

It's Not Nice to Pay an Invoice Twice: Payment Demands During COVID-19 by Assignees of Accounts Under UCC Section 9-406

By Gib Masters
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The mail room just received a piece of unregistered first-class mail from a company you don't recognize. The letter floats around the office for a couple of days before landing on the desk of your accounts payable clerk, who is taking the week off. The clerk returns and determines that the letter seems to be some sort of collection scam—the letter says to pay some collection company for an account receivable you owe to one of your vendors. But that vendor is set up for ACH debits, and a payment just went out the day before your A/P clerk returned. Because there's nothing to pay, your A/P clerk round-files the notice. Three more payments go out before you receive notice and complaint from the collection company: it's suing you for not paying those same four invoices.

First, the bad news: You still owe the collection company for the invoices. Next, the worse news: You call your critical vendor to say that you have to pay all future amounts over to the collection company, and your vendor threatens to withhold critical deliveries. Your vendor says that the collection company is gouging them on late fees and attorneys and isn't owed another penny. How did this become your problem?

THE LEGAL FRAMEWORK

Article 9 of the Uniform Commercial Code (the "UCC") provides a powerful collection tool for lenders and purchasers of accounts receivable. An "account debtor" (the party obligated to pay an account receivable) may be obligated to pay the same invoice twice if it receives a proper notice from an assignee but nonetheless pays the original owner of the account receivable.

Assignments and Pledges of Accounts

Payees on accounts, payment intangibles, and promissory notes ("payment obligations") may freely assign the obligations, notwithstanding any restrictions in the agreement between the account debtor and the payee/assignor. Section 9-406(d) of the UCC renders the anti-assignment term and any default resulting from violation of that term ineffective. This allows payees/assignors to monetize payment obligations through pledge or sale. The term "assignee" in the context of Section 9-406 means either a purchaser of a payment obligation or a secured party with a security interest in the payment obligation.

Effective Notification

An assignee may provide notice to the account debtor of the assignment or pledge under Section 9-406(b). A proper notice must be authenticated (signed, which includes electronic signatures). A notice that is authenticated may nonetheless be ineffective under either of the following circumstances:

1. If it does not reasonably identify the rights assigned.
2. At the option of an account debtor, if the notification tells the account debtor to pay the assignee less than the full amount of any installment or other periodic payment.

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Proof of Assignment

An account debtor may request proof from the assignee that the assignment was made under Section 9-406(c). Proof could consist of the signed agreement in which the assignor pledges or assigns the payment obligation. A filed financing statement, in and of itself, is not sufficient proof.

If the assignee fails to “seasonably” comply with the request for proof, then the account debtor may discharge the payment obligation by paying the assignor without risking the double-payment consequence described below. “Seasonably” means “timely,” but is not defined as a specific time frame. But official comment 4 to Section 9-406 explains that an account debtor that has received notification of an assignment and has requested reasonable proof of the assignment may discharge its obligation by paying the assignor when payment is due (or even earlier if reasonably necessary to avoid risk of default), but that paying the assignor substantially before the payment is due will not discharge the obligation unless the assignee has failed to seasonably provide requested proof of the assignment.

Consequences for Failing to Pay Assignee

Except as noted above, paying the assignor rather than the assignee after receiving a valid notification from the assignee does not discharge the underlying payment obligation, and the assignor can seek to enforce the payment obligation directly against the account debtor. This means that the account debtor may have to pay twice unless it can recover the double payment from the assignor.

Defenses to Payment

The assignee does not obtain greater rights to payment than the assignor. As provided in Section 9-404, “the rights of an assignee to an assigned or pledged payment obligation are subject to (1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract, and (2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.”

SUGGESTED PROCEDURES UPON NOTIFICATION

Because businesses are increasingly under stress, especially small businesses that may have entered into factoring agreements by which they’ve sold or pledged their accounts to hard money-lenders for quick cash at a discount, businesses should expect to see more diversion notices from banks, factors, and other finance companies. The UCC is pretty unforgiving if a company is late to respond. A business is wise to do the following:

1. Determine whether the notice meets requirements for effective notice and complete the checklist. To download a Sample Account Assignment Checklist, [click here](#).
2. Immediately notify the accounts payable department (or whomever is responsible for cutting checks and sending wires) of the assignment, and freeze any payments to the debtor.
3. If contacted by an attorney for the assignee or the assignor, refer the attorney to the company’s legal counsel. Once an attorney knows that the business is represented by counsel, the attorney cannot ethically have further contact with the company without consent of its attorney (internal or external).
4. Contact the legal department and provide a completed checklist. To download a Sample Account Assignment Checklist, [click here](#).

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5. Determine whether the amount claimed by the assignee is correct. The company may have paid a prior invoice before receiving the notice, or there may be an outstanding billing dispute between the company and the assignor.
6. Contact the assignee for any missing items of proof, or to assert contra, set-offs, or counterclaims.
7. Notify the assignor of the notice and the company's obligation to pay the assignee. If a payment is due or will become due shortly, notify the assignor that payment may be slightly delayed while the company awaits a response on the request for proof.
8. If the assignee is entitled to payment, update payment information in the business's system. Follow procedures for verifying payment information.
9. If a request for proof has not been satisfied, and a payment obligation risks default, make the payment to the assignor after a final notice to the assignee. Consult legal counsel before doing this.
10. If the assignor disputes the assignee's right to be paid, consult with the company's lawyer about whether to interplead the amounts owed (pay the funds to the court and let the assignor and assignee fight over them).

PRACTICAL CONSIDERATIONS

If you're receiving one of these notices, it's not necessarily a sign that your vendor is in trouble with its lender or factor, but it can be. If you have an ongoing business relationship with a cash-strapped vendor, you could find yourself with the problem in the example above. A desperate vendor that can't pay workers or keep the lights on may be better off pulling its workers or withholding goods and services, even though by doing so it would breach its agreement with you. The breach creates a counterclaim that can be offset against the receivable, which is bad for the lender or factor. Each of the parties has something to lose and something to gain, so quick action to negotiate a settlement in which each party gets less than it wants can head off a more disastrous result.

For more information about ongoing developments related to COVID-19, visit [Miller Nash Graham & Dunn's resource library](#).

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Gib Masters focuses his practice on financial transactions, debtor-creditor rights, and real estate. Gib represents a variety of clients, including large multinational corporations, small businesses, and individuals, in matters of commercial secured transactions, real estate acquisition and finance, real estate investment, construction lien disputes, UCC Article 9 perfection and priority issues, foreclosure, bankruptcy and receivership proceedings, structured finance, and syndicated tenancy-in-common financings.

Direct: 503.205.2444 | **Email:** gib.masters@millernash.com