# ADDING A DEBTOR TO THE JUDGMENT UNDER CCP 187 – ONE WAY TO STOP A DEBTOR'S SHELL GAME BEFORE IT'S TOO LATE

*By Ellen Kaufman Wolf and Scott Antoine, of Wolf Group L.A., a Business Law Firm with Practice Emphasis in Creditors' Rights and Remedies*

Creditors seeking to enforce judgments against sophisticated debtor entities will sometimes be chagrined to discover that the judgment debtor has transferred all of its assets (but none of its liabilities) to another company, or perhaps a series of companies, through a series of "merge and purge" transactions consisting of asset sales and/or mergers. In the end, the company holding the assets may be made up of largely the same ownership and control structure as the judgment debtor, and carrying on the same business. Rather than initiating new litigation and pursuing fraudulent conveyance claims, it may be possible to amend the existing judgment to add the corporation holding the assets as an additional judgment debtor under section 187 of the California Code of Civil Procedure.

Code of Civil Procedure Section 187 allows a judgment creditor to file a noticed motion to amend the judgment to add a nonparty alter ego or successor as a judgment debtor. See generally, *Farenbaugh & Son v. Belmont Const., Inc.,* 194 Cal. App. 3d 1023, 1027 (1987); *Schoenberg v. Benner*, 251 Cal. App. 2d 154, 164 (1967). This authority is typically utilized to add an additional judgment debtor on the grounds that an entity or person is the "alter ego" of the original judgment debtor. The theory is that the court is not really amending the judgment, but is merely inserting the correct name of the real defendant.

In order to add a judgment debtor under the "alter ego" doctrine, the moving party must show that there is such a unity of interest and ownership between the company and the alter ego defendant that their separateness no longer exists — there are a number of factors the court will consider in this regard. Often times it can be quite difficult to make this showing, particularly when dealing with sophisticated corporate debtors who are aware of these factors and take care to avoid common pitfalls.

But creditors should not be discouraged. Amendments to add third party judgment debtors may be allowed where necessary to prevent injustice even though alter ego liability is not involved. A "mere successor" company can be added as a judgment debtor under section 187 if it can be shown that the company is a "mere continuation" of a predecessor. *McClellan v. Northridge Park Townhome Owners Ass'n, Inc.*, 89 Cal. App. 4th 746 (2001). As explained by a leading treatise:

Where the purchaser corporation

- acquires the seller's assets (but not the liabilities) for inadequate consideration,

- has practically the same shareholders and management as the seller, and
- carries on the same business,

the purchaser may be regarded as a "mere continuation" of the seller. In such circumstances, the purchaser corporation is essentially the *same entity* as the seller, and may be held liable for the seller's obligations. This is especially so "when actual fraud or the rights of creditors are involved"—i.e., little or no cash is paid for the seller's assets and the object of the transaction appears to be avoidance of specific debts or liabilities. . . . **In this situation, a creditor who obtained a judgment against the seller may, but need not, file an independent action against the buyer. Instead, the creditor may, upon motion, amend the judgment to add the buyer as a judgment debtor**. C. Hugh Friedman, *California Practice Guide: Corporations,* ¶ 8:661 (The Rutter Group, ed. rev. 2011) citing *Blank v. Olcovich Shoe Corp.*, 20 Cal. App. 2d 456, 461 (1937); *CenterPoint Energy, Inc. v. Superior Court (City & County of San Francisco),* 157 Cal. App. 4th 1101, 1120–1121 (2007); *McClellan v. Northridge Park Townhome Owners Ass'n, Inc.*, 89 Cal. App. 4th 746, 752–56; *Katzir's Floor & Home Design, Inc. v. M–MLS.com*, 394 F.3d 1143, 1150 (9th Cir. 2004).

Witkin is in accord: "If a corporation

- organizes another corporation
- with practically the same shareholders and directors
- transfers all the assets
- does not pay all the first corporation's debts, and
- continues to carry on the same business

the separate entities may be disregarded and the new corporation held liable for the obligations of the old." 9 Witkin, *Summary of California Law,* Corporations § 16 (10th ed. 2005) citing, *inter alia, Blank*, 20 Cal. App. 2d at 461; *Thomson v. L.C. Roney & Co.*, 112 Cal. App. 2d 420, 429 (1952); *Economy Refining & Service Co. v. Royal Nat. Bank of New York*, 20 Cal. App. 3d 434, 439 (1971).

In *Phillips, Spallas & Angstadt, LLP v. Fotouhi*, 197 Cal. App. 4th 1132 (2011), the plaintiff, a law firm which held a judgment confirming an arbitration award against its former partner, obtained a charging order on the former partner's interest in his new partnership. The trial court also extended the charging order to a corporation that was not an arbitration award debtor. The Court of Appeal affirmed because that corporation was a "mere continuation" of the arbitration award debtor formed "to frustrate attempts to collect on the judgment." *Id.* at 1134.

Even an asset sale in bankruptcy can result in a "mere continuation" with successor liability. In *Blank v. Olcovich Shoe Corp.*, 20 Cal. App. 2d 456 (1937), during bankruptcy proceedings, a new corporation was organized and bought the bankrupt company's assets from the trustee. The new company offered shares to the debtor's shareholders in proportion to their

prior holdings. In an action against the new company, successor liability resulted. *Id.* at pp. 460-461. Citing evidence of similarity of names, identity of directorate, purchase of assets and offer of stock to the old shareholders at a nominal value, the court held that the new corporation was but a continuation of the old. While *Blank v. Olcovich Shoe Corp.* involved an independent action against the successor corporation, subsequent cases have held that a motion to add a judgment debtor pursuant to section 187 is appropriate in this context. "Where the successor corporation is a mere continuation and hence liable for the acts of its predecessor, the liability of the new corporation may be enforced in an independent action, as occurred in *Blank v. Olcovich Shoe Corp.* However, in the alternative, a motion pursuant to the procedural mechanism of section 187 enables the court to consider disregarding the corporate entity on any of several theories in order to add an additional judgment debtor." *McClellan v. Northridge Park,* 89 Cal. App. 4th 746, 754 (2001) [Emphasis added.]

Thus, it may be possible to add a judgment debtor under a "de facto merger" theory if a transaction guised as an asset sale is in reality a merger of two corporations. In order to prevail on a de facto merger theory, the movant would have to demonstrate that (1) no adequate consideration was given for the predecessor corporation's assets and made available for meeting the claims of its unsecured creditors; (2) one or more persons were officers, directors, or stockholders of both corporations." *CenterPoint v. Superior Court,* 157 Cal. App. 4th 1101 (2007). Courts have described five factors which indicate whether a transaction cast in the form of an asset sale actually achieves the same practical result as a merger: (1) was the consideration paid for the assets solely stock of the purchaser or its parent; (2) did the purchaser continue the same enterprise after the sale; (3) did the shareholders of the seller become shareholders of the purchaser; (4) did the seller liquidate; and (5) did the buyer assume the liabilities necessary to carry on the business of the seller? *Marks v. Minnesota Mining Co.*, 187 Cal. App. 3d 1429 (1986) (citations omitted).

Authority suggests that CCP Section 187 allows the court to disregard an illusory distinction between corporations on any of several theories in order to add an additional judgment debtor. See *McClellan, supra,* 89 Cal. App. 4th at p. 754. Section 187 affords trial courts "all the means necessary to carry [their jurisdiction] into effect," and courts may adopt "any suitable process or mode of proceeding ... which may appear most conformable to the spirit of this code" if the course of proceeding is not specifically provided. *Phillips, Spallas & Angstadt, LLP v. Fotouhi,* 197 Cal. App. 4th 1132 (2011). "Simply put, section 187 recognizes the inherent authority of a court to make its records speak the truth." *Greenspan v. LADT LLC* (2010) 191 Cal. App. 4th 486, 509 (2010).

Regardless of which theory is relied upon in seeking to add a judgment debtor, it is important that creditors act promptly to protect their rights, as an amendment pursuant to CCP Section 187 may be denied if the judgment creditor fails to act with due diligence. If the creditor has known about the successor entity for a significant period of time without acting, it may be

too late and the debtor may win the shell game, or at least force the creditor to file a new action rather than proceeding under the summary procedure provided by CCP Section 187.