

#39.160

5/2/77

Memorandum 77-31

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

Attached hereto is the staff draft of the Tentative Recommendation Relating to Attachment of Property Subject to Security Interest. This recommendation is a revision of the draft of a statute and Comments prepared by Professor Stefan A. Riesenfeld and considered at the April meeting. We hope this tentative recommendation can be approved at the May meeting for distribution for comment. If you have any editorial suggestions, please give them to the staff at the May meeting.

Respectfully submitted,

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STAFF DRAFT

TENTATIVE RECOMMENDATION

relating to

ATTACHMENT OF PROPERTY SUBJECT TO SECURITY INTEREST

BACKGROUND

The Attachment Law¹ contains detailed provisions for the manner of levy under a writ of attachment on various types of property.² These provisions were designed to provide an orderly means of obtaining a lien on the defendant's interest in property subject to attachment, regardless of whether it is tangible personal property in the possession of the defendant or a third person or is a debt owed to the defendant. These sections typically provide for seizure of tangible personal property in the hands of the defendant (except in a few situations where a lien on the property is created by service) and for service on the person obligated to the defendant or holding the defendant's property.³ Where an obligation of a third person to the defendant is garnished by service of a copy of the writ of attachment and the notice of attachment, a lien is created on the property⁴ and the garnishee is liable to the plaintiff in the amount of the defendant's property interest under the third person's control.⁵ Rights of other third persons may be asserted through the normal third-party claims procedure.⁶

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1. Code Civ. Proc. §§ 401.010-492.090. Except as otherwise noted, all citations are to the Code of Civil Procedure.
 2. See Sections 488.310-488.430.
 3. A detailed discussion of the levy procedures applicable to specific forms of property is presented infra. It should be noted that the defendant is given notice of the levy in every case, but this notice is for information and does not relate to the creation of a lien on the property.
 4. Section 488.500.
 5. Section 488.550.
 6. See Section 488.090 (incorporating third-party claims procedure applicable after judgment).

Although it functions well in most situations, this statutory scheme does not prescribe rules adequate to deal with situations where the plaintiff seeks to levy on personal property which the defendant has pledged as security for a loan. While the former law was far from clear, the decisions held in general that a secured party with a perfected security interest in collateral involving a bailment or the inebtedness of an account debtor to the defendant is entitled to the disposition of the collateral, including the collection of payments due thereon, without interference deriving from a subsequent levy of attachment by the plaintiff on the defendant's interest in the pledged property.⁷

RECOMMENDATIONS

The Commission has concluded, after reviewing the law pertaining to secured transactions under the Commercial Code,⁸ that these case law principles should be made explicit in the Attachment Law. In most situations where there is a prior perfected security interest in the property, the priority of the secured party should be recognized without the need to make a third-party claim.⁹ Equally important, the person obligated to the defendant on the pledged property or holding pledged property should not be forced to make payments or to turn the property over to the levying officer pursuant to the writ of attachment while the obligor or bailee is primarily obligated to the secured party.

7. See, e.g., Puissegur v. Yarbrough, 29 Cal.2d 409, 175 P.2d 639 (1964); Dubois v. Spinks, 114 Cal. 239, 294-295, 46 P. 25, ___ (1896); Deering v. Richardson-Kimball Co., 109 Cal. 73, 84, 41 P. 801, ___ (1895); Robinson v. Trevis, 38 Cal. 611 (1896); Axe v. Commercial Credit Corp., 227 Cal. App.2d 216, 38 Cal. Rptr. 555 (1964); Crow v. Yosemite Creek Co., 149 Cal. App.2d 188, 308 P.2d 421 (1957).

8. See Com. Code §§ 9101-9505 and related provisions in other divisions of the Commercial Code.

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

The incorporation of these principles in the Attachment Law will also require a modification of the levy procedures involving service of a notice of attachment on an account debtor, obligor, or bailee. Specifically, the Commission recommends that the Attachment Law be revised to take account of the paramount interests of secured parties in the following manner:

Accounts Receivable and Choses in Action

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

These provisions should be revised to provide that, where the account receivable or chose in action to be levied upon is subject to a perfected security interest,¹⁷ levy is made by serving a copy of the writ and the notice of attachment on the secured party rather than on the account debtor. The account debtor should then continue to make payments to the secured party. When the obligation of the defendant (who is the debtor under the security interest)¹⁸ to the secured party

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

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

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

13. Section 488.370(a).

14. Section 488.500(f).

15. Section 488.540.

16. Section 488.550.

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

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

is paid off, any excess in payments by the account debtor to the secured party should be paid to the levying officer for the purposes of the attachment.

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

Chattel Paper

Chattel paper²¹ is levied upon by serving the person in possession of the chattel paper with a copy of the writ and the notice of attachment and, if the chattel paper is in the defendant's possession, by taking custody of the chattel paper.²² Service and any required custody creates a lien on the chattel paper.²³ The account debtor obligated on

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

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

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

22. Section 488.330(a).

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

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

Where the chattel paper is subject to a prior security interest which is perfected by the secured party's possession of the chattel paper,²⁷ the writ and notice of attachment should be served on the secured party.²⁸ The account debtor obligated on the chattel paper should continue to make any required payments to the secured party. The account debtor should receive notice in this situation only where the secured party has left the liberty to the defendant to collect payments due on the chattel paper or to enforce or accept the return of tangible personal property the sale or lease of which resulted in the chattel paper.²⁹ The account debtor should also be served with a demand to make payment of all amounts due and to deliver returnable property to the levying officer rather than to the defendant.³⁰ When the secured party's interest is satisfied, any excess in payments or excess proceeds

24. Section 488.380(c).

25. Section 488.540.

26. Section 488.550.

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

28. The secured party and the person in possession under the rules set forth in Section 488.380(a) are, of course, the same in this situation. The difference here is that no notice is to be given the person obligated on the chattel paper so that the relation between such person and the secured party is not altered.

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

30. This rule is analogous to the proposed rule applicable to the return of property or payments where the defendant has been left the liberty to collect accounts receivable [and choses in action]. See text accompanying note 20 supra.

from the sale of the collateral should be paid to the levying officer for the purposes of the attachment.³¹

The Attachment Law should also be revised to make clear that the levy on chattel paper creates a lien that extends to the interest of the lessor in the tangible personal property that was leased to create the chattel paper.³² This provision is needed to clarify the respective interests of the secured party and the attachment plaintiff in the lessor's (defendant's) interest in the property which was leased to create the chattel paper.

Deposit Accounts

A deposit account³³ is levied upon by serving the financial institution holding the account with a copy of the writ and the notice of attachment.³⁴ Other persons in whose name the deposit account stands are required to be served, but this is not a condition of a valid levy.³⁵ Service on the financial institution creates a lien on the deposit account.³⁶

31. An exception should apply where the plaintiff has levied on inventory and proceeds pursuant to Section 488.360(c). See note 29 supra.

32. This proposed provision is derived from the rule that a perfected security interest in chattel paper gives the secured party a perfected security interest in the rights to payment evidenced thereby and in the debtor's security interest in the goods sold if that security interest is perfected by filing. See Bolduan v. Normandin (In re Western Leasing, Inc.), 17 U.C.C. Rep. 1369 (O. Ore. 1975). The proposed provision resolves for purposes of attachment the conflict in decisions under the Commercial Code concerning whether a security interest in chattel paper which is perfected by possession results in a perfected security interest in the lessor's property interest in the leased goods since the lessor's interest is not a security interest in need of perfection. See Comment, In Re Leasing Consultants, Inc.: The Double Perfection Rule for Security Assignments of True Leases, 64 Yale L.J. 1722 (1975).

33. See Section 488.380 ("Deposit account" defined).

34. Section 488.390(a).

35. Section 488.390(b).

36. Section 488.500(e).

Where the deposit account is subject to a perfected security interest³⁷ that is prior to the attachment lien, the writ and notice of attachment should be served on the secured party rather than the financial institution.³⁸ After the satisfaction of the security interest, the secured party should pay any excess to the levying officer for the purposes of the attachment.

Negotiable Documents

A negotiable document³⁹ is levied upon by serving the person in possession of the document with a copy of the writ and the notice of attachment and, if the document is in the defendant's possession, by taking custody of the document.⁴⁰ Service and any required custody creates a lien on the document.⁴¹ The Attachment Law also requires the obligor on the document to be given notice.⁴²

The rules for levy on negotiable documents should remain unchanged, regardless of whether the negotiable document is subject to a perfected security interest. If the security interest in the negotiable document is perfected by possession,⁴³ then the existing rules result in the secured party being served with a copy of the writ and the notice of attachment. If the security interest in the negotiable document is perfected by filing,⁴⁴ then the levy should be by seizure where the negotiable document is in the hands of the defendant in order to prevent

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

38. The financial institution which would be served under Section 488.390(a) will not be the secured party since the secured transactions provisions of the Commercial Code do not apply to a right of setoff. Com. Code § 9104(1). See 3 California Commercial Law § 1.26, at 92 (Cal. Cont. Ed. Bar Supp. 1976).

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

40. Section 488.400(a).

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

42. Section 488.400(c).

43. Com. Code § 9305.

44. Com. Code § 4904(1).

negotiation of the document to a holder in due course.⁴⁵ The prior interest of the secured party could then be asserted under the third-party claims procedures.⁴⁶ However, the person obligated on the negotiable document, i.e., the bailee who has issued the negotiable document, need not receive notice of the attachment since the bailee cannot deliver the goods represented by the negotiable document to anyone not in possession of the document.⁴⁷

Negotiable Instruments

A negotiable instrument⁴⁸ is levied upon by serving the person in possession of the document with a copy of the writ and the notice of attachment and, if the instrument is in the defendant's possession, by taking custody of the instrument.⁴⁹ Service and any required custody creates a lien on the instrument.⁵⁰ The person obligated on the instrument is also required to be given notice, but this is not a condition of a valid levy.⁵¹

Where the negotiable instrument is subject to a security interest which is perfected by possession,⁵² the same method of levy should apply--the levying officer should serve a copy of the writ and the notice of attachment on the secured party in possession of the negotiable instrument. After satisfaction of the security interest, any excess payments should be paid to the levying officer for the purposes of the attachment. However, the person obligated on the negotiable instrument should not be required to be served since the obligor should continue to make required payments to the secured party.

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

46. See Section 488.390 (incorporating postjudgment third-party claims procedures).

47. Com. Code §§ 7403, 7602.

48. See Section 488.160 ("negotiable instrument" defined).

49. Section 488.400(a).

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

51. Section 488.400(c).

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

Judgments

A final judgment⁵³ owing to the defendant is levied upon by filing a copy of the writ and the notice of attachment in the action in which the judgment was entered and serving the judgment debtor.⁵⁴ Such filing and service creates a lien on the judgment.⁵⁵

Where the judgment is subject to a perfected security interest,⁵⁶ the copy of the writ and the notice of attachment should be served on the secured party. Filing in the action in which the judgment was rendered should not be required in this case since the judgment debtor is obligated to the secured party under the security interest.

Goods in Possession of Bailee

Where no special method of levy is provided in the Attachment Law, tangible personal property in the possession of a third person is levied upon by serving the person in possession with a copy of the writ and the notice of attachment.⁵⁷ Service in this manner creates a lien on the property.⁵⁸

Where goods⁵⁹ in the possession of a bailee who has not issued a negotiable document are subject to a perfected security interest,⁶⁰ levy

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

54. Section 488.420(a).

55. Section 488.500(g).

56. Commercial Code Section 9104(h) excludes from the coverage of Division 9 of the Commercial Code "a right represented by a judgment (other than a judgment taken in a right to payment which was collateral)." The general rule as to perfection provides for filing a financial statement. Com. Code § 9302(1).

57. Section 488.330(a). This method of levy does not apply where the property is goods subject to a negotiable document. Section 488.330(a).

58. Section 488.330(e).

59. See Com. Code § 9105(1)(h) ("goods" defined).

60. A security interest in goods in the possession of a bailee who has not issued a negotiable document is perfected by issuance of a non-negotiable document in the name of the secured party, by the bailee's receipt of notification of the secured party's interest, or by filing as to the goods. Com. Code § 9304(3).

of attachment should be by service on the secured party. Levy in this manner will reach the defendant's interest in the goods after the secured party's interest is satisfied. Notice to the bailee is not necessary because the property in the possession of the bailee is subject first to satisfaction of the secured interest. Any proceeds from the sale of the goods to satisfy the security interest should be paid to the levying officer for the purposes of the attachment.⁶¹

PROPOSED LEGISLATION

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

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

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

61. See Section 488.550 (liability of garnishee).

§ 488.335. Goods subject to perfected security interest

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

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

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

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

§ 488.370. Accounts receivable; choses in action

SEC. 2. Section 488.370 of the Code of Civil Procedure is amended to read:

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

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

Comment. The introductory clause is added to subdivision (a) of Section 488.370 to reflect the enactment of Section 488.400 which prescribes the manner of levy on an account receivable or a chose in action which is subject to a perfected security interest.

406/470

§ 488.380. Chattel paper

SEC. 3. Section 488.380 of the Code of Civil Procedure is amended to read:

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

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

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

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

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

Comment. The introductory clause is added to subdivision (a) of Section 488.380 to reflect the enactment of Section 488.440 which prescribes the manner of levy on chattel paper subject to a security interest perfected by possession. If the security interest is perfected in some other manner, levy is made as provided in this section and the secured party may assert the security interest by means of the third-party claims procedure. See Section 488.090 and the Comment to Section 488.440.

Subdivision (c) of Section 488.380 is amended to reflect the amendment of subdivision (a) of Section 488.500 providing that the lien on chattel paper extends to the interest of the lessor in the tangible personal property the lease of which has resulted in the chattel paper. See the Comment to the amendment of subdivision (a) of Section 488.500.

If no paramount interest of a secured party (as recognized in Section 488.440) is involved, the property generally is to be delivered to the levying officer upon termination of the lease. An exception is provided where the leased property is inventory of the lessor and the creditor of the lessor has levied on the inventory by filing pursuant to Section 488.360(c). In such a case, the leased and returned inventory can be leased out again and the lien on the inventory shifts to the chattel paper resulting from that lease. [See Com. Code § 9306(1) (defining "proceeds").]

This rule relating to the return of the leased property is consistent with Commercial Code Section 9306(5) which applies to the return of goods the sale of which results in chattel paper.

968/891

§ 488.390. Deposit accounts

SEC. 4. Section 488.390 of the Code of Civil Procedure is amended to read:

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

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

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

- (1) Its compliance with the levy.
- (2) The nonpayment of any check or other order for the payment of money drawn or presented against the account.
- (3) The refusal to pay any withdrawal in respect to the account.

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

406/458

§ 488.400. Negotiable instruments; negotiable documents; money

SEC. 5. Section 488.400 of the Code of Civil Procedure is amended to read:

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

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

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

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

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

instrument is subject to a security interest which is perfected by filing, levy is made as provided in this section and the secured party may assert the security interest by means of the third-party claims procedure. See Section 488.090 and the Comment to Section 488.440.

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

968/892

§ 488.420. Judgments owing to defendant as a judgment creditor

SEC. 6. Section 488.420 of the Code of Civil Procedure is amended to read:

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

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

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

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

§ 488.440. Property subject to perfected security interest

SEC. 7. Section 488.440 is added to the Code of Civil Procedure, to read:

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

- (1) Accounts receivable.
- (2) Choses in action.
- (3) Chattel paper, if the security interest is perfected by possession of the chattel paper.
- (4) Deposit accounts.
- (5) Negotiable instruments, if the security interest is perfected by possession of the negotiable instrument.
- (6) Judgments, except that no judgment owing to the defendant shall be attached until after its entry as a final judgment and the time for appeal from such judgment has expired or, if an appeal is filed, until such appeal is finally determined.

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

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

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

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

Comment. Section 488.440 implements Commercial Code Section 9311 which permits the attachment of the debtor's rights in collateral. Section 488.440 also prescribes the method of levy on the collateral when it is subject to a perfected security interest. If the security interest is not perfected, the rights of the secured party are subordinate to the plaintiff's attachment lien. Com. Code § 9301(1)(b). Section 488.440 codifies the rules applied in such cases as *Puissegur v. Yarbrough*, 29 Cal.2d 409, 175 P.2d 830 (1964); *DuBois v. Spinks*, 114 Cal. 289, 294-295, 46 P. 95, ___ (1896); *Deering v. Richardson-Kimball Co.*, 109 Cal. 73, 84, 41 P. 801, ___ (1895); *Robinson v. Trevis*, 38 Cal. 611 (1869); *Axe v. Commercial Credit Corp.*, 227 Cal. App.2d 216, 38 Cal. Rptr. 558 (1964); and *Crow v. Yosemite Creek Co.*, 149 Cal. App.2d 188, 308 P.2d 421 (1957). According to the principles of these cases, a secured party having a perfected security interest in collateral which involves the indebtedness of an account debtor is entitled to the disposition of the collateral, including the collection of payments due thereon, without interference deriving from a subsequent levy of attachment on the pledgor's interest. A qualification of this rule is appropriate (1) where the security interest of the secured party is nonpossessory, i.e., the perfection is by filing rather than possession, or (2) where the secured party has left the collection to the defendant (the debtor on the secured obligation) pursuant to Commercial Code Section 9205 by virtue of a so-called indirect collection arrangement. See U.C.C. § 9-308, Comment 1. Such arrangements are commonly made in cases of accounts receivable or chattel paper financing.

These rules are extended by analogy to the return of goods, the sales or leases of which have resulted in the accounts receivable or chattel paper which were attached. Under subdivision (d), since the

levy on the chattel paper extends the attachment lien to the lessor's property interest in the leased goods and to the security interest of the seller in goods sold pursuant to Section 488.500(a), the goods are to be returned to the levying officer for the purposes of the levy but only if the secured party does not have paramount rights to possession.

Subdivision (c) makes clear that any excess of payments made to the secured party and any excess from the pledgee's sale of the goods returned to the secured party must be turned over to the levying officer to be held under the attachment lien. See Com. Code § 9311.

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

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

It should be noted that these rules apply only where accounts receivable or chattel paper are specifically levied upon. In the case of an attachment of the inventory of a going business, the attaching plaintiff may be satisfied with a levy on the inventory and proceeds therefrom pursuant to Section 488.360(c). Even where the plaintiff has levied on chattel paper and inventory pursuant to Section 488.360(c), returned goods will remain inventory.

§ 488.500. Lien of attachment, effective date

SEC. 8. Section 488.500 of the Code of Civil Procedure is amended to read:

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

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

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

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

(e) The lien of attachment on property on:

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

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

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

(f) The lien of attachment on property on:

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

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

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

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

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

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

(i) Notwithstanding subdivisions (b) through (h), inclusive, and except as otherwise provided by Section 486.110, where a temporary protective order has been issued pursuant to Chapter 6 (commencing with Section 486.010), the lien of attachment on property described in such order and subsequently attached is effective from the date of service of such order.

Comment. The second sentence of subdivision (a) of Section 488.500 is new. It makes clear that a lien of attachment on chattel paper extends to the property interest of the lessor during the life of the lease and after its termination. The lien under this new provision lapses only upon authorized delivery to the lessor instead of to the levying officer. See Sections 488.360(c), 488.380(c), 488.440(d). The second sentence of subdivision (a) is derived from the rule that a perfected security interest in chattel paper gives the secured party a

perfected security interest in the rights to payment evidenced thereby and in the debtor's security interest in the goods sold if that security interest is perfected by filing. See Com. Code § 9304(1); Bolduan v. Normandin (In re Western Leasing, Inc.), 17 U.C.C. Rep. 1369 (D. Ore. 1975). There is conflict in the decisions, however, concerning whether a security interest in chattel paper which is perfected by possession (Com. Code § 9305) results in a perfected security interest in the lessor's property interest in the leased goods since the lessor's interest is not a security interest in need of perfection. See Comment, In re Leasing Consultants, Inc.: The Double Perfection Rule for Security Assignments of True Leases, 84 Yale L.J. 1722 (1975).

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

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

SEC. 9. Section 488.540 of the Code of Civil Procedure is amended to read:

488.540. Where an account receivable, chattel paper, chose in action, negotiable instrument, or judgment is attached, the account debtor or obligor may pay the amount owing on such obligation to the ~~levying officer~~ officer unless the attached property is subject to a perfected security interest which entitles the secured party to such payments pursuant to subdivision (c) of Section 488.440. The receipt of such officer is a sufficient discharge for the amount paid.

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