

4/12/79

## Memorandum 79-22

Subject: Study D-400 - Assignment for Benefit of Creditors (Draft of Tentative Recommendation)

Attached to this memorandum is a staff draft of a tentative recommendation to repeal the existing statute relating to assignments for the benefit of creditors. The tentative recommendation also states that the Commission has found no widespread dissatisfaction with existing law and is designed to draw comment on this point. We plan to distribute the tentative recommendation widely for comment, not only to our general creditors' remedies mailing list and to the State Bar, but also to local bar associations. We hope the tentative recommendation can be approved for distribution at this meeting.

Also attached to this memorandum, for your information, is a copy of the bill introduced by Senator Beverly relating to assignments for the benefit of creditors. See Exhibit I (yellow). The major change the bill would make would be to permit the assignee to recover preferential transfers to the same extent a trustee in bankruptcy might. The bill also would give the assignor the same exemptions as under bankruptcy and would prescribe the same priorities for payment of wage claims and consumer debts under an assignment as under bankruptcy.

Respectfully submitted,

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Assistant Executive Secretary

STAFF DRAFT

## TENTATIVE RECOMMENDATION

relating to

## ASSIGNMENTS FOR THE BENEFIT OF CREDITORS\*

An assignment for the benefit of creditors is a business liquidation device available as an alternative to bankruptcy. Its use is prevalent in the commercial credit community in the larger urban areas. Assignments are handled predominantly by large creditors' associations and by attorneys who specialize in the field. An assignment is most successful where there is cooperation among debtor, creditors, and assignee.<sup>1</sup>

There is a statute that purports to govern assignments,<sup>2</sup> but the cases have upheld common law assignments not made pursuant to the statute.<sup>3</sup> Statutory assignments are no longer made and common law assignments are now made exclusively.<sup>4</sup>

The Commission's investigation of common law assignments was prompted by reports of abuse,<sup>5</sup> but the Commission has been informed by

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\* This tentative recommendation is made pursuant to the Law Revision Commission's authority to study assignments for the benefit of creditors. See 1972 Cal. Stats. res. ch. 27.

1. See generally Shapiro, Assignment for the Benefit of Creditors, in California Remedies for Unsecured Creditors (Cal. Cont. Ed. Bar 1957), and Greenfield, Alternatives to Bankruptcy for the Business Debtor, 51 L.A. Bar J. 135 (1975).
2. Civil Code §§ 3448-3473.
3. See, e.g., Bumb v. Bennett, 51 Cal.2d 294, 333 P.2d 23 (1958); Brainard v. Fitzgerald, 3 Cal.2d 157, 44 P.2d 336 (1935).
4. See, e.g., 1 B. Witkin, Summary of California Law Contracts § 729, at 609 (8th ed. 1973).
5. See, e.g., letters to the California Law Revision Commission from Sandor T. Boxer (January 12, 1978) and Hal. L. Coskey (March 23, 1979) (on file in the Commission's office); see also Recommendation Relating to The Attachment Law: Effect of Bankruptcy Proceedings; Effect of General Assignments for the Benefit of Creditors, 14 Cal. L. Revision Comm'n Reports 61, 63 (1977) ("The Commission plans to make a study of the law relating to general assignments for the benefit of creditors, particularly in light of reports of abuses under existing law.").

the major assignees in the state that they have received few, if any, complaints concerning the operation of assignments.<sup>6</sup> The Commission has learned only of unverified isolated instances of problems; there does not appear to be widespread concern about or general dissatisfaction with the law among persons affected by assignments. The Commission particularly solicits comments concerning the accuracy of this information.

The major assignees have indicated to the Commission that although the law governing common law assignments has shortcomings,<sup>7</sup> the present law is preferable to a regulatory scheme that may render assignments more expensive or less effective and thereby destroy their usefulness as an alternative to bankruptcy.<sup>8</sup> A creditor who is dissatisfied with the

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6. The Commission's informants include the Credit Managers Associations of California, the San Francisco Board of Trade, the Credit Managers Association of Southern California, and David Blonder, Los Angeles lawyer.

7. A number of shortcomings have been identified in the literature. See, e.g., California Debt Collection Manual § 3.42, at 135 (Cal. Cont. Ed. Bar 1978); H. Marsh, Creditors' Rights in California 282-83 (1962); Comment, Assignments for the Benefit of Creditors in California: A Proposed Revision of Ineffectual Statutory Provisions, 6 U.C.L.A. L. Rev. 573 (1959); Keatinge, Assignments for the Benefit of Creditors at California Law--Legal and Practical Aspects, 25 L.A. Bar Bull. 99 (1949); Comment, A Proposal for Strengthening the California Statute Concerning Assignments for the Benefit of Creditors, 36 Calif. L. Rev. 586 (1948).

The problems have been alleviated somewhat by legislation in recent years. For example, under the Uniform Commercial Code, the assignee is deemed to be a lien creditor for the purposes of priority over unperfected security interests. Com. Code § 9301. Attachment liens obtained prior to the assignment may be terminated. Code Civ. Proc. §§ 493.010-493.060; see also AB 617 (McAlister 1979) and Recommendation Relating to Effect of New Bankruptcy Law on the Attachment Law, 15 Cal. L. Revision Comm'n Reports \_\_\_\_\_ (1979). See also SB 1139 (Beverly 1979) (giving assignee rights of trustee in bankruptcy to avoid preferences).

8. See, e.g., letters to the California Law Revision Commission from Richard Kaufman (November 11, 1977) and David Blonder (March 22, 1979) (on file in the Commission's office).

operation of an assignment has the remedy of bankruptcy.<sup>9</sup>

In view of this situation, the Commission has concluded that further legislation governing assignments is inadvisable. The existing statute, which is not used, should be repealed.

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The Commission's recommendation would be effectuated by enactment of the following measure:

An act to amend Sections 7113.5 and 8657 of the Business and Professions Code, to repeal Title 3 (commencing with Section 3448) of Part 2 of Division Fourth of the Civil Code, and to amend Section 12100 of the Financial Code, relating to assignments for the benefit of creditors.

The people of the State of California do enact as follows:

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9. An assignment for the benefit of creditors is grounds for an involuntary case in bankruptcy and may be avoided by the trustee under the Bankruptcy Reform Act of 1978. See 11 U.S.C. §§ 303(h)(2) and 547(b) (Pub. L. No. 95-598). The availability of bankruptcy as a remedy has been limited, however, by an increase in the required amount of creditors' claims from \$500 to \$5,000 and a decrease in the preference period from four months to 90 days. See 11 U.S.C. §§ 303(b) and 547(b)(4) (Pub. L. No. 95-598).

Business & Professions Code § 7113.5 (amended)

SECTION 1. Section 7113.5 of the Business and Professions Code is amended to read:

7113.5. The avoidance or settlement by a licensee for less than their full amount of the lawful obligations of such licensee incurred as a contractor, whether by (a) composition, arrangement, or reorganization with creditors under state law, (b) composition, arrangement, or reorganization with creditors under any agreement or understanding, (c) receivership as provided in Chapter 5 (commencing at Section 564) of Title 7 of Part 2 of the Code of Civil Procedure, (d) ~~the making of an assignment for the benefit of creditors as provided in Title 3 (commencing at Section 3449) of Part 2 of Division 4 of the Civil Code,~~ (e) common law assignment for the benefit of creditors, ~~(f)~~ (e) trusteeship, or ~~(g)~~ (f) dissolution constitutes a cause for disciplinary action.

This section shall not apply to an individual settlement of the obligation of a licensee by such licensee with a creditor which is not a part of or in connection with a settlement with other creditors of such licensee.

No disciplinary action shall be commenced against a licensee for avoiding or settling in bankruptcy, or by composition, arrangement, or reorganization with creditors under federal law, the licensee's lawful obligations incurred as a contractor for less than the full amount of such obligations.

Comment. Section 7113.5 is amended to delete the reference to former Civil Code Sections 3448 through 3473, which are not continued. See Comment thereto.

30/180

Business & Professions Code § 8657 (amended)

SEC. 2. Section 8657 of the Business and Professions Code is amended to read:

8657. The adjudication of bankruptcy of a licensee or the confirmation of any other proceeding under the federal bankruptcy law, including a composition, arrangement, or reorganization proceeding, the appointment of a receiver of the property of a licensee as provided in

Chapter 5 (commencing with Section 564) of Title 7 of Part 2 of the Code of Civil Procedure, or the making of an assignment for the benefit of creditors ~~as provided in Title 3 (commencing with Section 3449) of Part 2 of Division 4 of the Civil Code~~ constitutes a cause for disciplinary action.

If a license is suspended or revoked upon the grounds set forth in this section, the registrar in his discretion may renew or reissue such license upon the condition that each contract undertaken by the licensee be separately covered by a bond or bonds conditioned upon the performance of, and the payment of labor and material required by, the contract.

Comment. Section 8657 is amended to delete the reference to former Civil Code Sections 3448 through 3473, which are not continued. See Comment thereto.

26/253

Code of Civil Procedure §§ 3448-3473 (repealed)

SEC. 3. Title 3 (commencing with Section 3448) of Part 2 of Division Fourth of the Civil Code is repealed.

Comment. Former Sections 3448 through 3473, inclusive, of the Civil Code, which governed statutory assignments for the benefit of creditors, are not continued. Common law assignments for the benefit of creditors are used to the exclusion of statutory assignments. See, e.g., B. Shapiro, Assignment for the Benefit of Creditors § 1 in California Remedies for Unsecured Creditors 429, (Cal. Cont. Ed. Bar 1957); I B. Witkin, Summary of California Law Contracts § 729, at 609 (8th ed. 1973); Keatinge, Assignments for the Benefit of Creditors at California Law--Legal and Practical Aspects, 25 L.A. Bar Bull. 99, 109 (1949).

969/011

Financial Code § 12100 (amended)

SEC. 4. Section 12100 of the Financial Code is amended to read:  
12100. The provisions of this division do not apply to any of the following:

(a) Persons or their authorized agents doing business under license and authority of the Superintendent of Banks of the State of California, or under any law of this state or of the United States relating to banks, trust companies, building or savings and loan associations, industrial loan companies, personal property brokers, credit unions,

title insurance companies or underwritten title companies (as defined in Section 12402 of the Insurance Code), escrow agents subject to Division 6 of the Financial Code, or California small loan companies.

(b) Persons or their authorized agents engaged in the business of paying to others bills, invoices, or accounts of an obligor, or of selling or cashing checks, including travelers' checks, drafts, or money orders issued by a person who has been licensed under and complied with, and continues to be licensed under and complies with, Article 3 of Chapter 14 of Division 1 of this code.

(c) The services of a person licensed to practice law in this state, when such person renders services in the course of his practice as an attorney at law, and the fees and disbursements of such person whether paid by the debtor or other person, are not charges or costs and expenses regulated by or subject to the limitations of this chapter; provided, such fees and disbursements shall not be shared, directly or indirectly with the prorater, check seller or cashier.

(d) Any transaction in which money or other property is paid to a "joint control agent" for dispersal or use in payment of the cost of labor, materials, services, permits, fees, or other items of expense incurred in construction of improvements upon real property.

(e) A merchant-owned credit or creditors association, or a member-owned or member-controlled or -directed association whose principal function is that of servicing the community as a reporting agency.

(f) Any person licensed under Chapter 1 of Part 6, Division 2 of the Labor Code, when acting in any capacity for which he is licensed under such part.

(g) Any person licensed under Part 1, Division 4, of the Business and Professions Code, when acting in any capacity for which he is licensed under that part.

(h) A common law ~~or~~ **statutory** assignment for the benefit of creditors or the operation or liquidation of property or a business enterprise under supervision of a creditor's committee.

(i) The services of a person licensed as a certified public accountant or a public accountant in this state, when such person renders services in a course of his practice as a certified public accountant or

a public accountant, and the fees and disbursements of such person whether paid by the debtor or other person, are not charges or costs and expenses regulated by or subject to the limitations of this chapter; provided, such fees and disbursements shall not be shared, directly or indirectly, with the prorater, check seller or cashier.

(j) Nonprofit community service organizations that have been incorporated under the General Nonprofit Corporation Law of the State of California whose membership consists exclusively of retailers, lenders in the consumer credit field, educators, attorneys, social service organizations, employers or employees organizations, and related groups, if the principal functions of such organizations are: (1) consumer credit education; (2) counseling on consumer credit problems and family budgets; and (3) arranging, and in certain cases administering, debt settlement plans, for which a charge for administrative services only may be made of 5 percent of the money disbursed monthly, or ten dollars (\$10) per month, whichever is the lesser, to offset expenses; provided essential records are kept in accordance with sound accounting practices, consumer funds are banked in a trust account and appropriate fidelity bond and insurance are maintained, that reports are made to debtors, and independent audits made; and further provided, however, that this subdivision shall exempt such organizations from this division only with respect to those activities described in Section 12002.1 and not with respect to those activities described in Section 12002.

Comment. Section 12100 is amended to delete the reference to "statutory" assignments. Former Civil Code Sections 3448 through 3473, which prescribed a statutory assignment, are not continued. See Comment thereto.