

Memorandum 77-14

Subject: Study 39.160 - Attachment (Lien on Inventory)

This memorandum discusses a problem regarding the extent of an attachment lien on inventory obtained by filing a notice with the Secretary of State. At the February 1977 meeting the Commission requested a more detailed explanation of this problem. The staff does not believe that it is necessary to prepare legislation to deal with the problem, but we think the Commission should be aware of it.

The Law as Enacted

As originally enacted, subdivision (c) of Section 488.360 of the Attachment Law provided, in relevant part, as follows:

[U]pon the election and the instructions of the plaintiff, the levying officer shall attach . . . 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 . . . inventory of the defendant. . . . [T]he notice shall be filed in the office of the Secretary of State. . . . A lien acquired pursuant to this subdivision shall provide the plaintiff the same rights and priorities in the attached property and proceeds of the attached property as those of a secured party with a perfected security interest in collateral where the filed financing statement covering the original collateral also covers proceeds. . . .

The relevant portion of the Comment read as follows:

Subdivision (c) permits the plaintiff to elect initially an alternate method of levy comparable to the perfection by filing of a consensual security interest in inventory under the Commercial Code. Compare Com. Code § 9302. The attachment lien acquired by filing not only provides the plaintiff with a "floating lien" on inventory but also gives the plaintiff the same rights and priorities in proceeds as those of a secured party who has obtained rights in proceeds of collateral under Section 9306 of the Commercial Code. Although subdivision (2) of Section 9306 appears to continue a security interest in the original collateral after it is sold, as well as in proceeds, the appearance is deceiving because Section 9307 provides that a buyer in the ordinary course of business takes free from the security interest in inventory (except farm products) even though he knows of it. Subdivision (c) accomplishes this same result by granting the plaintiff the same rights and priorities as those of a secured party under the Commercial Code. Obviously, subdivision (c) does not provide a plaintiff the same degree of

security as does subdivision (a). It does, however, provide a priority over other creditors and, if the business continues to be solvent, it may offer an adequate measure of security with a minimal interference with the defendant's affairs. Although subdivisions (a) and (c) require service of the writ and notice on the defendant, such service is not a condition of a valid levy.

The Law as Amended

In 1976, this portion of subdivision (c) of Section 488.360 was amended to read as follows (the relevant change is underscored):

[U]pon the election and the instructions of the plaintiff, the levying officer shall attach . . . 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 . . . 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 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. . . [T]he notice shall be filed in the office of the Secretary of State. . . . 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.

The relevant portion of the Comment to the 1976 amendment reads as follows:

Subdivision (c) is amended to provide specifically that the lien obtained by filing the notice pursuant to this subdivision may apply to after-acquired property and proceeds from the sale or exchange of attached inventory or farm products. The second sentence, providing for the contents of the notice, is added to make clear that the plaintiff who desires to attach proceeds or after-acquired property, or both, must so state in the notice filed with the Secretary of State or county recorder. Compare Com. Code §§ 9203(3), 9204. The next-to-last sentence of subdivision (c) is amended to make clear that a plaintiff who attaches property by filing a notice pursuant to subdivision (c) describing farm products or inventory, including proceeds or after-acquired property, or both, has the same rights and priorities as he would have if he had perfected a security interest (other than a purchase money security interest) in such property by filing a financing statement at the time and place he filed the notice under subdivision (c). See Com. Code § 9312(5), (6) (priority where special rules applicable to purchase money security interests do not apply).

Reason for 1976 Amendment

The indicated change was made to clarify the nature of the rights of the plaintiff and the priority to be afforded the lien obtained by filing with the Secretary of State. As the first excerpt quoted above indicates, the attachment lien was to provide the plaintiff with the same rights and priorities as those of a secured party with a perfected security interest in collateral. The determination of the priority to be afforded an attachment lien in inventory requires reference to the Commercial Code. Section 9312 of the Commercial Code, as operative on January 1, 1976, provides different priority rules depending on the type of security interest:

9312. (1) The rules of priority stated in other sections of this chapter and in the following sections shall govern where applicable: Section 4208 with respect to the security interest of collecting banks in items being collected, accompanying documents and proceeds; Section 9103 on security interests related to other jurisdictions; Section 9114 on consignments.

(3) A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if

(a) The purchase money security interest is perfected at the time the debtor receives possession of the inventory; and

(b) The purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21-day period where the purchase money security interest is temporarily perfected without filing or possession (subdivision (5) of Section 9304); and

(c) The holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(d) The notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 10 days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subdivisions (3) and (4)), priority between conflicting security interests in the same collateral shall be determined according to the following rules:

(a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

(b) So long as conflicting security interests are unperfected, the first to attach has priority.

(6) For the purposes of subdivision (5) a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

(7) If future advances are made while a security interest is perfected by filing or the taking of possession, the security interest has the same priority for the purposes of subdivision (5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.

Under Section 488.360(c), as enacted, the question arose as to which priority rules should apply. The decision was made, in close consultation with Mr. Bill Holden of the Secretary of State's office, to apply the general rules of priority applicable to nonpurchase money security interests--i.e., the rules stated in subdivisions (5) and (6) of Commercial Code Section 9312, rather than the rules stated in subdivisions (3) and (4) which apply to purchase money security interests. It would have been awkward or nonsensical to try to apply the rules stated in subdivision (3) of Section 9312 to the attachment lien on inventory obtained by filing because this subdivision requires additional notice (subdivision (3)(b)) which is not provided for in Section 488.360(c).

The intent of the Attachment Law regarding rights and priorities is to provide a scheme compatible with that provided in the Commercial Code. As indicated by Section 9312(3), the Commercial Code grants purchase money security interests a higher priority than other security interests. The Comment to Section 9312 states:

Prior law, under one or another theory, usually contrived to protect purchase money interests over after-acquired property interests (to the extent to which the after-acquired property interest was recognized at all). . . . While this Article broadly validates the after-acquired property interest, it also recognizes as sound the preference which prior law gave to the purchase money interest. That policy is carried out in subsections (3) and (4).

The 1976 amendment of Section 488.360(c) made clear, by inserting the parenthetical phrase underscored in the portion quoted supra, that the attachment lien was not intended to be elevated to the status of a purchase money security interest, but rather was to be treated as a nonpurchase money security interest, the priority of which is determined by the order of filing. We believe this decision is sound and are not aware of any opposing views.

Effect of 1976 Amendment on Extent of Attachment Lien on Inventory

The 1976 amendment which was designed to straighten out the priority rules applicable to attachment liens on inventory obtained by filing appears to have inadvertently altered the rights a plaintiff may obtain in inventory as a consequence of Commercial Code Section 9102(4) which provides as follows:

(4) Notwithstanding anything to the contrary in this division, no nonpossessory security interest, other than a purchase money security interest, may be given or taken in or to the inventory of a retail merchant held for sale, except 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. A cooperative association organized pursuant to Chapter 1 (commencing with Section 54001), Division 20 of the Food and Agricultural Code (Agricultural Cooperative Associations) or Part 3 (commencing with Section 13200), Division 3, Title 1 of the Corporations Code (Fish Marketing Act) is not to be deemed a merchant within the meaning of this subdivision. The phrase "purchase money security interest" as used in this subdivision does not extend to any after-acquired property other than the initial property sold by a secured party or taken by a lender as security as provided in Section 9107. This subdivision does not apply to the inventory of a person whose sales for resale exceeded 75 percent in dollar volume of his total sales of all goods during the 12 months preceding the attachment of the security interest.

Providing in Section 488.360(c) that the plaintiff obtains the same rights as would be obtained by a secured party who perfects a security

interest (other than a purchase money security interest) in the inventory has the effect of incorporating this exception provided in Commercial Code Section 9102(4). Hence, a plaintiff may not obtain an attachment lien on inventory of a retail merchant by filing with the Secretary of State where, most significantly, the inventory consists of durable goods having a unit retail value of less than five hundred dollars.

Conclusion

When Section 488.360(c) was originally drafted, it appears to have been the assumption that the attaching plaintiff would be able to obtain a lien on all inventory and proceeds. While this policy makes a certain amount of sense, on balance the staff believes that it is better for the attachment lien on inventory obtained under Section 488.360(c) to track with nonpurchase money security interests. Accordingly, there is no need to amend Section 488.360 from a policy standpoint.

Respectfully submitted,

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