least Do It Judiciously

Roger Bernhardt
Golden Gate University School of Law, rbernhardt@ggu.edu

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Introduction

This issue of the Reporter includes two somewhat uncommon cases involving judgment creditors: *Banc of America Leasing & Capital, LLC v 3 Arch Trustee Servs., Inc.* (reported at p 42), which held that she (my pronoun for the judgment creditor throughout this article) is not entitled to receive notices of default or of sale from foreclosure trustees merely because she has recorded an abstract of her judgment, and *Washington Mut. Bank v Jacoby* (reported at p 40), which held that her successor execution purchaser cannot claim the benefits of any property insurance carried by the judgment debtor. A judgment debtor's plight illustrates how risky it may be to put all that effort into obtaining a judgment against a debtor unless even more is put in thereafter.

Banc of America Leasing v 3 Arch Trustee Servs.

A judgment creditor is not much protected in our legal system. If she was not smart enough to get security for the loan she initially made (or was unlucky enough to get her contract breached or get hit by an uninsured motorist), she is remitted to a lengthy process of litigation that probably concludes with a judgment against, rather than a cash payment from, her adversary. Under Article 9 of the Commercial Code, her priority is below that of any secured party who has already perfected (or sometimes done little more than file a financing statement) before she levied execution. Under real estate law, she is not given priority over unrecorded preexisting mortgages and other interests in real property even when she has recorded her judgment (on the ground that she did not give value to qualify her for protection under our recording act). It is true that recording her judgment puts her in line against interests that are thereafter put into the records, but—as *3 Arch* demonstrates—simply recording the judgment does not entitle her to receive any notice of default or notice of sale, or even a notice that surplus funds are available following a trustee sale under an already existing deed of trust. (A judgment creditor who has recorded her abstract of judgment before any deed of trust was recorded does not need to worry about any default or any surplus from a trustee sale conducted under a later recorded deed of trust, since the title foreclosed on would already be subject to the judgment lien.) Our code has taken the political position that it is the judgment creditor who must search out and request notice from the trust deed beneficiary, rather than the beneficiary or its foreclosure trustee who must search for the judgment creditor (by adding a category to the record search it is undoubtedly already making, to find the names of people it has to notify). Whenever a rule says that A does not have to automatically give notice to B, then B, of course, has to expend the effort to find A and request that notice.

Under our statutes as they currently read, the only way for a judgment creditor officially to protect herself vis-a-vis an already recorded deed of trust is to record a request for notice of default under CC §2924b(a). That means that, as a practical matter, at the time she records her abstract of judgment, she also ought to search the record not only to find out whether her judgment debtor has title to any property, but also so that she sends proper requests for notice to the appropriate mortgage holders on any titles she finds. The best practice would be to search the record, record requests for notice of default when she first decides to sue her debtor, and go after his assets rather than waiting until a judgment has been entered. If a notice of default or notice of sale has already been recorded (as it had been in *3 Arch*), that request for notice will not work for any pending trustee sale (although it should be effective when the current default is subsequently cured but then followed by another notice of default later). But even when the request for notice is not formally effective, it can still be helpful. Phillip Adleson, of Adleson Hess & Kelly, APC, who represented the United Trustees Association (amicus curiae) in this case, told me that while trustees are reluctant to promise to send future courtesy (nonstatutory) notices to a newly appearing judgment creditor, on written request, trustees generally provide the new judgment creditor with a copy of the notice of surplus proceeds under CC §2924j, or with a claims form based on that section, when the trustee decides not to interplead the surplus. From then on, a diligent judgment creditor can keep herself current as to the status of that asset.

Washington Mut. Bank v Jacoby

Washington Mut. Bank v Jacoby illustrates that another respect in which the judgment creditor suffers by comparison with secured creditors is with regard to damage claims paid to property owners by their insurance carriers. Personal property secured creditors are protected as to those funds by virtue of Article 9's inclusion of proceeds within the definition of the collateral itself. Real estate mortgagees lack the benefit of that proceeds doctrine, but they know enough to provide in their deeds of trust that the trustors will insure the property and also that the insurance proceeds are additional security for their loan. But a judgment creditor has none of those protections. With regard to a judgment debtor, any insurance coverage that he carries on his property is a strictly private contract between him and the carrier, which means that any payments made by the carrier on account of property damage are not subject to any judgment lien that had attached to the title to the property, nor to a judgment/execution sale of the property. That was why the execution purchaser in *Jacoby* could not reach those funds under his assertion that he was the successor title holder of the insured real estate, and would also be the reason for denying the judgment creditor herself access to them. The fact that the claimant in *Jacoby* was an execution purchaser, purchasing at a judgment creditor's execution sale rather than being the judgment creditor himself, does not really make a difference on this point; the execution purchaser's inability to reach the insurance money was the same as the selling judgment creditor's. (Usually, I think, judgment creditors are the high bidders at their execution sales.)

For judgment creditors (as well as execution purchasers), a judgment debtor's insurance policy does not constitute a substitute asset that replaces the property; it does not "run with the land" to protect a subsequent title holder. Therefore, a judgment creditor needs to execute on the carrier before such funds are paid out if she wants to have a better claim to them than the judgment debtor. That means that she needs to discover their existence through a debtor's examination and then reach out for them through garnishment or some other form of execution: She cannot hope that they will come to her (or her execution purchaser) as any kind of successor to the title of the judgment debtor. (Levying on the insurance money will probably never be available to an execution purchaser like Jacoby, who was not a judgment lienor to begin with; nothing will help him except an inspection of the premises before bidding.)

It was also the case that the judgment lien in *Jacoby* appears to have been prior to the mortgage against the property, since the sheriff's sending of surplus funds from the execution sale to the mortgage holder makes sense only if the mortgage was inferior to the judgment—surplus execution sale proceeds go downstream, not upstream. But that is not a difference that matters as far as entitlement to the insurance proceeds is concerned. Despite its nonseniority, the mortgagee in *Jacoby* got the insurance money because it had taken the right steps—taking a security interest in the insurance policy and making itself a named insured—steps that no judgment creditor can take. Priority as to one asset (title) does not automatically protect that prior claimant with regard to some other asset (insurance) with which only the junior claimant has secured itself (and that the judgment creditor had never sought to reach on execution). But there were surplus insurance funds in *Jacoby* that even a junior claimant could have reached under the right circumstance.

Conclusion

So there are two—somewhat separate—lessons from these cases. From *3 Arch*, tell your asset searcher also to look for deeds of trust that encumber any real estate that has been found, and then (if there are any) record a request for notice of default and sale—or, if such notices have already been recorded, contact the trustee. From *Jacoby*, tell your searcher to look not only for real estate owned by your debtor, but also for any insurance on it (and then go after both).