



## CHAPTER 29

# Creditors' Rights and Remedies

Normally, creditors have no problem collecting the debts owed to them. When disputes arise over the amount owed, however, or when the debtor simply cannot or will not pay, what happens? What remedies are available to creditors when a debtor **defaults** (fails to pay as promised)? In this chapter, we focus on

some basic laws that assist the debtor and creditor in resolving their dispute without resorting to bankruptcy.

The remedies we discuss in this chapter are available regardless of whether a creditor is secured or unsecured. *Secured creditors* are those whose loans are backed by *collateral*, which is specific property (such as

a car or a house) pledged by a borrower to ensure repayment. The loans made by *unsecured creditors*, such as companies that provide credit cards, are not backed by collateral. Under Article 9 of the Uniform Commercial Code (UCC), certain remedies are available only to secured creditors.

### 29-1 Laws Assisting Creditors

Both the common law and statutory laws other than Article 9 of the UCC create various rights and remedies for creditors. Next, we discuss some of these rights and remedies, including liens, garnishment, and creditors' composition agreements.

#### 29-1a Liens

A **lien** is an encumbrance on (claim against) property to satisfy a debt or protect a claim for the payment of a debt. Liens may arise under the common law (usually by possession of the property) or under statutory law. *Mechanic's liens* are statutory liens, whereas *artisan's liens* were recognized at common law. *Judicial liens* may be used by a creditor to collect on a debt before or after a judgment is entered by a court. Liens are a very important tool for creditors because they generally take priority over other claims against the same property.

**Mechanic's Liens** Sometimes, a person who has contracted for labor, services, or materials to be furnished for making improvements on real property does not

immediately pay for the improvements. When that happens, the creditor can place a **mechanic's lien** on the property.

**Real Property Secures the Debt.** A mechanic's lien creates a special type of debtor-creditor relationship in which the real estate itself becomes security for the debt. ■ **EXAMPLE 29.1** Kirk contracts to paint Tanya's house for an agreed-on price to cover labor and materials. If Tanya refuses to pay or pays only a portion of the charges after the work is completed, a mechanic's lien against the property can be created. Kirk is then a lienholder, and the real property is encumbered (burdened) with the mechanic's lien for the amount owed. ■

If the property owner fails to pay the debt, the lienholder is technically entitled to foreclose on the real estate and sell it. (*Foreclosure* is the process by which a creditor legally takes a debtor's property to satisfy a debt.) The sale proceeds are then used to pay the debt and the costs of the legal proceedings. The surplus, if any, is paid to the former owner.

In the real world, however, small-amount mechanic's liens are rarely the basis of foreclosure. Rather, these liens simply remain on the books of the state until the house is sold. At closing (when the sale is finalized), the seller agrees to pay any mechanic's liens out of the proceeds of the sale before the seller receives any of the funds.

**Governed by State Law.** State law governs the procedures that must be followed to create a mechanic's (or other statutory) lien. Generally, the lienholder must file a written notice of lien within a specific time period (usually within 60 to 120 days) from the last date that material or labor was provided.

In the following case, the state mechanic's lien statute required the lien to be filed no more than 90 days after "the completion of the work." The contractor that filed the lien and the owner of the project against which the lien was filed disputed the meaning of the term "completion."

## Case Analysis 29.1

### Picerne Construction Corp. v. Villas

California Court of Appeal, Third District, 244 Cal.App.4th 1201, 199 Cal.Rptr.3d 257 (2016).

#### In the Language of the Court

MAURO, J. [Judge]

\*\*\*\*

Castellino [Villas, LLC] and Picerne [Construction Corporation] entered into an agreement in which Picerne would build an apartment complex called Castellino Villas at Laguna West (project or property) in the City of Elk Grove [California] (the City). The project consisted of 11 apartment buildings, separate garages, a clubhouse, and other facilities.

\*\*\*\*

The City issued certificates of occupancy for the 11 buildings within the project \*\*\* after a city inspector conducted a final inspection of each building. The first certificates of occupancy were issued on May 3, 2006. The final certificate of occupancy was issued on July 25, 2006.

Picerne employees and subcontractors continued to perform work at the project after July 25, 2006.

\*\*\*\*

[John] Olsen [Castellino's representative for the project] signed a document titled "Owner's Acceptance of Site" for Castellino on September 8, 2006.

\*\*\*\*

Castellino began renting apartments at the property in October 2006.

Picerne recorded a claim of mechanic's lien on November 28, 2006.

Picerne filed a complaint [in a California state court] to foreclose its mechanic's lien on December 29, 2006.

\*\*\*\*

\*\*\* The trial court \*\*\* determined \*\*\* Picerne is entitled to foreclose its lien.

\*\*\*\*

[On appeal to this court] Castellino \*\*\* contends Picerne does not have a valid mechanic's lien because Picerne did not record a claim of mechanic's lien within 90 days after substantial completion of the project.

\*\*\*\*

*In order to have a valid mechanic's lien, a claimant must record a claim of lien within a prescribed period of time after completion of the work of improvement \*\*\*. The failure of a claimant to timely record a claim of lien precludes the enforcement of a mechanic's lien.* [Emphasis added.]

[When Picerne filed its lien, mechanic's liens were governed by California Civil Code Section 3115, which] provided, "Each original contractor [a contractor who has a direct contractual relationship with the owner for the work], in order to enforce a lien, must record his claim of lien after he completes his contract and before the expiration of 90 days after the completion of the work of improvement." [According to Section 3116, the term "work of improvement" means the entire structure or scheme of improvement as a whole.]

\*\*\* The [California State] Legislature defined the term completion as "actual completion of the work of improvement." In addition, \*\*\* deemed to be equivalent to a completion [was] the acceptance by the owner or his

agent of the work of improvement.

Substantial evidence supports the trial court's finding that the owner accepted the project as of September 8, 2006. \*\*\* Picerne timely recorded its claim of mechanic's lien within 90 days after September 8, 2006.

\*\*\*\*

Castellino \*\*\* nevertheless claims that the time for Picerne to record its claim of mechanic's lien began to run before September 8, 2006. [Castellino] asserts the phrase "completion of the work of improvement" in Section 3115 means substantial completion of the work of improvement, and the project was substantially completed by July 25, 2006, when the City issued the final certificate of occupancy.

There are cases construing the \*\*\* mechanic's lien statute which interpreted "completion" as substantial completion.

\*\*\*\*

[But these cases were decided before the Legislature amended Section 3115 to define] completion of the work of improvement as actual completion of the work of improvement \*\*\*. The Legislature did not define "completion of the work of improvement" as substantial completion. Courts have looked at whether the work at issue was required under the claimant's contract in determining whether a work of improvement was completed.

Castellino argues that interpreting the term "completion" \*\*\* to mean substantial completion would be sound



Case 29.1 Continues

## Case 29.1 Continued

public policy because it would ensure transparency, visibility, objectivity, and certainty in the relationship between the contractor and the owner in the filing of mechanic's liens. However, following the language of the statute by construing "completion" as "actual completion" does not create uncertainty when reference can be made to the parties' agreement and the labor and materials furnished. Moreover, \*\*\* deemed equivalent to completion [is] acceptance of the work of improvement.

In addition, contrary to Castellino's argument, public policy supports the interpretation of completion as actual completion in this specific context. *The mechanic's lien statute is intended [primarily to benefit] persons who perform labor or furnish materials for works of improvement, and it is to be liberally construed for the protection of laborers and material suppliers, with doubts concerning the meaning of the statute generally resolved in favor of the lien claimant.* Interpreting completion as actual completion gives lien claimants the maximum amount of time

to assert their rights before such rights are cut off, whereas interpreting completion as substantial completion could cut off mechanic's lien rights much earlier. The interpretation espoused by Castellino would contravene the purpose of California's mechanic's lien law to protect the right to payment of those who have furnished labor or materials to works of improvement. Our construction of the term "completion" \*\*\* effectuates the intent of the mechanic's lien law. [Emphasis added.]

Substantial evidence supports the trial court's findings that even though the City had issued certificates of occupancy for the 11 buildings within the project, roof and stairway work required under the general contract continued between July 25, 2006 and September 19, 2006. Elizar Ortiz [an installer employed by Picerne's stairway subcontractor] testified he worked 22½ hours on September 15, 18, and 19, 2006, installing grip tape on all of the stairs at the project. The general contract called for the installation of anti-slip grip tape

on all concrete stair treads. Ortiz's testimony established the work he performed on September 15, 18, and 19, 2006 was not corrective or repair work.

The president of Picerne's roofing subcontractor testified his company performed roofing work at the project after July 25, 2006. He said such work included straightening out some of the valleys in the roofs, installing nailers and hips on the roof ridges, and nailing trim. \*\*\* The roof and stairway work performed after July 25, 2006, is not comparable to adding a few strokes of paint or turning a screw.

Picerne recorded a claim of mechanic's lien \*\*\* within 90 days of the date Castellino accepted the project and when the stairway and roofing subcontractors performed work required under their contracts. Accordingly, the trial court did not err in concluding Picerne timely recorded its claim of mechanic's lien.

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\*\*\* The judgment is affirmed.

### Legal Reasoning Questions

1. How did the California legislature define the term "completion"? Was this definition clear? Discuss.
2. How did the owner of the project at the center of this case want the court to interpret "completion"? What arguments support this contention?
3. Ultimately, how did the court define "completion"? Why?

**Artisan's Liens** When a debtor fails to pay for labor and materials furnished for the repair or improvement of *personal* property, a creditor can recover payment through an **artisan's lien**. As mentioned, artisan's liens usually take priority over other creditors' claims to the same property.<sup>1</sup>

**Lienholder Must Retain Possession.** In contrast to a mechanic's lien, an artisan's lien is *possessory*. That is, the lienholder ordinarily must have retained possession of the property and have expressly or impliedly agreed to provide the services on a cash, not a credit, basis. The lien remains

in existence as long as the lienholder maintains possession, and the lien is terminated once possession is *voluntarily* surrendered, unless the surrender is only temporary.<sup>2</sup>

■ **CASE IN POINT 29.2** Carrollton Exempted Village School District (in Ohio) hired Clean Vehicle Solutions America, LLC (CVSA, based in New York) to convert ten school buses from diesel to compressed natural gas. The contract price was \$660,000. The district paid a \$400,000 deposit and agreed to pay installments of \$26,000 to CVSA after the delivery of each converted bus. After the first two buses were delivered, the district

1. An artisan's lien has priority over a filed statutory lien (such as a title lien on an automobile or a lien filed under Article 9 of the UCC) and a bailee's lien (such as a storage lien).

2. Involuntary surrender of possession by a lienholder, such as when a police officer seizes goods from a lienholder, does not terminate the lien.

refused to continue the contract, claiming that the conversion made the two buses unsafe to drive.

Both parties filed breach of contract lawsuits. CVSA also asserted an artisan's lien over two other buses that it still had in its possession because it had started converting them to natural gas and spent \$65,000 doing so. Regardless of the outcome in the parties' lawsuits, CVSA has an artisan's lien that gives it a priority claim to those two buses so long as they remain in its possession. The buses will act as security for the district's payment of at least the amount CVSA has spent converting them to natural gas.<sup>3</sup> ■

**Foreclosure on Personal Property.** Modern statutes permit the holder of an artisan's lien to foreclose and sell the property subject to the lien to satisfy the debt. As with a mechanic's lien, the lienholder is required to give notice to the owner of the property before the foreclosure and sale. The sale proceeds are used to pay the debt and the costs of the legal proceedings, and the surplus, if any, is paid to the former owner.

**Judicial Liens** When a debt is past due, a creditor can bring a legal action against the debtor to collect the debt. If the action is successful, the court awards the creditor a judgment against the debtor (usually for the amount of the debt plus any interest and legal costs incurred). Frequently, however, the creditor is unable to collect the awarded amount.

To ensure that a judgment in the creditor's favor will be collectible, the creditor may request that certain property of the debtor be seized to satisfy the debt. (As will be discussed, under state or federal statutes, some kinds of property are exempt from attachment by creditors.) A court's order to seize the debtor's property is known as a *writ of attachment* if it is issued before a judgment. If the order is issued after a judgment, it is referred to as a *writ of execution*.

**Writ of Attachment.** In the context of judicial liens, **attachment** refers to a court-ordered seizure and taking into custody of property before a judgment is obtained on a past-due debt. (Attachment has a different meaning in the context of secured transactions.<sup>4</sup>) Because attachment is a *prejudgment* remedy, it occurs either at the time a lawsuit is filed or immediately afterward.

A creditor must comply with the specific state's statutory restrictions and requirements. The due process clause of the Fourteenth Amendment to the U.S. Constitution requires that the debtor be given notice and an opportunity to be heard. The creditor must have an enforceable right to payment of the debt under law and must follow certain procedures. Otherwise, the creditor can be liable for damages for wrongful attachment.

The typical procedure for attachment is as follows:

1. The creditor files with the court an *affidavit* (a written statement, made under oath). The affidavit states that the debtor has failed to pay and indicates the statutory grounds under which attachment is sought.
2. The creditor must post a bond to cover at least the court costs, the value of the property attached, and the value of the loss of use of that property suffered by the debtor.
3. When the court is satisfied that all the requirements have been met, it issues a **writ of attachment**. The writ directs the sheriff or other officer to seize the debtor's nonexempt property. If the creditor prevails at trial, the seized property can be sold to satisfy the judgment.

**Writ of Execution.** If a creditor wins a judgment against a debtor and the debtor will not or cannot pay the amount due, the creditor can request a **writ of execution** from the court. A writ of execution is an order that directs the sheriff to seize (levy) and sell any of the debtor's nonexempt real or personal property. The writ applies only to property that is within the court's geographic jurisdiction (usually the county in which the courthouse is located).

The proceeds of the sale are used to pay the judgment, accrued interest, and costs of the sale. Any excess is paid to the debtor. The debtor can pay the judgment and redeem the nonexempt property at any time before the sale takes place. (Because of exemption laws and bankruptcy laws, however, many judgments are practically uncollectible.)

## 29-1b Garnishment

An order for **garnishment** permits a creditor to collect a debt by seizing property of the debtor that is being held by a third party. As a result of a garnishment proceeding, for instance, the debtor's employer may be ordered by the court to turn over a portion of the debtor's wages to pay the debt. Many other types of property can be garnished as well, including funds in a bank account, tax refunds, pensions, and trust funds. It is only necessary that the property is not exempt from garnishment and is in the possession of a third party.

3. *Clean Vehicle Solutions America, LLC v. Carrollton Exempted Village School District Board of Education*, 2015 WL 5459852 (S.D.N.Y. 2015).

4. In secured transactions, *attachment* refers to the process through which a security interest becomes effective and enforceable against a debtor with respect to the debtor's collateral [UCC 9-203].



■ **CASE IN POINT 29.3** When Edward G. Tinsley divorced Michelle Townsend, they entered into a marital settlement contract. They agreed to sell the marital home and split the proceeds evenly. But Tinsley refused to cooperate with the sale. A court therefore appointed a trustee to sell the house for them and ordered the sheriff to evict Tinsley. Tinsley then conveyed the house to a trust established in his name. Even after the sheriff evicted Tinsley from the house and changed the locks, Tinsley managed to move back in and change the locks again.

Tinsley was arrested for trespassing and charged with contempt of court (for disobeying court orders). In the meantime, Tinsley secretly sold the home for \$150,000 and deposited the proceeds into a bank account held in the name of Edward G. Tinsley Living Trust at SunTrust Bank. After learning of the sale, the court-appointed trustee obtained a writ of garnishment on all of Tinsley's and his trust's bank accounts at SunTrust Bank. Despite numerous objections from Tinsley (and a trial and appeal), Sun Trust eventually complied with the garnishment order and sent all the funds to the trustee.<sup>5</sup> ■

**Procedures** Garnishment can be a prejudgment remedy, requiring a hearing before a court, but it is most often a postjudgment remedy. State law governs garnishment actions, so the specific procedures vary from state to state.

In some states, the judgment creditor needs to obtain only one order of garnishment, which will then apply continuously to the judgment debtor's wages until the entire debt is paid. In other states, the judgment creditor must go back to court for a separate order of garnishment for each pay period.

See this chapter's *Ethics Today* feature for a discussion of how creditors can obtain garnishment even when a debtor crosses state lines in an attempt to avoid paying the debt.

**Laws Limiting the Amount of Wages Subject to Garnishment** Both federal and state laws limit the amount that can be taken from a debtor's weekly take-home pay through garnishment proceedings.<sup>6</sup> Federal law provides a minimal framework to protect debtors from losing all their income to pay judgment debts.<sup>7</sup> State laws also provide dollar exemptions, and these amounts are often larger than those provided by federal law.

5. *Tinsley v. SunTrust Bank*, 2016 WL 687545 (Md.App. 2016).

6. A few states (such as Texas) do not permit garnishment of wages by private parties except under a child-support order.

7. For instance, the federal Consumer Credit Protection Act, 15 U.S.C. Sections 1601–1693r, provides that a debtor can retain either 75 percent of his or her disposable earnings per week or an amount equivalent to thirty hours of work paid at federal minimum wage rates, whichever is greater.

Under federal law, an employer cannot dismiss an employee because his or her wages are being garnished.

### 29-1c Creditors' Composition Agreements

Creditors may contract with the debtor for discharge of the debtor's liquidated debts (debts that are definite, or fixed, in amount) on payment of a sum less than that owed. These agreements are referred to as **creditors' composition agreements** (or *composition agreements*) and usually are held to be enforceable unless they are formed under duress.

## 29-2 Mortgages

When individuals purchase real property, they typically make a **down payment** in cash and borrow the remaining funds from a financial institution. The borrowed funds are secured by a **mortgage**—a written instrument that gives the creditor a lien on the debtor's real property as security for payment of a debt. The creditor is the *mortgagee*, and the debtor is the *mortgagor*.

### 29-2a Fixed-Rate versus Adjustable-Rate Mortgages

Lenders offer various types of mortgages to meet the needs of different borrowers, but a basic distinction is whether the interest rate is fixed or variable. A *fixed-rate mortgage* has a fixed, or unchanging, rate of interest, so the payments remain the same for the duration of the loan. Lenders determine the interest rate for a standard fixed-rate mortgage loan based on a variety of factors, including the borrower's credit history, credit score, income, and debts.

With an *adjustable-rate mortgage (ARM)*, the rate of interest paid by the borrower changes periodically. Typically, the initial interest rate for an ARM is set at a relatively low fixed rate for a specified period, such as a year or three years. After that time, the interest rate adjusts annually or by some other period, such as biannually or monthly. The interest rate adjustment is calculated by adding a certain number of percentage points (called the margin) to an index rate (one of various government interest rates).

ARMs contractually shift the risk that the interest rate will change from the lender to the borrower. Borrowers will have lower initial payments if they are willing to assume the risk of interest rate increases.