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Turned Upside Down: The Wisconsin Supreme Court Reverses the Rule on Judgment Liens

In 1999, the Wisconsin Supreme Court decided *Mann v. Badger Lines, Inc. (In re Badger Lines, Inc.)*, 224 Wis. 2d 646, 590 N.W. 2d 270 (1999), in which it addressed a question certified to it by the Seventh Circuit Court of Appeals: Does Wisconsin law require that a lien obtained by a judgment creditor who institutes supplementary proceedings under Wisconsin Statutes section 816.04 be perfected, and if so, how is the lien to be perfected? The Wisconsin Supreme Court concluded that a creditor's lien is valid and superior against other creditors at the time the creditor serves the debtor with a summons to appear at the supplementary proceeding under Wis. Stat. § 816.03(1)(b). *Mann*, 224 Wis. 2d at 649.

In October 1991, plaintiff Emerald Industrial Leasing Corporation ("Emerald") obtained a default judgment against defendant Badger Lines, Inc. ("Badger Lines"). It also obtained an order from the circuit court directing Badger Lines to appear at a supplementary proceeding under Wisconsin Statutes section 816.03 and enjoining Badger Lines from transferring its assets. In December 1991, the court commissioner appointed Douglas Mann ("Mann") as supplementary receiver and issued an order for Badger Lines to turn over its assets pursuant to Wisconsin Statutes section 816.04. In February 1992 (within ninety days of Mann's appointment and the turnover order), Badger Lines filed a voluntary petition under Chapter 7 of the United States Bankruptcy Code and Robert Waud ("Waud") was appointed as trustee. Mann asserted a secured claim in the Chapter 7 case based upon a receiver's lien. However, Waud filed a final report listing Emerald as an unsecured creditor because Mann's appointment and the turnover order had occurred within the 90-day preference period under 11 U.S.C. § 547. The Bankruptcy Court held that a judgment lien is created when the receiver is appointed and that the asserted lien was voidable as a preference. Mann, 224 Wis. 2d at 651.

Mann appealed and the United States District Court held that Emerald received a lien when the order to appear at the supplementary proceeding was entered, but remanded to the Bankruptcy Court the question of how such lien is to be perfected. On remand, the Bankruptcy Court determined that a judgment lien is perfected by either the appointment of a supplementary receiver or upon the issuance of a turnover order. Since both of these events occurred within the

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preference period, the lien was avoidable as a preference. *Id*. at 652. Mann appealed to the Seventh Circuit and because the court determined that it should not speculate on how the Wisconsin Supreme Court would rule on the issue, it certified the question. *Id* at 653.

The Wisconsin Supreme Court defined perfection as the single date or moment in time when a creditor obtains a lien which cannot be overtaken by another creditor on simple contract. Id. at 654. The court concluded that the answer to when perfection occurs was not found in the Wisconsin Statutes, but must be answered by existing case law. As part of its analysis, the Supreme Court reviewed the three very old cases (*Kellogg v. Coller*, 47 Wis. 649, 3 N.W. 433 (1879); Holton v. Burton, 78 Wis. 321, 47 N.W. 624 (1890); and Alexander v. Wald, 231 Wis. 550, 286 N.W. 6 (1939)).

In *Holton*, the court determined that a debtor could assign its property after supplementary proceedings because a lien had not yet arisen, which appeared to support Trustee Waud's view. In *Kellogg*, a sheriff served an order to appear for a supplementary examination before a second creditor had a similar order served. However, the first order was technically invalid because of an error in the sheriff's affidavit. The Supreme Court held that the first order was sufficient to give the first creditor a prior lien. In *Alexander*, both the service of the order to appear and the appointment of the receiver occurred outside of the preference period in the defendant's subsequent federal bankruptcy proceeding. However, the court emphasized the order to appear at the supplementary examination as the important fact without indicating that the appointment of the receiver was important at all.

In *Badger Lines*, the trustee argued that the holding in *Holton* and the Wisconsin's aversion to "secret liens" militated in favor of perfection occurring either at the appointment of a receiver or the entry of an order to turn over property. *Mann*, 224 Wis. 2d at 657-658. The court said that the case law "only dimly illumine [its] path" and that public policy considerations must be weighed to resolve the issue. *Id*. at 657. The court acknowledged that secret liens are disfavored in Wisconsin. However, it noted that there was no statewide registry of the appointment of receivers or orders to turnover of property. *Id*. at 658. Moreover, it concluded that public policy is served by requiring no additional steps after service of the notice to appear at the supplementary examination, as this result was consistent with actual practice in the commercial world and facilitated negotiation and settlement between the parties to the dispute. *Id*. at 660. The court concluded that a judgment lien arises upon service of a summons to appear at a supplementary

examination. *Id*. at 661.

This remained the state of the law until July 15, 2014, when the Wisconsin Supreme Court decided two cases addressing judgment liens. In the first, *Associated Bank, N.A. v. Collier*, 2014 WI 62 (2014), the narrow question presented to the court was whether a valid, docketed judgment was necessary to create a lien by service of an order to appear at a supplementary examination. A creditor, SB 1, which was a successor in interest to judgment creditor Associated Bank, obtained an order directing the defendant to appear at a supplementary examination. However, the defendant avoided service of the order to appear, and before it could be served, the defendant accepted service of suits from a friendly creditor, Decade, and stipulated to judgment. Decade served the defendant with an order to appear for a supplemental examination in November 2010. However, Decade's judgment was not properly docketed. In April 2011, SB 1 finally obtained service of the order to appear at the supplementary examination. In June 2011, on the eve of a hearing to show cause for failing to appear at SB 1's supplementary examination, the defendant filed a state insolvency proceeding in Florida which was eventually enjoined on SB 1's motion. SB 1 moved to obtain an order from the Wisconsin court directing the defendant to turn over certain personal property. Relying on , Decade objected, claiming it had a prior lien because it served the notice of supplementary examination first. SB 1 countered that its lien was superior because Decade's judgment had not been properly docketed. The court agreed that a docketed judgment was essential and granted SB 1's motion to turn over the personal property. Decade appealed and the court of appeals affirmed concluding that an order to appear at a supplementary proceeding "does not...present an alternative to a properly documented judgment." *Id*. ¶ 19. Decade appealed to the Wisconsin Supreme Court.

Presented with the narrow question of whether a properly docketed judgment is necessary to perfect a judgment lien arising by service of an order to appear at a supplementary examination under Wisconsin Statutes section 816.03 and *Badger Lines*, in an opinion authored by Justice Roggensack, the Wisconsin Supreme Court reversed decades of precedent and wholly rewrote the law of judgment liens in Wisconsin.

The Court began by indicating that supplementary proceedings are a form of discovery and do not create a liens at all. *Id*. ¶ 28. Instead, judgment liens only arise when a creditor levies on nonexempt property. *Id*. ¶ 23. A levy is accomplished by the creditor (1) obtaining a sheriff's execution on specific property under Wisconsin Statutes section 815.05(6); (2) garnishing specific

property in the hands of a third party under Wisconsin Statutes section 812.01; or (3) obtaining a court order to turn over and apply specific property to partially satisfy the judgment under Wisconsin Statutes section 816.08. *Id*. at ¶¶ 24-27.

The Court examined *Holton*, *Kellogg and Alexander*, and concluded that none of the cases addressed a blanket lien arising on all of the judgment debtor's personal property, and that it was problematic to argue too strongly from cases as old as *Kellogg* because the statutes being interpreted were different from those existing today. Id. ¶ 31. However, the Court then cited the even older case of *Knox v. Webster*, 18 Wis. 406 (1864), for the proposition that a lien on personal property arises from the time it is seized (or levied), which is what Wisconsin Statutes section 815.19 (1) currently provides. *Associated Bank*, 2014 WI 62, ¶ 40. The Court also concluded that a properly docketed judgment is a prerequisite to any lien. *Id*. ¶ 42.

Regarding the *Badger Lines* decision, the Court simply said that in that case the Supreme Court did not have before it a full record that displayed all of the issues, and that merely serving an order to appear at a supplementary proceeding (as it clearly held in *Badger Lines*) does not create a lien that is superior to the interests of other creditors. *Id*. ¶¶ 44-45. If a blanket lien was created by merely serving an order to appear at a supplementary examination, said the Court, executions under Wisconsin Statutes chapter 815, garnishments under chapter 812 and turnover orders would be nearly useless and would be contrary to the provisions of Wisconsin Statutes section # 815.19(1). *Id*. ¶ 47. Additionally, a blanket lien arising upon service to appear at a supplementary proceeding would inappropriately trump the efforts of a diligent creditor who discovers and pursues specific assets. *Id*. ¶ 48.

Referring to its companion decision in *Attorney's Title Guaranty Fund, Inc. v. Town Bank*, 2014 WI 63 (2014) (discussed below), the Court said that granting a blanket lien to a judgment creditor would frustrate the legislature's goal of a uniform system of secured transactions set forth in Wisconsin Statutes chapter 409. *Associated Bank*, 2014 WI 62, ¶ 49. Finally, the Court said the policy choice of whether to permit blanket judgment liens is best left to the legislature, citing statutes in Illinois and California which do so. *Id*. ¶ 52. The Court found that SB 1's obtaining an order for turnover of specific property gave it a valid lien on the defendant's property, and that service of the orders to appear for a supplemental examination by SB 1 or Decade did not create a lien in favor of either party. *Id*. ¶¶ 59-60.

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Justice Abrahamson, joined by Justice Bradley, who authored the *Badger Lines* decision, vigorously dissented. In the dissent, among other things, Justice Abrahamson blasted the majority for failing to recognize the practicalities of the real commercial world; for going beyond the question presented to wipe out 150 years of prior law relating to common-law liens; failing to acknowledge service of an order to appear at a supplementary examination as constituting an "equitable levy"; and "sunbursting" its decision (applying it retroactively) without regard to the goals of predictability, uniformity or efficiency of commercial transactions.

The dissent extensively reviewed the prior case law holding that service of a notice of supplementary proceeding operates as an equitable lien which creates a lien on the property of the judgment debtor, citing *In re Milburn*, 9 Wis. 24, 17 N.W. 965 (1883) and *Kellogg*. *Associated Bank*, 2014 WI 62, ¶¶ 91-105. Although acknowledging that an appropriate question to be addressed would be the extent of a blanket judgment lien on after-acquired property (*Id*. ¶ 80), Justice Abrahamson asserted that the "...majority opinion contorts and distorts Badger Lines to reach its result, changing the baseline rule that *Badger Lines* reiterated and upon which debtors and creditors have relied. Id. ¶ 108. "[T]the majority opinion resurrects and adopts the losing party's argument in *Badger Lines*, while professing to follow the holding in *Badger Lines*. Thus, the majority opinion blithely overturns *Badger Lines* and 150 years of Wisconsin jurisprudence, leaving creditors and debtors unsure of their rights." *Id* ¶¶119-120.

In the companion case of *Attorney's Title Guar. Fund, Inc. v. Town Bank*, 2014 WI 63 (2014), decided on the same day as *Associated Bank N.A. v. Collier*, the Court addressed the issue of priority between a judgment creditor which asserted a lien by virtue of the service of an order to appear at a supplementary examination and a subsequent creditor which asserted a secured claim under Wisconsin Statutes chapter 409.

Town Bank obtained a judgment against defendant Brophy and served an order upon him to appear at a supplementary examination in February 2006. In June 2007, Brophy obtained loans from Heartland Wisconsin Corp. ("Heartland") to settle a class action suit and pledged to Heartland the proceeds of a malpractice claim against his former attorney as collateral. It is unclear if the malpractice claim existed at the time of Town Bank's judgment. Brophy defaulted and filed for bankruptcy in August 2007. Town Bank first learned of the malpractice claim in the bankruptcy proceeding and filed a secured claim based upon its 2006 judgment lien. In January 2009, the bankruptcy case was dismissed and on the same day Heartland filed a financing statement covering its interest in the

malpractice claim as collateral.

In August 2009, Town Bank moved the circuit court to appoint a supplementary receiver with authority to proceed against the malpractice claim, but the circuit court did not act upon Town Bank's motion. In September 2009, the malpractice claim was settled and Attorney's Title filed an interpleader. Town Bank moved for summary judgment, which was granted. Heartland appealed and the court of appeals affirmed. Heartland appealed to the Wisconsin Supreme Court, which formulated the questions presented to it as follows: (1) whether the potential proceeds from a legal malpractice claim can be lawfully assigned as security for a contemporaneous debt; and (2) whether such proceeds were future property at the time of the 2006 supplemental examination conducted by Town Bank.

In its decision, which was also authored by Justice Roggensack, the Court cites *Associated Bank* and its holding therein that no blanket lien on property is created by the service of a notice to appear at a supplemental examination. *Attorney's Title Guar. Fund, Inc. v. Town Bank*, 2014 WI 63, ¶ 14. A judgment lien can only be created by levying on property in one of the three ways set forth in the Associated Bank decision. *Id*. ¶ 26. Town Bank only moved for the appointment of a supplementary receiver with powers to proceed against the malpractice claim. However, that motion was never ruled upon. *Id*. ¶ 31. The Court therefore held that Heartland's security interest in the malpractice proceeds attached and was perfected before Town Bank obtained a superior interest in the malpractice proceeds by levy. *Id*. ¶¶ 17, 31, 36.

The Court concluded by discussing the public policy aspects of Town Bank's assertion that it should be entitled to a lien in the malpractice claim proceeds, even though the proceeds did not exist at the time of the supplemental examination. The Court emphasized the special status accorded to a secured creditor under Article 9 of the Uniform Commercial Code because the secured creditor provides liquidity to a debtor by financing which may enable unsecured creditors to be paid. *Id*. ¶¶ 38-39. This special status allowed Heartland to be perfected when the malpractice claim proceeds arose and the lien attached, in contrast to Town Bank, which, as a judgment creditor, was required to levy on the proceeds to obtain a lien. *Id*. ¶ 40. If a blanket lien could be created by a judgment creditor, the judgment creditor could encumber property before the debtor has rights in it. "However, unlike a secured creditor, an unsecured judgment creditor provides no value to the debtor in exchange for such a benefit. It is this value to society as a whole --- financing to a debtor--- that justifies a secured creditor's protected status." *Id*. ¶ 42. The scope of the judgment lien Town Bank was

asserting, said the Court, would diminish the lending Wisconsin Statues chapter 409 seeks to encourage. Id. ¶ 44.

Justice Abrahamson dissented, relying upon the reasoning of her dissent in Associated Bank. Justice Bradley joined in this dissent and wrote separately to object to the Court raising the issue of assignability of the malpractice proceeds where that issue had not been raised in the proceedings below or before the Supreme Court. The issues posed by Heartland in its appeal dealt with the scope of the judgment creditor's common law receiver's lien on future property and whether the order to appear at a supplementary examination has to be filed in the public record to be valid. *Id*. ¶ 59. By reformulating the issues and not applying the "forfeiture rule" (precluding a party from raising issues Town on appeal not previously raised), the majority inappropriately created a potentially dispositive issue which could have unfairly aided Town Bank. *Id*. ¶ 63-64.

The *Associated Bank* and the *Attorney's Title* decisions are troubling. As Justice Abrahamson noted in her dissent, they ignore the realities of the commercial world. A judgment debtor may not disclose (or worse, attempt to conceal) assets from a judgment creditor. Without the benefit of a blanket lien, those assets may be wrongfully retained by the judgment debtor with impunity. Requiring the judgment creditor to identify and levy on specific property shifts the burden to an innocent party who is attempting to legally enforce its rights, and may encourage dishonest (or perhaps merely desperate) judgment debtors to take the risk of concealing assets. More importantly, the decisions disrupt commercial expectations retroactively and seemingly without a clearly articulated analysis. Creditors which have relied on the state of the law since *Badger Lines* now must review their matters and incur additional expense to meet the Supreme Court's new standards, which have been imposed without warning. While legitimate questions about the scope of judgment liens were raised by the cases, including the impact of such liens on after-acquired property, the Supreme Court seemed to selectively pick its way through precedents with the objective of turning the law of judgment liens upside down. In any event, a new day has dawned and secured and unsecured creditors alike must take heed.