#39.70 1/7/72

First Supplement to Memorandum 72-6

Subject: Study 39.70 - Attachment, Garnishment, Execution (Prejudgment Attachment Procedure)

The attached letter will be of interest in connection with the study of prejudgment attachment.

Respectfully submitted,

John H. DeMoully
Executive Secretary

1st Supp Memo 72-6 EXHIBIT I

January 6, 1972

Harold Marsh, Jr., Esq.
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Dear Sir:

As Manager of the Collection Department of this Association, I am naturally vitally interested in the thinking of everyone with regard to drafting legislation that will protect creditors in some manner, prior to obtaining a Judgment. In reading the various correspondence and the first draft of the proposed California Attachment Law by the Law Revision Commission, it occurred to me that what we should be striving for is something in between what we had prior to the Randone decision and no attachment at all.

I, therefore, propose for your thinking this idea:

A law that will provide for the plaintiff to post a bond wherein a suit had been filed on a commercial account. The Court, at the plaintiff's request will issue an Order to be served along with the Summons and Complaint, which would prohibit the defendant, under penalty, from transferring any assets other than the usual course of business. This would be meant to include the payment of any sums that could be considered a preference. Of course, the defendant could also post bond to be relieved of restraint.

I believe we could live with this type of legislation. It would protect creditors especially on bulk sales transfers on which they now have no protection since the Randone decision. It should restrain the type of debtor who may try to abscond. Admittedly it might take longer to settle a case than before the Randone decision but at least the creditors would have some security and I believe in many instances, it would persuade the defendant to come to terms.

I believe the legislature would be receptive to this type of restraint as it would not work a hardship on any defendant as he could continue his business in a normal fashion and in no

way effect his livelihood. There are several other aspects to this which I am sure come to your mind and I need not burden you with a lengthy letter.

I do believe this has some merit and I would appreciate your consideration in thinking about it.

Yours very truly,

HARRY C. GAULT
COLLECTION MANAGER

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January 10, 1972

REFER TO FILE NUMBER
31-167

Mr. John H. DeMoully
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Re: Proposed California
Attachment Statute

Dear John:

Thank you for your letter of January 4, 1972, transmitting the materials relating to the study of the Law Revision Commission with respect to the proposed revision of the California Attachment Statute in the light of the decision in Randone v. Appellate Department of the Superior Court. As I indicated to you on the telephone, I am representing the Credit Managers' Association of Southern California, the San Francisco Board of Trade and the San Diego Wholesale Credit Men's Association in connection with their consideration of the effects of this decision and any remedial legislation which might be proposed to the California Legislature. We are anxious to cooperate with the Law Revision Commission in connection with its study of the same subject and we appreciate your invitation to submit comments in writing for consideration by the Commission at its scheduled meeting on January 14-15, 1972.

This letter is being written in response to that invitation, but I should emphasize at the outset that we have just begun our consideration of the problem and that the ideas and suggestions set forth below are tentative in nature. Also, there has not been sufficient time to attempt to reduce these ideas to statutory language.

Therefore, the suggestions below merely constitute an outline of our present thinking regarding an approach which might strike a reasonable balance between the interests of creditors and of debtors in this area and which, we believe, would be upheld by the court under the rationale of the Randone case. I would appreciate it if you could distribute copies of this letter to the members of the Commission, if possible prior to the meeting on Thursday evening, January 13, but in any event at the commencement of that meeting, so that they may have an opportunity to review these tentative suggestions prior to the discussion on Friday.

Before setting forth our specific suggestions, I would like to discuss certain underlying principles upon which they are based. These principles in turn are based in large part upon the vast experience of the organizations above mentioned in representing their members in connection with the extension of business credit in the State of California.

1. We believe that it is necessary in any revision of the attachment statute to take into consideration the varying factual situations in which the remedy of attachment might be utilized, both from an economic and sociological point of view. In fact, as we understand the opinion, the Randone case held that the primary vice of the present attachment statute was that it failed to make such discriminations. The Court in effect invited the Legislature to revise the statute to separate out those situations where a prejudgment attachment could legally and constitutionally be provided.

Specifically, the principle upon which our suggestions are based is that commercial cases should be dealt with separately from consumer cases and that the prejudgment remedy of attachment, with a modified procedure to meet the objections in Randone to the present statute, be preserved in those cases where credit is extended to a business.

It seems apparent from a reading of the entire Randone opinion that the Court is focusing almost entirely

upon the plight of a consumer who is being deprived, without a hearing, of the necessities of life upon the basis of a claim which (in the Court's eyes) is probably fraudulent. In footnote 26 the Court quotes a Congressman, who was previously quoted in the Sniadach case, to the effect that "In a vast number of cases the debt is a fraudulent one, settled on a poor ignorant person who is trapped in an easy credit nightmare, in which he is charged double for something he could not pay for even if the proper price was called for, and then hounded into giving up a pound of flesh." It is clear that the Court was preoccupied with the plight of a poverty striken person who has bought a color TV set for five times the list price and is forced to let his family starve by the legal process employed by the seller to collect the debt.

On the other hand, the factual situation with which we are concerned involves as a typical case one business corporation selling goods on open account to another business corporation for $10,000 or $50,000 or $100,000 and desiring to have some effective means of enforcing the obligation, which has never been disputed, short of waiting for a case come to trial on the trial calendar two or three years after it is filed.

We do not believe that there is any reason to assume that the California Supreme Court would take the same view of a properly restricted prejudgment attachment statute applied to the latter case as they did with respect to the former. We doubt that a statute can be devised which is both constitutional (in the view of the present members of the California Supreme Court) and provides any effective prejudgment remedy for the collection of consumer debt. Therefore, the suggestions which are made below exclude the remedy of attachment in that situation.

2. We believe that the suggestion, that the remedy of attachment be granted only in cases where the creditor alleges that the debtor has removed or concealed his assets or intends to remove or conceal his assets, is impractical and furnishes no remedy to any creditor in a business context. In the first place, if the debtor has already removed or concealed his assets, the sheriff will

not be able to find them in order to levy the writ of attachment. On the other hand, if the creditor alleges that the debtor intends to remove or conceal his assets, he can have no conclusive proof of this state of mind of the debtor and only one of two things can happen. Either the creditor was right and the debtor succeeds in removing or concealing his assets before the writ is levied, in which case the procedure is pointless. Or the debtor is prevented from doing that by the levy and he then asserts that the fact that the goods were still available to be levied upon is proof that he never had the intention in the first place. The creditor is then subjected to an action for wrongful attachment for which he would probably have no defense. While the remedy thus restricted might be marginally useful in a handful of cases, as a practical matter it would generally be a delusion to creditors.

3. In any event, to focus attention upon the "fraudulent" debtor is completely to misconceive the problem as far as business creditors are concerned. When a business gets into financial difficulty, the natural tendency in almost all cases is for its managers to try to stall off all of its creditors, hoping for some miracle; and in the meantime to dissipate the assets, not through any fraudulent activities of the owners, but simply due to the fact that every day it keeps running it is losing money. The vain hope of the managers (who may or may not be the beneficial owners) is that somehow things will be turned around; and in the majority of cases they will continue running the business into the ground until there is nothing left for the creditors, unless the creditors are given a legal right to prevent this.

If a business cannot pay its debts, then it belongs of right to its creditors, and not to its previous owners, and the creditors should be able to stop the dissipation of its assets. The way in which this has been possible in the past was through the levy of an attachment.

It is not an answer to this problem to say that the creditors can put the business into bankruptcy. The fact is that they cannot do that unless an act of bankruptcy has occurred. One of the most common acts of bankruptcy

which has been used in the past is the levy of an attachment by one creditor while the business is insolvent, which permits other creditors to file an involuntary petition. The only other act of bankruptcy which would commonly be available in this situation would be a preferential payment to one creditor while the business is insolvent. However, if the remedy of attachment is abolished and the debtor decides to keep running by making no payments whatever to any of its creditors, the managers can survive until every last dime in the business has been used up for salaries and other expenses and nothing whatever is left for the creditors.

Nor is it any answer to this problem to say that New York has gotten along without any general prejudgment attachment statute. Professor Charles Seligson, who is one of the most experienced bankruptcy practioners in New York, has stated on several occasions at meetings of the Commission on the Bankruptcy Laws of the United States that one of the most serious problems concerning the bankruptcy laws is that, in his experience, by the time a business finally goes into bankruptcy there is literally nothing left for the creditors. I do not have any data to prove that this situation is worse in New York than in California; but it is undeniably true that in California in the past the creditors had a legal remedy (if they choose to use it) which could be employed to terminate the dissipation of assets by a failing business, whereas in New York they did not. Assuming that creditors in California have not generally used this remedy as soon as they should have, in their own self interest (which may be true), that is no reason to deprive them of it.

4. We do not proceed on the assumption, which seems to underlie some of the discussions of this problem, that all creditors are asserting fraudulent claims and that every alleged debtor has a valid defense to any action against him. Whatever the situation may be in the consumer area, we think that this assumption is untenable and indeed absurd in the type of credit situation to which we are directing our attention. We think that in this type of situation the Legislature can and should make a finding, which we believe would be respected by the Court, that

there is not one case in a thousand where the debtor has any defense whatever or has ever denied owing the money.

Based upon the foregoing general principles we have the following suggestions regarding the restriction and revision on the remedy of prejudgment attachment in California, which we believe would clearly survive the constitutional tests set down in the Randone case.

I. Restrict the remedy of attachment to an action against a business or a non-resident.

While there obviously is a problem in formulating a satisfactory definition which will distinguish "businesses" from "consumers," we believe that the following avenues of approach to that distinction are worth consideration:

A. In one respect it is very easy to distinguish debtors who are in business and that is simply to provide that the remedy of attachment is always available against a corporation or against a partnership with respect to partnership property. A business corporation or a partnership exists only to engage in business and the assets contributed to those artificial entities are a trust fund for their creditors. Any concern about depriving the defendant of the "necessities of life," with which the Randone case was so preoccupied, is obviously irrelevant in connection with a corporate or partnership debtor. We suggest that in addition to providing for the remedy of attachment against such business entities in the Code of Civil Procedure, an amendment should be made to the Corporations Code to make it a condition to the charter of every domestic corporation and of the qualification to do business in this State of every foreign corporation, and a condition of the formation of any general or limited partnership under the provisions of the Corporations Code, that the entity is subject to the rights of its creditors to attach its property in accordance with the provisions of the Code of Civil Procedure.

B. With respect to a sole proprietorship, there is obviously greater difficulty in distinguishing between a true business situation and the small artisan without employees or capital goods who is merely working for himself rather than for an employer, and who therefore

should probably be treated the same as an employee (or, in other words, as a "consumer"). However, at least one approach would be to provide that those businesses referred to in Division 6 of the Uniform Commercial Code dealing with bulk sales notices, even though conducted as sole proprietorships, would be treated in the same manner as corporations and partnerships with respect to the right of attachment. These businesses include retail and wholesale merchants and certain service businesses (baker, cafe or restaurant owner, garage owner, cleaner and dyer). It might also be possible to include in the "business" category a sole proprietorship based upon the number of its employees, even though it is not a merchant or one of the specific types of service businesses listed in Division 6 of the Uniform Commercial Code. In particular, a suggestion has been made that building contractors should be included in this category even when they are operated as sole proprietorships.

In any event, we do not believe that it is an impossible task to formulate a reasonable definition of an individual who should be treated like a corporation or partnership because he is "in business" on a substantial scale.

C. In addition to the foregoing categories, we believe that the remedy of attachment should be available with respect to non-residents and persons who are not subject to personal service of process, in order to permit a California creditor to obtain jurisdiction in this State. In our opinion, the definition of non-resident should include all foreign corporations which are not qualified to do business in this State and all individuals who are in fact non-residents, without regard to the wholly indeterminable question of whether they may or may not be subject to service of process through some "long-arm statute." It seems to us to be an impractical suggestion to say that the plaintiff must anticipate how far the courts are going to permit such non-resident service, at the risk of being sued for wrongful attachment. In addition, this category should include, in the precise terms of the sections of the Code of Civil Procedure dealing with service by publication, those persons who abscond or conceal themselves so that personal service is not feasible.

D. In addition to the preceding categories

of debtors, an attachment should unquestionably be permitted with respect to any goods which have been made the subject of a bulk sales notice. There is no conceivable constitutional reason why a creditor should not be permitted to levy upon goods when the debtor has advertised that he is turning them into cash, which can easily be concealed or dissipated. In fact, this is the only remedy available to a creditor under Division 6 of the California Uniform Commercial Code once a bulk sales notice is published. Unless this remedy is restored in that situation, it will be necessary either to completely rewrite Division 6 of the Uniform Commercial Code or to repeal it as being useless to the creditors whom it is designed to protect.

II. Restrict the nature of the claims for which an attachment can be levied to debts consisting of liquidated claims for money based upon money loaned, goods sold and delivered, rent, or services rendered.

One of the problems with the way in which the remedy of attachment has been broadened in California has been its extension to cover claims where there is a rather large probability that the defendant has at least an arguable defense to the claim, as opposed to those claims where such a defense probably will exist in only a minute fraction of the claims asserted. For example, to permit an attachment in an action for personal injury is to permit it in a situation where there is no reason to suppose that the claimant is more likely to prevail than the defendant and where it is virtually impossible to judge the relative merits of their positions without a full scale trial.

On the other hand, we believe that the concept behind the restriction in resident cases in the past to actions on a contract "for the direct payment of money" was a sound one. In other words, the Legislature was groping for a formula which would segregate those cases where it is highly improbable that the defendant is going to have any valid defense to the claim. Unfortunately, the California courts paid no attention to this limitation in the statute and extended the remedy to cases of "implied contract" where there had been a rescission of a previous transaction, or where a plaintiff "waived the tort and sued in assumpsit," and where probably a complex legal dispute was involved in

which either party was as likely to be in the right as the other.

We believe that restricting the remedy of attachment to those types of business debts mentioned above, where the debtor has agreed to pay a specified sum of money for goods or services or in repayment of a loan, would mean that in the overwhelming proportion of the cases there could be no legitimate argument as to whether the debt was or was not owed.

There would of course be a minority of cases in these categories where the defendant had a valid defense, and the procedure which we suggest below would give him every reasonable opportunity to assert that defense at the initiation of the proceeding.

III. Revise the procedure for attachment to authorize the issuance ex parte by the Clerk of a Temporary Restraining Order against the defendant prohibiting him from making any transfers of his non-exempt property otherwise than in the ordinary course of business, and the simultaneous issuance of a Notice of Hearing on the question whether an attachment should be issued, to be held five days after the service upon the defendant of the Temporary Restraining Order and Notice, if such hearing is demanded by the defendant.

The Constitution only requires that an opportunity for hearing be afforded the defendant, not that a hearing be held if the defendant does not want or request one. Therefore, in order to save the judicial time which would be involved in thousands of useless hearings, since most defendants will not deny under oath that they owe the debt, the defendant upon whom such a Notice is served should be required to file a request for the hearing within a four day period after such service; otherwise, the writ of attachment would be issued as a matter of course at the time the hearing is scheduled. Also, there should be a provision that if the plaintiff makes reasonable efforts to serve the Temporary Restraining Order and the Notice upon the defendant during a five day period and is unable to effect service, he should then be entitled to obtain the writ of attachment from the Court without such service or any hearing, since it has been

demonstrated that one of the situations where an attachment is clearly proper (i.e., where the defendant is concealing himself or has absconded) exists in that case.

The suggested procedure does not deprive any defendant of the use of his property prior to an opportunity for a hearing and he would be afforded a speedy right to have a judicial determination, if he so desires, that the attachment should not be permitted. He would, of course, be entitled to contest the issuance of the attachment on the basis that the conditions regarding the type of cases in which it is available do not exist. In addition, however, the defendant should be permitted to contest the issuance of the attachment on the ground that there is a reasonble probability that he has a valid defense to the claim of the plaintiff. Also, the defendant should in any case be permitted to prevent or lift the attachment by the posting of a bond as he is currently permitted to do.

The Temporary Restraining Order should by its terms prevent the defendant from removing or concealing any of his nonexempt property or making any transfer of any such property otherwise than in the ordinary course of business. It should also specifically enjoin him from moving his bank account or withdrawing any funds by any checks written after the service of the Temporary Restraining Order and until the hearing is held. This will, of course, prevent him from using the funds on deposit to pay other creditors; but it will not be substantially prejudicial to such a business defendant to suspend his payments to other creditors for a period of five days, in view of the fact that he will undoubtedly have already stalled them for months. In fairness to the creditor who is seeking the attachment, the debtor should not be permitted to prefer other creditors after the hearing has been noticed.

This arrangement would avoid the dishonoring of any checks already written by the debtor, with the consequent adverse effect upon his credit which was referred to by the Court in the Randone case, but at the same time would not permit him to move his bank account or write large checks to other creditors whom for one reason or another he may prefer to pay rather than the plaintiff, whether or not these other debts are legitimate.

If the defendant does not demand a hearing, or the defendant cannot be served with the Temporary Restraining Order, or the defendant is unable at the hearing to establish one of the above mentioned grounds for denying the attachment, the writ of attachment should then immediately issue to permit the plaintiff to levy upon the assets of the debtor or to place a keeper in his business.

IV. The lien created by the attachment process should arise upon the service of the Temporary Restraining Order upon the debtor or, if service proves to be impossible, upon the levy of the writ of attachment which is issued upon a showing that such service could not be effected.

The plaintiff's priority vis-a-vis other creditors of the debtor should date from the time such lien arises as under the present California law.

V. Attachment of real estate and securities.

With respect to the attachment of real estate and securities such as corporate stock, we suggest that this should be permitted substantially upon the present terms without regard to the type of defendant, although we believe that the type of claim for which an attachment is available should probably be restricted in these cases to the same ones suggested above. The reason for this is that the levy of attachment upon real estate does not deprive the defendant of its use, but merely prevents its transfer. Similarly, in the case of registered securities, the seizure of the certificate does not effect any transfer of the registered ownership and the dividends or interest would still be paid to the owner. He would merely be prevented from negotiating or concealing these highly fugitive types of property.

As a practical matter, since the plaintiff must seize the certificate under the Uniform Commercial Code in order to effect a levy upon corporate stock, the plaintiff will not often be in a position to make a valid levy. However, where he can do so, he should be permitted to have the sheriff take the certificates into custody so that the defendant cannot sell them or conceal them.

Whether or not negotiable instruments which are not in registered form should be treated similarly is also a question which should be considered.

As I indicated at the outset, these suggestions have not been definitively formulated and have not yet been thoroughly reviewed by the officers of the Credit Associations of California. Also, there has been no time to put them into detailed statutory language. However, we believe that some approach along these or similar lines can preserve the remedy of attachment as a useful and proper remedy in the commercial context. If that remedy is abolished, the accomodation which should be attempted between the interests of creditors and debtors will have been unfairly tilted in favor of debtors.

We do not believe that the tentative draft statute which has been submitted to the Commission by its Consultant is a workable or satisfactory solution to this problem. Nor do we believe that its proposed abolition of domestic attachment is required by the Randone case, if that case is read in the light of the facts to which the Court was addressing its discussion. We see no reason to assume that a consciencious balancing of the rights and interests of creditors and debtors in commercial transactions, which is judged to be fair and reasonable by the Law Revision Commission and by the California Legislature, would be declared unconstitutional by the California Supreme Court.

I want to thank you again for the opportunity to submit these comments. In response to your invitation I expect to attend the meeting of the Commission Friday afternoon and Saturday morning, January 14-15, and will be happy to discuss these thoughts with the members of the Commission if I can be of further assistance.

Sincerely yours,

Harold Marsh, Jr.
of NOSSAMAN, WATERS,
SCOTT, KRUEGER & RIORDAN

HM:pf

cc: Mr. Lee J. Fortner
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P.S. I am enclosing fifteen additional copies of this letter for your convenience if you wish to distribute them to members of the