



BUSINESS LAW SECTION

INSOLVENCY LAW COMMITTEE

THE STATE BAR OF CALIFORNIA

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JUDGMENT LIENS AGAINST REGISTERED ORGANIZATIONS; CODE OF CIVIL PROCEDURE §§ 697.530 AND 697.590

LEGISLATIVE PROPOSAL (BLS-2009-07)

TO: Office of Governmental Affairs
FROM: Donna Parkinson, Chair
Business Law Section (the "Section"), Insolvency Law Committee (the "Committee")
DATE: July 30, 2008
RE: Proposal by Insolvency Law Committee to Permit Judgment Liens Against Assets of Foreign Corporations and Other Registered Organizations

SECTION ACTION AND CONTACTS

Date of Approval by Section Executive Committee (the "Executive Committee"): July 18, 2008
Approval Vote:

For: 13 Against: 0

Date of Approval by Legislative Subcommittee of the Executive Committee: July 30, 2008
Approval Vote:

For: 7 Against: 0

Date of Approval by the Committee: July 11, 2008
Approval Vote:

For: 14 Against: 0

Date of Approval by the Uniform Commercial Code Committee: May 9, 2008
Approval Vote:

For: 21 Against: 0

Date of Approval by the Agribusiness Committee: April 23, 2008
Approval Vote:

For: 16 Against: 0

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HISTORY, DIGEST AND PURPOSE

This Legislative Proposal is submitted by the Insolvency Law Committee (the “Committee”) to integrate the revisions to Division 9 of the California Uniform Commercial Code that became effective in July 2001 with existing California laws relating to judgment liens. Specifically, this ALP reinstates the ability of judgment creditors in California to obtain judgment liens against the assets of corporations and other organizations that are incorporated or registered in other jurisdictions but have assets or their chief executive office in California.

The Committee seeks to promote predictability, efficiency and consistency in the administration of the federal and California laws governing insolvency and the rights and duties of creditors and debtors. The Committee evaluates and advocates changes in federal and state statutes and regulations affecting creditors and debtors. This Legislative Proposal is consistent with the Committee’s mission because the proposed change is intended to restore consistency to the rights of judgment creditors in California to obtain judgment liens against the assets of corporations and other organizations in California, regardless of whether those organizations are registered in California or in other states or countries.

History.

There is no legislative history and there are no Law Revision Commission or other official comments on the subject of this Legislative Proposal – the integration of California’s judgment lien laws with the broad revisions to Division 9 of the California Uniform Commercial Code that became effective in July 2001.

Relevant Existing Code Sections.

Division 9 of the California Uniform Commercial Code (California’s adoption of Article 9 of the Uniform Commercial Code) provides a system for establishing the perfection and priority of security interests and liens on many types of personal property through the filing of a financing statement with the California Secretary of State when the debtor is deemed located in California. California Commercial Code Section 9322(a) provides generally that, as between conflicting security interests perfected by filing a financing statement, priority ranks according to the time of filing the financing statement, with the earliest filing having priority over later ones.

California Code of Civil Procedure Section 697.510 provides a similar mechanism for a judgment creditor to create and perfect a judgment lien and be accorded priority by filing a notice that is very similar to a financing statement in the same system of record, thereby giving notice of the lien to other creditors when they conduct UCC searches with the California Secretary of State, *but only* “if a security interest [in those assets] could be perfected under the Commercial Code by filing a financing statement at that time with the [California] Secretary of State”. See Cal. Civ. Proc. Code 697.530(a). The lien attaches to accounts receivable, chattel paper, equipment, farm products, inventory and negotiable documents of title. See Cal. Civ. Proc. Code §§697.510(a) and 697.530(a). California Code of Civil Procedure Section 697.590 creates a

priority scheme for competing judgment liens and security interests by providing generally that they rank by time of filing or perfection, subject to special priority provisions for purchase money security interests and future advances.

Prior to the adoption of the broad revisions to Division 9 of the California Uniform Commercial Code that became effective in July 2001 (“*Revised Division 9*”), a corporation or limited liability company was deemed located in the State where it had its place of business, and if it had more than one, where its chief executive offices were located. Security interests were perfected by filing in the office designated by the law of the debtor’s location, which in California was the Secretary of State’s office. As a result, the integrated filing and priority rules for security interests and judgment liens worked well. If, for example, a secured party obtained a non-purchase money security interest in the California inventory of a debtor incorporated in Delaware and a judgment creditor created a judgment lien against the same debtor’s inventory, the priority of their conflicting interests would be determined by the timing of the filing of the secured party’s financing statement and the filing of the judgment creditor’s notice of lien. If the judgment creditor properly filed its notice prior to the filing of the financing statement by the secured party, the judgment lien against the inventory would have priority. These integrated rules worked well because the California Secretary of State’s UCC system was the proper place to file financing statements and notices of judgment liens both with respect to tangible assets in California and with respect to intangible assets if the debtor had its place of business or chief executive office in California. *See* Cal. Civ. Proc. Code §697.530(a) and former California Uniform Commercial Code Section 9401(a) (effective until July 1, 2001). Accordingly creditors and debtors could search and locate all relevant financing statements and notices of judgment liens in a single data base, and judgment creditors could create judgment liens against corporations and other registered organizations regardless of whether those organizations were organized or registered in California or in Delaware or any other jurisdiction.

Revised Article 9 changed the deemed “location” of a corporation, limited liability company or other “registered organization” to its place of formation, whether or not the entity has any assets or conducts any business in that jurisdiction. Unfortunately, as a recent bankruptcy court held, with respect to non-California entities, the integrated filing and perfection rules for security interests and judgment liens were adversely affected by the broad revisions in Revised Division 9 when it became effective in California on July 1, 2001. *Aura Systems, Inc. v. Barovich (In re Aura Systems, Inc.)*, 347 B.R. 720 (Bankr. C.D. Cal. 2006). The *Aura* court found that, since creating a judgment lien under this statute depends on being able to perfect a security interest by filing with the California Secretary of State, and because Revised Article 9 changed the deemed location of the judgment debtor (and therefore the place to file against it for perfecting a security interest under the UCC) to its place of incorporation, a judgment creditor could not obtain a valid judgment lien against the debtor in *Aura* because it was a Delaware corporation and filing a financing statement with the California Secretary of State no longer satisfied the statutory requirements of Section 697.530(a) with respect to creation of a judgment lien.

As indicated, a judgment creditor obtains a judgment lien against assets of the judgment debtor by filing a notice of the lien with the California Secretary of State “if a security interest [in those assets] could be perfected under the Commercial Code by filing a financing statement at that time with the [California] Secretary of State.” Cal. Civ. Proc. Code §697.530(a). Under the current filing rules in Revised Division 9, however, a secured creditor of a corporation, limited liability company, or other registered organization files a financing statement with the California Secretary of State only if the judgment debtor is incorporated or registered in California. Cal. Comm. Code §9301(1). If, as in the example described above, a Delaware corporation has inventory in California, a judgment lien under California law cannot be obtained against that inventory (or any other personal property assets of that corporation) because the proper place to file a financing statement against the inventory and other assets of the corporation is the Delaware Secretary of State’s office. In addition, if a notice of judgment lien were filed against the corporation’s California inventory, creditors and potential creditors of the corporation would be unaware of the lien unless they searched the UCC records of both Delaware and California. Whether creating a judgment lien against the assets of a foreign corporation doing business or having assets in California is possible under the laws of other states, which are not uniform as to their enforcement devices, would depend on the laws of those states, the territorial reach of their process, the presence or absence of assets, which their regimes make subject to encumbrance, and other factors. However, focusing on the devices made available in California, at present, California registered entities are subject to judgment liens under this State’s enforcement of judgment law, and registered entities formed under the law of other States doing the same business here are not.

Proposal.

This Legislative Proposal amends California Code of Civil Procedure Section 697.530 to allow judgment creditors to file notices of judgment liens against the assets of corporations, limited liability companies, and other registered organizations even if those organizations are incorporated or registered outside of California. It accomplishes that result by establishing the following new conditions for the creation of the lien against specific categories of assets: (i) for most tangible assets (equipment, farm products, inventory, or tangible negotiable documents of title) that the assets be located in California (see new section 697.530(a)(1)); and (ii) for intangible accounts receivable and tangible chattel paper that the debtor’s residence, place of business, or chief executive office be located in California, without regard to whether a corporate or other registered debtor is incorporated or registered inside or outside of California (see new section 697.530(a)(2)). New section 697.530(g) makes clear the existing Commercial Code rules for the location of a person apply, except the rule regarding registered organizations.

In addition, in order not to require creditors of corporations and other entities registered outside of California to search the UCC records of both the state of registration and California, this Legislative Proposal amends California Code of Civil Procedure Section 697.590 to establish a special priority rule for judgment liens against the assets of such registered entities. The amendment establishes that a California judgment lien in the assets of a non-California corporation or other registered entity is junior to a security interest in those assets perfected by

filing or other action in the state of registration, regardless of whether the financing statement is filed after the notice of judgment lien and regardless of whether the secured party knew of the judgment lien when it filed the financing statement. See new section 697.590(h).

Finally, this Legislative Proposal corrects an apparent oversight regarding agricultural liens in the amendments to Section 697.590 of the California Code of Civil Procedure made to accommodate the broad changes to Division 9 that became effective in July 2001. Those corrections add references to agricultural liens when appropriate to establish priority rules that should apply to judgment liens, on the one hand, and to security interests and agricultural liens, on the other. At the suggestion of the Agribusiness Committee, those corrections also confirm that the general priority rules between judgment liens and agricultural liens do not override statutes that give explicit priority to specific agricultural liens over conflicting judgment liens. The language of the non-override provision is based on similar language in California Uniform Commercial Code Section 9322(g) regarding the priority between agricultural liens and conflicting security interests. See new section 697.590(a)(1)(B), (a)(2), (a)(3), (b), and (g).

Reasons for the Proposal.

Although the disparate treatment under Section 697.530 of judgment debtors registered outside of California and those registered here appears to have been inadvertent, it nonetheless discriminates against judgment creditors based on the state of registration of their judgment debtors and creates a loophole or inconsistency in an established public policy permitting the creation of judgment liens. This Legislative Proposal is intended to close that loophole. To do so, this Legislative Proposal expressly permits the creation of a judgment lien against the assets of a judgment debtor that is a registered entity regardless of the state of registration, as long as either the debtor's tangible assets are located in California or, with respect to accounts receivable and tangible chattel paper, its place of business (if it has only one) or its chief executive office is in California.

This Legislative Proposal also recognizes that, under the state-of-registration filing rules under Article 9 as adopted in all other states, creditors of a corporation or other registered organization will likely conduct lien searches in the jurisdiction where the organization is incorporated or registered, but may not conduct lien searches of the records of the California Secretary of State. Accordingly, the Proposal's new subdivision (h) of Section 697.590 provides that judgment liens filed in California against an organization registered outside of California will not have priority over a security interest in the same assets perfected by filing a financing statement in the state where the organization is registered. The Committee continues to believe that it would be appropriate to require creditors of a foreign corporation or other foreign registered entity to search the records of the California Secretary of State if the entity has tangible assets or is headquartered in California. Moreover, the Committee believes that prudent creditors of non-California corporations and other registered organizations with assets or operations in California will continue to conduct searches in California because of the possible filing in California of federal tax or ERISA liens or state tax and other liens. Over the past 18 months, the Committee has had several discussions with the Uniform Commercial Code Committee about

these issues. Ultimately, to achieve a consensus on restoring the ability to obtain judgment liens against the assets of foreign corporations and other entities, the Committee has accepted the position of the Uniform Commercial Code Committee that, in order to promote national uniformity in due diligence procedures in commercial transactions, creditors of such entities should not be required to search in California, and judgment liens should not have priority over subsequent security interests perfected under the laws of other states.

APPLICATION

The amendments in this Legislative Proposal should take effect on January 1 of the calendar year immediately following its adoption. It is unnecessary for it to have any retroactive effect.

PENDING LITIGATION

We are not aware of any pending litigation that would be affected by this Legislative Proposal.

LIKELY SUPPORT AND OPPOSITION

We have sought and obtained the approval of the Uniform Commercial Code and Agribusiness Committees to this Legislative Proposal. We believe those committees are the only arms of the State Bar who would likely have material interest in this Legislative Proposal. We are not aware of any similar proposals being considered by the State Bar or the Legislature. We are not aware of any opposition to this Legislative Proposal.

FISCAL IMPACT

None.

GERMANENESS

This Legislative Proposal is germane to the mission of our Committee inasmuch as its adoption will promote both predictability and consistency in the administration of California laws governing insolvency and the rights and duties of creditors and debtors and, more generally, clarity and comprehensiveness in the law. This Legislative Proposal is also important to constituents of our Committee, who from time to time represent creditors seeking relief against corporate and other registered debtors.

TEXT OF PROPOSAL

SECTION 1. Section 697.530 of the Code of Civil Procedure is amended to read:

697.530. (a) A judgment lien on personal property is a lien on all interests in the following personal property that are subject to enforcement of the money judgment against the judgment debtor pursuant to Article 1 (commencing with Section 695.010) of Chapter 1 ~~at the time when the lien is created if a security interest in the property could be perfected under the Commercial Code by filing a financing statement at that time with the Secretary of State: , if at that time the personal property is~~

- ~~(1) Accounts receivable.~~
- ~~(2) Chattel paper.~~
- ~~(3) Equipment.~~
- ~~(4) Farm products.~~
- ~~(5) Inventory.~~
- ~~(6) Negotiable documents of title.~~

(1) equipment, farm products, inventory, or tangible negotiable documents of title (excluding as-extracted collateral (as defined in paragraph (6) of subdivision (a) of Section 9102 of the Commercial Code) and timber to be cut) and is located in this state; or

(2) accounts receivable or tangible chattel paper (as defined in paragraph (78) of subdivision (a) of Section 9102 of the Commercial Code) and the judgment debtor is located in this state.

(b) If any interest in personal property on which a judgment lien could be created under subdivision (a) is acquired after the judgment lien was created, the judgment lien attaches to the interest at the time it is acquired.

(c) To the extent provided by Section 697.620, a judgment lien on personal property continues on the proceeds received upon the sale, collection, or other disposition of the property subject to the judgment lien.

(d) Notwithstanding any other provision of this section, the judgment lien does not attach to:

(1) A vehicle or vessel required to be registered with the Department of Motor Vehicles or a mobilehome or commercial coach required to be registered pursuant to the Health and Safety Code.

(2) The inventory of a retail merchant held for sale except to the extent that the inventory of the retail merchant consists of durable goods having a unit retail value of at least five hundred dollars (\$500). For the purposes of this paragraph, "retail merchant" does not include (A) a person whose sales for resale exceeded 75 percent in dollar volume of the person's total sales of all goods during the 12 months preceding the filing of the notice of judgment lien on personal property or (B) a cooperative association organized pursuant to Chapter 1 (commencing with Section 54001) of Division 20 of the Food and Agricultural Code (agricultural cooperative associations) or Part 3 (commencing with Section 13200) of Division 3 of Title 1 of the Corporations Code (Fish Marketing Act).

(e) If property subject to a lien under this article becomes a fixture (as defined in paragraph (41) of subdivision (a) of Section 9102 of the Commercial Code), the judgment lien on such property is extinguished.

(f) Notwithstanding the filing of a notice of judgment lien, subject to the provisions of Chapter 6 (commencing with Section 708.010), a person obligated on an account receivable or chattel paper is authorized to pay or compromise the amount without notice to or consent of the judgment creditor unless and until there is a levy pursuant to Chapter 3 (commencing with Section 699.010).

(g) *For purposes of this section, whether a person is located in this state is determined in accordance with Section 9307 of the Commercial Code, except that location of a registered organization (as defined in paragraph (70) of subdivision (a) of Section 9102 of the Commercial Code) that is organized under the law of a state other than this state is determined without regard to subdivision (e) of Section 9307 of the Commercial Code.*

SEC. 2. Section 697.590 of the Code of Civil Procedure is amended to read:

697.590. (a) As used in this section:

(1) "Filing" means:

(A) With respect to a judgment lien on personal property, the filing of a notice of judgment lien in the office of the Secretary of State to create a judgment lien on personal property under this article.

(B) With respect to a security interest *or agricultural lien (as defined in paragraph (5) of subdivision (a) of Section 9102 of the Commercial Code)*, the filing of a financing statement pursuant to Division 9 (commencing with Section 9101) of the Commercial Code.

(2) "Perfection" means perfection of a security interest *or agricultural lien* pursuant to Division 9 (commencing with Section 9101) of the Commercial Code.

(3) "Personal property" means:

(A) With respect to a judgment lien on personal property, the property to which a judgment lien has attached pursuant to this article.

(B) With respect to a security interest *or agricultural lien*, the collateral subject to a security interest *or the farm products subject to an agricultural lien* pursuant to Division 9 (commencing with Section 9101) of the Commercial Code.

(4) "Purchase money security interest" means "purchase money security interest" as defined in Section 9103 of the Commercial Code.

(b) Except as provided in subdivisions (d), (e), (g), and ~~(e)-(h)~~, priority between a judgment lien on personal property and a conflicting security interest *or agricultural lien* in the same personal property shall be determined according to this subdivision. Conflicting interests rank according to priority in time of filing or perfection. In the case of a judgment lien, priority dates from the time filing is first made covering the personal property. In the case of a security interest *or agricultural lien*, priority dates from the *earlier of the* time a filing is first made covering the personal property or the time the security interest *or agricultural lien* is first perfected, ~~whichever is earlier,~~ provided that there is no period thereafter when there is neither filing nor perfection.

(c) For the purposes of subdivision (b), a date of filing or perfection as to personal property is also a date of filing or perfection as to proceeds.

(d) A purchase money security interest has priority over a conflicting judgment lien on the same personal property or its proceeds if the purchase money security interest is perfected at the time the judgment debtor (as a debtor under the security agreement) receives possession of the personal property or within 20 days thereafter.

(e) If a purchase money security interest in inventory has priority over a judgment lien pursuant to subdivision (d) and a conflicting security interest has priority over the purchase money security interest in the same inventory pursuant to Section 9324 of the Commercial Code, the conflicting security interest also has priority over the judgment lien on the inventory subject to the purchase money security interest notwithstanding that the conflicting security interest would not otherwise have priority over the judgment lien.

(f) A judgment lien that has attached to personal property and that is also subordinate under subdivision (b) to a security interest in the same personal property is subordinate to the security interest only to the extent that the security interest secures advances made before the judgment lien attached or within 45 days thereafter or made without knowledge of the judgment lien or pursuant to a commitment entered into without knowledge of the judgment lien. For the purpose of this subdivision, a secured party shall be deemed not to have knowledge of a judgment lien on personal property until (1) the judgment creditor serves a copy of the notice of judgment lien on the secured party personally or by mail and (2) the secured party has knowledge of the judgment lien on personal property, as “knowledge” is defined in Section 1201 of the Commercial.

(g) A perfected agricultural lien on personal property has priority over a judgment lien on the same personal property if the statute creating the agricultural lien so provides.

(h) A security interest in personal property perfected by the filing of a financing statement under the laws of a jurisdiction other than this state or perfected by another method pursuant to the law of a jurisdiction other than this state has priority over a judgment lien in the same personal property.

**SUPPLEMENTAL CONTACTS INFORMATION
(2008-09 STATE BAR YEAR)**

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