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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

(Sacramento)

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RANDALL HAMM et al.,

Plaintiffs and Respondents,

v.

CONSUMER PORTFOLIO SERVICES, INC., et al.,

Defendants and Respondents;

JOSE GALLEGOS,

Objector and Appellant.

C078147

(Super. Ct. No.  
34-2010-00081238-CU-BT-  
GDS)

A settlement agreement ended a class action filed to obtain relief from a secured creditor's attempts to recover deficiency judgments. Appellant objected to the settlement as unreasonable, claiming it exposed the class to tax liability that otherwise would not have existed had the parties agreed, or the court ruled, that the creditor had no legal right to any deficiency judgments. He also contended the class notice was insufficient. The

trial court disagreed with appellant and approved the agreement. We affirm, finding the trial court did not abuse its discretion.

### BACKGROUND

“Under California law, a secured creditor who sells the collateral after the debtor’s default may be entitled to a judgment for the difference between the amount owed and the proceeds of the sale. To obtain such a deficiency judgment, however, the creditor must satisfy certain statutory requirements. For secured debts subject to its provisions, the Rees-Levering Motor Vehicle Sales and Finance Act (Civ. Code, § 2981 et seq. [the Rees-Levering Act]) requires that a creditor, before selling a repossessed car, notify the debtor of the right to redeem the car before sale. (Civ. Code, § 2983.2.)” (*Bank of America v. Lallana* (1998) 19 Cal.4th 203, 206 (*Lallana*).

The Rees-Levering Act dictates the contents of the creditor’s notice of its intent to sell a repossessed car. (Civ. Code, § 2983.2.) A debtor is liable for any deficiency only if the creditor’s notice satisfies all of the statutory requirements. (*Ibid.*) “ “[T]he rule and requirement are simple. If the secured creditor wishes a deficiency judgment he must obey the law. If he does not obey the law, he may not have his deficiency judgment.” ’ [Citation.]” (*Lallana, supra*, 19 Cal.4th at p. 215.)

The underlying facts in this case are not in dispute. Plaintiffs Randall and Deborah Hamm purchased a used car in 2005. They financed their purchase. The loan agreement was eventually assigned to defendant Consumer Portfolio Services, Inc. (CPS).

CPS repossessed the car in 2010. It sent plaintiffs a notice of intent to sell the vehicle (NOI), informing them CPS would sell the car unless plaintiffs redeemed or reinstated the loan. Plaintiffs did not redeem or reinstate the loan. CPS sold the car, and it assessed a deficiency balance against plaintiffs.

Plaintiffs filed this action against CPS and another entity as a putative class action.<sup>1</sup> They alleged they were not liable for any deficiency because CPS's NOI did not comply with the Rees-Levering Act's requirements. They also alleged CPS violated the unfair competition law (Bus. & Prof. Code, § 17200 et. seq.) and breached their contract. They sought declaratory relief, injunctive relief prohibiting CPS from collecting the alleged deficiencies, credit repair, and restitution.

There were 2,189 members of the putative class, whose deficiency balances totaled \$18,158,243. CPS had collected a total of \$826,910 from putative class members in payments on their deficiency balances.

After discovery and failed settlement attempts, the parties entered into a settlement agreement in 2014. For its part, CPS agreed to the following terms:

- It will not contest plaintiffs' allegation that the NOI's sent to the settlement class members from June 24, 2006, to October 20, 2010, did not strictly comply with the requirements of the Rees-Levering Act.
- It will cease all efforts to collect deficiency balances from the class members.
- It will refund to class members 78.75 percent of all amounts they have paid on their deficiency balances.
- It will change its account records to reflect a zero balance on all class member accounts on which it assessed a deficiency balance.
- It will instruct credit rating agencies to delete all class members' trade lines with respect to their accounts.
- It will not issue an IRS Form 1099 to class members unless the IRS orders it to do so. The parties believed the settlement agreement would not create a taxable event under IRS regulations governing the discharge of indebtedness. (See 26 C.F.R. §

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<sup>1</sup> Also named as a defendant was ACC Master Holdings, LLC. For the reader's convenience, we refer to both this party and CPS as CPS.

1.6050P-1(b)(2) (2016).) However, if the IRS orders CPS to issue Form 1099, CPS will comply, and such compliance will not be a breach of the settlement agreement.

For their part, class members expressly waived all rights under Civil Code section 1542 and released CPS from all claims, known and unknown, which could have been asserted based on the facts alleged in the action and on CPS's NOI.

The trial court preliminarily approved the settlement agreement, preliminarily certified the class for purposes of settlement, and approved the notice of the proposed settlement to be sent to all class members (the class notice). The class notice related the terms of the proposed settlement. As to possible tax consequences to class members, the notice stated: "Any benefits you receive may or may not be the subject of state or federal taxation, depending on your circumstances. You are advised to seek separate legal and/or tax advice on matters of taxation."

The settlement administrator served the class notice, and no class members sought to be excluded from the settlement. Appellant Jose Gallegos filed the only objection.

Gallegos argued the settlement agreement was unfair, inadequate, and unreasonable. The crux of his objection was his belief that CPS's waiver of outstanding deficiency balances would create a taxable event for class members. Relying on an IRS private letter ruling, he asserted the IRS treats disputed debt forgiven as part of a settlement as a taxable event unless the creditor admits fault. Gallegos contended the parties could avoid creating tax liability by CPS admitting, or the court adjudicating, that the class members never legally owed the deficiency balances due to the defective NOI, but the settlement agreement did not contain such an admission or adjudication.

Gallegos further claimed that because of the settlement agreement's waiver of claims, class members would forfeit their ability to establish to the IRS that they never legally owed the deficiency balances. He argued the waiver would bar them forever from the means of escaping tax consequences.

Gallegos also contended the proposed class notice was false and misleading. He argued the class notice failed to inform class members of their tax liability under the settlement agreement. He also asserted the notice failed to inform members that their waivers meant they could never contest the tax liability.

The trial court denied Gallegos's objection, found the class notice adequate in all respects, and granted final approval to the settlement agreement. It ruled the agreement was fair, adequate, and reasonable. Initially, the court found the agreement was entitled to a presumption of fairness, as it was the result of arms-length bargaining between the parties, was reached after sufficient discovery to allow the parties and the court to act intelligently, counsel was experienced in similar litigation, and the percentage of objectors was small.

The court determined Gallegos had not submitted sufficient evidence to overcome the presumption of fairness. The settlement agreement provided significant benefits to class members, giving them relief "in a manner approximately commensurate with the potential value of their individual claims in light of the risks of continued litigation." The agreement arose after three separate mediation attempts over two years, and class counsel viewed the settlement as favorable to the class.

The trial court rejected Gallegos's arguments. It stated his argument—that a judicial determination holding the deficiency balances invalid under the Rees-Levering Act would ensure no tax liability would arise—was initially appealing. However, the argument "ignores that choosing to proceed to trial carries other risks, including the risk of total defeat on all claims and other outcomes in between. From the papers before it, the Court finds that the parties considered all of these risks and agreed that settlement was preferable."

The trial court dismissed Gallegos's reliance on IRS private letter rulings. The rulings were not binding on the parties to this action, nor were they binding precedent or citable authorities. Even when considered on their merits, the letter rulings at most

revealed only a potential for tax liability, and Gallegos had not proven otherwise. The court found the parties were aware of the rulings, and they endeavored to design a settlement that would not result in tax liability.

The court also determined the class notice adequately informed class members of potential tax liability. The notice “stated that any benefits received from the settlement might have potential tax consequences, such that class members should seek separate legal or tax advice on matters of taxation. The Class Notice thus adequately informed recipients of *exactly* what Objector’s papers have shown: that there is a *potential* for tax consequences.” (Original italics.)

The trial court also rejected Gallegos’s assertion that class members would have no means to challenge any tax liability should it arise. Nothing in the settlement agreement or its waiver of claims denied class members any defense they could raise against the IRS, including the defense that the NOI was legally defective.

Pursuant to the parties’ agreement, the trial court in its final order enjoined CPS “by operation of state law” from taking any further steps to collect deficiency balances purportedly owed by class members. The parties agreed to this injunction to reduce the possibility that the IRS would view the settlement agreement as a taxable event.

#### DISCUSSION

Gallegos contends the trial court abused its discretion when it approved the settlement agreement and found the class notice adequate. He claims the NOI was legally defective; as a result, there was no deficiency debt to waive or forgive. He argues the settlement does not benefit class members, as it creates a tax liability on forgiven debt they never legally owed. Gallegos also contends the class notice was deceptive and violated due process by failing to inform class members of the tax liability they would incur under the settlement and where they could turn for advice.

We conclude the trial court did not abuse its discretion approving the settlement and class notice.

## I

### *Standard of Review*

“Our review of the trial court’s approval of a class action settlement is limited in scope. We make no independent determination whether the settlement terms are ‘fair, adequate and reasonable,’ but only determine whether the trial court acted within its discretion. (*Kullar [v. Foot Locker Retail, Inc. (2008)]* 168 Cal.App.4th [116,] 127-128 [(*Kullar*)].) The trial court’s discretion is broad, and is to be exercised through the application of several well-recognized factors. (*Clark [v. American Residential Services LLC (2009)]* 175 Cal.App.4th [785], 799.) The list, which ‘ “is not exhaustive and should be tailored to each case,” ’ includes ‘ “the strength of plaintiffs’ case, the risk, expense, complexity and likely duration of further litigation, the risk of maintaining class action status through trial, the amount offered in settlement, the extent of discovery completed and the stage of the proceedings, the experience and views of counsel, the presence of a governmental participant, and the reaction of the class members to the proposed settlement.” ’ (*Kullar*, at p. 128 quoting *Dunk v. Ford Motor Co. (1996)* 48 Cal.App.4th 1794, 1801 (*Dunk* ).) ‘ “ ‘The most important factor is the strength of the case for plaintiffs on the merits, balanced against the amount offered in settlement.’ ” ’ (*Kullar, supra*, 168 Cal.App.4th at p. 130.) While the court ‘ “must stop short of the detailed and thorough investigation that it would undertake if it were actually trying the case,” ’ it ‘ “must eschew any rubber stamp approval in favor of an independent evaluation.” ’ (*Ibid.*)

“Some cases state that a presumption of fairness exists ‘where: (1) the settlement is reached through arm’s-length bargaining; (2) investigation and discovery are sufficient to allow counsel and the court to act intelligently; (3) counsel is experienced in similar litigation; and (4) the percentage of objectors is small.’ (*Dunk, supra*, 48 Cal.App.4th at p. 1802.) *Kullar* emphasizes that this is only an initial presumption; a trial court’s approval of a class action settlement will be vacated if the court ‘is not provided with

basic information about the nature and magnitude of the claims in question and the basis for concluding that the consideration being paid for the release of those claims represents a reasonable compromise.’ (*Kullar, supra*, 168 Cal.App.4th at pp. 130, 133.) In short, the trial court may not determine the adequacy of a class action settlement ‘without independently satisfying itself that the consideration being received for the release of the class members’ claims is reasonable in light of the strengths and weaknesses of the claims and the risks of the particular litigation.’ (*Id.* at p. 129.)” (*Munoz v. BCI Coca-Cola Bottling Co. of Los Angeles* (2010) 186 Cal.App.4th 399, 407-408, fn. omitted.)

In general, we review the trial court’s determination that the class notice was adequate for an abuse of discretion. (*Wershba v. Apple Computer, Inc.* (2001) 91 Cal.App.4th 224, 234-235 (*Wershba*.) We may review the sufficiency of the class notice de novo to the extent the trial court’s ruling “ ‘is based on assertedly improper criteria or incorrect legal assumptions . . . .’ ” [Citations.]” (*Cellphone Termination Fee Cases* (2010) 186 Cal.App.4th 1380, 1390.)

## II

### *Approval of Settlement Agreement*

The trial court did not abuse its discretion approving the settlement agreement. It reviewed the relevant factors and satisfied itself that the consideration CPS offered to class members was reasonable in light of the case’s strengths and risks.

The trial court first determined the settlement agreement was entitled to a presumption of fairness. It did not abuse its discretion in doing so. Reviewing the surrounding circumstances, the court found that experienced counsel negotiated the agreement at arm’s length. The parties had pursued investigation and discovery through three mediation attempts over two years. And out of 2,189 potential objectors, only one person objected. Gallegos does not contest these points.

After establishing the presumption, the trial court independently reviewed the settlement agreement’s fairness and adequacy in light of the strengths and weaknesses of

plaintiffs' case, and it determined the agreement was reasonable. It did not abuse its discretion in doing so. It found the agreement provides significant benefits to the class members, including cleared credit, enjoined cessation of collection efforts, and restitution to those who paid CPS. Indeed, the agreement provided class members relief "approximately commensurate with the potential value of their individual claims in light of the risks of continued litigation." It was reasonable for class members to settle their claims on such favorable terms rather than incur the expense and risk associated with a trial.

Gallegos contends the trial court abused its discretion in finding the agreement reasonable because, in effect, there was nothing to settle. He argues the NOI was defective, and, as a result, there could be no deficiency for which class members were liable. The trial court, however, reviewed plaintiffs' case to the extent necessary and was not as convinced as Gallegos that plaintiffs would win on the merits completely or that the settlement would create a tax liability. It noted Gallegos' argument ignored the risk of total defeat at trial on all claims and other outcomes in between.

The complaint raised the following primary issue: The Rees-Levering Act requires an NOI to state there is a conditional right to reinstate the loan "and all the conditions precedent thereto." (Civ. Code, § 2983.2, subd. (a)(2).) Plaintiffs' complaint alleged CPS's NOI failed to state all the conditions plaintiffs would be required to fulfill in order to reinstate the loan. The NOI informed plaintiffs they could reinstate the loan by paying \$4,159.02, an amount owed as of the date of the NOI that consisted of the defaulted payments, delinquency charges, and collection and repossession costs and fees CPS incurred. It also asked plaintiffs to call CPS if they desired to reinstate.

Gallegos contends the NOI is defective because it failed to inform plaintiffs of "all the conditions precedent" by failing to list any amounts that would come due between the date of the NOI and the deadline for reinstatement, and by failing to inform plaintiffs of a mandatory \$15 repossession fee (see Gov. Code, § 41612; Veh. Code, § 28).

The plaintiffs have what appears to be a strong case under the Rees-Levering Act. By using the phrase “all the conditions precedent,” the “Legislature intended that the NOI provide a level of specificity as to the conditions precedent to reinstatement sufficient to inform the buyer—*without need for further inquiry*—as to exactly what the buyer must do to cure the default. Thus, the statute requires that a creditor inform the buyer of any amounts the buyer must pay to the creditor and/or to third parties, and provide the buyer with the names and addresses of those who are to be paid. *The creditor must also inform the buyer regarding any additional monthly payments that will come due before the end of the notice period*, as well as of any late fees, or other fees, the amount(s) of these additional payments or fees, and when the additional sums will become due. If the creditor does not provide the defaulting buyer with this information, the creditor has not informed the defaulting buyer of ‘all the conditions precedent’ to reinstatement of the contract.” (*Juarez v. Arcadia Financial, Ltd.* (2007) 152 Cal.App.4th 889, 904-905, fn. omitted, italics added.)

Nonetheless, the trial court reasonably found legitimate reasons for the parties to settle the case. The class members obtained almost all the relief they sought without incurring the additional risk and cost of continuing the litigation and going to trial. This was valuable to plaintiffs even if they were destined to win relief. Plaintiffs obtained most of what they wanted at a lower cost.

It was not clear to the trial court that class members would incur tax liability under the settlement agreement. It acted within its discretion when ruling Gallegos had not established this point. The Internal Revenue Code states gross income includes “all income from whatever source derived,” including “[i]ncome from [the] discharge of indebtedness.” (26 U.S.C. § 61(a)(12).) The Internal Revenue Code requires applicable entities to report any discharges of indebtedness of any person in excess of \$600. (26 U.S.C. § 6050P.) Treasury regulations define a discharge of indebtedness to occur when, among other events, either of the following two “identifiable events” takes place:

“(F) A discharge of indebtedness pursuant to an agreement between an applicable entity and a debtor to discharge indebtedness at less than full consideration; [or] (G) a discharge of indebtedness pursuant to a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge debt . . . .” (26 C.F.R. § 1.6050P-1(b)(2) (2016).)

Gallegos contended the settlement agreement qualified as an identifiable event under the Treasury regulation. In the settlement, CPS agrees to discharge a “deficiency balance” by discontinuing all collection efforts, amending account records showing a deficiency balance to reflect a zero balance, and instructing credit reporting agencies to delete all class members’ trade lines on their credit reports. In addition, the class notice states the settlement is a compromise, an agreement to end further litigation. It is not to be construed as an admission of fault, wrongdoing, or liability on any of the parties’ part.

Gallegos relied on an IRS private letter ruling that, under similar facts as those before us, concluded that debt cancellation entered into voluntarily as part of a settlement over disputed debt was an identifiable event, but cancellation forced by operation of state law was not. He also relied on rulings by the San Diego County Superior Court in an action based on defective NOI’s. The court there granted class certification, even though the lender had refunded any deficiency collections and forgiven the debt, in part because whether the forgiven debt was taxable income was a common issue that could be adjudicated. The same court later granted summary judgment in favor of the plaintiffs, ruling the NOI’s were defective by operation of state law, and it granted injunctive relief.

In addition, Gallegos argued the settlement actually left class members worse off. Without citing to factual support in the record, he asserted most of the class members were by the time of settlement protected from any attempts to collect the deficiency by the four-year statute of limitations in Code of Civil Procedure section 337. He asserted most of the debt was old debt, and even credit reporting stopped after seven years. The settlement, in his opinion, created new debt in the form of a tax liability subject to a 10-

year statute of limitations. (26 U.S.C. § 6502.) And, Gallegos contended, the agreement would prevent class members from contesting the validity of the deficiency if the IRS sought payment.

However, there are other indications the settlement agreement is not just a decision by CPS to discharge debt or stop collection efforts, and it may not be an “identifiable event.” In the agreement, CPS concedes it will not contest plaintiffs’ claim that the NOI was defective. And the court’s final judgment enjoins CPS “by operation of state law” from taking any further steps to collect “any amounts purportedly owed” by class members. These points suggest the parties agreed that the deficiency balances never accrued due to CPS’s defective NOI, and CPS’s cessation of collection efforts are the result of a lawful judgment executing state law against CPS.

The parties acknowledge there are no published judicial opinions on point. We note a conflict appears to exist in federal tax law regarding whether a settlement of disputed debt is a taxable discharge of indebtedness. (See *Zarin v. Commissioner* (3d Cir. 1990) 916 F.2d 110, 113 [where gambling debt is unenforceable under state law, the debt’s forgiveness was not a taxable discharge of indebtedness]; *Preslar v. Commissioner* (10th Cir. 1999) 167 F.3d 1323, 1328 [to implicate the disputed debt doctrine, the original amount of the debt must be unliquidated, disagreeing with *Zarin*].) We raise this point only to illustrate the legal uncertainty over whether the settlement would create a taxable event. Given this ambiguity, it is difficult to find the trial court abused its discretion in finding the settlement was reasonable.

Gallegos’s reliance in court on a private letter ruling and another trial court’s orders is not appropriate. Private letter rulings “may not be used or cited as precedent.” (26 U.S.C. § 6110(k)(3); *Cleary v. County of Alameda* (2011) 196 Cal.App.4th 826, 853.) The ruling on which Gallegos relies expressly states “[t]his ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the [Internal Revenue] Code provides that it may not be used or cited as precedent.” A written trial court ruling also has no

precedential value. (*Santa Ana Hospital Medical Center v. Belshé* (1997) 56 Cal.App.4th 819, 831.)

Additionally, the settlement agreement did not bar class members from raising the NOI's invalidity as a defense to any IRS collection effort. The agreement's waiver of claims extended only to claims against CPS. Class members could, and most certainly would, contest the NOI's validity if the IRS determined the settlement was an identifiable event.

The trial court did not know whether the IRS would view the settlement agreement with its unique terms as an identifiable event. It did not have occasion to decide that issue, and indeed the courts would not have occasion until the IRS took issue with the agreement and class members challenged the IRS's actions. Nevertheless, the court independently evaluated the strength of the plaintiffs' case and the likelihood class members would incur tax liability, and concluded under these circumstances that the agreement was reasonable. We conclude the court did not abuse its discretion in doing so.

### III

#### *Sufficiency of the Class Notice*

Gallegos contends the class notice was legally insufficient. He asserts it was inadequate because it failed to disclose the settlement agreement would create tax liability, that class members would have to report the debt cancellation as income, and that class members could never contest the NOI's sufficiency if they were assessed a tax. He also faults the class notice for not informing class members of the amount of deficiency indebtedness that was being waived or where members could obtain free tax assistance. We conclude the court did not abuse its discretion approving the class notice.

The California Rules of Court require a court to give a certified class notice of the proposed settlement and its pending final approval. (Cal. Rules of Court, rule 3.769(f).) The notice must explain the proposed settlement and the procedures class members must

follow to submit written objections and appear at the settlement hearing. (*Ibid.*) When class members are given the right to request exclusion from the class, as they were here, the notice must include: “(1) A brief explanation of the case, including the basic contentions or denials of the parties; (2) A statement that the court will exclude the member from the class if the member so requests by a specified date; (3) A procedure for the member to follow in requesting exclusion from the class; (4) A statement that the judgment, whether favorable or not, will bind all members who do not request exclusion; and (5) A statement that any member who does not request exclusion may, if the member so desires, enter an appearance through counsel.” (Cal. Rules of Court, rule 3.766(d).)

“In regard to the contents of the notice, the ‘notice given to the class must fairly apprise the class members of the terms of the proposed compromise and of the options open to dissenting class members.’ (*Trotsky v. Los Angeles Fed. Sav. & Loan Assn.* [(1975)] 48 Cal.App.3d [134,] 151-152.) The purpose of a class notice in the context of a settlement is to give class members sufficient information to decide whether they should accept the benefits offered, opt out and pursue their own remedies, or object to the settlement. (*Ibid.*) As a general rule, class notice must strike a balance between thoroughness and the need to avoid unduly complicating the content of the notice and confusing class members. Here again the trial court has broad discretion. (*7-Eleven Owners for Fair Franchising v. Southland Corp.* [(2000)] 85 Cal.App.4th [1135,] 1164 [the court has ‘virtually complete discretion’ regarding notice to class members].)” (*Wershba, supra*, 91 Cal.App.4th at pp. 251-252.)

The trial court did not abuse its discretion by finding the class notice sufficiently explained the settlement. The notice met all of the requirements imposed by the California Rules of Court. It also sufficiently explained the terms of the settlement. Gallegos criticizes the notice for not expressly stating the members will incur tax liability, but whether members would incur liability was not clear. The notice stated the settlement might have tax consequences, which, as the trial court found, was what

Gallegos established, nothing more. Given the size of the class, the court did not err in not requiring the notice to explain how much of each member's deficiency would be waived. Nor was it necessary to inform the class members where they might obtain free tax advice. The notice suggested they should seek tax advice, and that was sufficient.

DISPOSITION

The judgment is affirmed. Costs on appeal are awarded to plaintiffs and CPS.  
(Cal. Rules of Court, rule. 8.278(a).)

NICHOLSON, Acting P. J.

We concur:

HULL, J.

BUTZ, J.