

ENFORCEMENT OF JUDGMENTS

How Hedge Fund Managers Can Address Common Issues and Risks When Enforcing Judgments Against Debtors

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Numerous hedge funds are adept at making investments based on the outcome of litigation. While the main type of foray garnering attention in this field has been litigation finance, the acquisition of unexecuted judgments has become an increasingly attractive opportunity. For more on litigation funding as an investment, see *"In Turbulent Markets, Hedge Fund Managers Turn to Litigation Funding for Absolute, Uncorrelated Returns"* (Jun. 24, 2009).

Before acquiring even one judgment, let alone an entire portfolio of them, however, there are a number of issues that a hedge fund manager's in-house counsel must consider in order to accurately render advice to management. The most common issues include whether the acquisition and eventual satisfaction of a judgment is economically feasible; how to maintain communication with litigation counsel to efficiently carry out the various methods of judgment enforcement; and methods for dealing with recalcitrant judgment debtors. Expertise in both legal and financial aspects of the enforcement process can help ensure a judgment will be swiftly and inexpensively satisfied, enabling a successful return on the investment.

See also *"Enforcement in the Cayman Islands of U.S. and Other Foreign Judgments: How Safe Is It for Hedge Fund Managers to Allow Judgment to Be Entered by Default?"* (Jul. 1, 2011).

Determining the Enforceability of a Judgment and the Feasibility of Satisfaction

The most important enforcement issue facing a hedge fund occurs long before a judgment is acquired. At the outset, it is critical to thoroughly investigate the form of the judgment, as well as the underlying debtor

and its assets. Prior to acquiring a judgment or instructing outside litigation counsel to commence litigation, legal and financial due diligence are vital to determine whether the pursuit of judgment satisfaction is economically viable for both the fund and its investors.

Verify Formalities Are Met

First and foremost, a hedge fund's in-house counsel should review the judgment to confirm that it complies with all formalities and local requirements. For example, it is imperative to ensure that the language "for which let execution issue forthwith" (or similar) exists on the face of the judgment. Doing so will often avoid any applicable statutory delays in enforcement, which debtors may otherwise enjoy and perhaps use to their advantage.

Though this language is seemingly ritualistic, omitting it can result in a substantive impediment to enforcement proceedings. In fact, Florida's appellate courts are in apparent conflict as to whether execution can even commence if this archaic phrase is absent from a judgment.^[1]

Monitor Debtor's Assets

Most importantly, a hedge fund should already have a good idea of the extent and location of a debtor's assets by the time a judgment is entered or acquired. If a debt is uncollectible, even a six- or seven-figure judgment is worthless. Therefore, asset investigation must remain at the forefront of nearly every decision in the enforcement process.

If collectible assets become moving targets, they must be tracked and monitored well in advance of acquiring a judgment and acting upon it. Even when a stay of enforcement is mandatorily imposed, restraining notices should be issued to debtors and the financial institutions they utilize in order to freeze assets. In New York, for example, a restraining notice can be issued by an attorney without court approval, operating with the threat of contempt and liability for damages if violated.^[2] In some jurisdictions, a restraining notice may also be issued pre-judgment if there is a chance that enforcement may be compromised in the interim.

Ongoing asset tracking is also advisable depending on the value, liquidity and other characteristics of the sought-after asset. In the event this information is not sufficiently obtained prior to acquiring the judgment, a private investigator can be invaluable for determining where assets are located, and thus, where enforcement is best sought.

Even after a judgment has been entered, there remain various means by which to obtain discovery in aid of execution, such as issuing written discovery requests, seeking information through subpoenas and deposing the debtor and third parties. As an investor, the obvious position to avoid is being forced to settle for less than your investment and enforcement expenditures.

Arrange for Enforcement

Should a debtor have valuable assets outside the jurisdiction where judgment was entered, litigation counsel should be instructed to localize the judgment. Fortunately, the enforcement process has been modernized to facilitate collection across state lines. If a state court judgment is at issue, most states have enacted the Uniform Enforcement of Foreign Judgments Act for domesticating a foreign state judgment. In many states, domestication requires initiating a new court action with a certified copy of the judgment.

The process for a federal judgment is even easier. Enforcing a federal judgment is accomplished by registration in accordance with 28 U.S.C. § 1963,

which only requires certification by the district court clerk along with a certified copy of the judgment. Unlike some state laws, notice to the debtor is not required when registering a federal judgment, enabling immediate enforcement and sometimes catching a debtor off-guard.

Enforcement Measures to Maximize Recovery and Minimize Expense

Judgment enforcement is typically governed by the law of the state where collection is sought, which can frequently mean collection is controlled by an arcane body of law replete with debtor-friendly roadblocks. Judgment satisfaction can be a costly endeavor, requiring litigation counsel to carefully navigate a minefield of procedural pitfalls and substantive hurdles, often requiring instant adaptation to changing circumstances.

Communication With Attorneys

For this reason, it is imperative for hedge fund principals to regularly communicate with their collection attorneys. Doing so will not only maintain up-to-date communications about the status of collection efforts, but more importantly, will ensure strict adherence to the litigation budget.

Throughout this process, the hedge fund manager's general counsel should be aware, and instruct internal management accordingly, that some courts deem certain communications with third-party investors outside the attorney-client privilege, and thus, potentially subject to discovery.^[3] Regardless of the jurisdiction where enforcement is sought, due care should be taken in this regard.

Enforcement Methods

There are several well-known methods for enforcing a judgment. Most are routine, but all depend on the particularities of the situation and, primarily, the extent, type and location of attachable assets. While deference should be given to the litigation counsel with boots

on the ground, a hedge fund's general counsel should instruct swift movement on the path of least resistance towards seizing a debtor's most valuable assets.

Under normal circumstances, it is standard procedure for legal counsel to immediately request the court to issue a writ of execution, which orders the seizure of certain property in satisfaction of a judgment. A writ of execution typically lists tangible and intangible assets in general terms, but it may also include real property.

While collection efforts should typically be directed to liquid assets within arms-reach, sometimes real property may be a debtor's only accessible asset. Before attempting to seize real property, counsel should be aware that some states, such as New Jersey, require all personal property to be exhausted before levying real property.^[4]

Once a writ of execution is issued, counsel should coordinate the asset seizure with the office of the local sheriff for a state court judgment, or the U.S. Marshals Service for a federal court judgment. Many details require confirmation well in advance, beyond the mere logistics of the execution. For example, an execution may require multiple sheriff's deputies or U.S. Marshals; a locksmith; moving and storage companies; and an onsite property appraiser. Attention to these details will streamline the process and save expenses in the long run, as many of these personnel charge by the hour.

Additionally, some divisions of the U.S. Marshals Service – such as those in Florida and New Jersey – also require a separate "Break Order" prior to executing a judgment. A Break Order will hold harmless and allow the U.S. Marshals to use whatever force necessary to locate, levy and remove property. This is a straightforward request that courts typically grant in a perfunctory manner, but may be yet another prerequisite to seizing a debtor's assets.

In the event attachable assets belong to or are owed to a debtor but possessed by a third party, outside counsel may be required to obtain a separate writ of garnishment. A writ of garnishment can be

issued with respect to particular property, such as bank accounts and safe deposit boxes, which will often surprise an unwitting debtor when it learns that its accounts have been frozen.

A debtor's wages can also be garnished through this writ, which can yield an otherwise effortless, steady stream of income. It is highly unlikely that a debtor will become unemployed just to avoid garnishment, so the hedge fund can collect income every month until the judgment is satisfied or the debtor is compelled to settle.

Another traditional but less utilized method of enforcement is obtaining a charging order for a limited liability company or partnership. This remedy "charges" a judgment debtor's interest in the entity, so any distribution will be paid to the judgment creditor rather than the debtor. Should a debtor have a lucrative interest in such an entity, this is yet another avenue for obtaining satisfaction of a judgment.

Whether enforcing a state or federal judgment, it is important to keep in mind that the law of the state where enforcement is sought will largely govern the proceedings.^[5] Therefore, there may be more (or fewer) collection devices at litigation counsel's disposal.

When coordinating the enforcement of a federal judgment, a hedge fund's general counsel should also consider whether it would be more advantageous to utilize the local sheriff (once the judgment is domesticated) or the U.S. Marshals Service. At times, a sheriff's office may have valuable intelligence to facilitate the execution, whereas some seizures are better suited by a team of U.S. Marshals knocking on a debtor's door.

Methods to Collect From Evasive and Uncooperative Debtors

Unfortunately, debtors frequently ignore or otherwise refuse to comply with the enforcement process, resulting in unnecessarily increased costs and delay. Should a debtor seek to evade or otherwise hinder the lawful

satisfaction of a judgment, counsel must act quickly to prevent the hedge fund's judgment from becoming an uncollectable and otherwise hollow victory.

The hedge fund manager should be aware of, and prepared to immediately seek, all additional remedies that become available as the extent of a debtor's recalcitrance increases. For example, if a debtor disobeys a court order or refuses to comply with discovery in aid of execution, the first step is to instruct outside counsel to immediately seek an order holding the debtor in contempt and enforcing compliance. Many states, like New Jersey, have intricate local procedures governing contempt proceedings, which often culminate in an arrest if the debtor continues to refuse to cooperate.^[6]

Depending on the situation, satisfaction of a judgment may only be possible through even more extraordinary relief. If collectible assets are being concealed or fraudulently transferred, many states permit the appointment of a receiver over debtors or its business.

In these instances, a receiver will not only step into the debtors' shoes to identify attachable assets, but it can also marshal assets in aid of execution. More drastic remedies may be available if assets have already been fraudulently transferred out of the jurisdiction, or if a debtor is a flight risk. For example, the U.S. Court of Appeals for the Seventh Circuit affirmed a district court order seizing a debtor's passport under these very circumstances.^[7]

No matter how many proactive measures are taken, sometimes even the most diligent judgment creditor can fall victim to a truly recalcitrant debtor. In the worst-case scenario, a hedge fund may be forced to instruct outside counsel to initiate new litigation just to satisfy the judgment it already obtained. The most common of these actions sound in fraudulent transfer, and many seek to impose a constructive trust over property or to pierce the corporate veil to enable recovery. While new litigation may be necessary in

some instances, counsel must always keep financial and practical considerations in mind to avoid needlessly throwing good money after bad.

Evasive and uncooperative debtors can easily hinder the judgment enforcement process, so it is essential to take initiative and be adaptable. In nearly every situation, there are a variety of methods and means for dealing with a wayward debtor, all while staying within the confines of the Fair Debt Collection Practices Act and comparable state law.

Conclusion

Judgment acquisition has the potential to be a lucrative investment, but the enforcement process can be a challenging endeavor, requiring both discipline and advance consideration of these common issues and risks. If the general counsel or chief compliance officer of a hedge fund adheres to these basic principles, he or she can significantly increase the chances of economically and efficiently satisfying the judgment and obtaining a return on their fund's investment.

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[1] Compare *Du Breuil v. Regnvall*, 527 So.2d 249 (Fla. 3d DCA 1988), with *Haines v. Black Diamond Props.*, 176 So.3d 1023 (Fla. 5th DCA 2015).

[2] NY CPLR § 5222.

[3] See, e.g. *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F.Supp.3d 711 (N.D. Ill. 2014); *Leader Techs., Inc. v. Facebook, Inc.*, 719 F.Supp.2d 373 (D. Del. 2010).

[4] See N.J. Stat. § 2A:17-1.

[5] See, e.g. Fed.R.Civ.P. 69.

[6] See N.J. Court Rule 4:59-1.

[7] See *Bank of America, N.A. v. Veluchamy*, 643 F.3d 185 (7th Cir. 2011).