Selected Post-Judgment Topics and Recent Developments

Invalid Assignments, "Innocent" Fraudulent Transfers, and Other Fun Surprises in Post-Judgment Enforcement

By Ellen Kaufman Wolf

A. VALIDITY AND ASSIGNED JUDGMENTS

1. Check for Validity of Assigned Judgment. Beware of this trap for the unwary—Anyone taking assignment of a Judgment for collection must be sure that all assignees of the Judgment (and any rights and claims thereunder) had proper legal capacity at the time of each assignment. A valid judgment becomes altogether unenforceable when it has been assigned at a time when the assignor’s corporate charter was suspended, and has not been revived before attempts to enforce the Judgment.

The court in Cal-Western Bus. Services, Inc. v. Corning Capital Group, 2013 WL 5936628 (Cal.App.Div. 2, Nov. 6, 2013), held that a plaintiff who was assigned rights to a judgment had no right to sue on the judgment, because the assignor was a suspended corporation at the time of the assignment. The court reasoned that a suspended corporation lacks capacity to enforce a judgment and/or maintain a lawsuit; Plaintiff assignee “stands in the shoes” of the suspended corporation and thus likewise lacked capacity to maintain the action on the Judgment. The court also held that defendant’s failure to timely assert an incapacity defense did not amount to a waiver of the defense, even after years of litigation on the merits.

There are other contracts at risk of invalidity as well, not only assignments of judgments. Leases, purchase and sale contracts, and any other agreements can also be invalidated if signed by a corporation without powers. Such corporations include a suspended corporation or a foreign nonqualified corporation (not authorized to do business in the state of California), and can also include LLCs if taxed as corporations. California law provides that specified limited liability companies (LLCs) and corporations that are suspended or forfeited for failure to file a tax return or for failure to pay delinquent taxes, penalties, or interest are subject to specified consequences, including contract voidability for the time period the entity is suspended or forfeited. As in the Cal-Western case cited above, contract voidability can be asserted by any party or alleged party to the contract other than the suspended taxpayer.

Also, a suspended or forfeited business entity loses the right to enforce its legal contracts. Timberline, Inc. v. Jaisinghani, (1997) 54 Cal. App. 4th 1361 (suspended corporation disqualified from exercising any right, power, or privilege, including prosecuting or defending an action, or appealing a judgment); accord, Ransome-Crummey Co. v. Superior Court 54 Cal.App.4th 1366 (1922) 188 Cal. 393, 396-397, 205 P. 446; Alhambra-Shumway Mines, Inc. v. Alhambra Gold Mine Corp. (1957) 155 Cal.App.2d 46, 50-51 317 P.2d 649; Boyle v. Lakeview

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1 Ellen Kaufman Wolf is the founder of Wolf Group L.A., a business law boutique for matters involving business, real estate, and estates, and emphasizing creditors’ rights and remedies. Ms. Wolf is the presiding Chair of the Executive Committee for the LACBA Remedies Section.

Any person who attempts to exercise the powers, rights and privileges of a suspended corporation (which would include prosecuting or defending claims) may be punished “by a fine of not less than $250 and not exceeding $1,000, or by imprisonment not exceeding one year”. California Revenue and Taxation Code Section 19719. This includes attorneys (except those retained by an insurance company, who are expressly exempt from Section 19719). Court rulings, and rules of professional responsibility, proscribe an attorney’s participation in proceedings which the attorney knows, or should know, are illegal or unjust. (See, e.g., In re Disbarment of C. C. Stephens, 77 Cal., 357, 359-60 (1888); California Rule of Professional Conduct No. 3-210, or No. 3-310(b)(4)).

Contracts by a suspended or forfeited business entity will remain voidable and unenforceable by the entity, and the entity will be powerless in court, unless corporate reviver and/or relief from contract voidability are sought and granted by taxing authorities, which can be a lengthy and expensive process.

This is a good reminder for all that the best practice, whenever involved with a purchase, sale, settlement, or other assignment of any asset, right or interest (and especially a judgment), is to be sure to obtain good standing certificates proving the corporate status of the applicable parties, including previous transferors of any assets. Also, in litigated matters, check the corporate status of the parties at the inception, and periodically throughout the case, especially on the eve of trials or dispositive motions. If not, be prepared to face unintended consequences later.

B. ATTORNEY FEE PROVISIONS POST-JUDGMENT


By affirming judgment of nonsuit as to one of two plaintiffs but reversing the judgment “in all other respects,” court of appeal reversed not only the judgment of nonsuit as to the other plaintiff but also that portion of the judgment that awarded costs to defendants, precluding them from collecting costs from the nonsuited plaintiff.

C. FRAUDULENT CONVEYANCE- INNOCENT FRAUDULENT TRANSFEREE TARGETS AND LENDER PAYOFF ISSUES

1. Creativity In Pursuing Innocent Transferees: E.g.,
a. Distributees from LLC. CB Richard Ellis, Inc. v. Terra Nostra Consultants, (2014) 178 Cal.Rptr.3d 640 (Cal. Ct. App. Oct. 7, 2014). In determining whether individual members of a dissolved limited liability company are liable for debts incurred by the LLC, on the ground that the LLC made a distribution to the members upon dissolution without having paid creditors, a trier of fact may rely on the date of "de facto" dissolution and find that the company had actually dissolved at the time of the distribution, based on the reality of the company’s finances and operations, even though formal dissolution occurred later.

Note – Fraudulent Transferee may be obligated to pay attorney fees. Under former Corporations Code Sec. 17355(a)(1)--nearly identical to current Sec. 17707.07(a)(1)--members of a prematurely dissolved LLC are deemed to be parties to the contract that created the unpaid debt and are thus liable for contractual attorney fees--so long as the total recovery against any individual member does not exceed that member’s distribution upon dissolution.

Question – Do fraudulent transfer cases turn on facts (resulted-oriented adjudication?) Does the court find fraudulent transfer in a non-obvious case? Or is it like obscenity – we know it when we see it…..

In the CBRE case, fraudulent transfer was obvious: the LLC was already in a dispute with CBRE. When the LLC sold its sole asset for $11.8 million, and received the net sale proceeds, one day later the LLC transferred essentially all of the proceeds to its members, without paying any commission to CBRE as provided in the purported listing agreement. Seven months later, the LLC filed a certificate of cancellation with the California Secretary of State, indicating that it had been dissolved by a vote of its members.

b. Sellers in Tender Offer- Sellers Beware. Fraudulent transfer assertions following a failed Leveraged Buyout were a hot topic in the 1990’s including the infamous PharMor case, and now have had a renaissance. During the credit run-up prior to 2008, many highly leveraged transactions were financed, including an $8.2 billion buyout led by Sam Zell for the stock of the Tribune Company. The company’s troubles spiraled after the sale, and as can be the case after a failed or troubled leveraged buyout, fraudulent transfer litigation was brought by certain creditors, seeking to recover the payments made to the company’s selling shareholders after the tender offer. The claimants also sought to avoid the lenders’ liens securing the buyout funds. Typically, these LBO’s are complex transactions, in which the crux of the fraudulent transfer complaint is that the debtor, whose assets were used to secure the funds for the buyout, did not receive reasonably equivalent value for the transfer, and the debtor was insolvent either at the time of, or as a result of, the transfer. Insolvency in fraudulent transfer law can be balance sheet insolvency, equitable insolvency, or other standards depending on state laws or bankruptcy laws. See e.g., - In re Tribune Company Fraudulent Conveyance Litigation, U.S District Court, New York Southern District Case No. 11MD2296 (RJS).
c. **Lenders - Lender Payoff Caution Required.** See e.g., *Senior Transeastern Lenders v. Official Committee of Unsecured Creditors (In re TOUSA)*, 680 F.3d 1298 (11th Cir., 2012).

Where, without receiving reasonably equivalent value, subsidiaries gave liens to collateralize new loans to refinance older loans of the parent entity, the paid-off lenders were fraudulent transferees under §548(a)(1) of the Bankruptcy Code and must disgorge.

The lenders who received the proceeds of the new loan were entities “for whose benefit” the liens were transferred within the meaning of §550(a)(1) of the bankruptcy code and were not, as they claimed, subsequent transferees of the loan proceeds. Consequently, the court concluded that the lenders who received the proceeds of the new loan could be liable to disgorge the funds they received.

The issue is that where a subsidiary guarantees or provides its assets as collateral on a loan where the subsidiary does not receive reasonably equivalent value, the proceeds of the loan paid to prior lenders of the parent are fraudulently conveyed. The new lender may be required to disgorge the funds.

The California Uniform Fraudulent Transfer Act (UFTA) provides the same relief as section 550(a)(1).

More specifically, California Civil Code section 3439.08(b) provides that to the extent the transfer is voidable as a fraudulent transfer, “the creditor may recover judgment for the value of the asset transferred... or the amount necessary to satisfy the creditor's claim, whichever is less,” and such a “judgment may be entered against the following: (1) The first transferee of the asset or the person for whose benefit the transfer was made. [or] (2) Any subsequent transferee other than a good faith transferee who took for value or from any subsequent transferee.” (emphasis added).

California’s UFTA defines person to include an entity. Civ. Code section 3439.01(g) (“‘Person’ means an individual, partnership, corporation, limited liability company... or any other legal or commercial entity.”).

“The legislative history is clear on the point that Section 3439.08(b) of the UFTA ‘is derived from Section 550(a) of the Bankruptcy Code.’” *Qwest Communications Corp. v. Weisz*, 278 F.Supp.2d 1188, 1192 n.2 (S.D.Cal.,2003) (quoting *In re Lucas Dallas, Inc.*, 185 B.R. 801, 810 (9th Cir. BAP 1995) (quoting Cal. Civ.Code § 3439.08, legislative committee comment-assembly, 1986 addition, ¶ 2 (West.Supp.1995))). “Therefore, ‘cases construing the Bankruptcy Code counterparts [of the UFTA] are persuasive authority due to the similarity of the laws in this area.’” *Id.*

Another issue that arises in these cases is the definition of reasonably equivalent value. A Transferee is to disgorge any value in excess of reasonably equivalent value received by debtor.
A “good faith transferee” in a fraudulent transfer suit “is entitled” to keep what it received “only to the extent” it gave “value.” *Williams v. FDIC (In re Positive Health Management)*, 2014 WL 5293705, at *8 (5th Cir. Oct. 16, 2014).

b. *What is value? Direct vs. indirect value* – typically indirect value is argued as obtaining credit extension or forbearance, or avoiding bankruptcy. Indirect value is generally not found where there is benefit only to parent or sibling companies. [See TOUSA case above.]