

Memorandum 79-8

Subject: Study D-400 - Assignment for Benefit of Creditors

Background

In 1977 the Commission obtained enactment of provisions to the effect that if a debtor makes a general assignment of property for the benefit of creditors, the assignment terminates any attachment liens on the property obtained within four months before the assignment was made. The objective of the legislation was to discourage preferences for certain creditors and to encourage ratable distribution of a debtor's assets among all creditors.

At the time the Commission recommended the legislation, the Commission was advised that assignments for the benefit of creditors are not always in the best interests of general creditors. The debtor may have fraudulent motives in making the assignment; the assignee may act improperly; the law has a number of shortcomings. The Commission made a commitment at that time to review the law relating to assignments for the benefit of creditors and to give the review some priority. The Commission's letter of transmittal with the 1977 recommendation states:

The Commission does not view this recommendation as a final disposition of the problems in this area of the law. The Commission plans to make a study of the law relating to general assignments for the benefit of creditors, particularly in light of reports of abuses under existing law.

During the summer of last year we had a law student, Mr. Arthur Levy of Boalt Hall, collect the literature relating to assignments for the benefit of creditors and compile and catalogue statutes of other jurisdictions governing general assignments. Mr. Levy did an excellent job of analyzing the law relating to assignments for the benefit of creditors, the problems that have arisen in the cases and the literature, and the varying solutions adopted by the jurisdictions.

Starting from the foundation prepared by Mr. Levy, the staff has reviewed the extensive materials available, drawn some tentative conclusions, and prepared a draft statute for Commission review, which is attached to this memorandum. This memorandum outlines the nature of assignments for the benefit of creditors and the significant questions and the policies resolved in preparing the draft.

Nature of Assignments for the Benefit of Creditors

The literature concerning assignments for the benefit of creditors is extensive and quite good. In addition to the treatises (mainly of 19th century vintage), there are more recent law journal articles. For information more detailed than that provided here see:

Note, A Classification of State Statutes Regulating General Assignments for the Benefit of Creditors, 20 Va. L. Rev. 222 (1933)

Note, Statutory Regulation of Assignments for the Benefit of Creditors, 47 Yale L.J. 944 (1938)

Hanna, Contemporary Utility of General Assignments, 35 Va. L. Rev. 540 (1949)

N.Y. L. Revision Comm'n, Act, Recommendation and Study Relating to Assignments for the Benefit of Creditors (1950)

Weintraub, Levin & Sosnoff, Assignments for the Benefit of Creditors and Competitive Systems for Liquidation of Insolvent Estates, 39 Corn. L.Q. 3 (1953)

Good sources directed principally toward California law include:

Comment, A Proposal for Strengthening the California Statute Concerning Assignments for the Benefit of Creditors, 36 Calif. L. Rev. 586 (1948)

Keatinge, Assignments for the Benefit of Creditors at California Law--Legal and Practical Aspects, 25 L.A. Bar Bull. 99 (1949)

Shapiro, Assignment for the Benefit of Creditors, in California Remedies for Unsecured Creditors (Cal. Cont. Ed. Bar 1957)

Comment, Assignments for the Benefit of Creditors in California: A Proposed Revision of Ineffectual Statutory Provisions, 6 U.C.L.A. L. Rev. 573 (1959)

Greenfield, Alternatives to Bankruptcy for the Business Debtor, 51 L.A. Bar J. 135 (1975)

The assignment for the benefit of creditors is basically a liquidation device in case of insolvency. The debtor who is insolvent transfers all assets to a third person--the assignee--who acts as a trustee for the benefit of all the debtor's creditors. The assignee ordinarily liquidates the assets and pays off the debts pro rata; any surplus is returned to the debtor.

The assignment is historically a common law rather than a statutory creation. Before the enactment of federal bankruptcy laws the state laws of insolvency controlled liquidations. Federal bankruptcy laws gradually supplanted the state insolvency laws; California, for example, no longer has an insolvency statute on its books.

Despite the rise of federal bankruptcy laws, assignments for the benefit of creditors continued to play a role as a liquidation device. The primary reasons for the tenacity of assignments appear to be their simplicity, quickness, and cheapness. An assignment for the benefit of creditors can be conducted efficiently and without the expense and delay of the bankruptcy machinery and bureaucracy.

There have been challenges to assignments for the benefit of creditors on the basis of conflict with the supremacy clause of the United States Constitution. While the cases are not crystal clear, the Supreme Court seems to have said that so long as state law does not discharge the debts of a debtor upon making a general assignment, state law does not violate the supremacy clause.

An assignment for the benefit of creditors is grounds for an involuntary case in bankruptcy. This means that if a debtor makes an assignment for the benefit of creditors, a dissatisfied creditor may commence a bankruptcy proceeding within four months and the assignment may be set aside if made within 90 days of the bankruptcy proceeding.

Despite the threat of bankruptcy, the business community feels that assignments for the benefit of creditors are a useful nonjudicial means of liquidating the debtor's assets for creditors. The assignment can only realistically function in an atmosphere of trust among debtors, creditors, and assignee. But if that atmosphere is present, the business community sees no need to go into bankruptcy, which is harmful to the debtor as well as to the creditors.

California Law

Because the assignment is basically an extra-judicial arrangement, there have been continuing problems where the debtor or the assignee fails to live up to the good faith required for the assignment to work properly. As a result, most states have enacted statutes that attempt to regulate assignments. California is no exception.

Civil Code Sections 3448 through 3473 prescribe detailed requirements for assigning the debtor's assets first to the sheriff, who calls a meeting of creditors. The creditors elect a successor assignee, and the sheriff makes a second assignment to the successor. There are detailed recording requirements, provisions for court supervision, etc.

As a consequence of these provisions and the inflexibility, time, and cost they involve, the "statutory" assignment has fallen into total disuse. Debtors and creditors have simply ignored the statute and have made "common law" assignments. In a series of cases the California Supreme Court has come to hold that the statute provides an alternative assignment procedure that does not affect common law assignments, thereby making the statute a dead letter. Section 3448 was added to the statute in 1959 to provide:

The provisions of this title are intended to provide an alternative method of making assignments for benefit of creditors in addition to common law assignments for such purpose which are hereby expressly recognized. The provisions of this title shall not be construed as preventing or invalidating a common law assignment of real or personal property, or both, for the benefit of creditors generally.

The net result is that common law assignments are made regularly in the business community in California. They are used primarily in large urban areas where creditors associations often act as assignees. For example, in Los Angeles the Credit Managers Association of Southern California handles many assignments and in San Francisco the Board of Trade handles many assignments. Generally speaking these assignments work well--they are run by a reputable organization that enjoys the trust of both debtors and creditors. See Exhibit 1 (pink) (letter from Credit Managers Association). This is a prerequisite for a successful assignment.

Problems arise in assignments in other cases, however. The Commission has been informed that often a debtor will make a bad faith assignment--concealing assets, fabricating debts to friends and relatives, making preferential transfers or preferences in the assignment--which under the common law the assignee is helpless to combat. Or the debtor will make a collusive assignment to an assignee who is committed not to the best interests of the creditors but rather to the assignee's own interest or the interest of the debtor. Such an assignee may inflate expenses or fail to act diligently. Under the common law the creditor has no protection against this sort of activity short of a lawsuit, which may be prohibitive as against the amount of the creditor's claim. See Exhibits 2 (yellow) and 3 (green) (letters from Sandor T. Boxer and Hal. L. Coskey).

The only practical solution in many of the problem cases is for the disgruntled creditor to force the debtor into bankruptcy, if possible. This is not wholly satisfactory for any of the parties, but it recognizes that only a basically friendly assignment is satisfactory.

The common law assignment for the benefit of creditors is not a creature of legislature. It is not even a creature of the courts, although a substantial number of assignment problems have been presented to trial and appellate courts. Assignments have been developed by the business community to fill a gap in existing insolvency procedures. The beneficial administration of an assignment estate is not advanced by resort to judicial supervision, and it is doubtful, from past experience, that the legislature will contribute any useful assignment legislation in the near future. The most salutary assignment, therefore, is one where all of the parties cooperate to encourage and to aid the assignee in obtaining the maximum return at the lowest reasonable cost. [Shapiro, Assignment for the Benefit of Creditors in California Remedies for Unsecured Creditors 466 (1957).]

What can be done by way of statute, short of forcing the debtor into bankruptcy, to provide protections for the parties to an assignment without making the statute useless? That is the question the remainder of this memorandum seeks to answer.

General Philosophy of Statute

It should be apparent from the foregoing discussion that the staff believes that any statutory regulation in this area should be modest. The concepts are expressed well in Professor Hanna's study for the New York Law Revision Commission:

State legislation regarding insolvent estates, aside from running some risk that it may be inoperative because it intrudes on the field assumed by Federal bankruptcy, must avoid a degree of regulation which will make general assignments so costly and deliberate that creditors will have no real choice except unregulated assignments or some form of bankruptcy procedure.

What this all amounts to is that state supervision of general assignments and indeed of any form of interference with informal debtor-creditor arrangements may well be misguided enthusiasm for law administration.

An attempt to compete with bankruptcy courts, even within permissible limits, would seem to be mistaken policy. What the states should do is facilitate mutually voluntary adjustments and then keep hands off. Bankruptcy is always in the background. It can take care of debtors to whom a discharge is imperative and of those who are a menace to creditors. [N.Y. L. Revision Comm'n Report 328-342 passim (1950).]

In line with this philosophy, the staff draft does not purport to be a comprehensive statute governing assignments for the benefit of creditors. It recognizes common law assignments and then adds a few regulatory provisions to govern them, along with a few enabling provisions to give the assignee useful powers that would not be available at common law.

The basic problem confronting this scheme is how to treat assignments that do not comply with the few basic requirements prescribed by statute. It is difficult to say that such assignments are void, since as a general rule a person is free to dispose of property and satisfy creditors in whatever manner the person pleases, including disposition by assignment. The Uniform Fraudulent Conveyance Act is the statutory limitation on a debtor's ability to deal freely with property as against creditors. On the other hand, it is equally difficult to say that an assignment that prefers certain creditors or that purports to transfer only some of the debtor's property should be given the same effect as a full and fair assignment of all the debtor's property for the benefit of all creditors.

The solution reached by the staff is to recognize the validity of all assignments, but to give only full and fair assignments certain statutory protections. Only full and fair assignments take priority over attaching and executing creditors; under other assignments the property continues to be subject to judicial process to enforce rights of creditors. Likewise, the assignee under a full and fair assignment is given powers to deal with property that another assignee would not have at common law. This scheme is consistent with the Commission's 1977 legislation to terminate attachment liens only on property that is the subject of a truly "general" assignment. See Code Civ. Proc. § 493.010.

Judicial Supervision

Because common law assignments are private arrangements between debtor and creditors, judicial supervision is nonexistent except in the unusual case where a party seeks to invoke a court's equitable power to take such actions as remove an assignee or compel an accounting. The lack of judicial involvement, and the corresponding quickness and cheapness of the procedure, appears to be the single major advantage of the assignment.

The regulatory statutes of all jurisdictions impose a judicial framework on the assignment for the benefit of creditors. The reason for this is to provide a single readily-accessible forum for dissatisfied persons to seek relief. A good example of this type of scheme can be found in Arizona--the assignment is filed with the probate court which thereupon has jurisdiction to hear contested matters on motion.

Despite the added time and expense judicial supervision entails, it serves a number of important purposes in addition to the general deterrent effect that tends to keep assignments fair. It provides a forum for removal of the assignee if the trust is abused. It enables the assignee to examine the debtor with the threat of court sanction in cases of suspected concealment of assets. It provides a forum in which preferential transfers made immediately prior to the assignment in contemplation of insolvency could be avoided. It enables ready determination of disputed claims by creditors.

The advantages of having judicial supervision available must be weighed against its cost and the possibility that the availability of a forum will tend to breed litigation. The staff believes an effort should be made to provide protections to the parties that do not rely on the judicial process. In the attached draft the staff has not created any court dispute-resolution mechanism but has attempted to provide procedures that will work well without the medium of court intervention.

A disgruntled creditor will still have a number of remedies available. The creditor may commence an involuntary case in bankruptcy, where full court procedures and protections are available. The creditor may refuse to give the debtor a discharge of the debts. And the creditor may seek to hold the assignee liable for violation of the trust.

Preferences Created by the Assignment

One major problem at common law is that the debtor may create preferences for certain creditors in the assignment. Preferences are antithetical to the basic concept of the assignment as a ratable distribution of assets among all creditors. One reform accomplished by the California statute was to make assignments that purported to prefer creditors void. This reform was lost, however, with the death of the statute and the resurrection of common law assignments.

Under the staff draft, the assignment may not create a preference for one creditor over another or the assignment will fail to receive statutory protection. Such an assignment will be subject to attaching and executing creditors.

Assignee

The key to the successful operation of an assignment is a good and competent assignee. The debtor selects the assignee, but unless the creditors have confidence in the assignee there will be problems. How can we ensure that the assignee will be satisfactory?

There are a number of possibilities--limit the assignee to a creditors' organization, create a licensing system, permit the creditors to select the assignee, make minimum qualifications. Each of these possibilities has obvious drawbacks. The debtor, as well as the creditor must have confidence in the assignee, or the debtor will not make the assignment. A qualification or licensing scheme would be difficult to administer and would not ensure the good faith of the assignee.

A related possibility that has been adopted in a number of jurisdictions is to authorize formation of a creditors' committee with the power to remove and replace the assignee. In practice in California creditors' committees are often formed to assist the assignee. The creditors' committee, in addition to having authority to replace the assignee, could be authorized to make determinations of when powers should be exercised, such as the power to sue to recover a fraudulent conveyance. The difficulties with a creditors' committee are (1) the problem of selecting members--who may vote, how are the votes weighted, what assurance is there that the creditor's claim is valid--and (2) the inequity of binding dissenting creditors by the act of a majority.

The staff believes a preferable alternative is to permit the debtor to select the assignee. The assignee would be required to be a disinterested person (i.e., a person other than the spouse, a relative, agent, etc. of the debtor). If at least three creditors were concerned about the assignee, they could require the assignee to make an undertaking, which would provide a source of funds in case of malfeasance; this would cut down the expense of the undertaking to cases where there is substantial concern. The undertaking should be by a licensed corporate

surety in order to avoid the problem of qualification of individual sureties, and the amount of the undertaking should be based on the debtor's estimate of the value of the assigned property in order to avoid court determination of the amount. Finally, the staff draft limits the commission available to the assignee, and bases the limit on the net dividends distributed to creditors; this will help to prevent overreaching and to ensure that the assignee acts in the interest of the creditors.

Cooperation of Debtor

One problem with the common law assignment is that there is no means of bringing the debtor before the court for examination concerning possible inflated debts or hidden assets. The staff draft attempts to ease this problem by requiring that the debtor make a complete inventory of assets and obligations under penalty of perjury, that the debtor transfer all relevant books and records to the assignee, and that the debtor respond fully and truthfully to inquiries of the assignee under penalty of perjury. These requirements will give the debtor incentive to cooperate. In addition, the debtor's failure to cooperate will deprive the assignment of the statutory protections from attaching and executing creditors.

Powers of Assignee

At common law the powers of the assignee are quite limited. The assignee stands in the shoes of the debtor and has no greater rights than the debtor had. The assignee is not in the position of, or considered a representative of, the creditors. The consequence of this rule is that the assignee is limited in the ability to recover assets of the estate. The assignee may not bring suit, for example, to recover fraudulent conveyances made by the debtor because the debtor would not have been able to do this.

This rule has been much criticized in the literature. Statutory abrogation of this rule has begun in California. Commercial Code Section 9301 makes the assignee a lien creditor for purposes of challenging unperfected security interests in the assigned property. The staff draft goes the rest of the way and gives the assignee the status of a lien creditor for all purposes with the power to take any action a creditor could take.

Another limitation on the power of the assignee is the inability to avoid preferential transfers made by the debtor while insolvent immediately before making the assignment. Such preferences are voidable in bankruptcy but not under an assignment, thereby making bankruptcy a more attractive alternative in some cases. If the assignment is to be viable, an assignee must have the same power to avoid preferences that the trustee in bankruptcy has. The Commission has already obtained enactment of legislation to terminate attachment liens obtained within four months prior to the assignment. The staff draft gives the assignee full power to avoid other preferential transfers. This provision is likely to prove controversial, but the staff suggests it be kept in the tentative draft for purposes of eliciting comments.

One problem with avoidance of preferences is that unlike liens, which can be voided by rule of law, physical transfers of property may require a court proceeding for recovery. This raises the specter of added costs and delay in assignments. The staff considered the possibility of creating a special streamlined court procedure for avoiding preferences, but the staff rejected this possibility because of the threat summary proceedings pose to legitimate interests of bona fide encumbrancers and purchasers. The staff draft settles for a simple admonitory provision that the assignee must only exercise a power if exercise will be for the best interest of creditors. The assignee's undertaking will be available to compensate for gross errors in judgment.

Secured Interests

What happens to secured interests that are on the assigned property? The assignee takes the property subject to the secured interests. When the assignee gets around to liquidating the estate and paying dividends to creditors, the secured party may participate for the full amount of the claim just as any other creditor and receive a pro rata distribution of dividends, ignoring the availability of the security for the claim of the secured party. If the distribution is not sufficient to pay off all claims, the secured party still has an interest in the secured property out of which the obligation may be satisfied. This is known as the "equity rule" and works to the detriment of general creditors in that the secured party helps exhaust the fund intended for unsecured creditors despite existence of the security from which the

secured party could be satisfied.

The "bankruptcy rule," on the other hand, tends to preserve the general estate funds for general creditors. Under the bankruptcy rule a creditor whose debt is secured may receive dividends pro rata only on the unsecured portion of the debt; the remainder must be realized out of the security. Alternatively, the creditor may relinquish the security to the assignee and participate as an unsecured creditor for the full amount of the claim just as any other general creditor.

One reform the California assignment statute made was to adopt the bankruptcy rule for secured creditors. This reform, too, was lost with the demise of the California statute. The staff draft reinstates the bankruptcy rule.

Discharge of Debtor

The major advantage that bankruptcy has over assignment is that after going through bankruptcy the debtor is discharged from all debts. This is the essence of a bankruptcy law, and state assignment statutes cannot provide the same benefit without running afoul of the supremacy clause of the United States Constitution.

However, the fact that an assignment statute cannot provide for discharge does not preclude creditors from voluntarily discharging the debtor, and state statutes may encourage creditors to voluntarily give discharges. The United States Supreme Court cases on this point are not completely clear, but they appear to go so far as to say that a state statute is valid which provides that the debtor is discharged from debts of a creditor who accepts any dividends under an assignment. And state statutes may recognize preferences created in the assignment for creditors willing to give the debtor a discharge.

The staff draft, while generally discouraging preferences in the assignment, recognizes preferences in the assignment for creditors who give the debtor a discharge. As a practical matter, this will force a discharge in nearly all cases since if a creditor refuses to discharge the debtor, the debtor can simply file a no-asset voluntary bankruptcy and obtain the discharge anyway.

Liability of Assignee

The ultimate protection of the parties against maladministration by the assignee is liability of the assignee. This is not always the best

sort of protection for it requires court action and subsequent collection. Collection can be made more certain by means of an undertaking requirement. Court action will still remain expensive, but will act as a deterrent in most cases and will provide a real remedy in a few cases.

The staff draft attempts to implement the provisions exposing the assignee to liability by requiring the assignee to make under penalty of perjury a detailed accounting of the manner of discharging the trust. The assignee is not released from the trust until six months have elapsed from the time of making the accounting, during which time the assignee is subject to suit.

Conclusion

The attached draft statute embodies the foregoing policy decisions. The draft statute does not purport to be a comprehensive treatment of assignments for the benefit of creditors, but is consciously limited to attempting to cure specific problems of common law assignments with a minimum of regulation. We do not think we should attempt to draft a miniature bankruptcy statute here; bankruptcy remains available for cases where it is needed.

The staff does not believe it has all the answers, and feels we should seek early input from knowledgeable persons. We are attempting to get the larger credit associations and the State Bar actively involved.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary



CREDIT MANAGERS ASSOCIATION OF SOUTHERN CALIFORNIA

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November 11, 1977

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California Law Revision
Commission
Stanford Law School
Stanford, California 94305

Attention: Nathaniel Sterling

Gentlemen:

Receipt is acknowledged of your letter of October 27.

First, permit us to state that our concern is on behalf of the 4,000-plus members of the five Associations within the State of California who are affiliated with the National Association of Credit Management, who are extenders of "commercial credit", i.e., credit extended in "merchant to merchant" transactions. We believe the statement we are about to make is supported by those members and also by the large majority of others who are engaged in the extension, collection and adjustment of "commercial credit" within the State.

Throughout all the years of this century, through and including the present time, the general assignment for the benefit of creditors has proven to be a reasonable, workable device to accomplish the liquidation of assets of business enterprises that are unable to continue. In many cases, an assignment for the benefit of creditors is more favorable to creditors than is a bankruptcy proceeding, which is the alternative. The general assignment is normally administered more rapidly and more economically, and with a greater degree of creditor control than is obtained in liquidation cases through bankruptcy. In most instances, the recovery to creditors in assignment cases is both greater and quicker than in bankruptcy.


Calif. Law Revision Commission
November 11, 1977
Page Two

We believe further that any legislation to regulate the administration of general assignments through a State agency, is not only unnecessary but would be deleterious because it would add still another layer of governmental interference and bureaucracy, the effect of which would merely add to the administrative burdens and costs of handling general assignments, and would create delays in distributing the proceeds to creditors.

Please understand that this is a brief response and is couched in general terms, if only because we are not yet informed as to what, if any, specific questions have been raised concerning the administration of general assignments within this State. Therefore, would you please keep us advised of any further communications that you may receive or forward on this subject, so that we might have an opportunity to respond more fully to specific matters that may be raised in the future. Thank you for your cooperation.

Yours very truly,

By


Richard Kaufman, Assistant
Secretary

RK/jbm

cc: Harold Marsh, Jr., Esq.
Lee J. Fortner (i/o)

EXHIBIT 2

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January 12, 1978

California Law Revision Commission
School of Law
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Stanford, California 94305

Attention: Nathaniel Sterling, Staff Counsel

Dear Mr. Sterling:

Please accept my apologies for the belated response to your request for assistance from our office. I can assure you that the topic which the commission now proposes to study is an important topic for the California commercial community. My delay in responding to your letter was occasioned solely by extenuating circumstances.

The basic problem with "common law" assignments for the benefit of creditors is that in most circumstances there is very little, if no, real supervision of any aspect of the activities of the assignee. This comes about because in the ordinary course of events no one creditor has a sufficient stake in the outcome of the assignment proceeding to spend any sums for attorneys fees to bring litigation before the state courts, to determine the propriety of actions taken by the assignee. Creditors quickly recognize that their potential dividend in any one case is likely to be relatively small. (I am sure you are familiar with the expression "ten cents on the dollar". While it may not be strictly accurate, it is certainly a pervasive feeling among trade creditors in most cases that I have observed).

The only real effective threat to an assignee occurs in the event of an involuntary petition of bankruptcy being filed within four months from the day of the assignment for the benefit of creditors. Under

such circumstances upon adjudication of bankruptcy, the Bankruptcy Court is vested with power to examine into the affairs of the assignee and to surcharge the assignee for breach of his trust to the creditors. While this threat is of particular concern to some assignees, others have virtually ignored it almost with impunity. If the petition in bankruptcy is filed more than four months from the date of the assignment, the Bankruptcy Court does not have jurisdiction to inquire into the conduct of the assignee.

By virtue of the lack of supervision the potential for abuse is substantial. I will cite for you a few instances which come to mind solely from memory. I have no doubt that a further evaluation of the conduct of some of the assignees would produce questionable results.

1. In one instance a debtor named as the assignee for the benefit of creditors the law partner of the debtor's attorney. The assignee promptly sold most of the assets to the principal of the debtor (the debtor was a corporation) who continued to carry on the same business, at the same location but with a slight change in the name. The sale took place before the creditors were even notified of the assignment for the benefit of creditors (there seems to be no requirement of a time limit within which to call a first meeting of creditors -- I am not even aware of a requirement that the assignee call any meeting of the creditors). The assignee failed to take a sufficient inventory so that a proper evaluation could be made as to the value of the assets which were transferred so that it could be determined if a fair consideration was obtained.

2. There is one assignee about whom I can say that I cannot recall a single case that his office has ever closed or any where I have ever received a dividend. After many abortive attempts to find out the status of a case, the file simply dies for lack of attention. My creditor clients simply do not have a sufficient stake to pay the legal and investigative fees that would be required to alter the situation.

3. Almost all of the assignees when closing a case utilize some sort of a reserve for unknown contingencies. I have yet to see one case where any accounting was ever made for the reserve. I have yet to see one case where a subsequent dividend was ever paid after it was determined that the reserve was not needed.

Nathaniel Sterling, Staff Counsel
January 12, 1978
Page Three

In appropriate cases an assignment for the benefit of creditors should produce a more expeditious result to creditors at the same, if not, lesser expense. Thus, there are certainly benefits to the creditor community from well run assignments. However, as I have quickly tried to point out, there are also dangers, because of the lack of supervision.

I would be pleased to explore the situation further, amplify my remarks or provide further assistance if you believe it could be of assistance.

Very truly yours,



SANDOR T. BOXER
of COSKEY, COSKEY & BOXER

STB/el

EXHIBIT 3

COSKEY, COSKEY & BOXER

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May 3, 1978

ARTHUR A. GREENBERG
CARL GRUMER
ARTHUR SCHAEFER

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Attention: John H. DeMouilly

Dear Mr. DeMouilly:

Pursuant to our earlier conversation with regard to the recent amendment to the attachment law and assignments for the benefit of creditors, I am enclosing a recent accounting which we received from an assignee. From a total estate of close to \$79,000.00, creditors received approximately \$29,000.00, and approximately \$33,000.00 went to fees to the assignee, counsel, and various expenses, including a "reserve for disputed claims" of \$13,362.00.

Has the Commission done anything in the area of assignments?
Is it interested?

Sincerely,

HAL L. COSKEY
of COSKEY, COSKEY & BOXER

HLC/bh/1

Enclosure

Assignee for the Benefit of Creditors of
Statement of Receipts and Disbursements

RECEIPTS

Receipts

Sale of Assets	\$76,000.00
Cash from Assignor	337.53
Accounts Receivable Collected	1,618.85
Payroll Tax Refund	900.80
Postage Refund	<u>50.00</u>

Total Receipts

\$78,907.18

DISBURSEMENTS

Disbursements

Federal Payroll Taxes	\$ 756.52	
California Payroll Taxes	774.79	
California Sales Tax	2,704.56	
L. A. County Personal Property Tax	4,492.56	
Labor Claims	940.20	
Inventory Taking	2,819.44	
Inspection, Sale and Check-out to Purchaser	1,245.00]
Adjustment on Sale of Assets	235.68	
Assignee's Commission	7,890.00	— 10 %
Insurance on Assets	138.00	
Accounting and Auditing	1,975.00	— ↑
Utilities and Rent	244.88	
Adjuster's Expense	780.00	
Administrative Expense	2,367.00	— WHAT
Preparation of payroll and sales tax returns, audits by taxing agencies	878.00	— ↑
Advertising Sale of Assets	681.37	
Collection Expense	229.00	— ?
Packing, Transfer and Storage of records	369.48	—
Title Search on Assets	75.25	
Review of Creditors Claims and Closing	985.00	— BY WHOM
Printing and Postage	606.43	
Reserve for Disputed Claims	13,362.99	— WHO GETS
Attorney for Assignor ()	3,500.00	— THIS ?
Attorney for Assignee () and ()	2,000.00	— 50% reserved
First and Final Dividend to Creditors of 13.833% on claims totaling \$208,602.33	<u>28,856.03</u>	

Total Disbursements

\$78,907.18

ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

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

Comment. Former Sections 3448 through 3473, inclusive, of the Civil Code, which governed statutory assignments for the benefit of creditors, are not continued. Common law assignments for the benefit of creditors are used to the exclusion of statutory assignments. See, e.g., B. Shapiro, Assignment for the Benefit of Creditors § 1 in California Remedies for Unsecured Creditors 429, (Cal. Cont. Ed. Bar 1957); I B. Witkin, Summary of California Law Contracts § 729, at 609 (8th ed. 1973). Keatinge, Assignments for the Benefit of Creditors at California Law--Legal and Practical Aspects, 25 L.A. Bar Bull. 99, 109 (1949). Former Sections 3448 through 3473 are replaced by new Title 3 (commencing with Section 3445) that governs common law assignments for the benefit of creditors.

404/150

SEC. . Title 3 (commencing with Section 3445) is added to Part 2 of Division Fourth of the Civil Code, to read:

TITLE 3. ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

CHAPTER 1. GENERAL PROVISIONS

§ 3445. Scope of title

3445. This title governs common law assignments for the benefit of creditors which are hereby expressly recognized.

Comment. Section 3445 makes clear that new Title 3 is intended only to regulate common law assignments and not to create a separate statutory assignment scheme. Contrast former Section 3448 (statutory provisions an alternative to common law assignment) and Bumb v. Bennett, 51 Cal.2d 294, 333 P.2d 23 (1958) (recognizing both common law and statutory assignments).

405/424

§ 3446. Effect of nonconforming assignment

3446. An assignment for the benefit of creditors that does not satisfy the requirements of this title is not for that reason void, but has the following effect:

(a) The assignment does not defeat any lien or encumbrance in the assigned property obtained by legal process by a nonassenting creditor

after the time the assignment was made and before subsequent transfer of the property, and the assigned property remains subject to legal process to satisfy such a lien or encumbrance.

(b) The assignee is limited to the powers an assignee would have at common law and has none of the additional powers provided in this title.

Comment. Section 3446 recognizes that an assignment that fails to satisfy the requirements of this title may nonetheless have binding effect on those creditors who assent to it. Participation by creditors estops them from acting to defeat the effect of the assignment. See, e.g., Lacy v. Gunn, 144 Cal. 511, 78 P. 30 (1904). This enables the parties to use the type of assignment appropriate for them in cases where all parties can agree.

An assignment ordinarily precludes a creditor from obtaining a priority or using legal process to apply assigned property to the debt. See, e.g., Bumb v. Bennett, 51 Cal.2d 294, 333 P.2d 23 (1958). Subdivision (a) provides that an assignment that fails to satisfy the requirements of this title does not bind nonassenting creditors, who may establish priorities in and apply the assigned property as against the assignee. This resolves a conflict in existing case law. Compare Handley v. A. Pfister & Co., 39 Cal. 283 (1870) (nonconforming assignment prevails over subsequent attachment) with Jarvis v. Webber, 196 Cal. 86, 236 P. 138 (1925) (nonconforming assignment does not prevail over subsequent attachment).

Subdivision (b) provides that the assignee of a nonconforming assignment may not exercise the powers granted in Chapter 3 that are broader than the common law powers of an assignee. See Sections 3465 through 3469 and Comments thereto.

An assignment for the benefit of creditors that fails to satisfy the requirements of this title has consequences in addition to those specified in this section. See, e.g., Civil Code § 3440 (fraudulent conveyances); Code Civ. Proc. §§ 493.010, 493.030 (prior attachment liens); Com. Code §§ 6103 (bulk transfers), 9301, 9302 (perfection of security interests).

405/768

§ 3447. Assignment by nonresident

3447. An assignment for the benefit of creditors of property located in this state made by a nonresident of this state is governed by Section 3446.

Comment. Section 3447 recognizes assignments by nonresidents of California. Such assignments must satisfy California requirements, however, in order to receive the full benefits of California law. This continues portions of former Sections 3449 and 3451.

CHAPTER 2. ASSIGNMENT

§ 3450. Contents of assignment

3450. An assignment for the benefit of creditors shall be in writing, signed by the debtor or the debtor's agent, and shall satisfy all of the following requirements:

(a) The assignment shall transfer all of the debtor's property that is transferable and not exempt from execution, including all rights of action whether arising from contract, tort, or otherwise.

(b) The assignment shall be made in trust for the benefit of all the debtor's creditors.

Comment. Section 3450 is drawn from provisions formerly found in Code of Civil Procedure Section 493.010 (effect of general assignment for the benefit of creditors on attachment). This section alters the common law rule that permits partial assignments. See, e.g., *Bumb v. Bennett*, 51 Cal.2d 294, 333 P.2d 23 (1959). The policy of this section is to provide the statutory protections of this title only for assignments designed to distribute all of the debtor's transferable nonexempt assets ratably among all creditors. But see Section 3452 (discharge provision).

Where the debtor is a partnership, the assignment must be made by all the partners. Corp. Code § 15009(3)(a). Where the debtor is a corporation, approval of both the board and the outstanding shares is required. Corp. Code § 1001(a). As used in this section, the terms "debtor" and "creditor" are defined in Sections 3429 and 3430.

Subdivision (a) requires the assignment to transfer all assets, including causes of action. Cf. *Peterson v. Ball*, 211 Cal. 461, 296 P. 291 (1931) (assignment of all property included causes of action). The provision of subdivision (a) that the assets must be transferable recognizes that some property, such as a lease subject to a condition that it may not be transferred without the consent of the lessor, may not be assignable; such property need not be included in the assignment for the benefit of creditors. See 16 Cal. Jur.3d Creditors' Rights § 62, at 491-420 (1974); Shapiro, Assignment for the Benefit of Creditors, in *California Remedies for Unsecured Creditors* 461 (Cal. Cont. Ed. Bar 1957). Subdivision (a) is also consistent with the rule that property exempt from execution does not pass to the assignee unless specifically included in the assignment. See former Section 3470; *Vollestedt Kerr Lumber Co. v. Production Homes, Inc.*, 130 Cal. App.2d 507, 279 P.2d 615 (1955).

Under subdivision (b) the assignment is made in trust and the normal consequences of the trust apply. See, e.g., Section 3463 (duties of assignee). The assignment in trust is irrevocable except with the consent of all the beneficiaries. See, e.g., *Forbes v. Scannell*, 13 Cal. 242 (1859); former Section 3473.

§ 3451. Prohibited provisions

3451. An assignment for the benefit of creditors shall not do any of the following:

(a) Create a preference of one creditor or class of creditors over any other creditor or class of creditors, but the assignment may recognize the existence of priorities to which creditors are otherwise entitled.

(b) Provide for the payment of any claim known to the debtor to be false or fraudulent, or for the payment of more upon any claim than is known to be justly due from the debtor.

(c) Reserve any interest in the assigned property to or for the benefit of the debtor before all existing debts are paid.

(d) Confer upon the assignee any duty or power which, if exercised, might prevent or delay the immediate conversion of the assigned property to the purposes of the trust.

(e) Exempt the assignee from liability for neglect of duty or misconduct.

Comment. Subdivision (a) of Section 3451 continues a provision formerly found in Code of Civil Procedure Section 493.010 (effect of general assignment for the benefit of creditors on attachment). This alters the common law rule that permits preferences. See, e.g., Bumb v. Bennett, 51 Cal.2d 294, 333 P.2d 23 (1958). The assignment for the benefit of creditors may not create preferences if it is to have the effect provided by this title. But see Section 3452 (discharge provision). This rule is not violated by the recognition of priorities that are not created by the assignment itself such as, for example, prior secured interests, wage claims, prior execution liens, or tax claims. The assignee takes property subject to security interests and other liens and encumbrances on the property. See, e.g., Section 3453 and Comment thereto.

Subdivisions (b) through (e) are drawn from former Section 3457. Subdivision (b) is supplemented by Section 3455 (list of debts made under penalty of perjury). Subdivision (c) is consistent with the schedule for payment of dividends prescribed by Section 3473. Subdivision (d) supplements Section 3469 (limitation on exercise of powers); an assignee is granted all necessary powers by this title. See Section 3465. Subdivision (e) is consistent with the trust duty of the assignee. See Sections 3463 and 3475.

§ 3452. Discharge provision

3452. Notwithstanding any other provision of this title, an assignment for the benefit of creditors that creates a preference for

creditors who give the debtor a discharge from their claims does not violate the requirements of this title.

Comment. Section 3452 recognizes the intent of this title to encourage creditors to discharge a debtor who makes an assignment for the benefit of creditors that satisfies the requirements of this title. See Section 3473 (payment of dividends). This preserves the common law rule of *Boteler v. Robinson*, 105 Cal. App. 611, 615, 288 P. 135, 137 (1930). Section 3452 does not, however, permit the assignment to include a compulsory release provision. See *Jarvis v. Webber*, 196 Cal. 86, 236 P. 138 (1925). A provision such as Section 3452 that recognizes contractual discharge arrangements appears not to conflict with the federal bankruptcy laws. See, e.g., *Johnson v. Star*, 287 U.S. 527 (1933).

405/775

§ 3453. Liens on property

3453. (a) An assignment for the benefit of creditors transfers property of the debtor to the assignee subject to all liens and encumbrances on the property.

(b) An assignment for the benefit of creditors stays the enforcement of all liens and encumbrances on the property for a period of 90 days following the time the assignment was made.

Comment. Subdivision (a) of Section 3453 states the common law rule that the assignment does not void any liens on the assigned property. See, e.g., *First Nat'l Bank v. Menke*, 128 Cal. 103, 60 P. 675 (1900). The assignee may avoid certain preferential liens and unperfected security interests. See Section 3468 and Comm. Code § 9301. See also Code Civ. Proc. § 493.030 (general assignment terminates lien of attachment or temporary protective order).

Subdivision (b) is new; it is intended to preclude enforcement processes so as to prevent the dissipation of assets and enable the assignee to proceed with the orderly liquidation of the estate. The assignee may sell property subject to an existing lien, may sell the property free of liens and discharge liens from the proceeds of sale, or may take other appropriate action to satisfy or discharge a lien. See former Section 3468. The lienholder whose lien is not discharged may recover only the unsecured portion of the claim unless the lienholder relinquishes the security to the assignee. Section 3471(b).

405/778

§ 3454. Interest on claims

3454. An assignment for the benefit of creditors does not stop the accrual of interest on claims of creditors.

Comment. Section 3454 clarifies the rule as to the accrual of interest on an assignment. Previous law was not clear. See *Shapiro, Assignment for the Benefit of Creditors* § 22 in *California Remedies for Unsecured Creditors* 448 (Cal. Cont. Ed. Bar 1957).

§ 3455. List of creditors, debts, and property

3455. (a) At the time of making an assignment for the benefit of creditors or promptly thereafter the debtor shall provide the assignee all of the following information:

(1) A list of the names of all creditors of the debtor, together with the business or mailing address of each creditor.

(2) An accounting of the amount owed to each creditor, the nature of the obligation, and any security therefor.

(3) An inventory of all property of the debtor including its location and value at the time of making the assignment and a statement of any property the debtor claims is not transferable or is exempt from execution.

(4) A list of major transfers, including payments and encumbrances, made to or for the benefit of creditors for or on account of an antecedent debt on or within 90 days before the time the assignment was made.

(b) The information required by this section shall be true to the best knowledge and belief of the debtor by declaration under penalty of perjury and shall be supplemented when necessary, but shall not be conclusive as to any information provided by the debtor.

(c) The assignee shall make the information provided pursuant to this section available to any creditor of the debtor upon request.

Comment. Section 3455 supersedes portions of former Sections 3449, 3461, and 3462. It is designed to assist the assignee in fulfilling the trust. It also enables creditors to obtain necessary information to protect their interests. The terms "debtor" and "creditor" as used in this section are defined in Sections 3429 and 3430.

The information provided by the debtor pursuant to this section affects no rights in the property of the debtor; all property of the debtor is transferred by the assignment and all creditors are benefitted by the assignment, regardless of omissions or inaccuracies in the information provided. See Section 3450. However, in case of a failure to comply with this section, the assignment does not satisfy the requirements of this title and is not entitled to the statutory protections provided by this title. See Section 3446 (effect of nonconforming assignment).

§ 3456. Transfer of property

3456. (a) At the time of making an assignment for the benefit of creditors or promptly thereafter the debtor shall deliver or surrender possession of all the assigned property to the assignee, together with all relevant books, papers, and accounts, and shall execute any documents or instruments and perform any other act reasonably required to make the transfer effective.

(b) The debtor shall respond fully and faithfully by declaration under penalty of perjury to all inquiries made by the assignee concerning the assignment.

Comment. Subdivision (a) of Section 3456 is drawn from comparable provisions of N.Y. Debt. & Cred. Law § 4(e) (McKinney Supp. 1977-78) and 39 Pa. Cons. Stat. Ann. §§ 44, 45 (Purdon 1954).

Subdivision (b) requires continuing debtor cooperation as part of the assignment. This supersedes provisions of former Section 3462 for examination of the debtor.

405/790

CHAPTER 3. ASSIGNEE

§ 3460. Qualifications

3460. An assignment for the benefit of creditors shall be made to an adjustment bureau, board of trade, or other credit association or other disinterested person qualified to perform the functions of an assignee.

Comment. Section 3460 gives the debtor discretion to name any qualified person as an assignee. Cf. Section 14 ("person" includes corporation as well as natural person). The requirement that the assignee be disinterested precludes an assignment to such persons as a creditor or a relative, employee, agent, or attorney of the debtor.

This title makes no provision for removal of an assignee by the court or by a majority of creditors. Creditors who are dissatisfied with the performance of the assignee may require a bond pursuant to Section 3461, may refuse to discharge the debt, or may seek relief in bankruptcy. See also *Farmers and Merchants Nat'l Bank v. Peterson*, 5 Cal.2d 601, 55 P.2d 867 (1936) (equity jurisdiction of court to remove assignee).

405/793

§ 3461. Undertaking

3461. Upon demand of three or more creditors the assignee shall give an undertaking for the faithful discharge of the trust. The under-

taking shall be executed by an authorized corporate surety for the benefit of the debtor and all the creditors and shall be in the amount of twice the value of the property assigned as determined in the inventory provided by the debtor.

Comment. Section 3461 supersedes the bond requirement of former Section 3467. It is intended to limit the expenses in the administration of the assignment while affording protection to debtors where there appears to be a substantial problem. An undertaking is required only when demanded by three or more creditors. To avoid court determination of the sufficiency of sureties and the amount of the undertaking, a corporate surety is required and the amount is fixed. The terms "debtor" and "creditor" as used in this section are defined in Sections 3429 and 3430.

405/794

§ 3462. Commission

3462. The assignee shall be entitled to a commission of 10 percent of the total dividends distributed to creditors or such lesser amount as is provided in the assignment.

Comment. Section 3462 supersedes former Section 3471. It is intended to permit an agreement in the assignment as to the assignee's commission, subject to a statutory maximum. A commission is allowed by statute notwithstanding the silence of the assignment. Cf. Menke v. Miller, 56 Cal. 628 (1890) (construing former Section 3471). The maximum provided in this section is based on dividends distributed rather than on the total estate of the debtor to provide the assignee an incentive to generate the greatest dividends for creditors. The commission of the assignee is in addition to necessary and reasonable administrative expenses. See Section 3473 (payment of dividends).

405/798

§ 3463. Duties of assignee

3463. The assignee shall take, hold, and dispose of the assigned property and its proceeds upon the trusts and conditions and for the purposes provided in the assignment and in this title.

Comment. Section 3463 continues the substance of the last sentence of former Section 3449. It states the basic duty of the assignee to faithfully discharge the trust. See, e.g., Baker v. Bartol, 6 Cal. 438 (1856) (duty of assignee to husband and protect the assigned estate and administer it fairly and faithfully in a spirit of honesty). See also Section 3475 (release of assignee).

This title, unlike provisions of former Title 3 (commencing with former Section 3448), does not require recordation of the assignment. The assignee should, however, record the transfer of any real property to keep title clear, and is subject to other statutory duties and requirements. See, e.g., Com. Code § 9302 (perfection of security interests); Rev. & Tax. Code § 18650 (notice to Franchise Tax Board).

§ 3464. Protection of assignee

3464. The assignee is not liable for acts otherwise proper in the execution of the trust, merely for the reason that the assignment is afterward adjudged void.

Comment. Section 3464 continues the substance of former Section 3472.

CHAPTER 4. POWERS OF ASSIGNEE

§ 3465. General powers

3465. The assignee has all rights necessary and convenient for the expeditious administration and discharge of the trust, and has the additional powers provided by statute.

Comment. Section 3465 makes clear that in addition to the specific powers granted in this chapter, the assignee has general power to administer the debtor's estate. See *Handley v. A. Pfister & Co.*, 39 Cal. 283 (1870) (assignee has power coupled with trust for the benefit of creditors). The assignee may recover and liquidate assets, sue on contract or tort rights, sell, compound, or compromise debts and claims, and generally take any other action with respect to the assigned property necessary to carry out the trust. See, e.g., *Wilhoit v. Cunningham*, 87 Cal. 453, 25 P. 675 (1891) (power to sue). The assignee of partnership property may enforce contributions by partners to satisfy liabilities. Corp. Code § 15040. The exercise of a power such as the power to sue to recover property is subject to the limitation that the power not be exercised in marginal cases. See Section 3469.

§ 3466. Powers as successor of assignor

3466. The assignee has all the rights and powers the assignor had with respect to the assigned property.

Comment. Section 3466 codifies the common law principal that the assignee stands in the shoes of the debtor and is the absolute owner of all the debtor's legal and equitable interests in the property assigned. This supplements the general powers of the assignee provided in Section 3465.

§ 3467. Powers as representative of creditors

3467. The assignee stands in the position of a lien creditor of the debtor and has all rights and powers a creditor would have against

the debtor or property of the debtor, including but not limited to proceeding under the Uniform Fraudulent Conveyance Act, Title 2 (commencing with Section 3439), with respect to conveyances or obligations fraudulent as to creditors.

Comment. Section 3467 reverses former Section 3460 and the common law rule that the assignee for the benefit of creditors is not in the position of a representative of creditors. See, e.g., *Moore v. Schneider*, 196 Cal. 380, 238 P. 81 (1925); but see *First Nat'l Bank v. Pomona Tile Mfg. Co.*, 82 Cal. App.2d 592, 186 P.2d 693 (1947) (assignee may represent creditors) (dictum). The authority provided by this section applies only to an assignment that satisfies the requirements of this title. See Section 3446(b).

Under this section the assignee stands in the position of a lien creditor and may thus contest unperfected liens. See Comm. Code § 9301. The exercise of a power under this section is subject to the limitation that the power not be exercised in marginal cases. See Section 3469.

405/809

§ 3468. Power to avoid preferential transfers

3468. (a) As used in this section, "transfer" has the meaning prescribed in subdivision (40) of Section 101 of Title 11 of the United States Code.

(b) The assignee may avoid a transfer of property of the debtor to or for the benefit of a creditor made while the debtor was insolvent and made before the time of making the assignment to the same extent a trustee may avoid such a transfer made on or before the date a petition is filed commencing a case under Title 11 of the United States Code (Bankruptcy) and subject to the same limitations and consequences.

Comment. Section 3468 is intended to give the assignee the same power as a trustee in bankruptcy to avoid preferential transfers. See 11 U.S.C. § 547. This power will help ensure that the assignment remains a useful alternative to bankruptcy. The avoidance and recovery of preferences by the assignee is subject to the limitation that the power not be exercised in marginal cases. See Section 3469.

Under subdivision (a) preferential transfers include voluntary and involuntary dispositions of any interest in property. 11 U.S.C. § 101(40). Thus a judicial lien imposed on the debtor's property would be a transfer. See also Code Civ. Proc. §§ 493.010-493.060 (effect of bankruptcy proceedings and general assignments--voiding of attachment liens and temporary protective order liens).

The preference period under subdivision (b) is generally 90 days, although the period may extend to a year in special circumstances. See 11 U.S.C. § 547(b)(4). The right to avoid and recover a preference is subject to a number of limitations and consequences, including time limitations, rights of bona fide purchasers, and subrogation of the estate to lien rights. See, e.g., 11 U.S.C. §§ 546, 550, 551.

§ 3469. Limitation on exercise of powers

3469. The assignee shall not exercise a power to the extent it appears to the assignee that such exercise will not be for the best interest or benefit of the creditors.

Comment. Section 3469 places a limitation on the discretion of the assignee to exercise powers provided in this chapter. A proceeding under the Uniform Fraudulent Conveyance Act, or an action to avoid and recover preferences, for example, may be inappropriate in light of the value of the property to be recovered for the estate. The decision whether a power should be exercised is in the discretion of the assignee who is a trustee and must meet fiduciary standards of conduct for the benefit of creditors. See Section 3463 (duties of assignee).

405/815

CHAPTER 5. PROCEDURE

§ 3470. Notice to creditors

3470. (a) Promptly after the making of an assignment for the benefit of creditors the assignee shall give actual notice of the assignment to the creditors listed by the debtor in the information provided the assignee and to any other creditors of which the assignee becomes aware.

(b) The assignee shall once a week for a period of four weeks after the making of an assignment for the benefit of creditors publish notice of the assignment in a newspaper of general circulation in the city, or if none in the county, in which the debtor's business or mailing address is located.

(c) The notice shall include the address of the assignee and shall prescribe the manner of presentation of claims by creditors.

Comment. The notice requirements of Section 3470 supersede those of former Sections 3449 and 3468.

Subdivision (a) does not specify the manner of notice to creditors, which may be by personal delivery, telephone, mail, or any other means provided the creditors receive actual notice.

Subdivision (b) requires publication for the purpose of informing creditors who may not have been listed by the debtor in the information provided the assignee pursuant to Section 3455.

Subdivision (c) does not prescribe a claims presentation period. Distribution of dividends on allowed claims must be made after the lapse of 90 days from the time the assignment is made, however. Section 3473.

§ 3471. Presentation and allowance of claims

3471. (a) The assignee shall allow all claims presented by declaration under penalty of perjury by creditors that are liquidated or are in a readily ascertainable amount upon a showing adequate to the assignee that the claims are valid and nonfraudulent obligations of the debtor.

(b) If the claim of a creditor is secured by a lien on assigned property, the assignee shall estimate the value of the security and shall allow only that portion of the claim that is unsecured unless the creditor relinquishes the security to the assignee.

Comment. Subdivision (a) of Section 3471 prescribes no formal requirements for claim presentation or court procedure for allowance. The assignee must be satisfied that the claims are sufficient before they are allowed. An assignee may be liable on the undertaking for improper claim allowance. See Section 3475. A creditor dissatisfied with a claim allowance also has the remedies of refusal to discharge and bankruptcy.

Subdivision (b) adopts the "bankruptcy rule" for payment of secured claims found in former Section 3468.

§ 3472. Records and accounts

3472. The assignee shall keep regular records and accounts of all transactions under the assignment which the assignee shall make available to any creditor of the debtor upon request.

Comment. Section 3472 is new; it avoids the need for interim accountings by the assignee. For the requirement of a final accounting, see Section 3474. A creditor who is dissatisfied with the administration of the assignment may refuse to grant the debtor a discharge, may seek to impose liability on the assignee, or may seek relief in bankruptcy.

§ 3473. Payment of dividends

3473. (a) After liquidation of the assigned property and as soon as practical after the lapse of 90 days from the time the assignment was made, the assignee shall declare and distribute dividends.

(b) The distribution of dividends shall be in the following order of priority:

(1) Necessary and reasonable expenses of administration and the commission of the assignee.

(2) Allowed claims entitled by law to priority in their order of priority.

(3) Allowed claims of creditors entitled to a preference created in the assignment for creditors who give the debtor a discharge from their claims, distributed on a pro rata basis.

(4) Allowed claims of other creditors, distributed on a pro rata basis.

(5) The remainder, if any, shall be returned to the debtor.

Comment. Subdivision (a) of Section 3743 requires prompt satisfaction of the claims of creditors. The assignee must wait until the 90-day preference period of the bankruptcy law before distributing dividends. See 11 U.S.C. § 547; contrast former Section 3468 (30-day waiting period).

Subdivision (b) prescribes the order of priority of dividends. All claims within a class must be satisfied before any distributions may be made to a class having lower priority.

Paragraph (1) gives highest priority to administration costs and the assignee's commission. This is consistent with *Abrams v. United States*, 274 F.2d 8 (8th Cir. 1960) (administrative expenses may take priority over federal claims) and reverses the rule of *Division of Labor Law Enforcement v. Stanley Restaurants*, 228 F.2d 420 (9th Cir. 1955) (wage claim has priority over expenses of administration). See Note, 45 Calif. L. Rev. 66, 70 (1957). For limitations on the assignee's commission, see Section 3462.

Paragraph (2) refers to priorities prescribed by other law. These priorities include by way of illustration debts due the United States (26 U.S.C. §§ 6321-6322; 31 U.S.C. §§ 191-192), wage claims (Code Civ. Proc. § 1204), mechanics liens (Civil Code § 3110), and claims of state and local government (Fish & Game Code § 1058; Rev. & Tax. Code §§ 6756, 18933, 26312, 30321, 32386; Unemp. Ins. Code § 1701).

Paragraph (3) recognizes preferences created in the assignment for creditors who discharge the obligations of the debtor. See Section 3452 and Comment thereto.

Paragraph (5) is consistent with prior law creating an equitable reversion of the surplus. See, e.g., *Wilhoit v. Cunningham*, 87 Cal. 453, 25 P. 675 (1891). Any amounts returned to the debtor pursuant to paragraph (5) may be subject to obligations of the debtor not discharged under the assignment for some reason.

405/819

§ 3474. Final accounting

3474. (a) Promptly after liquidation of the assigned property and distribution of all dividends, the assignee shall by declaration under penalty of perjury make a detailed final accounting of the property that came into the possession of the assignee, its liquidation, and the distribution of dividends.

(b) The final accounting shall be made to the debtor and to each creditor who presented a claim to the assignee prior to the time the accounting was made, whether or not the claim was allowed. The assignee shall make the final accounting available to any other creditor of the debtor upon request.

Comment. Section 3474 supersedes the accounting provision of former Section 3469. It requires a comprehensive and detailed accounting by the assignee but specifies no fixed period of time within which the accounting must be made. The assignee and any undertaking given are not released until six months after the accounting is made. Section 3475. The terms "debtor" and "creditor" as used in this section are defined in Sections 3429 and 3430.

405/820

§ 3475. Release of assignee

3475. Unless an action against the assignee or an action on the undertaking has been commenced, the assignee and any undertaking given for the faithful discharge of the trust are released from the obligation of the trust six months after the making of the final accounting.

Comment. The 6-month limitations period of Section 3475 is comparable to the 6-month accounting period prescribed by former Section 3469.

405/823

SEC. . If any provision of this act or the application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

Comment. A severability clause is added to this act in case of possible conflict with the bankruptcy clause of the United States Constitution. See Johnson v. Star, 287 U.S. 527 (1933); Pobreslo v. Boyd Co., 287 U.S. 518 (1933).

CONFORMING CHANGES

Business & Professions Code § 7113.5 (amended)

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

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

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

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

Comment. Section 7113.5 is amended to delete the references to "statutory" and "common law" assignments. Former Civil Code Sections 3448 through 3473, which prescribed a statutory assignment, are not continued. See new Section 3445 and Comment thereto.

405/927

Business & Professions Code § 8657 (amended)

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

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

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

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

Comment. Section 8657 is amended to delete the reference to former Civil Code Sections 3448 through 3473, which are not continued. See new Section 3445 and Comment thereto.

405/939

Civil Code § 3440 (amended)

SEC. . Section 3440 of the Civil Code is amended to read:

3440. Every transfer of personal property and every lien on personal property made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery followed by an actual and continued change of possession of the things transferred, is conclusively presumed fraudulent and void as against the transferor's creditors while ~~he~~ the transferor remains in possession and the successors in interest of those creditors, and as against any person on whom the transferor's estate devolves in trust for the benefit of others than the transferor and as against purchasers or encumbrancers in good faith subsequent to the transfer.

This section shall not apply to any of the following:

(a) Things in action.

(b) Ships or cargoes at sea or in a foreign port.

(c) Security interests and the sale of accounts, contract rights or chattel paper governed by the Uniform Commercial Code, and contracts of bottomry or respondentia.

(d) Wines or brandies in the wineries, distilleries, or wine cellars of the makers or owners of the wines or brandies, or other persons having possession, care, and control of the wines or brandies, and the

pipes, casks, and tanks in which the wines or brandies are contained, if the transfers are made in writing and executed and acknowledged, and if the transfers are recorded in the book of official records in the office of the county recorder of the county in which the wines, brandies, pipes, casks, and tanks are situated.

(e) ~~The transfer, or assignment, statutory or otherwise, made~~
An assignment for the benefit of creditors generally or that satisfies the requirements of Title 3 (commencing with Section 3445) or a transfer
by any assignee acting under such an assignment ~~for the benefit of creditors generally~~, or to any security agreement made for the benefit of creditors generally.

(f) Property exempt from execution.

(g) Standing timber if the contract or grant in relation to the same is recorded as provided in Section 1220 of this code.

(h) A transfer of personal property if:

(1) Said personal property is leased back to the transferor immediately following said transfer.

(2) The transferor (lessee) or the transferee (lessor) records at least 10 days before the date of the transfer and leaseback in the office of the county recorder in the county or counties in which the personal property is situated, a notice of the intended transfer and leaseback which states the name and address of the transferor (lessee) and transferee (lessor). The notice shall contain a general statement of the character of the personal property intended to be transferred and leased back, and show the date when and place where the transaction is to be consummated.

(3) The transferor (lessee) or the transferee (lessor) publishes a copy of the notice pursuant to Section 6061 of the Government Code in a newspaper of general circulation published in the judicial district in which the personal property is situated, if there is one, and if there is none in the judicial district, then in a newspaper of general circulation in the county embracing the judicial district. The publication shall be completed not less than five days before the date of the intended transfer and leaseback.

This section shall not affect the rights of a secured party who acquires from the transferee or ~~his~~ the transferee's successor a security interest in the personal property transferred if

1. The intended debtor or secured party records at least 10 days before the consummation of the security agreement in the office of the county recorder in the county or counties in which the personal property is situated, a notice of the transfer and intended security agreement which states the names and addresses of the transferor and transferee and of the intended debtor and secured party. The notice shall contain a general statement of the character of the personal property transferred and intended to be subject to the security interest, and show the date when and place where the security agreement is to be consummated, and

2. The intended debtor or secured party publishes a copy of the notice pursuant to Section 6061 of the Government Code in a newspaper of general circulation published in the judicial district in which the personal property is situated, if there is one, and if there is none in the judicial district, then in a newspaper of general circulation in the county embracing the judicial district. The publication shall be completed not less than five days before the date of the intended security agreement.

Subdivision (2) of Section 2402 of the Commercial Code is not restricted by the provisions of this section.

Comment Section 3440 is amended to provide that an assignment for the benefit of creditors must satisfy the requirements of Sections 3445 through 3475 if it is to receive fraudulent conveyance exemption. This broadens the limitation formerly found in Section 3440 that the assignment must be for creditors generally, and is consistent with the policy of Section 3446 (effect of nonconforming assignment). See Comment to Section 3446.

405/821

Code of Civil Procedure § 493.303 (amended)

SEC. . Section 493.010 of the Code of Civil Procedure is amended to read:

493.010. As used in this chapter, "general assignment for the benefit of creditors" means an assignment which satisfies ~~all of the following requirements:~~

~~(a) The assignment is an assignment of all the defendant's assets that are transferable and not exempt from execution.~~

~~(b) The assignment is for the benefit of all the defendant's creditors.~~

(c) The assignment does not itself create a preference of one creditor or class of creditors over any other creditor or class of creditors, but the assignment may recognize the existence of preferences to which creditors are otherwise entitled the requirements of Title 3 (commencing with Section 3445) of Part 2 of Division Fourth of the Civil Code .

Comment. Section 493.010 is amended to refer to comparable provisions of the statute governing assignments for the benefit of creditors. See Civil Code §§ 3446 and 3451.

405/944

Commercial Code § 6103 (amended)

SEC. . Section 6103 of the Commercial Code is amended to read:

6103. The following transfers are not subject to this division:

(1) Those made to give

(a) A purchase money security interest (Section 9107);

(b) A security interest in or to inventory consisting of durable goods having a unit retail value of at least five hundred dollars (\$500) or motor vehicles, house trailers, trailers, semitrailers, farm and construction machinery and repair parts thereof, or aircraft; or

(c) A security interest in the inventory of a wholesale merchant;

(2) Assignments for the benefit of ~~all the creditors of the transferor~~ creditors that satisfy the requirements of Title 3 (commencing with Section 3445) of Part 2 of Division Fourth of the Civil Code , and subsequent transfers by the assignee thereunder;

(3) Transfers of property subject to a lien or other security interest in settlement or realization of such lien or other security interest, if there was compliance with this division in connection with the creation of such lien or security interest or such creation was exempt from compliance with this division;

(4) Sales by executors, administrators, receivers, trustees in bankruptcy, or any public officer under judicial process;

(5) Sales made in the course of judicial or administrative proceedings for the dissolution or reorganization of a corporation and of which notice is sent to the creditors of the corporation pursuant to order of the court or administrative agency;

(6) Transfers of property which is exempt from execution;

(7) The transfer of goods in a warehouse where a warehouse receipt has been issued therefor by a warehouseman (Section 7102) and a copy of such receipt is kept at the principal place of business of the warehouseman and at the warehouse in which said goods are stored.

Comment. Section 6103 is amended to provide that an assignment for the benefit of creditors must satisfy the requirements of Civil Code Sections 3445 through 3475 if it is to receive bulk transfers exemption. This broadens the limitation formerly found in Section 6103 that the assignment must be for creditors generally, and is consistent with the policy of Civil Code Section 3446 (effect of nonconforming assignment). See Comment to Section 3446.

28/847

Commercial Code § 9301 (amended)

SEC. . Section 9301 of the Commercial Code is amended to read:

9301. (1) Except as otherwise provided in subdivision (2), an unperfected security interest is subordinate to the rights of

(a) Persons entitled to priority under Section 9312;

(b) A person who becomes a lien creditor before the security interest is perfected;

(c) In the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business to the extent that ~~he~~ the person gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) In the case of accounts and general intangibles, a person who is not a secured party and who is a transferee to the extent that ~~he~~ the person gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within 10 days after the debtor receives possession of the collateral, ~~he~~ the secured party takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for the benefit of creditors from the time of assignment under an assignment that satisfies the requirements of Title 3 (commencing with Section 3445) of Part 2 of Division Fourth of the Civil Code , and

a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment.

(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before ~~he~~ the person 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.

Comment. Section 9301 is amended to provide that an assignment for the benefit of creditors must satisfy the requirements of Civil Code Sections 3445 through 3475 if it is to receive priority to unperfected security interests. This is consistent with the policy of Civil Code Section 3446 (effect of nonconforming assignment). See Comment to Section 3446.

405/946

Commercial Code § 9302 (amended)

SEC. . Section 9302 of the Commercial Code is amended to read:

9302. (1) A financing statement must be filed to perfect all security interests except the following:

(a) A security interest in collateral in possession of the secured party under Section 9305;

(b) A security interest temporarily perfected in instruments or documents without delivery under Section 9304 or in proceeds for a 10-day period under Section 9306;

(c) A security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

(d) A purchase money security interest in consumer goods; but filing is required for a motor vehicle or boat required to be registered;

(f) A security interest of a collecting bank (Section 4208) or arising under the division on sales (see Section 9113) or covered in subdivision (3) of this section;

(g) An assignment for the benefit of ~~all the creditors of the transferor~~ creditors that satisfies the requirements of Title 3 (commencing with Section 3445) of Part 2 of Division Fourth of the Civil Code , and subsequent transfers by the assignee thereunder;

(h) A security interest in a deposit account. Such a security interest is perfected:

(1) As to a deposit account maintained with the secured party when the security agreement is executed;

(2) As to a deposit account not described in subparagraph (1) when notice thereof is given in writing to the organization with whom the deposit account is maintained.

(i) A security interest in or a claim in or under any policy of insurance including unearned premiums. Such interest shall be perfected when notice thereof is given in writing to the insurer.

(2) If a secured party assigns a perfected security interest, no filing under this division is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(3) The filing of a financing statement otherwise required by this division is not necessary or effective to perfect a security interest in property subject to

(a) A statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title or which specifies a place of filing different from that specified in this division for filing of the security interest; or

(b) The provisions of the Vehicle Code which require registration of a vehicle or boat; but during any period in which collateral is inventory, the filing provisions of this division (Chapter 4) apply to a security interest in that collateral; or

(c) A certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection (subdivision (2) of Section 9103).

(4) Compliance with a statute or treaty described in subdivision (3) is equivalent to the filing of a financing statement under this division and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in Section 9103 on multiple state transactions. Duration and renewal of perfection of a security interest perfected by compliance with the statute or treaty are governed by the provisions of the statute or treaty; in other respects the security interest is subject to this division.

Comment. Section 9302 is amended to provide that an assignment for the benefit of creditors must satisfy the requirements of Civil Code Sections 3445 through 3475 if it is to receive filing exemption. This broadens the limitation formerly found in Section 9302 that the assignment must be for creditors generally, and is consistent with the policy of Civil Code Section 3446 (effect of nonconforming assignment). See Comment to Section 3446.

405/941

Financial Code § 12100 (amended)

SEC. . Section 12100 of the Financial Code is amended to read:

12100. The provisions of this division do not apply to any of the following:

(a) Persons or their authorized agents doing business under license and authority of the Superintendent of Banks of the State of California, or under any law of this state or of the United States relating to banks, trust companies, building or savings and loan associations, industrial loan companies, personal property brokers, credit unions, title insurance companies or underwritten title companies (as defined in Section 12402 of the Insurance Code), escrow agents subject to Division 6 of the Financial Code, or California small loan companies.

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

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

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

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

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

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

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

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

(j) Nonprofit community service organizations that have been incorporated under the General Nonprofit Corporation Law of the State of California whose membership consists exclusively of retailers, lenders in the consumer credit field, educators, attorneys, social service organizations, employers or employees organizations, and related groups, if the principal functions of such organizations are: (1) consumer credit education; (2) counseling on consumer credit problems and family budgets; and (3) arranging, and in certain cases administering, debt settlement plans, for which a charge for administrative services only may be made of 5 percent of the money disbursed monthly, or ten dollars (\$10) per month, whichever is the lesser, to offset expenses; provided essential records are kept in accordance with sound accounting practices, consumer funds are banked in a trust account and appropriate fidelity bond and insurance are maintained, that reports are made to debtors, and independent audits made; and further provided, however,

that this subdivision shall exempt such organizations from this division only with respect to those activities described in Section 12002.1 and not with respect to those activities described in Section 12002.

Comment. Section 12100 is amended to delete the references to "common law" and "statutory" assignments. Former Civil Code Sections 3448 through 3473, which prescribed a statutory assignment, are not continued. See new Section 3445 and Comment thereto.