

CLIENT ALERT

Highest Court in New York Reaffirms Lenders' Security Rights to Accounts Receivable

DECEMBER 5, 2022

In a recent decision, the court of appeals of the state of New York, New York's highest court, ruled that, under section 9-406 of the Uniform Commercial Code of the state of New York, a lender's security interest in accounts receivable constitutes an assignment and thus lenders are assignees of accounts receivable in which they have a present security interest.

As a result, the court of appeals reaffirmed that a lender and the borrower may contractually agree that the lender can direct the borrower's account debtors to pay accounts receivable they owe to the lender, rather than the borrower, if the lender provides the account debtors notice that they are to pay the lender. Because the lender's security interest is an assignment, if the lender notifies an account debtor that it is to pay accounts receivable to the lender, rather than the borrower, the account debtor's obligation to pay the accounts receivable is only discharged if it pays the accounts receivable to the lender.

If the account debtor nonetheless pays the accounts receivable owing to the borrower, rather than the lender, after notice is given, the account debtor is still not relieved of its obligation to pay the lender. In such a case, the account debtor would be required to "pay double" what it initially owed because it would have paid the borrower and is still required to pay the lender. The lower courts expressed concern about an account debtor being required to "pay double," but the court of appeals stated that such a risk is the "statutory consequence of failing to pay a secured party who has notified the account debtor to pay the secured party directly."

While this ruling was expected and reaffirms rights that lenders already rely on, it reverses two lower New York court rulings to the contrary and sets the question to rest in the state of New York and for agreements governed by the laws of the state of New York. Lenders should ensure that collateral documents properly grant a security interest in accounts receivable and that such security interest has been properly perfected by filing a UCC-1 financing statement to have the benefit of this ruling.

The case is [Worthy Lending v. New Style Contractor](https://www.nycourts.gov/ctapps/Decisions/2022/Nov22/86opn22-Decision.pdf), and a link may be found at <https://www.nycourts.gov/ctapps/Decisions/2022/Nov22/86opn22-Decision.pdf>.

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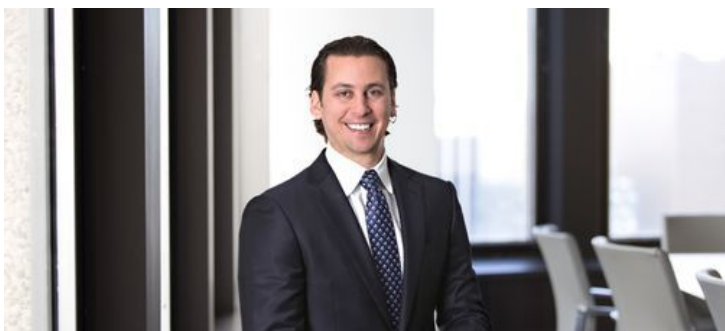
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