# Payment Rights as Article 9 Collateral
# Classification, Substantive Rules, and Conflict of Laws Rules

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## Problems

1. Credit card receivables

Consumer bought a camera from Store, paying with a credit card issued by Issuer Bank. Store uses Acquiring Bank as its credit card service provider. This transaction created several rights to payment including the following: (1) Issuer Bank has a right to be paid the price of the camera by Consumer; and (2) Store has a right to be paid the price of the cameral (minus a fee) by Acquiring Bank. What type of Article 9 property is Issuer Bank's right to be paid by Consumer? What type of Article 9 property is Store's right to be paid by Acquiring Bank? See UCC §§ 9-102(a)(2)(vii) and 9-102(a)(61) and revised Comments 5a and 5d.

2. Surety's right to reimbursement

In order to obtain credit from Lender at favorable rates, Borrower arranged for Surety to guarantee Borrower's obligation to Lender. Surety agreed to guarantee the obligation in exchange for the payment of premium of $20,000, which is due shortly. Under the law of suretyship and guaranty, Surety will have a claim against Borrower for reimbursement if Surety is called upon to pay Lender. What type of Article 9 property is Surety's claim against Borrower for the premium? What type of Article 9 property is Surety's contingent claim against Borrower for reimbursement? See UCC § 9-102(a)(2)(iv). (Would it make any difference if Surety's right to reimbursement was expressly provided for by the agreement between Borrower and Surety?)

3. Stripped Payment Rights

Lessor leased industrial equipment to Lessee for ten years pursuant to a true lease. Lessor sold its right to be paid by Lessee to SPV. The contract of sale expressly provides that Lessor's rights in the equipment are not transferred to SPV as part of the sale transaction. What type of Article 9 property is Lessor's right to be paid by Lessee, shorn from any right in the leased goods? Would it make any difference if the lease were a "dirty lease" that, under UCC Section 1-203, is actually a credit sale of the equipment in which the obligation to pay the remaining purchase price is secured by the equipment? See UCC §§ 9-102(a)(11) and 9-102(a)(2)(i), *In re Commercial Money Center, Inc.*, 350 B.R. 465 (Bankr. App. 9th Cir. 2006), and revised Comment 5d to UCC § 9-102.

4. “Article 9 Instruments”

Merchant is in the business of selling goods to customers on credit. When a credit transaction is entered into, Merchant requires the customer to sign not only a credit purchase agreement but also a “debt acknowledgment,” a one-paragraph document that states that the customer acknowledges that it owes the stated sum of money to Merchant. Merchant typically sells it rights to be paid by customers to Factor. As part of these sales, Merchant signs the back of each debt acknowledgment and delivers it to Factor. A similar practice is followed by some other companies in the region that sell goods on credit, but it is not common. What type of Article 9 property is Merchant’s claim against a customer based on a debt acknowledgment? See UCC § 9-102(a)(47); *Morgan v. Farmers & Merchants Bank*, 856 So. 2d 811 (Ala. 2003).

5. Health-care-insurance receivables

Employer’s health care plan for its employees is a self-insured plan managed by Unified Health Care (“Unified”). Under the plan, Employer deposits sums at regular intervals with Unified. In-network providers who are primary care physicians agree with Unified that they will be paid a fixed amount per year for each employee who has designated the physician as primary care physician and an additional amount for each office visit of an employee pursuant to a standard fee schedule. Unified pays the physicians from funds deposited with Unified by Employer. Payments for office visits are typically made four to six weeks after the visit. What type of Article 9 property are the physicians’ rights to payment from Unified with respect to the payments per visit? What type of Article 9 property are the physicians’ rights to payment from Unified with respect to fixed annual payments? Does it make any difference if Employer’s health care plan is regulated as insurance under state or federal law? (If state regulation of the plan as insurance makes a difference, which state’s law should be considered?) See UCC § 9-102(a)(46) and *American Investment Financial v. United States*, 364 F. Supp.2d 1321 (D. Utah 2005).

6. Debt securities

Owner sold its ownership interest in a business to Buyer. Buyer paid part of the purchase price in cash and gave Owner several documents that were each labeled “promissory note.” The documents were, in form, similar to typical non-negotiable notes, and were identical except for the name of the payee and the amount due. When it appeared that Buyer would be unable to honor its payment obligation, Owner retained financial professionals to market the “promissory notes.” Buyer did not maintain books on which the transfer of the “promissory notes” could be registered but, presumably Buyer could have maintained such books. Assuming that the divisibility and investment function tests of UCC § 8-102(a)(15) are satisfied, what type of Article 9 property are the “promissory notes”? See *Highland Capital Management LP v. Schneider*, 8 N.Y.3d 406 (2007); UCC §§ 9-102(a)(47), 9-102(a)(49), and 8-102(a)(15); Comment 13 to UCC § 8-102; New York UCC § 8-103(h).

7. Ownership interests in LLCs

Owner is one of five members of LLC. As a member, Owner has certain management rights as well as the right to distributions of funds from LLC. LLC's operating agreement, to which the members and LLC are parties, provides that a member's rights with respect to LLC cannot be transferred in whole or part without the consent of all of the other members. Owner would like to borrow money, using her rights with respect to LLC as collateral. What type of Article 9 property is Owner's full package of rights with respect to LLC? What type of Article 9 property are Owner's rights to receive distributions from LLC? See UCC §§ 9-102(a)(42) and 9-102(a)(61).

8. Choice of law issues

Lessor, a Pennsylvania corporation with chief executive office in Pennsylvania, entered into a "Lease Agreement" with Builder, an international construction company with a chief executive office in Europa. Pursuant to the Lease Agreement, Lessor supplied several large items of construction equipment (including cranes and the like) to Builder for use in a project in Pennsylvania and Builder agreed to pay a fixed amount of money to Lessor every month for five years. Under the terms of the Lease Agreement, if Builder makes all sixty payments it will automatically become the owner of the equipment. The Lease Agreement states that it is governed by the law of Europa. Under the law of Europa, (i) agreements denominated as leases are never recharacterized as secured sales of the leased goods, (ii) security interests in goods are generally made effective against lien creditors by filing a public notice, and (iii) security interests in intangible rights are not subject to filing. What rights does Lessor have in the construction equipment? Under which law is the determination made? If Lessor has a security interest in the equipment, which law determines how it must be perfected? What type of Article 9 property is Lessor's entire package of rights (including the right to be paid and its claim, however characterized, with respect to the goods)? Which law governs? Does it make any difference why the question is being asked? See *In re Eagle Enterprises, Inc.*, 237 B.R. 269 (E.D. Pa. 1999).

9. Disposition of payment rights on default

Obligor is the account debtor on a payment intangible owed to Obligee. The terms of the payment intangible provide that it may not be assigned without written permission from Obligor and that any purported assignment without that permission is ineffective. Obligee borrowed money from Lender and granted Lender a security interest in the payment intangible to secure Obligee's repayment obligation. Obligee subsequently defaulted on its obligation to Lender. May Lender dispose of the payment intangible by sale, notwithstanding the restriction on transfer? Will the buyer at that disposition be able to enforce the payment intangible against Obligor? What if the payment intangible was created by a contract entered into before July 1, 2013? See UCC §§ 9-406, 9-408. See also Neil B. Cohen and William H. Henning, *Freedom of*

*Contract vs. Free Alienability: An Old Struggle Emerges in a New Context*, 46 Gonzaga L. Rev. 353 (2011)

As a variation, consider that New York has not enacted the provision in the 2010 amendments to Article 9 that added the last clause to UCC § 9-406(e) ("… other than a sale pursuant to a disposition under Section 9-610 or an acceptance of collateral under Section 9-620.") Assume *arguendo* that, as a result, the restriction on assignment would not be overridden by NY UCC § 9-406 insofar as that restriction purports to restrict disposition by sale without permission of Obligor. Does NY UCC § 9-406 apply if (i) Obligee is located in New York? (ii) Obligor is located in New York? (iii) the agreement between Obligee and Lender states that it is governed by New York law? (iv) the agreement between Lender and the buyer at a foreclosure sale states that it is governed by New York law; (v) the agreement between Obligor and Obligee creating the payment intangible states that it is governed by New York law? See UCC §§ 1-301 and 9-301. See Comment 3 to UCC § 9-401.

<u>10. Pre-filing accounts lender versus buyer of accounts</u>

Company and Lender had been negotiating for a line of credit for Company secured by, inter alia, all of Company's accounts. On July 1, with Company's authorization, Lender pre-filed a financing statement listing Company as debtor and indicating the accounts as collateral. (At that time, Lender did not have an enforceable security interest in Company's accounts.) On July 15, Company sold all of its accounts to Factor, who filed a properly completed financing statement that day. On August 1, agreement was reached between Company and Lender with respect to the line of credit, Lender advanced funds to Company, and Company granted an enforceable security interest in its accounts to Lender. Does Lender have an interest in the accounts covered by the July 15 transaction with Factor? Does Factor have an interest in those accounts? If both have an interest in the accounts, whose interest is superior? See UCC §§ 9-322(a)(1) and 9-318.

<u>11. Does pre-filing with respect to a sale of payment intangibles have any effect?</u>

Company and Finco had been negotiating a transaction under which Company would sell certain payment intangibles to Finco. On July 1, with Company's authorization, Finco pre-filed a financing statement listing Company as debtor and indicating payment intangibles as collateral. (At that time, Finco had not bought the payment intangibles and did not otherwise have an enforceable security interest in them.) On July 15, Company borrowed money from Bank and granted Bank an enforceable security in, inter alia, all of its payment intangibles; on the same date, Bank filed a financing statement listing Company as debtor and including payment intangibles in the indication of collateral. On August 1, Company and Finco consummated the sale of payment intangibles to Finco. All requirements of UCC § 9-203(b) were satisfied. Does Finco have an interest in the payment intangibles sold on August 1? Does Bank have an interest in the payment intangibles sold on August 1? If both have an interest in the payment intangibles, whose interest is superior? See UCC §§ 9-322(a)(1), 9-309(3).

12. Measuring improvement in position under Bankruptcy Code § 547(c)(5)

On February 1, 2012, D entered into a revolving loan arrangement with C pursuant to which C would loan D money from time to time and D agreed to repay the loans within 60 days. The loan agreement, signed that day, provided that, as collateral for D's obligation to repay C for all loans, D granted C a security interest in all of D's accounts, "whether now owned or acquired in the future." C filed a financing statement with respect to this security interest on February 1, 2012. On May 31, 2015, D filed a bankruptcy petition. On that date, D owed C $1,000,000 and the face value of D's accounts (*i.e.*, the amount owed to D by its customers) was $1,050,000. On March 2, 2015, just 90 days earlier, D owed C $1,000,000 and the face value of D's accounts was $1,100,000. All of D's accounts had "turned over" between March 2 and May 31 – that is, none of D's May 31 accounts had been owned by D on March 2. Analysis reveals that the March 2 accounts had a market value of 70% of their face value (*i.e.*, a buyer would have been willing to buy the accounts from D on that date for 70 cents on the dollar), or $70,000; similar analysis reveals that the May 31accounts had a market value of 50% of their face value, or $525,000. The records of D show that $650,000 was actually collected with respect to the March 2 accounts, while $800,000 was collected with respect to the May 31 accounts. The table below summarizes this information:

| **Date** | **Debt** | **Face Value** | **Market Value** | **Amount Collected** |
|---|---|---|---|---|
| March 2 | $1,000,000 | $1,100,000 | $770,000 | $650,000 |
| May 31 | $1,000,000 | $1,050,000 | $525,000 | $800,000 |

Is any part of C's interest in the accounts a preference that is voidable under Bankruptcy Code § 547? Is any additional information needed? See Bankruptcy Code § 547(c)(5); *In re Ebbler Furniture and Appliances, Inc.*, 804 F.2d 87 (7$^{th}$ Cir. 1986); *In re Universal Foundry Co.*, 163 B.R. 528 (E.D. Wisc. 1993). See also Neil B. Cohen, "Value" Judgments: Accounts Receivable Financing and Voidable Preferences Under the New Bankruptcy Code, 66 Minn. L. Rev. 639 (1982).