

Memorandum 77-53

Subject: Study 39.160 - Attachment (Property Subject to Security Interest)

The Commission's tentative recommendation relating to the attachment of property which is subject to a security interest, a copy of which is attached to this memorandum, was distributed for comment this summer. We have received comments from two persons, Mr. Harold Marsh (see Exhibit 1) and Mr. Thomas Shardlow (see Exhibit 2). Professor Stefan A. Riesenfeld has prepared a response to Mr. Marsh's letter (see Exhibit 4).

The purpose of the tentative recommendation is to revise the procedures governing the levy of attachment in order to recognize the prior rights of a secured party with a perfected security interest. The implementation of this policy is somewhat complicated because of the need to cast the necessary amendments in the terminology of the Commercial Code and to take account of the various ways in which a security interest may be perfected in particular types of property under the Commercial Code. We suggest that you review the tentative recommendation, paying particular attention to Section 488.440, and then read Mr. Marsh's letter and Professor Riesenfeld's response together. Professor Riesenfeld's comments follow the order in which the various points are raised in Mr. Marsh's letter.

Notice of Levy to Account Debtor

The major defect identified by Mr. Marsh and recognized by Professor Riesenfeld is that Section 488.440 in the recommendation does not provide for notice to the account debtor so that, when the security interest is satisfied, the account debtor will make payments to the levying officer rather than to the attachment defendant. See Exhibit 1, p.2; Exhibit 4, pp.3-4 (points 5 and 6). As Professor Riesenfeld correctly states, the purpose of the recommendation is not to make the secured party a collecting agent of the attaching plaintiff, but rather it is to recognize the prior rights of the secured party while ensuring that, when the security interest is satisfied, any property in the hands of the secured party will be turned over to the levying officer (usually) for the purpose of the attachment. It is not intended that the

account debtor of the attachment defendant should continue to make payments to the secured party after the security interest is satisfied. In order to prevent the account debtor from making payments to the attachment defendant, a new subdivision (c) should be added to Section 488.440 (as set out on page 21 of the tentative recommendation) which provides for notice of levy to the account debtor in certain circumstances.

(c) Promptly after levy and in no event more than 45 days after levy, the levying officer shall serve the account debtor or obligor obligated under the collateral, other than an obligation evidenced by chattel paper or a negotiable instrument which is in the possession of the secured party, with a copy of the writ and the notice of attachment. The notice of attachment shall inform the account debtor or obligor that payments should continue to be made to the secured party until the security interest is satisfied or sooner released and that thereafter payments shall be made to the levying officer. [Until the account debtor or obligor is served as required by this subdivision, payments made in good faith to the defendant shall be applied to the discharge of the obligation of the account debtor or obligor to the defendant.] A failure to serve the account debtor or obligor pursuant to this subdivision does not affect the lien created pursuant to subdivision (a).

Clarification of Secured Party's Duties Upon Satisfaction of the Security Interest

Mr. Marsh suggests (see Exhibit 1, p.2) and Professor Riesenfeld concurs (see Exhibit 4, p.4) that the statute should provide for the release by the secured party of uncollected payments to the levying officer and for the delivery to the levying officer of instruments, chattel paper, and documents. Accordingly, subdivision (c) of Section 488.440 should be relettered and revised as follows:

(d) Except in a case described in subdivision (e), the secured party may collect the payments due from the account debtor or obligor obligated on the account receivable, chose in action, chattel paper, deposit account, negotiable instrument, or judgment and may enforce or accept the return of tangible personal property sold or leased. After the satisfaction of the security interest, the secured party may deliver any excess property or pay any excess payments or proceeds of the property remaining in the possession of the secured party to the levying officer and may release uncollected rights to payment and deliver any chattel paper or negotiable instrument in the possession of the secured party to the levying officer .

We do not suggest including negotiable documents in this subdivision because Section 488.440 does not deal with negotiable documents. The tentative recommendation does not propose to change the rules governing the levy on negotiable documents which are subject to a perfected security interest because possession of the negotiable document is the crucial factor in determining the right to the goods in the possession of the bailee. See the discussion on pages 7-8 in the tentative recommendation.

Attachment and Future Advances

Mr. Thomas Shardlow raises some questions concerning the relation between an attachment lien and a floating lien on accounts receivable which secures future advances. See Exhibit 2. Mr. Shardlow suggests that enactment of the proposed Section 488.440 would impair the priority of an unsecured creditor who has levied upon accounts receivable which are subject to a future advances clause and recommends that the Commission consider providing that an attachment lien has priority over the lien of a secured party on accounts receivable which arises under a future advances clause where money is advanced after the creation of the attachment lien.

The staff recommends that no change be made in this regard. The intent of Section 488.440 is to recognize and clarify existing case law. Section 488.440 does not change the priorities between secured and unsecured creditors as they are determined under the Commercial Code. In our view, the priorities between secured and unsecured creditors are and should continue to be determined by Commercial Code Section 9301(4). This section provides:

(4) A person who becomes a lien creditor while a security interest in perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

This rule protects the priority of the secured party for 45 days (a period derived from the federal tax lien law, I.R.C. § 6323) and for any additional period during which the secured party does not have notice or where the advance is made pursuant to a commitment that was made without notice. See Ayer, The New Article 9 and the California Commercial Code,

21 U.C.L.A. L. Rev. 937, 965-68 (1974); H. Sigman, Attorney's Handbook on Division 9 (Cal. Cont. Ed. Bar 1976) (discussion following Section 9301). We see no reason to reexamine the scheme of priorities established by Section 9301(4) which became effective on January 1, 1976.

Levy on Pledged Securities

Mr. Marsh urges that the Commission consider providing for levying on pledged securities. See Exhibit 1, p.4. Professor Riesenfeld agrees with Mr. Marsh on this point. See Exhibit 4, p.5.

Section 488.410 in the Attachment Law provides that a security in the possession of a third person (except for the case of an escrow under the Corporate Securities Law or where the security has been surrendered to the issuer) may be levied upon in the manner provided by Section 8317 of the Commercial Code. Section 8317 provides that a levy is not valid unless the security is actually seized by the levying officer and also provides for injunctive relief. Section 8317 is set forth in Exhibit 3. In this respect, Section 488.410 continues the substance of Section 541 of the interim attachment statute which was in effect from 1972 through 1976. This method of levy of attachment is incorporated for purposes of execution by Section 688(b).

The Commission has several times considered this problem in the course of preparing the Attachment Law and has previously decided to continue the preexisting law in order to avoid any conflict with Commercial Code Section 8317. Section 8317 has been variously interpreted by the few courts to consider the question of its effect on creditor's remedies. We are not aware of any California cases on this issue. Decisions in Pennsylvania have interpreted Section 8317 literally with the result that levies have been held to be ineffective without actual seizure of the certificate held by the third person. See *Neifeld v. Steinberg*, 438 F.2d 423 (3d Cir. 1971); *DeShong v. Cody*, 36 Pa. D. & C.2d 109 (1964); *Ellison v. Mitchell*, 26 Pa. D. & C.2d 45 (1961); *Nederlandsche Handel-Maatschappij, N.V. v. Sentry Corp.*, 163 F. Supp. 800 (E.D. Pa. 1958); *Loiseaux, Liability of Corporate Shares to Legal Process*, 1972 Duke L.J. 947, 958-59. However, in New York, it has been held that, although garnishment of pledged stock did not constitute a valid levy as against a bona fide purchaser, it did entitle the sheriff to poundage. *Knapp v. McFarland*, 462 F.2d 935 (2d Cir. 1972). The

court in Knapp also stated that UCC Section 8-317 was enacted to protect bona fide purchasers and not to determine what manner of levy suffices to enforce the judgment as against the judgment debtor. It should be noted, however, that New York law is distinct from California law in that the pre-code rule that a levy is valid if it serves as an injunction against transfer has been applied in New York under UCC Section 8-317 with the effect that the garnishment of a custodian of stock under a voting trust agreement has been held to be a sufficient levy to confer quasi in rem jurisdiction over the owner of the stock. See *Proteus Food & Industries, Inc. v. Nippon Reizu Kabushiki Kaisha*, 4 U.C.C. Rep. 961 (N.Y. Supp. Ct., 1968). We are unaware of any suggestion in California that a garnishment creates an injunction against transfer.

It is generally stated that the reason for UCC Section 8-317 is to protect potential purchasers from the enforcement of a judgment creditor's lien on the securities. If this is the only significant policy behind the seizure requirement, then there is no reason to prohibit the garnishment of securities which are pledged or otherwise held by third persons. As with a negotiable instrument, the garnishment of the third person holding the stock certificate would make the third person liable for the value of the property reached by the garnishment. See Section 488.550 in the tentative recommendation attached hereto.

The staff recommends that Section 488.410 be revised to read substantially as follows:

488.410. (a) Except as provided in Section 488.440, to attach a security, the levying officer shall (1) serve the person in possession of the security with a copy of the writ and the notice of attachment and (2) if the security is in the possession of the defendant, take the security into custody.

(b) If the security is not in the possession of the defendant, promptly after levy and in no event more than 45 days after levy, the levying officer shall serve the defendant with a copy of the writ and the notice of attachment.

[(c) If the security is not in the possession of the issuer, promptly after levy and in no event more than 45 days after levy, the levying officer shall serve the issuer of the security with a copy of the writ and the notice of attachment.]

(d) A failure to serve the defendant pursuant to subdivision (b) [or the issuer pursuant to subdivision (c)] does not affect the lien created pursuant to subdivision (a).

It might also be advisable to amend Commercial Code Section 8317 by adding an introductory clause cross-referring to the Attachment Law. The specific references in existing Section 488.410 to escrows under the Corporate Securities Law and to securities surrendered to the issuer may be eliminated as unnecessary since they are covered by the general terms of subdivision (a) of the proposed section.

The staff is not certain that proposed subdivision (c) which provides for notice to the issuer (except where the issuer is the garnish-ee) serves any significant purpose. The corporation is entitled to treat the registered owner as the person entitled to dividends, regardless of a pledge or levy. See Com. Code § 8207(a); 1 H. Ballantine & G. Sterling, California Corporation Laws § 142.05, at 8-50 to 8-51 (4th ed. 1976). Under former law, when stock was levied upon by garnishing the corporation, the creditor obtained a lien on the dividends that had accrued or were to accrue. See *Cates v. Consolidated Realty Co.*, 25 Cal. App. 531, 144 P. 301 (1914). In order to obtain the right to dividends, a pledgee is advised to cause the shares to be registered in the name of the pledgee if in fact the parties have agreed that the dividends have been pledged. However, the staff believes it is inappropriate to attempt to provide that notice of levy to the issuer creates a duty to pay dividends to the levying officer (assuming they have not been pledged or that the security has been garnished in the hands of a third person other than a pledgee) since the Commercial Code does not create such a duty when a pledgee gives notice to the issuer. See the Comment to UCC Section 8-317. Presumably, the judgment creditor may garnish the dividends in the hands of the corporation once the dividends have been declared since the declaration creates a debt to the shareholder. See 1 H. Ballantine & G. Sterling, California Corporation Laws § 142.05, at 8-44 to 8-45 (4th ed. 1976).

Another issue concerning levy on securities is raised by the possibility of corporate shares not represented by a certificate. See 1A H. Ballantine & G. Sterling, California Corporation Laws § 215, at 10-117 (4th ed. 1976); ABA Comm. on Stock Certificates, Second Report (Jan. 1977), from 32 Bus. Law. 1183 (1977) (the proposed revision of UCC

Section 8-317 from this report is in Exhibit 3). Section 416(b) of the Corporations Code authorizes such a system of issuance, recordation, and transfer of shares by electronic or other means. The staff does not propose to deal with this potential problem until the nature of the proposed revisions of Article 8 of the UCC is known.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

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July 5, 1977

REFER TO FILE NUMBER

Professor John H. DeMouilly
California Law Revision Commission
Stanford University
Stanford, California 94305

Dear John:

I have your letter of June 24, 1977 enclosing the tentative recommendation of the Law Revision Commission relating to attachment of property subject to a security interest.

It seems to me that the recommendation does not meet all of the practical problems which will arise in connection with such a levy upon property subject to a security interest. Specifically, it seems to assume in most instances that where the security interest is satisfied, payments will continue to be made to the secured party over and above the amount of the debt that the property secures and that the secured party should then remit these amounts to the Sheriff who has levied by garnishing the secured party. There is, of course, nothing which requires the debtor-defendant to make any payments to the secured party beyond the amount of the debt which he owes to the secured party, and there is nothing which permits the secured party to refuse to release the security interest once the entire amount of his debt has been discharged. On the contrary, the secured party is required to give such a release by the Uniform Commercial

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Code.

In this connection, it seems to me essential that several different situations be distinguished, and it also seems to me to be improper to attempt to make the secured party a collector of the debt of the levying plaintiff.

Any statute on this subject should deal specifically with the rights and duties of all three parties in at least the following different circumstances:

(a) The debt of the secured party is paid in full by the debtor, and the security interest thereby is discharged. In this instance, presumably the law could provide that the secured party should deliver any tangible property or negotiable documents or instruments to the levying officer, but some method must be provided to continue the perfection of the levy with respect to any property not in the possession of the secured party where the security interest has been perfected by filing or without either filing or possession. At this point the secured party certainly cannot be further involved in the dispute between the plaintiff and defendant and is required to furnish a termination statement to the debtor by the UCC.

(b) The collateral, whether or not in the possession of the secured party, is sold on foreclosure. In this situation, presumably it should simply be provided that any proceeds realized over and above the debt owed to the secured party should be remitted to the levying officer rather than to the debtor as provided in Section 9504(2) of the UCC. It is also essential that a provision be included stating

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that the right of a secured party to have a foreclosure sale and to sell free of the attachment lien is not impaired.

(c) The right of the secured party under Section 9505(2) of the UCC to propose to the debtor that the secured party retain the collateral in satisfaction of the obligation must be specifically dealt with and the rights of the attaching creditor in that circumstance specified. Possibly the attaching creditor could be treated as a subordinate secured party who has given written notice of a claim of an interest in the collateral under that section and who is entitled to object to the proposed retention, which objection requires that the secured party proceed with a sale.

(d) The situation where the debtor requests a release of collateral even though the debt has not been paid and the secured party is willing to give such a release (perhaps of only a portion of the collateral where he regards the amount remaining as sufficient security) must also be considered.

It seems to me that the foregoing problems, and there are undoubtedly many others that will surface on further study, indicate that insufficient thought has been given in the proposal to what happens or may happen after the writ of attachment is levied on the equity of the defendant in property subject to a security interest. At the time of levy, of course, it is easy to say simply that the secured party has a first lien and the attaching creditor has a second lien; and in the event of a bankruptcy, for example, it will be easy to recognize their priorities in that order. In other eventualities, however, the rules regulating this tripartite relationship must be carefully considered. It is true that these

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problems may already exist without any definitive answer, since there is nothing in the present law that would prevent a levying creditor from garnishing a pledgee, for example, to levy upon the equity of the pledgor in the collateral. In fact, the California cases have clearly recognized this as a proper method of levy in that circumstance. However, if the entire subject is to be codified, such problems certainly should be specifically addressed.

In considering these problems, it seems to me that the overriding principle must be that it would be improper to impose upon the secured party any burdens or any additional duties to the attaching creditor, except perhaps to deliver the property or the proceeds in excess of his debt to the levying officer rather than to the debtor, since the secured party has had nothing to do with the plaintiff.

In considering this entire subject, the decision which was made in Section 488.410 of the Code of Civil Procedure to prohibit any levy upon pledged securities should certainly be reconsidered. I have never seen any attempt to justify this decision, which is contrary to the cases under Section 8317 of the UCC holding that that section does not prohibit a levy upon the equity of a pledgor of securities by garnishing the pledgee. If this rule were extended to the levy of a writ of execution, and there does not seem to be any argument for a distinction between a writ of execution and a writ of attachment, it would create an exemption from the debts of the owner for all margin accounts in the State of California and all corporate stocks and bonds pledged to banks or other lenders. Such wealth must amount in the aggregate to hundreds of millions of dollars. Such a rule could only be described as unconscionable.

Since it is recognized in the present statute and in the proposal that it is appropriate for an attach-

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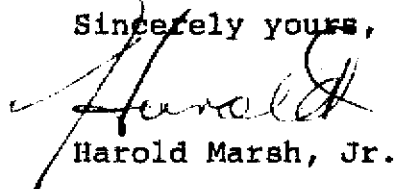
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ing creditor to levy upon the equity of the owner of a pledged negotiable instrument or a pledged negotiable document, what argument can be made for immunizing the equity of the owner of a pledged security from legal process? If the reason is suppose to have something to do with protecting the negotiability of the security, why isn't it equally applicable to negotiable instruments and documents? If the alleged reason has nothing to do with negotiability, what justification is there for distinguishing between a pledged diamond ring and a pledged stock certificate?

Since it is now restudying the entire subject of a levy upon property subject to a security interest, the Commission should address these questions and, if this exemption is to be continued, it should at least state why it believes it appropriate. I realize that the contrary rule may create problems for brokers or banks which hold such securities in pledge, but no more so than for a lender who holds a pledged negotiable instrument or document. As suggested above, the statute should carefully spell out the duties of the pledgee where such a levy is made and should avoid imposing upon the pledgee any substantial burdens, since he is a stranger to the controversy between the plaintiff and defendant.

I hope that the foregoing comments will assist you and the Commission in further consideration of this subject. I would urge that after further study a new tentative recommendation be published which deals with these problems and that comments be actively solicited from persons who are intimately conversant with Article 9 transactions and particularly with the problems of foreclosure and enforcement of security interests.

Sincerely yours,



Harold Marsh, Jr.

HM/ma

cc: Members of the California
Law Revision Commission
Members of the Executive
Committee, Business Law
Section

VERNON EDWARD MURRAY

PROFESSIONAL CORPORATION

July 20, 1977

CALIFORNIA LAW REVISION COMMISSION
Stanford School of Law
Stanford, California 94305

REFERENCE: Tentative Recommendation
Relative to Attachment of
Property Subject to Security
Interest

Gentlemen:

I suggest that the relationship of proposed C.C.P. Sections 488.40 to the common floating lien situation be expressly dealt with in the proposed law or a comment thereto.

Here is the problem as I envision it: Assume that a defendant's accounts receivable are subject to a security interest which covers after-acquired accounts receivable and which secures future advances. Let us further assume that the secured party has arranged to loan 80% of the face value of the receivables to the defendant and that at the moment of levy the defendant has \$100,000 in collectable accounts receivable subject to a perfected security interest in the amount of \$80,000.

One would expect that the levying creditor would be able to reach the \$20,000 "equity" in the accounts receivable. A careful reading of proposed Section 488.40 indicates that this will not be so. Consider the following situations:

A. The accounts receivable continue to be "turned over": Under this situation the secured party would continue to collect accounts receivable, applying them toward its security interest and "loan" the defendant additional sums up to 80% of the accounts receivable. Since the security interest is never satisfied, there is no "excess property or excess payments" to deliver to the levying officer. Presumably after 90 to 120 days the receivables which were levied on will be gone, the creditor will have nothing while the debtor will have been able to utilize his receivables as if there had been no levy at all.

VERNON EDWARD MURRAY

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CALIFORNIA LAW REVISION COMMISSION

July 20, 1977

B. The accounts receivable are liquidated. The above example assumes the the levy does not give the creditor an interest in after acquired accounts receivable assigned to the secured party. Even assuming that it does, the creditors interest can still be defeated. Assume that after the levy the debtor stops financing his receivables through the secured party. If the secured party is willing to continue to loan based on 80% of the outstanding accounts receivable, eventually there will be (for purpose of illustration) \$100 in receivables outstanding subject to an 80% secured interest. The creditor's \$20,000 equity has now become \$20.00.

C. The amount financed is restricted: As a special instance of the above example, assume simply that the defendant cuts the amount of his receivables being financed from \$100,000 to \$50,000. The equity in receivables subject to the lien has been reduced from \$20,000 to \$10,000! Attachments are the most common where a business cannot (rather than will not) pay its debts. However, if proposed Section 488.440 is passed, the creditor's ability to salvage what he can get of a failing business may be severely restricted.

Recommendation: None of the abovementioned situations could occur if the law were to provide that, notwithstanding any future advances clauses, any monies advanced after the levy would be secured by a lien second to the lien of attachment. Alternatively, at a minimum, the law could provide that the levy gives the creditor a lien upon after acquired property being collected by the secured party.

I would appreciate it if you would put me on your mailing list for all materials related to this particular study.

Sincerely,

VERNON EDWARD MURRAY
PROFESSIONAL CORPORATION

By

Thomas E. Shardlow

TES:s1

EXHIBIT 3

Commercial Code Section 8317 and a Proposed Revision

§ 8317. Attachment or Levy Upon Security. (1) No attachment or levy upon a security or any share or other interest evidenced thereby which is outstanding shall be valid until: (a) the security is actually seized by the officer making the attachment or levy, or (b) in the case of a security held in escrow pursuant to the provisions of the Corporate Securities Law, a copy of the writ and a notice that the securities are attached or levied upon in pursuance of such writ is served upon the escrow holder; but a security which has been surrendered to the issuer may be attached or levied upon at the source.

(2) A creditor whose debtor is the owner of a security shall be entitled to such aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching such security or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process. (Stats.1963, c. 819, § 8317.)

California Code Comment

By John A. Bohn and Charles A. Williams

Prior California Law

1. There are two views of the effect of subdivision (1) on prior California law.

The Northern Subcommittee of the State Bar Committee on Article [Division] 8 stated that there was no practical change:

"[This section] provides for the manner of attachment or levy upon a security. In effect, subsection (1) provides that no such levy is valid until the security has actually been seized. However, a security which has been surrendered to the issuer may be levied upon at the source. It is not entirely free from doubt as to whether, as a practical matter, this changes California law. Code of Civil Procedure, Section 542(4) purports to provide that a levy is perfected by leaving a copy of the writ and notice with an officer of the issuer. On the other hand, Section 2477 of the Corporations Code (USTA) provides that a corporation shall not be compelled to issue a new certificate for shares until the old certificate is surrendered. This, of course, raises the question as to whether a judgment creditor ac-

tually gets anything by a purported levy without seizing the security. In *Clark v. Western Feeding Co.*, 10 Cal.App.2d 727, 52 P.2d 991 (2d Dist. 1935) the court held that since 1931 under the USTA as adopted in California the transferee of a duly indorsed stock certificate prevailed over an execution purchaser of a registered owner's interest. This was a typical situation in which the security was not seized, but the sheriff served a writ of execution on the corporation. In light of the purpose of the USTA, as well as the modern trend to make the stock certificates themselves the controlling indicia of title to the shares, the *Clark* case seems correct. A similar point of law is now being litigated and is before the California Supreme Court in two cases which have been combined for hearing. *Reynolds v. Reynolds*, 4 Cal.Rep. 464 (1st Dist. 1960), petition for hearing granted and case transferred, June 22, 1960. [Footnote: Subsequent to the writing of this report, the Supreme Court of the State of California has held that a corporation is not required to issue a new certificate until the old

certificate is surrendered. Reynolds v. Reynolds (Sept. 21, 1960) 54 A.C. 673. Therefore, adoption of Section 18317 [8317] will not change the law of this state.] Regardless of the court's decision in these cases, the theory of the UCC would appear to be the only practical approach to the problem in modern commercial practice." Sixth Progress Report to the Legislature by Senate Fact Finding Committee on Judiciary (1959-1961) Part I, The Uniform Commercial Code, p. 391.

The Legislative counsel in California Annotations to the proposed UCC took the position prior to the decision in the Reynolds case that there was a change:

"This section represents a substantial change in the California procedure in that under U.C.C. the levy is valid only when the security 'is actually seized' whereas under the Code of Civil Procedure, Section 542(4) the levy is perfected by leaving a copy of the writ and a notice with officer of issuing corporation. For old California rules on priority of attachment see National Bank of the Pacific v. Western Pacific Railway, 157 Cal. 573, 108 Pac. 676." Sixth Progress Report to the Legislature by Senate Fact Finding Committee on Judiciary (1959-1961) Part I, The Uniform Commercial Code, p. 121.

In the light of the Reynolds case holding that under prior law a corporation need not issue a new certificate until the old one is surrendered, then as a practical matter a levy under Code of Civil Procedure § 542(4) (service upon an officer without actual seizure) was ineffec-

tive. It would then follow that subdivision (1) providing for actual seizure does not change California law.

2. Subdivision (2) is new. See Official Comment 1. This subdivision continues the rule under section 14, USTA. This section was not adopted as a part of the California version of the USTA.

Changes from U.C.C. (1962 Official Text)

3. Subdivision (1) was changed in the California version from the Official Text as follows:

"No attachment or levy upon a security or any share or other interest evidenced thereby which is outstanding shall be valid until: (a) the security is actually seized by the officer making the attachment or levy, or (b) in the case of a security held in escrow pursuant to the provisions of the Corporate Securities Law, a copy of the writ and a notice that the securities are attached or levied upon in pursuance of such writ is served upon the escrow holder; but a security which has been surrendered to the issuer may be attached or levied upon at the source."

The amendment was recommended by the Marsh and Warren Report as a result of a suggestion by the Attorney General that the Official Text would not adequately cover the case of levy upon securities held in escrow under the Corporate Securities Law.

"The procedure of seizure of the certificate in making a levy upon securities is impractical in the case of securities held in escrow under the Corporate Securities Act, since

this would permit them to be taken from the possession of the escrow holder and sold free of the escrow upon execution sale, contrary to the provisions of the Corporate Securities Act. The language suggested in (b) is adapted from subdivision 6 of § 542 of the CCP,

dealing with a levy upon personal property in the possession of one other than the judgment debtor." Sixth Progress Report to the Legislature by the Senate Fact Finding Committee on Judiciary (1959-1961) Part 1, The Uniform Commercial Code, p. 544.

Uniform Commercial Code Comment

Prior Uniform Statutory Provision: Sections 13, 14, Uniform Stock Transfer Act.

Changes: Rephrased for clarity.

Purposes of Changes:

1. In dealing with investment securities the instrument itself is the vital thing and therefore a valid levy cannot be made unless all possibility of the security finding its way into a transferee's hands has been removed. This can be accomplished only when the security has been reduced to possession by a public officer or by the issuer. A holder who has been enjoined can still transfer the security in contempt of court. See *Overlock v. Jerome Portland Copper Mining Co.*, 29 Ariz. 560, 243 P. 400 (1926). Therefore, although injunctive relief is provided in subsection (2) so that creditors may use this method to gain control of the security, the security itself must be reached to constitute a proper levy. The method used in *Hodes v. Hodes*, 176 Or. 102, 155 P.2d 564 (1945), where the Oregon court enjoined the transfer of a security in a safe deposit box in the state of Washington, directing a copy of the writ to be served upon the issuer, although not operative as an effective levy, is a

method of reaching the security approved by the section.

2. An attachment filed at the issuer's office against the shares represented by the security on the books is ineffective unless the security itself has been surrendered to the issuer. The case law holdings that priority in time of transfer or attachment governed the validity of the levy are rejected under this Article as under the Stock Transfer Act. See for example, *National Bank of Pacific v. Western Pac. R. Co.*, 157 Cal. 573, 108 P. 676, 27 L.R.A.,N.S., 987, 21 Ann.Cas. 1391 (1910).

3. This section deals with the problems of attaching or levying creditors and prevents such persons from securing rights paramount to those of purchasers who have actual possession of the security. It does not apply in cases where a governmental agency, for reasons of public safety or the like, seeks to confiscate securities. See, for example, the situation in *Silesian American Corp. v. Clark*, 332 U.S. 469, 68 S.Ct. 179, 92 L.Ed. 81 (1947), upon which this section has no bearing.

Definitional Cross References:

- "Creditor". Section 1-201.
- "Issuer". Section 8-201.
- "Security". Section 8-201.

PROPOSED REVISION OF UCC SECTION 8-317 FROM
ABA COMMISSION STOCK CERTIFICATES, SECOND REPORT (JAN. 1977)

Section 8-317. Creditors' Rights. [Attachment or Levy Upon Security.]

(1) Subject to the exceptions in subsections (3) and (4), no attachment or levy upon a certificated security or any share or other interest [evidenced] represented thereby which is outstanding shall be valid until the security is actually seized by the officer making the attachment or levy but a certificated security which has been surrendered to the issuer may be [attached or levied upon at the source] reached by a creditor by legal process at the issuer's chief executive office.

(2) An uncertificated security registered in the name of the debtor may not be reached by a creditor except by legal process at the issuer's chief executive office.

(3) The interest of a debtor in a certificated security which is in the possession of a secured party not a financial intermediary or in an uncertificated security registered in the name of a secured party not a financial intermediary or in the name of a nominee of such secured party may be reached by a creditor by legal process upon the secured party.

(4) The interest of a debtor in a certificated security which is in the possession of or registered in the name of a financial intermediary or in an uncertificated security registered in the name of a financial intermediary may be reached by a creditor by legal process upon the financial intermediary on the books of which the interest of the debtor appears.

(5) Unless otherwise provided by law, a creditor's lien upon the interest of a debtor in a security obtained pursuant to subsection (3) or (4) shall not operate as a restraint of the transfer of such security, free of the lien, to a third party for new value, but, in the event of such transfer, such lien shall apply to the proceeds of such transfer in the hands of the secured party or financial intermediary subject to any claims which have priority.

(6) [(2)] A creditor whose debtor is the owner of a security shall be entitled to such aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching such security or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be [attached or levied upon] reached by ordinary legal process.

Explanation of Changes

This section has been substantially rewritten and expanded, not only to provide for the rights of creditors of the owners of uncertificated securities, but also to provide expressly for remedies against the interest of debtors in certificated securities which are not within the debtor's control. It is one of the few sections in this revision in which it is intended to extend the coverage of Article 8 as to certificated securities.

Subsection (1) states the rule of the present statute for certificated securities which provides that a creditor's lien upon a certificated security is not valid until actual seizure. The chief justification for this rule is the protection of purchasers from the debtor. The rule is entirely appropriate when the security is within the debtor's control. When the debtor does not have such control, the rule has no function.

The present statute recognizes a single exception to the rule where the security has been surrendered to the issuer. New subsection (1) includes this exception and expressly provides that such a security can be reached by serving the issuer at its chief executive office, replacing the cryptic phrase "at the source." The most logical place to serve the issuer would be the place

where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9-103(3)(d).

Subsection (2) provides that process upon the issuer is the only method for a creditor to reach an uncertificated security registered in the name of the debtor. This conclusion was reached with some reluctance since it requires a creditor to institute legal action and/or a debtor to defend that action in a jurisdiction which may have no relationship to either of the parties or the dispute other than the happenstance that the debtor owns a security of the particular issuer. Nevertheless, attempts to formulate a procedure by which even a judgment creditor could effectively reach his debtor's uncertificated securities without such legal action resulted in what seemed to be an intolerable burden for issuers.

Subsection (3) provides a second exception to the seizure rule when a certificated security is in the possession of a secured party. In such a case, an effective lien can be established by service on the secured party without depriving him of his possession. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security. For essentially the same reasons, subsection (3) also covers the case where an uncertificated security has been transferred into the name of a secured party either at the inception of the loan or thereafter.

Subsection (4) recognizes that certificated securities are frequently held in account for customers by banks or brokers and that such securities may be registered not only in the name of the debtor but, more commonly, in street or other nominee name. Additionally, in such cases, the securities may have been commingled, repledged or deposited so that no particular security could be identified as that of the debtor. The subsection provides that the debtor's account can be reached by process upon the entity upon whose books the interest of the debtor appears. This appears to be the most effective way of preventing the transfer of the debtor's interest and thus protecting the creditor. It is only that entity that is aware of the debtor's interest, irrespective of where the securities are located or in what name they happen to be registered. For the same reason, subsection (4) also covers the case where uncertificated securities are registered in street name.

Subsection (5) expressly provides that securities in which the debtor's interest is reached pursuant to subsections (3) or (4) may be transferred for new value, negating the creditor's lien, but, when and if they are, that the lien will be transferred to the proceeds. Nothing in subsection (5) is intended to validate any transfer that would otherwise constitute a fraudulent conveyance. Furthermore, subsection (5) is expressly subject to the procedural laws of the states and no attempt has been made to prescribe the consequences of obtaining such a lien or the procedures for its enforcement.

Particular terms to describe creditor's process have been avoided in this section. This section is not intended to have any effect on the availability of garnishment or similar third party process as a pre-judgment or post-judgment remedy. Such matters are a proper concern of the procedural rules of the states, subject, of course, to constitutional limitations.

Exhibit 4

To: California Law Revision Commission

From: Stefan A. Riesenfeld

Mr. Harold Marsh's letter of July 5, 1977 discussing the Commission's tentative recommendation relating to attachment of property subject to a security interest was transmitted to me for comment. I am happy to comply with your request.

The gist of Mr. Marsh's criticism can be seen in the following statement:

"[The recommendation]...seems to assume in most instances that where the security interest is satisfied, payments will continue to be made to the secured party over and above the amount of the debt that the property secures and that the secured party should then remit these amounts to the Sheriff who has levied by garnishing the secured party. There is, of course, nothing which requires the debtor-defendant to make any payments to the secured party beyond the amount of the debt which he owes to the secured party, and there is nothing which permits the secured party to refuse to release the security interest once the entire amount of his debt has been discharged. On the contrary, the secured party is required to give such a release by the Uniform Commercial Code."

In my opinion Mr. Marsh misconstrues the objectives of the recommendation and indulges in some legal propositions which are quite inaccurate. He raises, however, matters which call for clarification in §488.440.

1. The proposed draft does not assume that the secured party will receive payments after the secured debt has been paid in full, except in specific circumstances discussed below. Least of all, does the draft assume that such payments will be made or required from the debtor-defendant. If at all, such payments will be made by an obligor of the debtor (an account debtor).

2. There are instances where the secured party will and must receive payments from a third party in excess of the secured debt. These instances are, e.g.

a. cases where the obligation assigned as security (to use the pre-Code terminology) involves an indivisible payment in excess of the secured debt. The granting of a security interest in an account receivable may be in the nature of a partial assignment (e.g. a debt of \$10,000 is assigned as a security for a debt of \$5,000). The rules against splitting causes of action entitle the obligor of the assigned debt to make a payment of the whole sum to the assignee.

b. cases where the right to payments are evidenced by instruments and chattel paper. The obligor must make the payments to the holder.

3. It is incorrect that the Uniform Commercial Code requires the "release" of the security interest once the secured debt is discharged. The U.C.C. requires issuance of a termination statement (UCC §9-404). The debtor can require a "release" of the security to the grantor of the security interest only, if such release does not impair intervening junior rights, including rights under an intervening levy.

4. The purpose of the recommendation is to protect and recognize the superior rights of the secured party but this purpose should not impair the rights of junior parties. This respect for the rights of junior parties may prevent a release of the collateral to the debtor or the debtor's debtor. This was exactly what Axe v. Commercial Credit Corp., 227 CA 2 216, 38 Cal Rptr. 558 (1963) decided and what is sought to be codified by the recommendation (see text of recommendation to ¶tn. 7). The Code does not change these rules but rather recognized them in §9-311.

5. I agree with Mr. Marsh that §488.440 (b) and (c) should be clarified to prevent a misconstruction. The levying creditor is entitled to the rights of the debtor-defendant in the collateral, i.e. the rights to a surplus remaining after foreclosure, the rights to redeem, and the right to the remaining collateral after satisfaction of the security interest.

For that reason the party obligated under the collateral should receive notice of the levy under subsection (a), such notice specifying that any payments not made or to be made to the secured party must be made to the sheriff and not to the defendant. This provision should be part of (b) in analogy of §488.400 (c). This notice, however, is only required where the obligation is not evidenced by an instrument, document or chattel paper in the possession of the secured party.

I also agree with Mr. Marsh that §488.440 (c) should be clarified by providing specifically that the secured party may release all uncollected rights to payment to the sheriff and deliver to him all instruments, documents and chattel paper.

6. Turning now to the specific points (a) to (d) raised in the Marsh letter:

ad (a): I do not understand what is meant by a method to continue perfection of the levy. Perfection applies only to consensual security interests under the Code, not to levy liens. The notices to the secured party and to the obligor should suffice to create a valid levy lien, which remains effective upon delivery of tangible property, chattel paper, negotiable documents and instruments to the sheriff after the security interest is satisfied. The right to a termination

statement has absolutely nothing to do with the rights of a junior lienor, at least so far as I can see. If the collateral is in the hands of the debtor-defendant the security interest remains perfected despite of the levy, and will remain superior to the levy lien.

ad (b): This matter is taken care of in §488.440 (c). The word "may" is used, since the garnishee may retain the property in trust for the creditor. A formal amendment of UCC §9-504 or a provision that a foreclosure of a senior security interest closes out a junior lien seems to be unnecessary.

ad (c): A provision giving the levy lienor the rights under Section 9505(2) seems likewise to be unnecessary though not harmful.

ad (d): After the levy the debtor-defendant is not entitled to a release except to the levying officer. I see no virtue in a specific rule to that effect in addition to §488.440 (c), as clarified.

7. §488.410 (which supposedly tracks with UCC 8-317) was many times before the Commission. As I stated often before, I wholeheartily agree with Mr. Marsh, but the views of former commission-member Gregory have persuaded the Commission to the contrary. Perhaps the forthcoming revision of Article VIII by the ALI will produce a more reasonable approach.

6/10/77

STATE OF CALIFORNIA

CALIFORNIA LAW
REVISION COMMISSION

TENTATIVE RECOMMENDATION

relating to

ATTACHMENT OF PROPERTY SUBJECT TO SECURITY INTEREST

CALIFORNIA LAW REVISION COMMISSION
Stanford Law School
Stanford, California 94305

Important Note: This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be considered when the Commission determines what recommendation, if any, it will make to the California Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you object to the tentative recommendation or that you believe that it needs to be revised. COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE SENT TO THE COMMISSION NOT LATER THAN AUGUST 15, 1977.

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

TENTATIVE RECOMMENDATION
relating to
ATTACHMENT OF PROPERTY SUBJECT TO SECURITY INTEREST

BACKGROUND

Upon the enactment of the Commercial Code, the broad property categories of the common law were replaced by a set of carefully defined types of property. The Attachment Law¹ employs the new Commercial Code terminology and contains detailed provisions for the manner of levy on each of the various categories of property under a writ of attachment.² These provisions were designed to provide an orderly means of obtaining a lien on the defendant's interest in property subject to attachment, regardless of whether it is tangible personal property in the possession of the defendant or of a third person or whether it is an account receivable, chattel paper, chose in action, deposit account, negotiable document, negotiable instrument, or judgment. These sections typically provide for seizure of tangible personal property in the hands of the defendant (except in a few situations where a lien on the property is created by service) and for service on the person obligated to the defendant or holding the defendant's property.³ Where an obligation of a third person to the defendant is garnished by service of a copy of the writ of attachment and the notice of attachment, a lien is created on the property⁴ and the garnishee is liable to the plaintiff in the amount of the defendant's property interest under the third person's control.⁵

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1. Code Civ. Proc. §§ 481.010-492.090. Except as otherwise noted, all citations are to the Code of Civil Procedure.
 2. See Sections 488.310-488.430.
 3. A detailed discussion of the levy procedures applicable to specific forms of property is presented infra. It should be noted that the defendant is given notice of the levy in every case, but this notice is intended to alert the defendant to the action against his or her property and does not relate to the creation of a lien on the property.
 4. Section 488.500.
 5. Section 488.550.

Rights of other third persons may be asserted through the normal third-party claims procedure.⁶ Neither the Attachment Law nor prior statutes prescribe levy procedures that take account of the prior rights of secured parties in property sought to be attached. Consequently, the attachment statutes have been technically deficient in that they purport to allow the plaintiff to reach property subject to a perfected security interest by garnishing the account debtor or obligor rather than the secured party.

The courts have occasionally been called upon to decide the relative priorities of attaching plaintiffs and secured parties. These decisions hold in general that a secured party with a perfected security interest in collateral involving a bailment or the indebtedness of an account debtor to the defendant is entitled to the disposition of the collateral, including the collection of payments due thereon, without interference deriving from a subsequent levy of attachment by the plaintiff on the defendant's interest in the pledged property.⁷

RECOMMENDATIONS

The Commission recommends that the substance of the decisional law regarding the rights of secured parties with perfected security interests as against attaching unsecured creditors be codified in the Attachment Law.⁸ To accomplish this, the levy procedures should be revised so that, in most situations where there is a prior perfected security interest in the property, the priority of the secured party will be

6. See Section 488.090 (incorporating third-party claims procedure applicable after judgment).

7. See, e.g., *Puissegur v. Yarbrough*, 29 Cal.2d 409, 412-13, 175 P.2d 830, 831-32 (1964); *Dubois v. Spinks*, 114 Cal. 289, 294-95, 46 P. 95, 96 (1896); *Deering v. Richardson-Kimball Co.*, 109 Cal. 73, 84, 41 P. 801, 803-04 (1895); *Robinson v. Trevis*, 38 Cal. 611, 614-15 (1896); *Axe v. Commercial Credit Corp.*, 227 Cal. App.2d 216, 220-23, 38 Cal. Rptr. 558, 563 (1964); *Crow v. Yosemite Creek Co.*, 149 Cal. App.2d 188, 308 P.2d 421 (1957).

8. The recommended provisions are consistent with the terminology and rules relating to secured transactions under the Commercial Code. See Com. Code §§ 9101-9508 and related provisions in other divisions of the Commercial Code.

recognized without the need for the secured party to make a third-party claim.⁹ Equally important, the person obligated to the defendant on the pledged property or holding pledged property should not be forced to make payments or to turn the property over to the levying officer pursuant to the writ of attachment while the obligor or bailee is primarily obligated to the secured party.

Specifically, the Commission recommends that the levy procedure in the Attachment Law be revised to take account of the paramount interests of secured parties in the following manner:

Accounts Receivable and Choses in Action

An account receivable¹⁰ or chose in action¹¹ is levied upon under the Attachment Law by serving the account debtor¹² with a copy of the writ of attachment and the notice of attachment.¹³ Service on the account debtor creates a lien on the attached property.¹⁴ After levy, the account debtor is freed of the obligation to make payments to the defendant and is discharged to the extent of payments made to the levying officer.¹⁵ The account debtor remains liable, however, in the amount of the obligation that is not paid over.¹⁶

These provisions should be revised to provide that, where the account receivable or chose in action to be levied upon is subject to a perfected security interest,¹⁷ levy is made by serving a copy of the

9. To the extent relevant to this discussion, a security interest is perfected, depending on the type of collateral involved, by filing (goods, negotiable documents, chattel paper, accounts, or general intangibles) or by taking possession (goods, negotiable documents, chattel paper, instruments, or money). Com. Code §§ 9302, 9304, 9305. The lien of an attaching plaintiff (a "lien creditor" under Com. Code § 9301(3)) has priority over an unperfected security interest. Com. Code § 9301(1)(b). The debtor's interest in collateral subject to a perfected security interest is specifically made liable to attachment. Com. Code § 9311.

10. See Section 481.030 ("account receivable" defined).

11. See Section 481.050 ("chose in action" defined).

12. See Section 481.020 ("account debtor" defined).

13. Section 488.370(a).

14. Section 488.500(f).

15. Section 488.540.

16. Section 488.550.

17. A security interest in an account receivable or chose in action is perfected by filing a financing statement. Com. Code § 9302(1).

writ and the notice of attachment on the secured party rather than on the account debtor. The account debtor should then continue to make payments to the secured party. When the obligation of the defendant (who is the debtor under the security interest)¹⁸ to the secured party is paid off, any excess in payments by the account debtor to the secured party should be paid to the levying officer for the purposes of the attachment.

These general principles should be subject to an exception where the secured party has left the liberty to the defendant to collect payments due on accounts receivable or to enforce or accept the return of tangible personal property the sale or lease of which resulted in the account receivable.¹⁹ In such cases, the levying officer should serve the account debtor with a copy of the writ and the notice of attachment and with a demand to make payment of all amounts due and to deliver returnable property to the levying officer rather than to the defendant.²⁰ The secured party should also be served so that the secured party will be afforded an opportunity to make a third-party claim in order to assert the priority of the security interest.

Chattel Paper

Chattel paper²¹ is levied upon by serving the person in possession of the chattel paper with a copy of the writ and the notice of attachment and, if the chattel paper is in the defendant's possession, by

18. See Com. Code § 9105(1)(d) ("debtor" defined).

19. Commercial Code Section 9205 permits the secured party to leave the "liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions"

20. An exception to this requirement that the property be returned to the levying officer should be provided in a case where the returned property upon its return would constitute inventory or farm products which have been levied upon pursuant to Section 488.360(c) (floating attachment lien on inventory or farm products obtained by filing with Secretary of State).

21. See Section 481.040 ("chattel paper" defined). It should be noted that, under this definition, a negotiable instrument, for example, may be a part of chattel paper and, in such a case, is treated as chattel paper.

taking custody of the chattel paper.²² Service and any required custody creates a lien on the chattel paper.²³ The account debtor obligated on the chattel paper is required to receive notice and until served is unaffected by the attachment; after service, payments required under the chattel paper are to be made to the levying officer.²⁴ The account debtor is freed of the obligation to make payments to the defendant once the chattel paper is attached²⁵ but remains liable in the amount of the obligation not paid.²⁶

Where the chattel paper is subject to a prior security interest which is perfected by the secured party's possession of the chattel paper,²⁷ the levy should be made by serving the writ and notice of attachment on the secured party rather than on the account debtor.²⁸ The account debtor obligated on the chattel paper should continue to make any required payments to the secured party. When the secured party's security interest is satisfied, any excess in payments by the account debtor to the secured party or excess proceeds from the sale of the collateral in the hands of the secured party should be paid to the

22. Section 488.380(a).

23. Section 488.500(c), (e).

24. Section 488.380(c).

25. Section 488.540.

26. Section 488.550.

27. A security interest in chattel paper is perfected either by filing (Com. Code § 9304(1)) or by possession of the chattel paper (Com. Code § 9305). The proposed changes in the rules concerning levy of attachment on chattel paper would not apply where the security interest is perfected by filing. In that situation, levy would be under the normal rules which require service on the person in possession of the chattel paper and, if it is in the defendant's possession, seizure of the chattel paper.

28. Where perfection is by possession, under the rules set forth in Section 488.380(a), the secured party and the person in possession of the chattel paper are, of course, the same. The difference in levy procedures which would result from the proposed revision is that no notice is to be given the person obligated on the chattel paper so that the relation between the account debtor and the secured party is not altered.

levying officer for the purposes of the attachment.

These general rules should be subject to an exception where the secured party has left the liberty to the defendant to collect payments due on the chattel paper or to enforce or accept the return of tangible personal property the sale or lease of which resulted in the chattel paper.²⁹ In such cases, the levying officer should serve the account debtor with a copy of the writ and the notice and attachment and a demand to make payment of all amounts due and to deliver returnable property to the levying officer rather than to the defendant.³⁰

The Attachment Law should also be revised to make clear that the levy on chattel paper creates a lien that extends to the interest of the lessor in the tangible personal property that was leased to create the chattel paper.³¹ This provision is needed to clarify the respective interests of the secured party and the attachment plaintiff in the lessor's (defendant's) interest in the property which was leased to create the chattel paper.

Deposit Accounts

A deposit account³² is levied upon by serving the financial institution holding the account with a copy of the writ and the notice of attachment.³³ Other persons in whose name the deposit account stands

29. See Com. Code § 9205; notes 19 and 20 supra.

30. An exception regarding return of the excess should apply where the plaintiff has levied on inventory or farm products pursuant to Section 488.360(c). See note 20 supra.

31. This proposed provision is derived from the rule that a perfected security interest in chattel paper gives the secured party a perfected security interest in the rights to payment evidenced thereby and in the debtor's security interest in the goods sold if that security interest is perfected by filing. See Bolduan v. Normandin (In re Western Leasing, Inc.), 17 U.C.C. Rep. 1369 (D. Ore. 1975). The proposed provision resolves for purposes of attachment the conflict in decisions under the Commercial Code concerning whether a security interest in chattel paper which is perfected by possession results in a perfected security interest in the lessor's property interest in the leased goods since the lessor's interest is not a security interest in need of perfection. See Comment, In Re Leasing Consultants, Inc.: The Double Perfection Rule for Security Assignments of True Leases, 84 Yale L.J. 1722 (1975).

32. See Section 481.080 ("deposit account" defined).

33. Section 488.390(a).

are required to be served, but this is not a condition of a valid levy.³⁴ Service on the financial institution creates a lien on the deposit account.³⁵

Where the deposit account is subject to a perfected security interest³⁶ that is prior to the attachment lien, the writ and notice of attachment should be served on the secured party rather than the financial institution.³⁷ After the satisfaction of the security interest, the secured party should pay any excess to the levying officer for the purposes of the attachment.

Negotiable Documents

A negotiable document³⁸ is levied upon by serving the person in possession of the document with a copy of the writ and the notice of attachment and, if the document is in the defendant's possession, by taking custody of the document.³⁹ Service and any required custody creates a lien on the document.⁴⁰ The Attachment Law also requires the obligor on the document to be given notice.⁴¹

The rules for levy on negotiable documents should remain unchanged, regardless of whether the negotiable document is subject to a perfected security interest. If the security interest in the negotiable document is perfected by the secured party's possession,⁴² then the existing

34. Section 488.390(b).

35. Section 488.500(e).

36. A security interest in a deposit account is perfected by filing. Com. Code § 9302(1).

37. The financial institution which would be served under Section 488.390(a) will not be the secured party since the secured transactions provisions of the Commercial Code do not apply to a right of setoff. Com. Code § 9104(i). See 3 California Commercial Law § 1.20, at 92 (Cal. Cont. Ed. Bar Supp. 1976).

38. See Section 481.090 ("document" defined).

39. Section 488.400(a).

40. Section 488.500(c), (e).

41. Section 488.400(c).

42. Com. Code § 9305.

rules result in the secured party being served with a copy of the writ and the notice of attachment. If the security interest in the negotiable document is perfected by filing,⁴³ then the levy should be by seizure where the negotiable document is in the hands of the defendant in order to prevent negotiation of the document to a holder in due course.⁴⁴ The prior interest of the secured party may then be asserted under the third-party claims procedure.⁴⁵ However, the person obligated on the negotiable document (i.e., the bailee who has issued the negotiable document) need not receive notice of the attachment since the bailee cannot deliver the goods represented by the negotiable document to anyone not in possession of the document.⁴⁶

Negotiable Instruments

A negotiable instrument⁴⁷ is levied upon by serving the person in possession of the document with a copy of the writ and the notice of attachment and, if the instrument is in the defendant's possession, by taking custody of the instrument.⁴⁸ Service and any required custody creates a lien on the instrument.⁴⁹ The person obligated on the instrument is also required to be given notice, but this is not a condition of a valid levy.⁵⁰

Where the negotiable instrument is subject to a security interest which is perfected by possession,⁵¹ the same method of levy should apply--the levying officer should serve a copy of the writ and the

43. Com. Code § 9304(1).

44. See Com. Code §§ 7501, 7502, 9309.

45. See Section 488.090 (incorporating postjudgment third-party claims procedure).

46. Com. Code §§ 7403, 7602.

47. See Section 481.160 ("negotiable instrument" defined).

48. Section 488.400(a).

49. Section 488.500(c), (e).

50. Section 488.400(c).

51. A security interest in a negotiable instrument is perfected by possession. Com. Code § 9305. Note that a negotiable instrument may be a part of chattel paper in which case a security interest in the chattel paper may be perfected by filing. See note 21 supra.

notice of attachment on the secured party in possession of the negotiable instrument. After satisfaction of the security interest, any excess payments should be paid to the levying officer for the purposes of the attachment. However, the person obligated on the negotiable instrument should not be required to be served since the obligor should continue to make required payments to the secured party.

Judgments

A final judgment⁵² owing to the defendant is levied upon by filing a copy of the writ and the notice of attachment in the action in which the judgment was entered and serving the judgment debtor.⁵³ Such filing and service creates a lien on the judgment.⁵⁴

Where the judgment is subject to a perfected security interest,⁵⁵ the copy of the writ and the notice of attachment should be served on the secured party. Filing in the action in which the judgment was rendered should not be required in this case since the defendant's judgment debtor is obligated to the secured party under the security interest.

52. See Section 488.420(c) (limiting judgments subject to attachment to final judgments).

53. Section 488.420(a).

54. Section 488.500(g).

55. Commercial Code Section 9104(h) excludes from the coverage of Division 9 of the Commercial Code "a right represented by a judgment (other than a judgment taken in a right to payment which was collateral)." A security interest in a right represented by a judgment excluded from coverage of Division 9 of the Commercial Code is perfected by execution and delivery to the transferee of a written assignment of the judgment. Civil Code § 955.1.

Goods in Possession of Bailee

Where no special method of levy is provided in the Attachment Law, tangible personal property in the possession of a third person is levied upon by serving the person in possession with a copy of the writ and the notice of attachment.⁵⁶ Service in this manner creates a lien on the property.⁵⁷

Where goods⁵⁸ in the possession of a bailee who has not issued a negotiable document are subject to a perfected security interest,⁵⁹ levy of attachment should be by service on the secured party. Levy in this manner will reach the defendant's interest in the goods remaining after the secured party's interest is satisfied. Notice to the bailee is not necessary because the property in the possession of the bailee is subject first to satisfaction of the security interest. Any excess proceeds from the sale of the goods after satisfaction of the security interest should be paid to the levying officer for the purposes of the attachment.⁶⁰

PROPOSED LEGISLATION

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

An act to amend Sections 488.360, 488.370, 488.380, 488.390, 488.400, 488.420, 488.500, 488.540, and 488.550 of, and to add Sections 488.335 and 488.440 to, the Code of Civil Procedure, relating to attachment.

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

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56. Section 488.330(a). This method of levy does not apply where the property is goods subject to a negotiable document. Section 488.330(d).
57. Section 488.330(e).
58. See Com. Code § 9105(1)(h) ("goods" defined).
59. A security interest in goods in the possession of a bailee who has not issued a negotiable document therefor is perfected by issuance of a nonnegotiable document in the name of the secured party, by the bailee's receipt of notification of the secured party's interest, or by filing as to the goods. Com. Code § 9304(3).
60. Cf. Section 488.550 (liability of garnishee).

§ 488.335. Goods subject to perfected security interest (new)

SECTION 1. Section 488.335 is added to the Code of Civil Procedure, to read:

488.335. (a) To attach the defendant's interest in goods which are in the possession of a bailee who has not issued a negotiable document therefor and which are subject to a perfected security interest under the Commercial Code, the levying officer shall serve upon the secured party a copy of the writ and the notice of attachment.

(b) Promptly after levy and in no event more than 45 days after levy, the levying officer shall serve the defendant with a copy of the writ and the notice of attachment. A failure to serve the defendant pursuant to this subdivision does not affect the lien created pursuant to subdivision (a).

Comment. Section 488.335 provides the method of attaching the defendant's interest in goods which are in the possession of a bailee who has not issued a negotiable document covering the goods and which are subject to a perfected security interest where the security interest has been perfected under the Commercial Code (1) by issuance of a nonnegotiable document in the name of the secured party, (2) by the bailee's receipt of notification of the secured party's interest, or (3) by filing as to the goods. See also Com. Code §§ 7102(1)(a) ("bailee" defined), 9105(1)(h) ("goods" defined). Where a negotiable document has been issued, it is levied upon pursuant to Section 488.400. Section 488.335 codifies the rule in *Crow v. Yosemite Creek Co.*, 149 Cal. App.2d 188, 308 P.2d 421 (1957), taking account of Commercial Code Section 9304(3) (perfection of security interest in goods in possession of bailee who has not issued negotiable document). A levy pursuant to this section reaches both (1) the defendant's interest in any surplus remaining after satisfaction of the interest of the secured party and (2) the defendant's right to redeem the property from the security interest. See Civil Code § 2903; Com. Code §§ 9504, 9506.

17/006

§ 488.360. Farm products and inventory of a going business (amended)

SEC. 2. Section 488.360 of the Code of Civil Procedure is amended to read:

488.360. (a) To attach farm products or inventory of a going business, if the defendant consents, the levying officer shall place a keeper in charge of such property for a period not to exceed 10 days. During such period, the defendant may continue to operate his farm or business at his own expense provided all sales are final and are for cash or the equivalent of cash. For the purposes of this subdivision, payment by check shall be deemed the equivalent of a cash payment. The levying officer shall incur no liability for accepting payment in the form of a cash equivalent. The proceeds from all sales shall be given to the keeper for the purposes of the levy unless otherwise authorized by the plaintiff. If the defendant does not consent or, in any event, after the end of such 10-day period, the levying officer shall take such property into his exclusive custody unless other disposition is made by the parties to the action. At the time of levy or promptly thereafter, the levying officer shall serve the defendant with a copy of the writ and the notice of attachment.

(b) Where property is levied upon pursuant to subdivision (a), the defendant may apply for an order pursuant to this subdivision for the release of property exempt pursuant to subdivision (b) of Section 487.020. Such application shall be made by filing with the court and serving on the plaintiff a notice of motion. Service on the plaintiff shall be made not less than three days prior to the date set for hearing. The hearing shall be held not more than five days after the filing of the notice of motion unless, for good cause shown, the court orders otherwise. The notice of motion shall state the relief requested and shall be accompanied by an affidavit supporting any factual issues raised and points and authorities supporting any legal issues raised. At the hearing on the motion, the defendant has the burden of showing that the property, or a portion thereof or the proceeds therefrom, attached pursuant to subdivision (a), is exempt pursuant to subdivision (b) of Section 487.020. Upon such showing, the court shall order the removal of the keeper and return the defendant to possession of such exempt property and may make such further order as the court deems appropriate to protect the plaintiff against frustration of the collection of his claim. Such order may permit the plaintiff to levy on farm products or inventory of a going business and on proceeds or after-acquired property, or both, by filing pursuant to subdivision (c) and

may provide reasonable restrictions on the disposition of the property previously levied upon.

(c) Notwithstanding the provisions of subdivision (a), upon the election and the instructions of the plaintiff, the levying officer shall attach farm products or inventory of a going business by filing a notice in the form prescribed by the Secretary of State which indicates that the plaintiff has acquired an attachment lien on the farm products or inventory of the defendant and, where permitted by the writ of attachment or court order, on ~~identifiable~~ cash proceeds (as that term is used in Section 9306 9306(1) of the Commercial Code) or after-acquired property, or both. The notice shall state the name and mailing address, if known, of both the plaintiff and the defendant and shall describe the property attached and state whether ~~identifiable~~ cash proceeds or after-acquired property, or both, are attached. When the property is growing crops or timber to be cut, the notice shall be recorded in the office of the county recorder in the county where the real property on which the crops are growing or on which the timber is standing is located. Where, on the date of recording, the real property on which the crops are growing or on which the timber is standing stands upon the records of the county in the name of a person other than the defendant, the recorder shall index such attachment when recorded in the names of both the defendant and such other person identified in the writ. In all other cases, the notice shall be filed in the office of the Secretary of State. The fee for filing and indexing each notice of attachment, notice of extension, or notice of release in the office of the Secretary of State is three dollars (\$3). Upon the request of any person, the Secretary of State shall issue a certificate showing whether there is on file, on the date and hour stated therein, any notice of attachment, naming a particular person, and if a notice is on file, giving the date and hour of filing of each notice and the name of the plaintiff. The fee for the certificate issued by the Secretary of State is two dollars (\$2). A combined certificate may be issued pursuant to Section 7203 of the Government Code. Upon request, the Secretary of State shall furnish a copy of any notice of attachment or notice affecting a notice of attachment for a fee of one dollar (\$1) per page. A lien acquired by filing or recording a notice pursuant to this subdivision provides the

plaintiff with the same rights and priorities in the attached property as would be obtained by a secured party who perfects a security interest (other than a purchase money security interest) in such property by filing a financing statement at such time and place. Promptly after filing or recording and in no event more than 15 days after the date of filing or recording pursuant to this subdivision, the levying officer shall send by registered or certified mail, return receipt requested, a copy of the writ and the notice of attachment to the defendant and, in the case of crops growing or timber standing on real property, to any other person identified in the writ in whose name the real property stands upon the records of the county at the address of such other person as shown by the records of the office of the tax assessor of the county where the property is located.

(d) A failure to serve the defendant or any other person pursuant to subdivision (a) or (c) shall not affect the lien created pursuant to either subdivision.

Comment. Subdivision (c) of Section 488.360 is amended to expand the definition of "proceeds" to include "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." See Com. Code § 9306(1). This change permits the attachment lien on goods which are leased to create chattel paper to shift to the chattel paper ("proceeds" under the expanded definition) during the term of the lease, to shift back to the goods when the leased goods are returned, and to shift again to the chattel paper when the goods are leased again, ad infinitum. See Code Civ. Proc. § 488.380 (chattel paper); Com. Code §§ 9306(2) (security interest continues in collateral), 9306(3) (perfected security interest in proceeds), 9306(5) (security interest in returned goods), 9312(5) (priorities).

A determination of the effect of filing a notice with the Secretary of State under subdivision (c) of Section 488.360 requires reference to some complex provisions of the Commercial Code since the plaintiff by so filing obtains the "same rights and priorities in the attached property as would be obtained by a secured party who perfects a security interest (other than a purchase money security interest) in such property by filing a financing statement at such time and place." For example, if the attachment defendant is in the business of selling and leasing

trucks, the plaintiff may obtain an attachment lien on such inventory (see Section 481.120) by filing a notice with the Secretary of State describing the inventory and may also obtain an attachment lien on proceeds ("whatever is received upon the sale, exchange, collection or other disposition" of the inventory) and after-acquired inventory. The defendant may continue to operate the business and the floating attachment lien will cover the property in its various forms in the same manner as a floating lien under Division 9 of the Commercial Code. Hence, if the defendant leases a truck, thereby creating chattel paper (see Section 481.040, defining "chattel paper"), the lien of attachment continues in the chattel paper because it is proceeds. The determination of the plaintiff's rights in the chattel paper depends on an application of Commercial Code Section 9306(3)(a) which provides that a security interest in proceeds is perfected if the interest in the original collateral (the inventory here) is perfected and the proceeds are collateral in which a security interest may be perfected by filing in the office where the financing statement covering the original collateral was filed. Since a security interest in the chattel paper could be perfected by filing in the same place as a security interest in the inventory, i.e., the office of the Secretary of State (see Commercial Code Sections 9302, 9304(1), 9401(1)(c)), a security interest in the chattel paper as proceeds would be continuously perfected from the time of perfection of the security interest in the inventory (see Commercial Code Section 9312(6)) and, correspondingly, the attachment lien in the chattel paper obtained by virtue of Section 488.360(c) and the Commercial Code provisions incorporated thereby dates for the purpose of the determination of priorities from the date of filing the notice of attachment of the inventory with the Secretary of State. Upon the termination of the lease, the truck would be returned to the defendant and be subject to the original attachment lien on inventory. Should it be leased again, the lien would again shift to the chattel paper.

If the defendant sells the chattel paper arising from the lease of the truck in the ordinary course of business, the rights of the purchaser would be superior to those of the attaching plaintiff since the plaintiff is in the position of a secured party whose security interest in the chattel paper arises because it is proceeds of inventory subject

to a security interest. Com. Code § 9308(b). The attachment lien would cover identifiable cash proceeds received from the sale of the chattel paper since proceeds includes whatever is received from the disposition of proceeds (Commercial Code Section 9306(1)), and the security interest would continue in such identifiable cash proceeds pursuant to Commercial Code Section 9306(3)(b). If the cash proceeds are used to purchase more inventory, the new inventory would be subject to the attachment lien since it is after-acquired property.

968/890

§ 488.370. Accounts receivable; choses in action (amended)

SEC. 3. Section 488.370 of the Code of Civil Procedure is amended to read:

488.370. (a) ~~To~~ Except as provided in Section 488.440, to attach an account receivable or a chose in action, the levying officer shall serve the account debtor or, in the case of an interest in or a claim under an insurance policy, the insurer with a copy of the writ and the notice of attachment.

(b) Promptly after service on the account debtor or insurer and in no event more than 45 days after the date of service on the account debtor or insurer, the levying officer shall serve the defendant and any other person identified in writing by the account debtor or insurer as an obligee with a copy of the writ and the notice of attachment. The levying officer shall incur no liability for serving any person identified by the account debtor or insurer as an obligee. A failure to serve the defendant or other obligees pursuant to this subdivision shall not affect the lien created pursuant to subdivision (a).

Comment. The introductory clause is added to subdivision (a) of Section 488.370 to reflect the enactment of Section 488.440 which prescribes the manner of levy on an account receivable or a chose in action which is subject to a perfected security interest.

406/470

§ 488.380. Chattel paper (amended)

SEC. 4. Section 488.380 of the Code of Civil Procedure is amended to read:

488.380. (a) ~~To~~ Except as provided in Section 488.440, to attach chattel paper, the levying officer shall (1) serve the person in possession of such chattel paper with a copy of the writ and the notice of attachment and (2) if the chattel paper is in the possession of the defendant, take the chattel paper into custody.

(b) If the chattel paper is not in the possession of the defendant, promptly after levy and in no event more than 45 days after levy, the levying officer shall serve the defendant with a copy of the writ and the notice of attachment.

(c) Promptly after the attachment of the chattel paper and in no event more than 45 days after the chattel paper is attached, the levying officer shall serve the account debtor obligated on the attached chattel paper with a copy of the writ and the notice of attachment. Until such service is completed, the attachment shall in no way affect the rights and duties of the account debtor. After such service is completed, the account debtor shall make any payments required under the chattel paper to the levying officer. If the chattel paper results from a lease of tangible personal property, upon termination of the lease because of the expiration of the term or because of default, the lessee shall deliver the leased property to the levying officer except that tangible personal property shall be returned to the defendant where, upon its return, it would constitute inventory or farm products that the plaintiff has levied upon pursuant to subdivision (c) of Section 488.360.

(d) A failure to serve the defendant pursuant to subdivision (b) or the account debtor pursuant to subdivision (c) shall not affect the lien created pursuant to subdivision (a).

(e) Any payments required by the chattel paper and made by the account debtor to the person in possession of the chattel paper after levy shall be delivered by such person to the levying officer to be held pursuant to the attachment.

Comment. The introductory clause is added to subdivision (a) of Section 488.380 to reflect the enactment of Section 488.440 which prescribes the manner of levy on chattel paper subject to a security interest perfected by possession. If the security interest is perfected in some other manner, levy is made as provided in this section and the

secured party may assert the security interest by means of the third-party claims procedure. See Section 488.090 and the Comment to Section 488.440.

Subdivision (c) of Section 488.380 is amended to reflect the amendment of subdivision (a) of Section 488.500 providing that the lien on chattel paper extends to the interest of the lessor in the tangible personal property the lease of which has resulted in the chattel paper. See the Comment to Section 488.500. If no paramount interest of a secured party (as recognized in Section 488.440) is involved, the property generally is to be delivered to the levying officer upon termination of the lease. An exception is provided where the leased property is inventory of the lessor and the creditor of the lessor has levied on the inventory by filing pursuant to Section 488.360(c). In such a case, the leased and returned inventory can be leased out again and the lien on the inventory shifts to the chattel paper resulting from that lease. See Code Civ. Proc. § 488.360(c); Com. Code § 9306(1) (defining "proceeds"). This rule relating to the return of the leased property is consistent with Commercial Code Section 9306(5) which applies to the return of goods the sale of which results in chattel paper.

968/891

§ 488.390. Deposit accounts (amended)

SEC. 5. Section 488.390 of the Code of Civil Procedure is amended to read:

488.390. (a) Except as provided in Section 488.440 and except where the account is represented by a negotiable instrument, to attach a deposit account, the levying officer shall serve the financial institution holding such account with a copy of the writ and the notice of attachment.

(b) Promptly after the attachment of the deposit account and in no event more than 45 days after the deposit account is attached, the levying officer shall serve the defendant, and any other person in whose name the account is held, with a copy of the writ and the notice of attachment. A failure to serve the defendant or other persons pursuant to this subdivision shall not affect the lien created pursuant to subdivision (a).

(c) While the attachment is in force, the financial institution shall not be liable to any person by reason of any of the following:

(1) Its compliance with the levy.

(2) The nonpayment of any check or other order for the payment of money drawn or presented against the account.

(3) The refusal to pay any withdrawal in respect to the account.

Comment. The introductory clause is added to subdivision (a) of Section 488.390 to reflect the enactment of Section 488.440 which prescribes the manner of levy on a deposit account subject to a perfected security interest.

406/458

§ 488.400. Negotiable instruments; negotiable documents; money
(amended)

SEC. 6. Section 488.400 of the Code of Civil Procedure is amended to read:

488.400. (a) ~~To~~ Except as provided in Section 488.440, to attach a negotiable instrument, a negotiable document, or money not placed in a deposit account, the levying officer shall (1) serve the person in possession of such instrument, document, or money with a copy of the writ and the notice of attachment and (2) if the property is in the possession of the defendant, take the instrument, document, or money into custody.

(b) If the instrument, document, or money is not in the possession of the defendant, promptly after levy and in no event more than 45 days after levy, the levying officer shall serve the defendant with a copy of the writ and the notice of attachment.

(c) Promptly after the negotiable instrument ~~or document~~ is attached and in no event more than 45 days after the negotiable instrument ~~or document~~ is attached, the levying officer shall serve any person obligated under the instrument ~~or document~~ with a copy of the writ and the notice of attachment. Until an obligor is served as required by this subdivision, payments made in good faith by him to the previous holder of the instrument shall be applied to the discharge of his obligation.

(d) A failure to serve the defendant pursuant to subdivision (b) or an obligor pursuant to subdivision (c) shall not affect the lien created pursuant to subdivision (a).

Comment. The introductory clause is added to subdivision (a) of Section 488.400 to reflect the enactment of Section 488.440 which prescribes the manner of levy on a negotiable instrument subject to a security interest which is perfected by possession.

Subdivision (c) is amended to eliminate the requirement that notice of attachment be given the issuer of the negotiable document. Notice to the issuer of a negotiable document is neither necessary nor advisable since the bailee cannot deliver the goods to anyone not in possession of the document. See Com. Code § 7403 (obligation of bailee). See also Code Civ. Proc. § 481.090 ("document" defined). Com. Code § 7102 ("bailee" defined).

968/892

§ 488.420. Judgments owing to defendant as a judgment creditor
(amended)

SEC. 7. Section 488.420 of the Code of Civil Procedure is amended to read:

488.420. (a) ~~To~~ Except as provided in Section 488.440, to attach a judgment owing to the defendant, the levying officer shall (1) file in the action in which the judgment was entered a copy of the writ and the notice of attachment and (2) serve a copy of the writ and the notice upon the judgment debtor in such action.

(b) Promptly after levy and in no event more than 45 days after levy, the levying officer shall serve the defendant with a copy of the writ and the notice of attachment. A failure to serve the defendant pursuant to this subdivision shall not affect the lien created pursuant to subdivision (a).

(c) No judgment owing to the defendant shall be attached until after its entry as a final judgment and the time for appeal from such judgment has expired or, if an appeal is filed, until such appeal is finally determined.

Comment. The introductory clause is added to subdivision (a) of Section 488.420 to reflect the enactment of Section 488.440 which prescribes the manner of levy on a judgment which is subject to a perfected security interest.

§ 488.440. Property subject to perfected security interest (new)

SEC. 3. Section 488.440 is added to the Code of Civil Procedure, to read:

488.440. (a) The defendant's interest in the following property, if the property is subject to a perfected security interest of another person under the Commercial Code, shall be attached by serving the secured party with a copy of the writ and the notice of attachment:

- (1) Accounts receivable.
- (2) Choses in action.
- (3) Chattel paper, if the security interest is perfected by possession of the chattel paper.
- (4) Deposit accounts.
- (5) Negotiable instruments, if the security interest is perfected by possession of the negotiable instrument.

(6) Judgments, except that no judgment owing to the defendant shall be attached until after its entry as a final judgment and the time for appeal from such judgment has expired or, if an appeal is filed, until such appeal is finally determined.

(b) Promptly after levy and in no event more than 45 days after levy, the levying officer shall serve the defendant with a copy of the writ and the notice of attachment. A failure to serve the defendant pursuant to this subdivision shall not affect the lien created pursuant to subdivision (a).

(c) Except in a case described in subdivision (d), the secured party may collect the payments due from the account debtor or obligor obligated on the account receivable, chose in action, chattel paper, deposit account, negotiable instrument, or judgment and may enforce or accept the return of the tangible personal property sold or leased. After the satisfaction of the security interest, the secured party may deliver any excess property or pay any excess payments or proceeds of the property remaining in the possession of the secured party to the levying officer.

(d) In a case where the defendant has the liberty to collect payments due on the account receivable or chattel paper or to enforce or accept the return of tangible personal property the sale or lease of

which resulted in the account receivable or chattel paper which was attached, the levying officer shall serve the account debtor or obligor obligated on the account receivable or chattel paper with a copy of the writ and notice of attachment and with a demand to pay to the levying officer all amounts due and to deliver to the levying officer all returnable tangible personal property except where the property upon its return would constitute inventory or farm products that the plaintiff has attached pursuant to Section 488.360(c).

Comment. Section 488.440 implements Commercial Code Section 9311 which permits the attachment of the debtor's rights in collateral. Section 488.440 also prescribes the method of levy on the collateral when it is subject to a perfected security interest. If the security interest is not perfected, the rights of the secured party are subordinate to the plaintiff's attachment lien. Com. Code § 9301(1)(b). Section 488.440 codifies the rules applied in such cases as *Puissegur v. Yarbrough*, 29 Cal.2d 409, 412-13, 175 P.2d 830, 831-32 (1964); *Dubois v. Spinks*, 114 Cal. 289, 294-95, 46 P. 95, 96 (1896); *Deering v. Richardson-Kimball Co.*, 109 Cal. 73, 84, 41 P. 801, 803-04 (1895); *Robinson v. Trevis*, 38 Cal. 611, 614-15 (1869); *Axe v. Commercial Credit Corp.*, 227 Cal. App.2d 216, 220-23, 38 Cal. Rptr. 558, 563 (1964); and *Crow v. Yosemite Creek Co.*, 149 Cal. App.2d 188, 308 P.2d 421 (1957). The principle derived from these cases is that a secured party having a perfected security interest in collateral which involves the indebtedness of an account debtor is entitled to the disposition of the collateral, including the collection of payments due thereon, without interference deriving from a subsequent levy of attachment on the pledgor's interest. Subdivision (d) provides an exception to this rule which applies where the secured party has left collection of the amounts due on accounts receivable or chattel paper to the defendant (the debtor on the secured obligation) pursuant to Commercial Code Section 9205 by virtue of a so-called indirect collection arrangement, commonly made in cases of accounts receivable or chattel paper financing. See U.C.C. § 9-308, Comment 1. In this situation, the account debtor is also served so that the plaintiff's interests in the attached property will be protected.

These rules are extended by analogy to the return of goods, the sales or leases of which have resulted in the accounts receivable or chattel paper which was attached. Under subdivision (d), since the levy on the chattel paper extends the attachment lien to the lessor's property interest in the leased goods and to the security interest of the seller in goods pursuant to Section 488.500(a), the goods are to be returned to the levying officer for the purposes of the levy but only if there is not a secured party who has paramount rights to possession under the terms of a security agreement or upon default. See Com. Code § 9503 (possession on default). It should be noted that a written lease results in chattel paper whereas an oral lease results in an account receivable. Compare Section 481.030 ("account receivable" defined) with Section 481.040 ("chattel paper" defined).

Subdivision (c) makes clear that any excess of payments made to the secured party and any excess from the pledgee's sale of the goods returned to the secured party is subject to the attachment lien and may be turned over to the levying officer to avoid liability under Section 488.550. Cf. Com. Code § 9311 (alienability of debtor's rights).

The rules codified in this section ensure that a secured party is not deprived of a paramount right to freely enforce the security interest and that the account debtor or obligor obligated on the collateral is not exposed to dual liability from a splitting of the cause of action.

This section does not cover all the situations where the attached property is subject to a security interest. If the secured party has left a negotiable document or chattel paper in the possession of the attachment defendant or has left the attachment defendant with the liberty of collection of chattel paper or accounts receivable, the levying officer seizes the negotiable document (pursuant to Section 488.400) or chattel paper (pursuant to Section 488.380) and exercises the powers of the attachment defendant for the benefit of the persons ultimately entitled thereto, and the secured party should assert prior entitlement by means of a third-party claim. See Section 488.090 (third-party claim).

The rules provided by this section apply only where an account receivable or chattel paper is specifically levied upon. In the case of an attachment of the inventory of a going business or farm products, the

attaching plaintiff may be content with a levy pursuant to Section 488.360(c) on the inventory or farm products, the proceeds therefrom, and after-acquired property. Even in a case where the plaintiff has initially levied on chattel paper and on inventory pursuant to Section 488.360(c), returned goods will revert to inventory.

If the account debtor or obligor defaults on the obligation to the secured party, the secured party may, of course, resort to the remedies provided in the Commercial Code. See Com. Code §§ 9501, 9502. If the secured party does not pursue the available remedies, the attaching plaintiff may be subrogated to the secured party's rights by redeeming pursuant to Civil Code Sections 2903-2904 and proceed against the account debtor or obligor. In addition, the plaintiff may sue the account debtor or obligor for conversion and join the secured party. The secured party is also liable as provided in Section 488.550.

12/765

§ 488.500. Lien of attachment; effective date (amended)

SEC. 9. Section 488.500 of the Code of Civil Procedure is amended to read:

488.500. (a) Except as provided in subdivision (c) of Section 488.360, levy of a writ of attachment creates a lien on the property levied upon which is valid against all subsequent transferees of the property. The lien of attachment on chattel paper extends to the interest of the lessor in tangible personal property the lease of which resulted in the chattel paper.

(b) The lien of attachment on real property levied upon pursuant to Section 488.310 becomes effective on the date of recording pursuant to that section.

(c) The lien of attachment on property levied upon pursuant to Section 488.320 (tangible personalty in possession of defendant), 488.360(a) (inventory and farm products, alternate method), 488.380(a)(2) (chattel paper in possession of defendant), 488.400(a)(2) (negotiable instruments, documents, or money in possession of defendant), or 488.410(a) (securities in possession of defendant) becomes effective on the date the levying officer takes custody of the property pursuant to such provision.

(d) The lien of attachment on property levied upon pursuant to Section 488.340 (equipment, other than motor vehicles, of a going business), 488.350 (motor vehicles and vessels which are equipment of a going business), or 488.360(c) (farm products and inventory, alternate method) becomes effective on the date of filing pursuant to such provision.

(e) The lien of attachment ~~on property on:~~

(1) Property levied upon pursuant to Section 488.330 (tangible personalty in possession of third person), 488.380(a)(1) (chattel paper in possession of third person), 488.390 (deposit accounts), 488.400(a)(1) (negotiable instruments, documents, or money in possession of third person), or 488.410(b) (securities in possession of certain third persons) becomes effective on the date of service on the person in possession of such property.

(2) Property levied upon pursuant to Section 488.335 (goods subject to perfected security interest) becomes effective on the date of service on the secured party.

(3) Chattel paper, a deposit account, or a negotiable instrument levied upon pursuant to Section 488.440 becomes effective on the date of service on the secured party.

(f) The lien of attachment ~~on property on:~~

(1) An account receivable or chose in action levied upon pursuant to Section 488.370 (~~accounts receivable; choses in action~~) becomes effective on the date of service on the account debtor or insurer.

(2) An account receivable or chose in action levied upon pursuant to Section 488.440 becomes effective on the date of service on the secured party.

(g) The lien of attachment ~~on a~~ on:

(1) A judgment levied upon pursuant to Section 488.420 becomes effective on the date of service on the judgment debtor.

(2) A judgment levied upon pursuant to Section 488.440 becomes effective on the date of service on the secured party.

(h) The lien of attachment on property levied upon pursuant to Section 488.430 becomes effective on the date of filing pursuant to that section.

(i) Notwithstanding subdivisions (b) through (h), inclusive, and except as otherwise provided by Section 486.110, where a temporary

protective order has been issued pursuant to Chapter 6 (commencing with Section 486.010), the lien of attachment on property described in such order and subsequently attached is effective from the date of service of such order.

Comment. The second sentence of subdivision (a) of Section 488.500 is new. It makes clear that a lien of attachment on chattel paper extends to the property interest of the lessor during the life of the lease and after its termination. The lien under this new provision lapses only upon authorized delivery to the lessor instead of to the levying officer. See Sections 488.360(c), 488.380(c), 488.440(d). The second sentence of subdivision (a) is derived from the rule that a perfected security interest in chattel paper gives the secured party a perfected security interest in the rights to payment evidenced thereby and in the debtor's security interest in the goods sold if that security interest is perfected by filing. See Com. Code § 9304(1); *Bolduan v. Normandin* (*In re Western Leasing, Inc.*), 17 U.C.C. Rep. 1369 (D. Ore. 1975). There is conflict in the decisions interpreting the Commercial Code, however, concerning whether a security interest in chattel paper which is perfected by possession (Com. Code § 9305) results in a perfected security interest in the lessor's property interest in the leased goods since the lessor's interest is not a security interest in need of perfection. See Comment, *In re Leasing Consultants, Inc.: The Double Perfection Rule for Security Assignments of True Leases*, 84 Yale L.J. 1722 (1975). The purpose of the amendment of subdivision (a) is to resolve this conflict insofar as the Attachment Law is concerned.

Subdivisions (e), (f), and (g) are amended to reflect the enactment of Section 488.440 applicable where property of the defendant which is subject to a perfected security interest is levied upon.

968/672

§ 488.540. Collection of account receivable, chattel paper, chose in action, negotiable instrument, or judgment (amended)

SEC. 10. Section 488.540 of the Code of Civil Procedure is amended to read:

488.540. Where an account receivable, chattel paper, chose in action, negotiable instrument, or judgment is attached, the account

debtor or obligor may pay the amount owing on such obligation to the levying officer. The receipt of such officer is a sufficient discharge for the amount paid. This section does not apply where the attached property is subject to a perfected security interest which entitles the secured party to such payments pursuant to subdivision (c) of Section 488.440.

Comment. Section 488.540 is amended to reflect the enactment of Section 488.440 which provides for the priority of a secured party holding a perfected security interest in attached property. Section 488.540 applies, however, where the secured party has left the liberty to the defendant under Commercial Code Section 9205 to collect payments due on the account receivable or chattel paper or to enforce or accept the return of tangible personal property the sale or lease of which resulted in the account receivable or chattel paper. See Section 488.440(d).

17/010

§ 488.550. Liability of garnishee; enforcement by suit (amended)

SEC. 11. Section 488.550 of the Code of Civil Procedure is amended to read:

488.500. (a) As used in this section, "obligor" means a person who has in his possession personal property belonging to the defendant, an account debtor of the defendant, ~~or~~ a person obligated to the defendant on a negotiable ~~instrument;~~ instrument, or a secured party holding property or proceeds in excess of that necessary to satisfy a security interest entitled to priority.

(b) An obligor is liable to the plaintiff for the value of the defendant's interest in the property held by the obligor or for the amount owed to the defendant at the time of service of the copy of the writ and notice of attachment upon him. Such liability continues until the attachment is released or discharged or until the property is delivered or payment of the amount owed is made to the levying officer.

(c) If the obligor's liability still continues under subdivision (b) and if the obligor admits his possession of property belonging to the defendant or his indebtedness to the defendant, the plaintiff may bring an action to enforce the obligor's liability at any time. If a

garnishee or obligor denies, in whole or in part, his possession of property belonging to the defendant or his indebtedness to the defendant, or if a garnishee fails to provide the memorandum required by Section 488.080, the plaintiff may bring an action against the garnishee or obligor only if the obligor's liability still continues under subdivision (b) and if at the time the action is brought the defendant could have maintained such action. The defendant shall be joined in any action under this subdivision brought by the plaintiff against a garnishee or obligor. The period between the date of service of the copy of the writ and the notice of attachment and the date that a garnishee provides the memorandum required by Section 488.080 is not part of the time limited for the commencement of an action.

Comment. The definition of "obligor" as used in Section 488.550 is amended to include a secured party who has been garnished pursuant to Section 488.440 and who has a surplus of collateral or of proceeds from the sale of collateral after satisfaction of a prior security interest. This provision recognizes that, once a secured party has received satisfaction, such person is in the same position as any other garnishee holding property of or owing a debt to the defendant.