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## Attorney Fees and Lien Priorities

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## Attorney Fees and Lien Priorities

Roger Bernhardt

*[I have really written two Midcourse Corrections columns for this issue, but have hidden them under one heading so that the CEB publishers would not realize I was breaking their rules. This first one is on offsets, attorney fees, and lien priorities; below it is a second column on the Statute of Frauds.—RB]*

### ***Behniwal v Mix***

Until I read the decision in *Behniwal v Mix* (2006) 147 CA4th 621, 54 CR3d 427, reported on p 84, I had always innocently believed that a purchaser who was successful in a specific performance action, and who had an attorney fees clause in his contract, could deduct what he was awarded by the court for those fees from the amount that he would have to pay. Now I have learned that the rule is otherwise, but I have to say that I regret that and I would like to find some way to get around it.

The Behniwals finally prevailed in their action to compel the Mixes to honor their contract to sell their condominium unit to them for \$540,000 and, in addition, were awarded over \$250,000 in attorney fees. (The matter had gone to the court of appeal on at least three prior occasions, and I have commented on two of its previous opinions—see 29 CEB RPLR 222 (Jan. 2006) and 28 CEB RPLR 83 (May 2005).) The trial court ordered the attorney fees to be deducted from the purchase price, but that order was reversed on this appeal. According to Justice Sills, who had authored all of the opinions in this interesting saga, the attorney fees award ranks below two deeds of trust on the seller's property as well as the seller's homestead declaration. Since those three other claims by themselves exceed the purchase price, if attorney fees were taken off the top, it would play "absolute havoc with the law of liens and lien priorities." 146 CA4th at 632.

Justice Sills reached this conclusion by some very elegant reasoning. He first determined that an attorney fees award in a specific performance action by itself does not reduce the price in the same way that an equitable adjustment might. (The older cases that seemed to say that were doing so only as a kind of "rough justice" in contexts where priority did not matter.) The fee award is not mere incidental relief to a specific performance decree, but rather an additional right—created by the attorney fees clause in the contract—with no special claim to any lien superpriority. Attorney fees are just a money judgment that will function like a lien (with concomitant lien priority) only after it has been recorded.

### ***Offsets and Priorities***

It is hard to disagree with any of that reasoning, but the legislature may have superseded it by its treatment of offsets. The statement in CCP §431.70 that cross demands "are compensated so far as they equal each other" does not seem to make an offset depend on any particular priority status. If the Behniwals' attorney fees are treated as though they had already been paid to Mix (see *Murphy v FDIC* (9th Cir 1994) 38 F3d 1490), any lien inferiority on their part would not

matter because the cross demands were “deemed compensated.” See *Murchison v Murchison* (1963) 219 CA2d 600, 33 CR 285.

In fact, the judicial principle that offset is *more* appropriate when the cross party may be insolvent (and thus less likely to be able to honor its half of the burden; see *Erlich v Superior Court* (1965) 63 C2d 551, 47 CR 473) seems also to run contrary to the notion that offsets are controlled by lien priority principles. In those cases, giving a litigant an offset right certainly worsens the position of its adversary’s other creditors.

Nor would offset necessarily wreck our system of priorities, as Justice Sills seems to fear. No preexisting deed of trust on the seller’s property would be pushed down by a buyer’s offset because a third party lender, not being a party to the specific performance litigation, would find its instrument unaffected by it—only the identity of the trustor would change. The successful purchaser would take title to the property, subject to whatever balance there was on existing deeds of trust, and no attorney fees award would trump those liens. If the balance of cash the purchaser then pays isn’t enough to retire the preexisting liens entirely, they just stay on the title. Sooner or later, the purchaser will have to pay them off.

### ***Priority Against Later Claims***

In *Behniwal*, the lien priority that had to be dealt with concerned three interests that were created *after* the purchasers had filed their lawsuit and recorded their lis pendens. Even if the right of offset was subject to the rules of priority, why did the attorney fees award have to go behind those three later claims?

Justice Sills’s answer was that, as a technical matter, the attorney fees could achieve lien status only after a money judgment had been rendered and recorded, all of which happened after the other three interests went of record. But that only triggered the question: Why shouldn’t the purchasers’ award relate back to the date they recorded their lis pendens, which was *before* those three interests appeared?

Relation back is what I would have expected, but in Justice Sills’s view, the lis pendens only notifies third parties that the buyer is suing to enforce a sale of the land at the stated contract price (unreduced by offsets) (147 CA4th at 638):

A buyer or moneylender, then, could have reasonably relied on the buyers’ own pleadings to conclude that, should the buyers be successful, the court would force the sellers to convey the property for the contract price of \$540,000.... [A] lender could also reasonably rely on the pleadings to conclude that the property could be safely encumbered *up* to that \$540,000 amount.

That the pleadings also gave notice of a potential attorney fee award did not matter because that award would be only a later money judgment that could not relate back to the earlier lis pendens. Justice Sills treats the lis pendens differently than a recorded deed of trust, which puts all subsequent parties on notice that attorney fees in any foreclosure will also come off the top and before them.

That proposition is true only after this decision has made it a correct statement, but before the decision was announced, I believed that the general principle was that a lis pendens

- Puts purchasers and encumbrancers on notice that they will take subject to any judgment thereafter entered in the case;

- Will bind them to any judgment that might be entered (see *BGJ Assocs., LLC v Superior Court* (1999) 75 CA4th 952, 89 CR2d 693; *Ahmanson Bank & Trust Co. v Tepper* (1969) 269 CA2d 333, 74 CR 774); and
- Would apprise them of the possibility that an award of attorney fees could be offset against the purchase price.

Despite this opinion, I think attorneys should still caution subsequent takers as to this risk. There remains a real danger that they could be charged with inquiry notice of all plaintiff's claims, including attorney fees.

### ***Priority Against the Other Claim***

I think doubts about priority would be even stronger for the law firm that took the second deed of trust. How can those lawyers claim to be BFPs without notice, entitled to protection of the recording acts against a plaintiff's attorney fees claim, when they are engaged in representing their client against that claim—and, therefore, surely have actual knowledge of it? We are not told the circumstances of that transaction in *Behniwal*, but if a law firm's deed of trust was given to secure payment for services to be rendered, would not those fees have the status of future advances made with actual knowledge of the junior claim? (I second the observation made by Justice Sills that the losing side's attorney is the only real winner in the case.)

Finally, I would have doubts about assuring the defendant sellers that any homestead they filed after they had been sued would protect them against their buyers. Generally, a later filed homestead can prevail against an earlier filed action, but in this case that earlier action sought attorney fees that the sellers had agreed to in their sales contract (executed before anything else had happened). I would worry that the attorney fees clause in the sales contract could justify treating the fee award as a kind of preexisting consensual claim against which the homestead might not prevail. (Miller & Starr say that the homestead exemption does not apply against an equitable mortgage, whether it is recorded or not. 5 California Real Estate §13:43 (3d ed 2000).)

But all of my speculations turn out to be faulty in light of the decision in *Behniwal*, which significantly raises the stakes for purchasers contemplating specific performance litigation. Not only must they be prepared to prove that their contract is just and reasonable (as well as merely enforceable) and be prepared to stay ready, willing, and able throughout the entire litigation to pay the purchase price whenever the vendors are ordered or offer to perform, but now they also must be prepared to have their expected award of attorney fees held subordinate to any liens the sellers (involuntarily or voluntarily) impose on the property during the litigation, devastating their ability to offset those fees against the price they will still have to pay.

Justice Sills is too respected, and has thought too hard about this case, to make it likely that any other appellate tribunal will disagree with him. The legislature is certainly not going to bother itself with the small (and difficult) problem this case presents. So I predict that this is going to stay as our rule.

### ***Can Anything Be Done About It?***

Is there a way for purchasers to reduce the risks this rule creates? I cannot offer much help if the deal has already fallen apart and they are about to sue. They will not receive a fee award until the end, and then it will rank only as a money judgment with no superpriority despite any *lis pendens* they have earlier filed. Maybe they could file an attachment enabling the judgment to

relate back to the lis pendens filing, but can purchasers both attach and lis pendens the very property they are attempting to purchase? Even if they can, our supreme court has held that a later homestead prevails over a prior attachment anyway. *Becker v Lindsay* (1976) 16 C3d 188, 127 CR 348.

Better language in the agreement, inserted at the drafting stage, is the only hope. Thus, some provision in the contract should give lien status to any attorney fees later awarded and also provide for relation back to the date of contract execution. It would be hard, if not impossible, to negotiate any individualized version of that kind of arrangement, but published forms could do that for everybody.

Since attorney fees clauses occur in most contracts, and are therefore presumably desirable to both sides, a supplemental provision in the same paragraph that gives those fees some teeth might generate little controversy at the early contract formation stage. If the same provision also allowed the prevailing sellers to use their fee awards to include the purchasers' deposits (even when there is no, or only a lesser, liquidated damages clause), both sides might be better off.