

NEW YORK COURT OF APPEALS ROUNDUP

‘WORTHY’ CLARIFIES RIGHTS OF SECURED CREDITORS UNDER UCC

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The Commission on Judicial Nomination submitted seven candidates to Gov. Kathy Hochul for consideration for appointment as Chief Judge of the Court of Appeals after former Chief Judge Janet DiFiore stepped down as of Aug. 31, 2022. The seven candidates are Judge Anthony Cannataro, acting Chief Judge of the Court of Appeals; Professor Abbe Gluck of Yale Law School; Justice Hector LaSalle, Presiding Justice of the Appellate Division, Second Department; Justice Jeffrey Oing, Associate Justice of the Appellate Division, First Department; Dean Alicia Ouellette of Albany Law School; Judge Edwina Richardson-Mendelson, Deputy Chief Administrative Judge for Justice Initiatives; and Corey Stoughton, Esq. of the Legal Aid Society. The candidates have been reviewed and rated by a variety of bar associations and, as of the date of writing, Governor Hochul had not made her selection and has until December 23 to announce her nominee for approval by the State Senate.

Meanwhile, the Court of Appeals continues to hear cases and recently issued a decision clarifying the rights of secured creditors under New York’s Uniform Commercial Code. In a unanimous decision in *Worthy Lending v. New Style Contactors*, written by Judge Rowan D. Wilson, the Court held that the holder of a presently exercisable security interest in a debtor’s receivables is included within the ambit of an “assignee” entitled under UCC 9-406 to receive payments directly from an account debtor after providing the account debtor with notice of the assignment.

Plaintiff Worthy Lending entered into a Promissory Note and Security Agreement dated Oct. 11, 2019 with non-party Checkmate Communications pursuant to which Checkmate could borrow up to \$3 million and Worthy was granted a security interest in substantially all of Checkmate’s existing and future assets, including its accounts receivable. Defendant New Style Contractors engaged Checkmate as a subcontractor on two public constructions projects in Queens and Manhattan, so the accounts receivable arising from invoices Checkmate issued to New Style constituted collateral pledged to Worthy.

Section 4(k) of the Promissory Note and Security Agreement granted Worthy the right to “notify and instruct account debtors”—like New Style—“to remit payment of Accounts and other Collateral directly to Lender” even before any default occurs and provided that Checkmate would not “interfere with the collection of the Collateral in the manner set forth in this section.” Worthy perfected its security interest in Checkmate’s assets by filing a UCC-1 financing statement against Checkmate with the Secretary of State of New Jersey. On Oct. 2, 2019 Worthy sent New Style a notice of its security interest in and collateral assignment of the New Style accounts receivable and directed New Style to make all further remittances only to Worthy rather than Checkmate. The notice specifically stated that, pursuant to UCC 9-406, any payments of accounts made to Checkmate (or anyone other than Worthy) will not discharge any of New Style’s obligations with respect to those accounts and New Style will remain fully liable to Worthy for the full amount of those obligations.

Checkmate subsequently defaulted on the note, Worthy accelerated Checkmate’s obligations and demanded payment, and Checkmate filed for bankruptcy with an outstanding debt to Worthy of more than \$3 million. Because Worthy believed that New Style had made payments to Checkmate despite the Oct. 2, 2019 notice, Worthy commenced an action in Supreme Court, New York County against New Style alleging that, pursuant to UCC 9-607, Worthy is entitled to recover from New Style all amounts New Style

owed to Checkmate after New Style's receipt of the Oct. 2, 2019 notice. New Style moved to dismiss, *inter alia*, on the grounds that UCC 9-607 only applies to assignments rather than security interests. The trial court granted the motion, 2020 N.Y. Misc. LEXIS 9442 at *8 (N.Y. Sup. Ct. Nov. 17, 2020), the Appellate Division, First Department affirmed, 196 A.D.3d 422, 422 (1st Dep't 2021), and the Court of Appeals granted leave to appeal.

The Court reversed, finding that the clear language of UCC 9-406, UCC 9-607 and the commentary on both sections makes clear that secured creditors are treated as assignees for purposes of these sections of the Uniform Commercial Code and are entitled to enforce their rights to obtain payment directly from account debtors like New Style here. The Court noted that UCC 9-607(a)(3) expressly provides that "[i]f so agreed ... a secured party ... may enforce the obligations of an account debtor ... and exercise the rights of the debtor with respect to the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor."

UCC 9-406 provides that an account debtor who receives a secured creditor's notice asserting its right to receive payment directly can either pay the secured creditor and receive a full discharge of those obligations or, if in doubt, can withhold payment while it seeks proof from the secured creditor that it has a valid assignment.

The trial court had focused on language in UCC 9-607(e) to the effect that the "section does not determine whether an account debtor, bank, or other person obligated on collateral owes a duty to a secured party." See 2020 N.Y. Misc. LEXIS 9442 at *6 (N.Y. Sup. Ct. Nov. 18, 2020). The Court of Appeals rejected the argument that this somehow precludes a secured party from using the collection and enforcement mechanism in UCC 9-607. Rather it merely states that UCC 9-607, by itself, does not determine whether the account debtor owes a duty to a secured party; it does not prevent the secured party and debtor from agreeing to create that duty. This is also consistent with the official comments of the UCC Permanent Editorial Board (PEB) explaining that UCC 9-607 permits "the secured party to enforce and collect [from an account debtor] after default or earlier if so agreed." UCC 9-607, Comment 6.

In this instance, it was the Promissory Note and Security Agreement that expressly provided Worthy with the right to direct New Style to make payment directly to Worthy and precluded Checkmate from interfering if Worthy exercised that right.

The Court also rejected New Style's argument that UCC 9-406 only permits assignees and not secured parties to demand payment directly from the account debtor. The UCC commentary explains that a security interest is treated as an assignment, expressly stating that "[t]he term 'assignment,' as used in [UCC Article 9], refers to both an outright transfer of ownership and a transfer of an interest to secure an obligation." Commentary No. 21 at 4.

The Court also rejected New Style's argument that Worthy could not rely on UCC 9-607 because of the language in UCC 9-607(a)(3) quoted above which provides that a secured party may enforce an account debtor's obligations "if so agreed" and because there apparently was a dispute between secured party Worthy and debtor Checkmate. The Court found that the "if so agreed" language simply referred to an agreement creating or modifying the security interest and was not meant to preclude a secured creditor from relying on UCC 9-607 whenever the debtor disputed the existence or amount of the debt. A contrary ruling would render UCC 9-406 and UCC 9-607 meaningless by enabling a debtor to prevent its secured creditor from obtaining the value of its security interest simply by claiming a dispute exists.

While the lower courts expressed concern that, having already paid Checkmate, New Style may now be required to pay double, see 2020 N.Y. Misc. LEXIS 9442 at *6, 196 A.D.3d at 423, the Court of Appeals found that this is just the statutory consequence of failing to pay a secured party who sent the proper notice to the account debtor. Accordingly, if New Style continued to pay Checkmate despite receiving the Oct. 2, 2019 notice then, as between Worthy and New Style, it is fair to place the burden imposed by double payment on New Style.

So, it is now clear in New York that secured creditors who are granted the right by their debtors to demand payment directly from those debtors' account debtors may enforce that right against the account debtor pursuant to the New York Uniform Commercial Code notwithstanding any claimed dispute between the debtor and secured creditor.

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