

Yolanda's, Inc. v. Kahl & Goveia Commercial Real Estate — Expanding a Creditor's Post-Judgment Examination of a Non- Debtor Third Party

Gary B. Rudolph



After obtaining graduate/undergraduate degrees from American University, Washington D.C. I moved to San Diego, California graduating from California Western School of Law in 1981. I am a shareholder at Sullivan Hill Lewin Rez & Engel, APLC specializing in representing creditors, commercial debtors, trustees, receivers, and fiduciaries.

When a judgment creditor seeks to examine a non-debtor third party regarding the location and/or transfer of assets of the judgment debtor, what are the parameters for the examination? The case of *Yolanda's, Inc. v. Kahl & Goveia Commercial Real Estate*¹ is factually straight forward; however, its holding implies a more complicated answer to the question, and sets boundaries for the examination of a non-debtor third party by a judgment creditor that arguably exceed those specified in the California Code of Civil Procedure.

The starting point for this analysis is California Code of Civil Procedure section 708.120, which provides that a judgment creditor may examine a third party who has possession or control of property in which the judgment debtor has an interest or is indebted to the judgment debtor in amount exceeding \$250.²

In *Yolanda's*, a creditor obtained a judgment of approximately two million dollars against several individuals and the entities they controlled. The same individuals also controlled a third-party entity that was not a judgment debtor (or even a party to the litigation). The judgment creditor obtained (1) an order requiring the “person most knowledgeable” to appear as a third-party witness for a post-judgment debtor’s examination, and (2) the issuance of a subpoena to produce documents. In response, the witness produced documents showing bills

of sale transferring vehicles and other items of property from one of the defendants to one of its principals.

However, during the examination, counsel for the third-party witness instructed the witness not to answer questions about the location of those assets, because the examinee no longer had “possession or control over the property in question”³ as facially required by section 708.120.

After briefing and a hearing, the court concluded that authority for the issued subpoena was not limited to section 708.120;⁴ rather, the court had inherent authority to create a proper procedure for examination under the broad language of section 187.⁵ The court also granted the creditor permission to inquire as to the ultimate disposition of the assets transferred, as well as the relationship between the transferee and other judgment debtors and related parties for purposes of establishing alter-ego liability, and to ask any other questions that might assist the judgment creditors in determining the true financial condition of the judgment debtors and the nature and location of judgment debtor’s assets and sources of income.⁶

The third party examinee appealed that order. The court of appeal treated the appeal as a petition for writ of mandate, and then denied it.⁷

In reaching its decision, the court of appeal determined that “whatever the limitations of section 708.120, section 708.130 subdivision (a) has a broader reach.”⁸ It provides: “Witnesses may be required to appear and testify before the court or referee in an examination proceeding under this article in the same manner as upon trial of an issue.”⁹

Expanding on that analysis, the court of appeal explained, “[t]his subdivision allows any person with information leading to the enforcement of the judgment to be subpoenaed to testify in an examination proceeding in the same manner as a trial witness. (AHART, CAL. PRACTICE GUIDE: ENFORCING JUDGMENTS AND DEBTS (The Rutter Group 2016) ¶ 6:1280, pp. 6 G–2–6G3).”¹⁰

An interesting discussion ensued regarding application of the trial court’s inherent power under section 187.¹¹ Section 187 afforded the trial court inherent power to adopt “any suitable method of practice if the procedure is not specified by the statute or the Rules of Court.”¹² Counsel for the examinee asserted that section 187 did not apply, because section 708.120 in fact expressly limits the examinations of a third party to property of the judgment debtor held by a third party and debts owed by a third party to a judgment debtor.¹³ Clearly, neither of those qualifying conditions was present.

In dismissing that argument, the appellate court responded that nothing in section 704.120 stated that it would be the *only* procedure for examining a third party. “In fact, section 708.130 expressly provides otherwise. To the extent section 708.130 may not apply there is no reason why the court could not use its power under section 187 to fashion an appropriate procedure.”¹⁴ The third-party examinee placed primary reliance on *Fox Johns Lazar Peken & Wexler, APC v. Superior Court of California*¹⁵ to support its position that section 708.120 did not allow for a more expansive examination.¹⁶ The court of appeal dismissed the argument by determining that section 708.130(a) had a broader reach,¹⁷ thereby expanding the scope of the examination to allow questions regarding the location of property even if the third party examinee no longer had possession or control over the property.¹⁸

The Great Divide

Balancing the judgment creditor’s right to obtain complete information regarding the assets of a judgment

debtor against the rights of a third-party, non-debtor examinee is the cornerstone of the debate.

California courts have emphasized the importance of enabling a creditor to recover on its judgments: “The policy of the law favors the enforcement of judgments.”¹⁹ Judgment creditors rely on a Judgment Debtor’s Examination “to leave no stone unturned in the search for assets which might be used to satisfy the judgment.”²⁰ “There is no policy favoring the concealment of the Judgment Debtor’s assets from the judgment creditor.”²¹

In this legal environment, the practical application of section 708.120 is to provide a simple and inexpensive mechanism for a creditor to obtain an examination of a third party regarding potential assets of the judgment debtor.²² The examination may often lead to information demonstrating potential alter-ego liability, as well as identification of potential transfers to an immediate or mediate transferee—which is why the examination of a non-debtor third party can proceed upon an *ex parte* application supported by an affidavit that the third person has possession or control of property in which the judgment debtor has an interest or is indebted to the judgment debtor in amount exceeding \$250.²³ Why shouldn’t a judgment creditor be able to conduct a wide-ranging examination of a third party with proven ties to the judgment debtor?

Yet the opponents of the *Yolanda’s* decision maintain that the evidentiary bar pronounced in section 708.120(a) is already too low and the *Yolanda’s* decision may have further lowered that bar, causing undue prejudice to third parties who happen to be in possession of the judgment debtor’s property. In the process of “turning over every stone,” there must be due consideration of the rights of the third-party examinee.

The *Yolanda’s* decision, arguably, expanded the plain meaning of section 708.120(a) by utilizing the less-specific statute, section 708.130, and the “catch-all” inherent power of the court codified in section 187.²⁴ Interestingly, section 187 is to be utilized in the exercise of the court’s jurisdiction if there is not a specific statute addressing a particular issue. Query: doesn’t section 708.120(a) already specifically address the mechanism for obtaining an order to examine a third-party witness such that application of the less-specific statute, section 708.130, is unnecessary, and, if so, did the *Yolanda’s* court wrongly apply section 187? Is expanding the

application of section 187 parallel to the analysis found in § 105(a) of the Bankruptcy Code, which provides—“[t]he court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title”²⁵ Bankruptcy practitioners have routinely relied on 11 U.S.C. § 105(a) in requesting relief where there is no specific bankruptcy statute or rule providing the relief sought.

Another question militating against *Yolanda's* is, how does it co-exist with section 2035.010(b): “One shall not employ the procedures of this chapter for purposes of either ascertaining the possible existence of a cause of action or defense to it, or of identifying those who might be made a party to an action not yet filed.”²⁶ Has the *Yolanda's* decision created an end-run around the normal discovery process to obtain information regarding fraudulent transfers or alter ego allegations?

Possible Solutions

For those who think *Yolanda's* goes too far in protecting creditors, at the expense of third-party examinees, Professor Dan Schechter has examined addressing some of these questions, including the drafting of a proposed amendment to section 708.102(a).²⁷ For example, Professor Schechter suggests that

two parts of that statute need to be broadened: the preconditions to the examination of the third party, and the scope of that examination. With respect to the preconditions it makes sense to require the judgment creditor to show the court that the third party to be examined has some nexus to wrongful transactions involving the judgment debtor's assets; otherwise innocent strangers who have ordinary dealings with the judgment debtor would be subject to inconvenience of an examination. Presumably the judgment creditor would gather the evidence necessary for the threshold showing during its initial examinations of the judgment debtor.²⁸

The proposed amendment by Professor Schechter also would require the judgment creditor to make a prima facie showing that, using the badges of fraud set forth in Civil Code section 3439.04(b), the non-debtor third party was involved in a potential fraudulent transfer involving the judgment debtor or its insiders.²⁹ But this proposal may have unintended complications. Could it raise questions

such as (1) how many badges of fraud are necessary to be presented by affidavit; (2) does the affiant have to identify the evidentiary basis for connecting the third-party witness with any of the badges of fraud; or (3) does the amendment effectively eviscerate the legislature's desired simplicity for obtaining an examination of a third-party examinee? Yet, doesn't the *Yolanda's* decision necessitate an amendment to section 708.120(a) such that its application can be implemented without patchwork references to sections 187 and 708.130?

Since section 708.120(a) does not provide a requirement that the third-party examinee be put on notice of the scope of the examination, the examinee often appears pro se. It may be useful to amend the statute to require such notice to the third-party examinee and an opportunity to retain counsel or object to the scope of the examination by applying for a protective order, if appropriate under section 708.200.³⁰

In the end, it may be best to continue to rely on the *Yolanda's* decision, since the purpose of the examination is to turn over every stone relating to assets and the financial condition of the judgment debtor. The examinee may be testifying with spontaneity, thereby reducing the possibility that the examinee could transfer assets before the examination or otherwise engage in activities that would result in further concealment of assets from the judgment creditor (although if the relationship between the examinee and the judgment debtor is close enough, a scheme to isolate assets from the judgment creditor may already have passed that stage).

Conclusion

*Yolanda's*³¹ may just be the beginning of a debate as to the expanding scope of judgment creditors' examination of non-debtor third parties.

Endnotes

- 1 11 Cal. App. 5th 509 (2017).
- 2 CAL. CIV. PROC. CODE § 708.120(a). Except as otherwise stated in the article, all references in the article to section refer to the Code of Civil Procedure.
- 3 11 Cal. App. 5th at 513.
- 4 CAL. CIV. PROC. CODE § 708.120
- 5 11 Cal. App. 5th at 512 (citing CAL. CIV. PROC. CODE § 187) (“When jurisdiction is, by the Constitution or this Code or by any other statute, conferred on a Court or judicial officer, all the means necessary to carry it into effect or also given; and in the exercise of this jurisdiction, if the course of the proceeding be not specifically pointed out by this Code or the Statute, any

- suitable processer mode of proceeding may be adopted, which may appear most comfortable to the spirit of this Code”).
- 6 *Id.* at 512.
- 7 *Id.* at 511.
- 8 *Id.* at 514.
- 9 CAL. CIV. PROC. CODE § 708.130(a).
- 10 *Yolanda’s, Inc.*, 11 Cal. App. 5th at 514.
- 11 *See supra* note 5.
- 12 *Yolanda’s, Inc.*, 11 Cal. App. 5th at 514 (citing *Citizens Utils. Co. v. Superior Court*, 382 P.2d 356 (Cal. 1963)).
- 13 *Id.* at 514-15.
- 14 *Id.* at 515.
- 15 *Fox Johns Lazar Peken & Wexler, APC v. Superior Court of Cal.*, 219 Cal. App. 4th 1210, 1221 (2013). In *Fox Johns*, a judgment creditor served a judgment debtor’s attorneys (Fox Johns Lazar Perkin & Wexler, APC (“Fox Johns”)) with a subpoena for production of documents and obtained an order for a third-party examination of the judgment debtor’s lead attorney at Fox Johns (Michael Wexler) under California Code of Civil Procedure section 708.120. *Fox Johns*, 219 Cal. App. 4th at 1213. Before doing so, the judgment creditor had examined the judgment debtor’s chief financial officer under California Code of Civil Procedure section 708.110, and the judgment creditor received “a voluminous document production of financial and other records.” *Id.* at 1214. Then, at his section 708.120 examination, Mr. Wexler refused to answer certain questions, which led to various contested motions, orders, and unfruitful discussions regarding the permissible scope of Mr. Wexler’s examination. The court issued orders requiring Mr. Wexler to appear and produce “certain documents.” *Id.* at 1214–15. Fox Johns and Mr. Wexler appealed the orders.
- On appeal, Fox Johns and Mr. Wexler contended that “any examination under section 708.120 is limited in scope by the statute’s language.” In other words, section 708.120 would limit the examination of Mr. Wexler to questions relating to (1) Fox Johns’ possession or control of property in which the judgment debtor had an interest; and (2) Fox Johns’ indebtedness to the judgment debtor. *Id.* at 1219. The judgment creditor’s stated purposes in examining Mr. Wexler were far more extensive than the stated purposes of a third-party examination set forth in section 708.120. The judgment debtors’ stated purposes were to discover the identity of Fox Johns’ clients, review Fox Johns’ billing of other clients, or otherwise obtain information about entities that might be the alter ego of the judgment debtor. *Id.* at 1219. The court of appeal agreed with Fox Johns and Mr. Wexler, holding that section 708.120 “does not allow for a more expansive examination.” *Id.* at 1221. Rather, the third party being examined can only be questioned “regarding the property of the judgment debtor it possesses or the debt it owes the judgment debtor.” *Id.* Accordingly, in *Fox Johns*, the court of appeal concluded that a subpoena duces tecum grounded in a third party examination under section 708.120 must be limited in scope to documents concerning (1) the third party’s possession of the judgment debtor’s property; and (2) any debt the third party owes to the judgment debtor. *Id.* at 1222.
- 16 *Yolanda’s, Inc.*, 11 Cal. App. 5th at 514.
- 17 *Id.*
- 18 *Id.* at 511.
- 19 *Id.*
- 20 *Id.* at 515 (citing *Troy v. Superior Court*, 186 Cal. App. 3d 1006, 1014 (1986)).
- 21 *Id.*
- 22 *See In re Burns*, 291 B.R. 846, 850 (B.A.P. 9th Cir. 2003). In 1982, California enacted a comprehensive Enforcement of Judgments Law (“EJL”) governing the enforcement of all civil judgments in California. HON. ALAN M. AHART, CAL. PRACTICE GUIDE: ENFORCING JUDGMENTS & DEBTS § 6:1–6:2 (The Rutter Group, 2002); CAL. CIV. PROC. CODE §§ 680.010-709.030. The EJL reflects the legislative intent to allow judgment creditors a “speedy and inexpensive means . . . to obtain priority over other creditors.” *See also Fox Johns*, 219 Cal. App. 4th at 1221 (“Simply put, the purpose of section 708.120 is to provide a tool that allows a judgment creditor to find property or money that is owed to the judgment debtor. To this end, it allows the judgment creditor to obtain an order to examine a third party who it believes possesses the judgment debtor’s property or owes the judgment debtor a debt over \$250.”).
- 23 CAL. CIV. PROC. CODE § 708.120(a).
- 24 *Id.* §§ 708.130, 187.
- 25 11 U.S.C. § 105(a).
- 26 CAL. CIV. PROC. CODE § 2035.010(b).
- 27 *Post-Judgment Examination of Non-Debtor Third Party May Delve Into Alter Ego and Fraudulent Transfer Issues, Despite Narrow Wording of Statute*, 2017-19 COM. FIN. NEWSL. NL 38, May 15, 2017.
- 28 *Id.* For discussion of a case in which the judgment creditor was empowered to gather evidence, *see Judgment Creditor May Compel Judgment Debtor to Provide Documents Concerning Non-Debtor Third Parties*, 2016-02 COM. FIN. NEWSL. NL 4, Jan. 11, 2016.
- 29 *Post-Judgment Examination of Non-Debtor Third Party May Delve Into Alter Ego and Fraudulent Transfer Issues, Despite Narrow Wording of Statute*, 2017-19 COM. FIN. NEWSL. NL 38, May 15, 2017.
- 30 CAL. CIV. PROC. CODE § 708.200.
- 31 *Yolanda’s, Inc. v. Kahl & Goevia Commercial Real Estate*, 11 Cal. App. 5th 509 (2017).