

#39.160

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Memorandum 77-24

Subject: Study 39.160 - Attachment (General Assignment for Benefit of Creditors and Bankruptcy)

Attached to this memorandum is a copy of the Recommendation Relating to The Attachment Law--Effect of Bankruptcy Proceedings, Effect of General Assignments for the Benefit of Creditors. This recommendation has been revised to reflect the decisions made at the March meeting, but we thought you would like to see the recommendation because the changes were substantial. We do not plan to discuss this recommendation at the meeting unless a Commissioner has a problem with it. If you have any editorial suggestions, please give them to the staff at the meeting.

Respectfully submitted,

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#39.160

3/22/77

STATE OF CALIFORNIA

CALIFORNIA LAW
REVISION COMMISSION

RECOMMENDATION

relating to

THE ATTACHMENT LAW

Effect of Bankruptcy Proceedings

Effect of General Assignments for the Benefit of Creditors

CALIFORNIA LAW REVISION COMMISSION
Stanford Law School
Stanford, California 94305

BACKGROUND

Under the Bankruptcy Act, the trustee in bankruptcy may have an attachment lien voided in summary proceedings before the bankruptcy court by showing that the defendant was insolvent when the lien was obtained and that the lien was obtained within four months before the petition in bankruptcy was filed.¹

Prior to its repeal,² Section 542b of the Code of Civil Procedure provided that the lien of the temporary restraining order obtained in connection with an attachment terminated upon the filing by the defendant of a petition in bankruptcy. This provision was not continued in the Attachment Law,³ making it necessary for the trustee in bankruptcy to initiate proceedings to obtain an order declaring void the lien of a temporary protective order issued under the Attachment Law.⁴

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1. Section 67a(1), 11 U.S.C. § 107(a)(1) (1970), provides as follows:

Every lien against the property of a person obtained by attachment, judgment, levy, or other legal or equitable process or proceedings within four months before the filing of a petition initiating a proceeding under this Act by or against such person shall be deemed null and void (a) if at the time when such lien was obtained such person was insolvent or (b) if such lien was sought and permitted in fraud of the provisions of this Act: Provided, however, That if such person is not finally adjudged a bankrupt in any proceeding under this Act and if no arrangement or plan is proposed and confirmed, such lien shall be deemed reinstated with the same effect as if it had not been nullified and voided.

See Bankruptcy Act § 67a(3)-(4), 11 U.S.C. § 107(a)(3)-(4) (1970); 4 W. Collier, Bankruptcy § 67.15[1] (14th ed. 1975); E. Jackson, California Debt Collection Practice §§ 9.116-9.117 (Cal. Cont. Ed. Bar 1968). The lien may also be preserved for the benefit of the bankrupt's estate. Bankruptcy Act § 67a(3), 11 U.S.C. § 107(a)(3) (1970).

2. Code Civ. Proc. § 542b, added by Cal. Stats. 1972, Ch. 550, § 19, was repealed by Cal. Stats. 1974, Ch. 1516, § 12 (operative Jan. 1, 1977).
3. Cal. Stats. 1974, Ch. 1516 (operative Jan. 1, 1977).
4. See also Code Civ. Proc. § 488.110 (lien of temporary protective order).

Former Section 542b also provided for the termination of the lien of the temporary restraining order upon the making by the defendant of a general assignment for the benefit of creditors, a less formal and less expensive alternative to bankruptcy.⁵ The Attachment Law did not continue this provision, but Code of Civil Procedure Section 486.040 permits the court to fashion a temporary protective order containing "such provisions as the court determines would be in the interest of justice and equity to the parties." This general language would appear to authorize a temporary protective order that would permit a general assignment for the benefit of creditors.

RECOMMENDATIONS

The Commission recommends that a new chapter be added to the Attachment Law to deal with the effect of bankruptcy proceedings and general assignments for the benefit of creditors.

Under the proposed chapter, the lien of a temporary protective order or of an attachment automatically terminates when, within four months from the date the lien was obtained, a petition in bankruptcy is filed by or against the defendant⁶ or the defendant makes a general

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5. See generally D. Cowans, *Bankruptcy Law and Practice* § 83 (1963); Shapiro, Assignment for the Benefit of Creditors, in *California Remedies for Unsecured Creditors* 429 (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). It should also be noted that the making of a general assignment for the benefit of creditors is an act of bankruptcy. Bankruptcy Act § 3a, 11 U.S.C. § 21(a) (1970).
 6. The automatic termination of liens applies only where the petition in bankruptcy is filed and administered in California. This limitation is necessary to minimize the impact on creditors attaching in California of voiding liens only in this state. The recommended statute, unlike the Bankruptcy Act, would void liens which were obtained when the defendant was not insolvent. If there are multistate creditors involved, it would be unfair to the creditor attaching in California to void his attachment lien when the attachment liens obtained by creditors in other states would not be similarly voided.

assignment⁷ for the benefit of creditors.⁸ Terminating such preferential liens as a matter of state law furthers the policy favoring procedures generally designed to distribute the debtor's assets ratably and also eliminates the need for proceedings in bankruptcy to obtain an order declaring such liens void.⁹

The new chapter provides an orderly procedure through which an assignee under a general assignment for the benefit of creditors or a trustee in bankruptcy¹⁰ may obtain the release of property levied upon where the lien is terminated. The plaintiff in the action in which the attachment has been issued is given notice and a 10-day period within which to object to the release of the property.

The new chapter provides that the assignee under the general assignment for the benefit of creditors is subrogated to the rights of the attaching creditor. This will prevent the termination of the attachment lien by the making of a general assignment from benefitting a lienholder whose lien was subordinate to that of the attaching creditor but superior to the rights of the assignee, such as a secured party who obtained his security interest after the attachment but before the making of the general assignment.

7. The recommended statute requires that the general assignment be one that includes all the defendant's assets not exempt from execution, that it be for the benefit of all the defendant's creditors, and that the assignment itself not stipulate any preferences among creditors.
8. The laws of several other states provide for voiding certain liens upon the making of a general assignment. N.J. Rev. Stat. § 2A:19-3 (1952); N.Y. Debt. & Cred. Law § 15(6a) (McKinney Supp. 1976-77); N.C. Gen. Stat. § 23-3 (1965); Tenn. Code Ann. § 47-13-116 (1964).
9. The termination under state law would not take place where the trustee in bankruptcy obtains a court order preserving the lien for the benefit of the estate under Section 67a(3) of the Bankruptcy Act, 11 U.S.C. § 107(a)(3) (1970).
10. Where a receiver has been appointed in bankruptcy or there is a debtor in possession, such person should be authorized to apply for the release of the property as a corollary of such person's power to void a lien under the Bankruptcy Act. See Bankruptcy Act § 2a(3), 11 U.S.C. § 11(a)(3) (1970) (receiver) and §§ 67a(3), 188, 342, 11 U.S.C. §§ 107(a)(3), 588, 742 (1970) (debtor in possession).

The new chapter, like the Bankruptcy Act, provides for the reinstatement of terminated liens where the defendant is finally adjudged not to be a bankrupt or if no arrangement or plan is proposed and confirmed.¹¹ An analogous provision of the new chapter provides that a lien under the Attachment Law which was terminated by the making of a general assignment is reinstated where the general assignment is set aside as a fraudulent conveyance or for some other reason.

PROPOSED LEGISLATION

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

An act to add Chapter 13 (commencing with Section 493.010) to Title 6.5 of Part 2 of the Code of Civil Procedure, relating to attachment.

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

SECTION 1. Chapter 13 (commencing with Section 493.010) is added to Title 6.5 of Part 2 of the Code of Civil Procedure, to read:

CHAPTER 13. EFFECT OF BANKRUPTCY PROCEEDINGS AND GENERAL ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

§ 493.010. General assignment for the benefit of creditors defined

493.010. As used in this chapter, "general assignment for the benefit of creditors" means a common law assignment for the benefit of creditors which assigns all the defendant's assets that are transferable and not exempt from execution for the benefit of all the defendant's creditors and which does not prefer a creditor or class of creditors over any other creditor or class of creditors.

11. See Bankruptcy Act § 67a(1), 11 U.S.C. § 107(a)(1) (1970), quoted in note 1 supra.

Comment. Section 493.010 defines "general assignment for the benefit of creditors" in such a manner as to limit the application of the provisions of this chapter that provide for the termination of the lien of a temporary protective order or of attachment upon the making of a general assignment. This section reflects the policy that an attaching plaintiff should not lose his preference as against an assignment for the benefit of creditors unless the assignment is designed to distribute all of the defendant's transferable nonexempt assets ratably among all creditors. The provision that the assets must be transferable recognizes that some property, such as a lease which is subject to a condition that it may not be transferred without the consent of the lessor, need not be included in the assignment for it to be a general assignment for the benefit of creditors under this section. See Shapiro, Assignment for the Benefit of Creditors, in California Remedies for Unsecured Creditors 461 (Cal. Cont. Ed. Bar 1957) (pertaining to leases and citing Medinah Temple Co. v. Currey, 162 Ill. 441, 44 N.E. 839 (1896)); 16 Cal. Jur.3d Creditors' Rights § 62, at 419-420 (1974). The general assignment for the benefit of creditors may not create preferences if it is to have the effect of terminating a lien under the Attachment Law. This rule is not violated by the existence and recognition of statutory preferences that are not created by the assignment, such as, for example, prior secured interests, wage claims, execution liens, or tax claims.

§ 493.020. General assignment for the benefit of creditors not precluded

493.020. Nothing in this title precludes the making by the defendant of a general assignment for the benefit of creditors.

Comment. Section 493.020 makes clear that regardless of the terms of any writ of attachment, temporary protective order (Sections 486.010-486.110), or turnover order (Section 482.080), the defendant may make a general assignment for the benefit of creditors. Section 493.020 and the remainder of Chapter 13 reflect the policy favoring general assignments for the benefit of creditors (which contemplate the ratable distribution to creditors of the assignor's assets) over attachment (which permits one general creditor to establish a priority over other general creditors).

§ 493.030. Termination of lien of temporary protective order or attachment

493.030. (a) The lien of a temporary protective order terminates if, within four months after the temporary protective order is served on the defendant, either of the following occurs:

(1) The defendant makes a general assignment for the benefit of creditors.

(2) A petition initiating a proceeding under the National Bankruptcy Act is filed in California by or against the defendant for administration in California.

(b) The lien of attachment terminates as to particular property if, within four months after the effective date of the lien of attachment on such property pursuant to Section 488.500, either of the following occurs:

(1) The defendant makes a general assignment for the benefit of creditors.

(2) A petition initiating a proceeding under the National Bankruptcy Act is filed in California by or against the defendant for administration in California.

(c) Notwithstanding subdivisions (a) and (b), the lien of a temporary protective order or of attachment is not terminated where the bankruptcy court orders the lien preserved for the benefit of the bankrupt estate.

Comment. Subdivisions (a) and (b) of Section 493.030 provide for the termination of the lien of a temporary protective order or of an attachment upon the making of a general assignment for the benefit of creditors (defined in Section 493.010) or the commencement of bankruptcy proceedings in California within four months after the creation of the lien. See also Sections 486.090 (expiration of temporary protective order), 486.110 (lien of temporary protective order from time of service), 488.500 (lien of attachment), 488.510 (duration of lien of attachment).

Subdivision (c) recognizes that, in some cases, the trustee may seek to be subrogated to the rights of a lienholder whose lien is deemed null and void. See Bankruptcy Act § 67a(3), 11 U.S.C. § 107(a)(3) (1970).

Subdivision (a) is derived from a portion of former Section 542b which provided for the termination of the lien created by service of the notice of attachment hearing and the temporary restraining order when the defendant filed a proceeding under the Bankruptcy Act or made a general assignment for the benefit of creditors.

Subdivision (b) is new. It provides for the automatic termination of the lien of attachment, thereby making it unnecessary to initiate court proceedings under the Bankruptcy Act to have the lien of attachment declared void. This principle is also applied where the defendant makes a general assignment for the benefit of creditors (defined in Section 493.010) within the specified time.

The terminating effect of bankruptcy proceedings is limited to cases where the petition is filed and administered in California in order to minimize the effect on creditors with California writs of attachment in cases where the defendant has assets in more than one state and attachment liens in other states are not void under Section 67a(1) of the Bankruptcy Act, 11 U.S.C. § 107(a)(1) (1970).

This chapter does not affect other provisions voiding liens arising under this title. See, e.g., Ins. Code § 1034 (voidable preferences in insolvency proceedings applicable to insurers).

§ 493.040. Release of attachment

493.040. (a) Where a lien of attachment terminates pursuant to Section 493.030, the assignee of a general assignment for the benefit of creditors or, in the case of a bankruptcy, the trustee, receiver, or the debtor in possession if there is no trustee or receiver, may secure the release of the attachment by filing with the levying officer a request for release of attachment, executed under oath, which describes the property to be released from the attachment and:

(1) In the case of an assignee, a copy of the general assignment for the benefit of creditors.

(2) In the case of a trustee, receiver, or debtor in possession, a certified copy of the petition in bankruptcy.

(b) Within five days after the filing of the request for release of attachment, the levying officer shall mail to the plaintiff a copy of

the papers filed and a notice that the property will be released pursuant to the request for release of attachment unless otherwise ordered by court within 10 days after the date of mailing the notice of request for release of attachment.

(c) Unless otherwise ordered by court, the levying officer shall release the attachment pursuant to the request for release of attachment after the expiration of 10 days from the date of mailing the notice of request for release of attachment to the plaintiff. Where the property has been taken into custody, it shall be released to the person making the request or some other person designated in the request for release of attachment. Where the property has not been taken into custody, it shall be released as provided in subdivision (c) of Section 488.560.

Comment. Section 493.040 provides a procedure for releasing property from an attachment which has terminated pursuant to Section 493.030. Section 493.040 seeks to provide the levying officer with sufficient information to dispose of the attached property in an expeditious and orderly manner. By giving the plaintiff notice before the release takes place, the plaintiff in an appropriate case is able to protect his interests in preserving his priority. Through its incorporation of the release provisions of Section 488.560(c), Section 493.040 is also intended to inform garnishees that they are relieved of the duties and liabilities of a garnishee arising from service of the notice and writ of attachment.

§ 493.050. Reinstatement of lien

493.050. (a) The lien of the temporary protective order or of attachment, which has terminated pursuant to Section 493.030, is reinstated with the same effect as if it has not been terminated in the following cases:

(1) Where the termination is the result of the making of a general assignment for the benefit of creditors and the general assignment for the benefit of creditors is set aside as a fraudulent conveyance or for some other reason.

(2) Where the termination is the result of the filing of a petition initiating a proceeding under the National Bankruptcy Act and the defendant is not finally adjudged a bankrupt or no arrangement or plan is proposed and confirmed under the National Bankruptcy Act.

(3) Where the termination is the result of the filing of a petition initiating a proceeding under the National Bankruptcy Act and the trustee abandons property which had been subject to the lien of the temporary protective order or attachment before it was terminated.

(b) The period from the making of a general assignment for the benefit of creditors until reinstatement of the lien of the temporary protective order or of attachment may not be counted in determining the duration of the temporary protective order or the lien of attachment.

Comment. Section 493.050 provides for reinstatement of the terminated lien where the general assignment for the benefit of creditors is set aside, the defendant is not finally adjudged a bankrupt, a bankruptcy arrangement or plan is not proposed and confirmed, or the trustee in bankruptcy abandons property that had been subject to a terminated lien. Paragraph (2) of subdivision (a) is derived from a proviso contained in Section 67a(1) of the Bankruptcy Act, 11 U.S.C. § 107(a)(1) (1970). Paragraph (1) applies this principle to the analogous situation where the general assignment for the benefit of creditors fails. Paragraph (3) codifies for the purposes of this chapter the principle that, after abandonment, the property is restored to its former status as if it had never been held by the trustee. See Pounds v. Chicago Insurance Co., 298 So.2d 134 (La. App. 1974).

Subdivision (b) provides for the tolling of the running of the effective periods of the temporary protective order under Section 486.090 and the lien of attachment under Section 488.510 when the defendant makes a general assignment for the benefit of creditors. Federal law provides for the tolling of state statutes of limitation upon the filing of a petition in bankruptcy. Bankruptcy Act § 11f, 11 U.S.C. § 29(f) (1970); Booloodian v. Ohanesian, 13 Cal. App.3d 635, 91 Cal. Rptr. 923 (1970) (tolling of period of attachment lien under former Section 542b). Note that the effective date of the lien of the reinstated attachment may relate back to the date of service of a temporary protective order as provided in Section 488.500(1).

§ 493.060. Assignee subrogated to rights of plaintiff

493.060: Upon the making of a general assignment for the benefit of creditors, the assignee is subrogated to the rights of the plaintiff under the temporary protective order or attachment.

Comment. Section 493.060 subrogates the assignee under the general assignment for the benefit of creditors to the rights of the attaching plaintiff in order to prevent the termination of the lien of the temporary protective order or of attachment from benefitting a lienholder whose lien was subordinate to the plaintiff's lien but whose lien is not terminated by the making of the general assignment.