

139 B.R. 931, 17 UCC Rep.Serv.2d 962
(Cite as: 139 B.R. 931)



United States Bankruptcy Appellate Panel
of the Ninth Circuit.

In re Morris M. RAITON, Debtor.
Evelyn Anne Patricia RAITON, Appellant,

v.

G & R PROPERTIES, a California Partnership,
Forrest Gardner, Foremost Spring Company, Inc.,
and Morris M. Raiton, Appellees.

BAP No. CC-91-1069 VJMe.
Bankruptcy No. LA 89-04672 KM.
Adv. No. LA 89-1543 KM.
Argued and Submitted Oct. 24, 1991.
Decided May 11, 1992.

Chapter 11 debtor sought to avoid former wife's security interests in debtor's partnership interest and stock. The Bankruptcy Court, Kathleen P. March, J., granted summary judgment for debtor. Former wife appealed. The Bankruptcy Appellate Panel, Volinn, J., held that: (1) issuance of stipulated charging order by California state court created valid lien upon debtor's interest in partnership, and (2) genuine issue of material fact as to whether debtor actually regained control over collateral after bailee released it to Internal Revenue Service precluded summary judgment in favor of debtor on issue of avoidance of wife's interest in debtor's stock.

Reversed and remanded.

West Headnotes

[1] Partnership 289 ↪ 220(.5)

289 Partnership
289IV Rights and Liabilities as to Third Persons
289IV(D) Actions by or Against Firms or Partners
289k220 Execution and Enforcement of Judgment in General
289k220(.5) k. In General. Most Cited

Cases

(Formerly 289k220)

Under California law, service of charging order on nondebtor general partner constituted service on partnership. West's Ann.Cal.C.C.P. §§ 416.40, 708.320, 708.320(a).

[2] Partnership 289 ↪ 220(.5)

289 Partnership
289IV Rights and Liabilities as to Third Persons
289IV(D) Actions by or Against Firms or Partners
289k220 Execution and Enforcement of Judgment in General
289k220(.5) k. In General. Most Cited

Cases

(Formerly 289k220)

California law did not require useless and redundant service of motion for charging order on partnership when charging order itself was stipulated to by parties and entered by court and issued and served upon partnership. West's Ann.Cal.C.C.P. § 708.320.

[3] Partnership 289 ↪ 220(4)

289 Partnership
289IV Rights and Liabilities as to Third Persons
289IV(D) Actions by or Against Firms or Partners
289k220 Execution and Enforcement of Judgment in General
289k220(4) k. Levy, Lien, and Custody of Property. Most Cited Cases

Under California law, lien on debtor's partnership interest was created by issuance of stipulated charging order by California state court prior to filing of bankruptcy. West's Ann.Cal.C.C.P. §§ 708.320, 708.320(a).

[4] Partnership 289 ↪ 220(4)

289 Partnership
289IV Rights and Liabilities as to Third Persons

139 B.R. 931, 17 UCC Rep.Serv.2d 962
(Cite as: 139 B.R. 931)

289IV(D) Actions by or Against Firms or Partners

289k220 Execution and Enforcement of Judgment in General

289k220(4) k. Levy, Lien, and Custody of Property. Most Cited Cases

Charging order entered pursuant to California Uniform Partnership Act replaces levy of execution and provides judgment creditor with lien on partnership property. West's Ann.Cal.Corp.Code § 15028.

[5] Partnership 289 ↪220(4)

289 Partnership

289IV Rights and Liabilities as to Third Persons

289IV(D) Actions by or Against Firms or Partners

289k220 Execution and Enforcement of Judgment in General

289k220(4) k. Levy, Lien, and Custody of Property. Most Cited Cases

Under California law, when there is no motion for charging order, lien on partnership property is created upon issuance of charging order; when there is motion for charging order, lien is created upon service of motion on partnership. West's Ann.Cal.C.C.P. § 708.320(a).

[6] Bankruptcy 51 ↪2703

51 Bankruptcy

51V The Estate

51V(H) Avoidance Rights

51V(H)1 In General

51k2702 Rights of Debtor or Injured Creditors

51k2703 k. Debtor in Possession. Most Cited Cases

Secured Transactions 349A ↪144

349A Secured Transactions

349AIII Construction and Operation

349AIII(B) Rights as to Third Parties and Priorities

349Ak144 k. Priority of Liens Arising by Operation of Law. Most Cited Cases

Under California law, lien on partnership interest created by issuance of stipulated charging order in debtor's dissolution of marriage action had priority over and was superior to security interests in same properties which were unperfected as of date when charging order was issued; moreover, lien was superior to debtor in possession's interest as hypothetical lien creditor. West's Ann.Cal.C.C.P. §§ 708.320, 708.320(a); West's Ann.Cal.Com.Code § 9301(1).

[7] Federal Civil Procedure 170A ↪2510

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(C) Summary Judgment

170AXVII(C)2 Particular Cases

170Ak2510 k. Sales Cases in General. Most Cited Cases

Genuine issue of material fact as to whether perfection of security interest in certificated securities by possession was effectuated precluded summary judgment in favor of debtor to avoid security interest in stock on ground of lack of perfection. West's Ann.Cal.Com.Code §§ 9305, 9305 comment 2; U.C.C. §§ 9-305, 9-305 comment.

[8] Secured Transactions 349A ↪89

349A Secured Transactions

349AII Perfection of Security Interest

349Ak89 k. Possession by Secured Party Without Filing. Most Cited Cases

Under California Commercial Code, possession for purposes of perfection of security interest is effectuated when collateral is physically transferred to secured party or its agent or to bailee who has been notified of secured party's interest. West's Ann.Cal.Com.Code §§ 9305, 9305 comment.

[9] Secured Transactions 349A ↪89

349A Secured Transactions

349AII Perfection of Security Interest

139 B.R. 931, 17 UCC Rep.Serv.2d 962
(Cite as: 139 B.R. 931)

349Ak89 k. Possession by Secured Party Without Filing. Most Cited Cases

Under California law, once debtor has parted with possession of collateral and secured party, personally or through agent, obtains possession, perfection continues until debtor exerts or regains control over collateral; simple loss of possession by secured party does not per se invalidate security interests. West's Ann.Cal.Com.Code §§ 9305, 9305 comment.

[10] Federal Civil Procedure 170A 2510

170A Federal Civil Procedure

170AXVII Judgment

170AXVII(C) Summary Judgment

170AXVII(C)2 Particular Cases

170Ak2510 k. Sales Cases in General.

Most Cited Cases

Genuine issue of material fact as to whether debtor regained control over stock as collateral for charging order issued in favor of debtor's former wife due to bailee's unauthorized surrender of stock to Internal Revenue Service precluded summary judgment in favor of debtor to avoid wife's interest in stock. West's Ann.Cal.Com.Code §§ 9305, 9305 comment.

***932** John J. Gilligan, Long Beach, Cal., for appellant, Evelyn Anne Patricia Raiton.

David R. Haberbush, Los Angeles, Cal., for appellee, Morris M. Raiton.

Before VOLINN, JONES, and MEYERS, Bankruptcy Judges.

***933 OPINION**

VOLINN, Bankruptcy Judge:

OVERVIEW

Appellant appeals the grant of partial summary judgment to Debtor, avoiding Appellant's security interests in Debtor's partnership property and stock.

Debtor and Appellant are former spouses. Pur-

suant to their dissolution of marriage agreement, Debtor executed in favor of Appellant a note secured by Debtor's share in a partnership and by Debtor's stock securities. To protect Appellant's partnership security interest, Debtor and Appellant stipulated that a charging order on Debtor's partnership property be entered. With respect to the security interest in Debtor's stock, the court designated a third party to hold the stock certificates constituting Debtor's 50% interest in the corporation in escrow for Appellant. This third party was a general partner in Debtor's partnership and owner of the other 50% of the stock in Debtor's corporation. Subsequently, pursuant to the enforcement of a levy on Debtor's property, the third party, without consent of the appellant, delivered Debtor's stock certificates to the Internal Revenue Service (IRS) where they remain.

On March 7, 1989, Debtor filed under Chapter 11 and, pursuant to § 544, ^{FN1} sought to avoid Appellant's security interests in Debtor's partnership interest and stock. The bankruptcy court granted Debtor's summary judgment motion avoiding both of Appellant's security interests. We REVERSE the grant of summary judgment and REMAND this matter to the bankruptcy court for a trial on the merits.

FN1. Unless otherwise stated, all references to "sections" refer to the Bankruptcy Code, 11 U.S.C. § 101 et seq.

STATEMENT OF FACTS

Appellant Evelyn Raiton and Debtor Morris Raiton are former spouses. During their marriage they owned and operated two businesses: G & R Properties (G & R) and Foremost Spring Company, Inc. (Foremost). G & R is a partnership formed between Appellant, Debtor, and Forrest Gardner (Gardner). Appellant, Debtor, and Gardner also formed Foremost. The community property interest of Appellant and Debtor in Foremost stock totaled 50%. The remaining 50% of the Foremost stock was owned by Gardner. The G & R partnership's main asset is a commercial building which houses

139 B.R. 931, 17 UCC Rep.Serv.2d 962
(Cite as: 139 B.R. 931)

the corporation Foremost as its primary tenant.

On August 19, 1986, Appellant and Debtor dissolved their marriage in state court in Orange County, California. As part of the division of property agreement, Debtor received the community property interest in the Foremost stock and, in return, Debtor executed a promissory note in favor of Appellant with a principal sum of \$340,000. The first \$140,000 of this note was secured by the Foremost stock certificates owned by the Debtor and the remaining \$200,000 was secured by the Debtor's interest in G & R. On April 30, 1986, Debtor and Appellant executed a security agreement memorializing the above security agreements. As part of the dissolution of marriage, the court entered an order on August 19, 1986, in which Gardner was designated to act as escrow holder for Appellant of Debtor's Foremost stock. On that same date, the court also entered a charging order in favor of Appellant for Debtor's interest in G & R partnership. On September 17, 1986, more than two years prior to the filing of this bankruptcy case, Gardner received formal notice of the charging order and notice of his designation as escrow holder of the Debtor's stock.

To pay off Debtor's note, Gardner directed Debtor's partnership share of G & R's income to be paid to Appellant. When Foremost stopped paying rent to G & R on September 26, 1988, these payments ceased. Gardner held Debtor's Foremost stock certificates until, without advising Appellant, he delivered them to the IRS on January 25, 1989, pursuant to enforcement *934 of a levy on Debtor's property. The stock remains in the possession of the IRS.

Appellant filed a state court action for dissolution of the G & R partnership. On March 7, 1989, Debtor filed his Chapter 11 petition which stayed Appellant's action for dissolution.

On July 27, 1989, Debtor filed an adversary complaint seeking, *inter alia*, to avoid Appellant's security interests in Debtor's share of G & R part-

nership and Debtor's Foremost stock. The bankruptcy court granted Debtor's motion for summary judgment which sought to avoid Appellant's interests in Debtor's Foremost stock and partnership interests in G & R. The basis of the court's ruling was that because neither security interest was perfected under Article 9 of California's Commercial Code, the security interests could not survive Debtor's "strong arm" powers under § 544.

ISSUES PRESENTED

1. Whether a lien existed on a debtor partner's interest in the partnership prior to the debtor's filing bankruptcy when a stipulated charging order was issued over two years prior to the date the debtor filed bankruptcy?

2. Whether perfection by possession ceases when an escrow holder entrusted with a creditor's collateral delivers it without authorization from that creditor to another party who claims an adverse claim to the collateral?

STANDARD OF REVIEW

The proper standard of an appellate court reviewing a partial summary judgment is to view the evidence in the light most favorable to the non-moving party and then determine under a *de novo* standard (1) whether there is no genuine issue of material fact and (2) whether the moving party was entitled to judgment as a matter of law. *In re New England Fish Co.*, 749 F.2d 1277, 1280 (9th Cir.1984).

DISCUSSION

Section 544 governs the power of the debtor in possession to avoid security interests. *See* § 1107(a) (a debtor in possession shall have all the powers of a trustee). Under § 544(a)(1), the trustee or debtor in possession stands in the shoes of a "hypothetical lien creditor whose lien arose on the day the bankruptcy petition was filed." *In re Wind Power Systems, Inc.*, 841 F.2d 288, 292 (9th Cir.1988). As a lien creditor, the debtor in possession possesses the right and power to avoid any lien claims or security interests which are unperfected on the date that the

139 B.R. 931, 17 UCC Rep.Serv.2d 962
(Cite as: 139 B.R. 931)

bankruptcy petition is filed. *Id.*

A. CHARGING ORDER

[1] Appellant contends that the charging order provided a superior lien over Debtor's hypothetical lien status. Debtor contends that the charging order did not create a lien under California Civil Procedure Code (CCPC) § 708.320(a) because Appellant failed to serve the charging order on all the partners and failed to file a motion for the charging order.

CCPC § 708.320 establishes who must be served with a motion for a charging order and the point at which a lien is created if a motion for a charging order is filed:

(a) Service of a notice of motion for a charging order on the judgment debtor and on the other partners or the partnership creates a lien on the judgment debtor's interest in the partnership.

(b) If a charging order is issued, the lien created pursuant to subdivision (a) continues under the terms of the order. If issuance of the charging order is denied, the lien is extinguished.

Cal.Civ.Proc.Code § 708.320 (West 1987).

Debtor contends that no lien was created by the charging order because all the partners in G & R were not served. In its conclusions of law, the bankruptcy court held that the partnership was not properly served because one of the partners was not served.

CCPC § 708.320(a) requires service on the "judgment debtor and on the other partners *or the partnership....*" (emphasis*935 added) ^{FN2} That is, all the partners need not be served if there is service on the partnership.

FN2. The citation of CCPC § 708.320 in Debtor's brief omits the "or the partnership" clause.

Under CCPC § 416.40, service on a partnership is satisfied by service on "the person designated as

agent for service of process ... or to a general partner or the general manager of the partnership...." Accordingly, service on all the partners is not required so long as a general partner other than the judgment debtor is served. In the present case, the partnership was served when Gardner, who is a non-debtor general partner, was served with the charging order. Therefore, the court erred in finding that the partnership was not properly served.

[2] Debtor also contends that, pursuant to CCPC § 708.320, no lien can be created by a charging order unless notice of a motion for the charging order is served upon the partnership. Debtor's presumption that a separate motion is required for a charging order to become a lien is misplaced. In the present case, no separate motion was presented because both parties, Appellant and Debtor, stipulated to an agreement that such an order would be issued. Since both Appellant and Debtor agreed to the charging order as part of the division of property agreement in the dissolution of their marriage, requiring that a separate motion be brought on the existing charging order serves no purpose and constitutes a useless act. Debtor offers neither authority nor rationale to support the proposition that CCPC § 708.320 contemplates such a useless act.

It is well-established that, in cases involving notice, the law does not require a useless act. See *Adamson Companies v. Zipp*, 163 Cal.App.3d Supp. 1, 10, 210 Cal.Rptr. 165, 171 (1984); *Arcata Publications Group v. Beverly Hills Publishing Co.*, 154 Cal.App.3d 276, 280, 201 Cal.Rptr. 223, 225 (1984). Once the charging order was issued and served upon the partnership, the partnership acknowledged and followed the terms of the charging order when it paid Appellant from its profits. We find that CCPC § 708.320 does not require the useless and redundant service of a motion for a charging order when the charging order is stipulated to by the parties and entered by the court.

Creation of lien by a charging order.

[3] Appellant contends that the issuance of the charging order created a lien prior to the filing of

139 B.R. 931, 17 UCC Rep.Serv.2d 962
(Cite as: 139 B.R. 931)

bankruptcy. This contention is based upon case law decided prior to the enactment of CCPC § 708.320. Debtor argues that § 708.320(a) supersedes the prior law.

[4] A charging order entered pursuant to California's Uniform Partnership Act § 15028 replaces a levy of execution and provides the judgment creditor with a lien on the partnership property. *Baum v. Baum*, 51 Cal.2d 610, 612–613, 335 P.2d 481, 483 (1959). Under case law decided prior to the enactment of CCPC § 708.320, courts have stated in dicta that the issuance of a charging order creates a lien on the debtor partner's partnership interest. *Taylor v. S & M Lamp Co.*, 190 Cal.App.2d 700, 710, 12 Cal.Rptr. 323, 329 (1961). This general rule has also been implied in decisions from other jurisdictions which have interpreted the identical provision. See *In re Stocks*, 110 B.R. 65, 67 (Bankr.N.D.Fla.1989); *In re Pischke*, 11 B.R. 913, 918 (Bankr.E.D.Va.1981); *Krauth v. First Continental Dev-Con, Inc.*, 351 So.2d 1106, 1108 (Fla.App.1977); *But see City of Arkansas City v. Anderson*, 242 Kan. 875, 752 P.2d 673, 684 (1988) (issuance and service of the charging order upon the partnership creates a lien on the debtor partner's partnership interest).

[5] Contrary to the Debtor's contention, CCPC § 780.320(a) does not contradict this rule. Rather, both rules complement each other. CCPC § 780.320(a) applies when there is a motion for a charging order; it provides that if there is a motion for a charging order, the lien is created earlier than when there is no motion: that is, upon service of the motion for a charging order on the partnership. Here, CCPC § 780.320(a)*936 does not apply because the Appellant and Debtor stipulated to issuance of the charging order. When there is no motion for the charging order, such as in the present case, a lien is created upon issuance of the charging order.

[6] In the present case, a lien on Debtor's partnership interest was created by the issuance of the charging order on August 19, 1986. Under Califor-

nia Commercial Code (CCC) § 9301(1), this lien has priority over and is superior to security interests in the same properties if those security interests are unperfected as of the date when the charging order was issued. Moreover, this lien is superior to the debtor in possession's interest as a "hypothetical lien creditor." *In re Stocks*, 110 B.R. at 67. We conclude that the bankruptcy court erred when it avoided Appellant's security interest in Debtor's partnership interest.

B. PERFECTION OF A SECURITY INTEREST IN STOCKS

Appellant contends that the court erred in avoiding her security interest in Debtor's Foremost stock because it was perfected at the time Debtor filed bankruptcy. This contention is based upon Appellant's argument that her security interest in stocks continued to be perfected at the time Debtor filed bankruptcy because Debtor had no control over the stocks.

Debtor responds with two arguments: (1) Appellant never perfected stocks by possession; and (2) assuming that the stock certificates were perfected, perfection by possession by Appellant ceased when the IRS gained possession of Debtor's Foremost stock certificates.

Perfection of Stock Certificates by Possession.^{FN3}

FN3. The bankruptcy court made its ruling based upon California Commercial Code (CCC) § 9305. Prior to the 1977 change in the code, certificated securities were covered under CCC § 9305. However, after the creation and enactment of Article 8 in 1977, perfection of security interests in certificated securities was explicitly excluded from Article 9 and governed instead by Article 8. CCC § 9305 provides in pertinent part as follows:

A security interest in ... instruments (*other than certificated securities*) ... may be perfected by the secured party's tak-

139 B.R. 931, 17 UCC Rep.Serv.2d 962
(Cite as: 139 B.R. 931)

ing possession of the collateral.
(emphasis added)

The Official Comment to Uniform Commercial Code (UCC) § 9-305, which the California Commercial Code adopted, states as follows:

The definition of "instrument" in Section 9-105(1)(i) includes a certificated security and the perfection of security interests in all securities is governed by Section 8-321. Hence, certificated securities are expressly excluded from this section.

The stock certificates at issue in the present case constitute Article 8 certificated securities. See *F.D.I.C. v. W. Hugh Meyer & Assoc. Inc.*, 864 F.2d 371 (5th Cir.1989). Nevertheless, the California variation of UCC § 8-321 which addresses perfection by possession contains the identical provision found in UCC § 9-305:

A security interest is perfected by possession from the time possession is taken without relation back and continues so long as possession is retained, unless otherwise specified in this division. The security interest may be otherwise perfected as provided in this division before or after the period of possession by the secured party. Cal.Com.Code § 9305.

The official comment in CCC § 9305 states that the typical pledge of a certificated security is unaffected by the addition of Article 8. Therefore, applying CCC § 9305 instead of CCC § 8321 to the facts in the present case has no effect on the outcome.

[7] California Commercial Code (CCC) § 9305, which governs perfection by possession, provides

in part as follows:

A security interest in ... instruments (other than certificated securities), ... may be perfected by the secured party's taking possession of the collateral. If such collateral ... is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this division....

Cal.Com.Code § 9305 (West 1990).

[8] Under CCC § 9305, possession is effectuated when the collateral is physically transferred to the secured party or its agent or to a bailee who has been notified of the secured party's interest.

*937 Official Comment to U.C.C. § 9-305, which was adopted by the California Commercial Code, states:

Possession may be by the secured party himself or by an agent on his behalf: it is of course clear, however, that the debtor or a person controlled by him cannot qualify as such an agent for the secured party....

U.C.C. § 9-305 Comment 2 (1977).

In the present case, Appellant alleges that Gardner was designated as the escrow holder of Debtor's stock certificates for Appellant and that Gardner acted as Appellant's bailee when he received notice of his status. Since Gardner had possession of the Debtor's stock, Appellant argues that her security interest was perfected when Gardner received notice of Appellant's interest in the stock. Debtor contends that Gardner never acted as bailee for Appellant, but instead acted as an agent for Debtor.

Viewing the evidence in the light most favorable to the non-moving party, the Appellant, it

