To be Argued by:
RICHARD G. HADDAD
(Time Requested: 15 Minutes)

New York Supreme Court

Appellate Division—First Department

WORTHY LENDING, LLC,

Appellate Case No.: 2020-04842

Plaintiff-Appellant,

– against –

NEW STYLE CONTRACTORS, INC.,

Defendant-Respondent.

BRIEF FOR PLAINTIFF-APPELLANT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

Rules

PRELIMINARY STATEMENT

This appeal arises from a Decision and Order by the Supreme Court (Bluth, J.) dismissing the Complaint filed by Plaintiff-Appellant Worthy Lending, LLC ("Worthy") against Defendant-Respondent New Style Contractors, Inc. ("New Style"). Worthy is a secured creditor who gave New Style prior notice under the Uniform Commercial Code that all payments for services provided by its borrower could only be paid to Worthy and not to the borrower. Nonetheless, New Style apparently paid the borrower. The Supreme Court misapplied the Uniform Commercial Code and ruled that payment to the borrower released New Style of liability to Worthy, and that Worthy has no cause of action against New Style. The Supreme Court's Order should be reversed because it fails to follow the New York Uniform Commercial Code, disregards the plain words of the operative documents, and reached a result that is contrary to the express direction of the Permanent Editorial Board of the Uniform Commercial Code.

The Supreme Court erroneously held that a secured party with a security interest is not the same as an assignee for purposes of N.Y. UCC Section 9-406. A fundamental flaw in the Supreme Court's ruling is that there is no legal distinction between a security interest and an assignment under Section 9-406. Therefore, upon its receipt of the notice of assignment, New Style was obligated to make payments on accounts owed to Worthy's borrower directly to Worthy and only to Worthy in

order for the debt to be satisfied. New Style failed to do so and now owes Worthy at least $1,473,581.42.

The Supreme Court further erred in holding that Plaintiff does not have a cause of action for collection under the New York Uniform Commercial Code because of an alleged "dispute" with Worthy's borrower. Contrary to the Supreme Court's holding, there is no "dispute" and none was pleaded. Worthy has a cause of action for collection pursuant to N.Y. UCC Section 9-607(a)(3) which permits a secured party to "enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor . . ." N.Y. UCC § 9-607(a)(3); *see Gen. Motors Acceptance Corp. v. Clifton-Fine Cent. Sch. Dist.*, 85 N.Y.2d 232, 236, 623 N.Y.S.2d 821, 823 (1995) ("Generally, after the account debtor receives notification that the right has been assigned and the assignee is to be paid, and it continues to pay the assignor, the account debtor is liable to the assignee . . .").

In short, Worthy has a security interest in and is entitled to collect payments owed by New Style to the borrower. Worthy put New Style on notice of this security interest and directed New Style to remit payment directly to Worthy, but New Style failed to do so. Worthy is therefore entitled to collect the New Style accounts arising after New Style's receipt of the notice of assignment, directly from New Style, regardless of whether Defendant has already paid them to the borrower or to anyone

else. To rule otherwise would be to misconstrue and misapply the New York Uniform Commercial Code, and set a dangerous commercial precedent, impairing lenders' rights to collect on their collateral.

STATEMENT OF QUESTIONS PRESENTED ON APPEAL

1. Whether Plaintiff's notice of assignment was sufficient under N.Y. UCC Section 9-406 to require that Defendant make payments directly to Plaintiff where, under UCC Article 9, a security interest is treated as an assignment, and where Plaintiff sent a letter to Defendant putting it on notice of its security interest in all of the borrower's present and future accounts?

   Supreme Court's Answer: The Supreme Court erroneously ruled that the notice of assignment was insufficient, based on its incorrect finding that a security interest is not the same as an assignment under Section 9-406.

2. Whether Plaintiff has a cause of action for collection against Defendant, where N.Y. UCC Section 9-607 by its terms gives a secured party the right to enforce an account debtor's obligations to a debtor and where the borrower, which does not dispute Plaintiff's right to collect from Defendant, granted Plaintiff a security interest in all of its accounts?

Supreme Court's Answer: The Supreme Court erroneously ruled that Plaintiff does not have a cause of action under Section 9-607 because of an un-pleaded and non-existent "dispute" with respect to the obligation.

STATEMENT OF THE CASE

A. The Financing Agreement and Plaintiff's Security Interest

Pursuant to a Promissory Note and Security Agreement dated October 11, 2019 (the "Financing Agreement"), Worthy made loans to Checkmate Communications LLC ("Checkmate") from time to time. [R-14 ¶ 6; R-20-36] In exchange, Section 3(a) of the Financing Agreement provided that:

> To secure the prompt payment and performance of [all of Checkmate's obligations to Worthy], [Checkmate] hereby pledges and grants to [Worthy] a continuing security interest in and lien upon the Collateral, whether now existing or hereafter arising and wherever located. [R-14 ¶ 6; R-23]

The "Collateral" as defined in the Financing Agreement, is substantially all existing and future assets and properties of Checkmate, including, "all right, title and interest of [Checkmate] in and to its (a) accounts . . .". [R-14 ¶ 6; R-27-28].

Under Section 3(b) of the Financing Agreement, Checkmate "irrevocably and unconditionally authorize[d] [Worthy] to file . . . such financing statements with respect to the Collateral naming [Worthy] or its designee as the secured party and [Checkmate] as debtor." [R-23] Thus, to evidence and perfect its interest in the

Collateral, Worthy filed UCC-1 Financing Statements against Checkmate with the Secretary of State of New Jersey (as amended and/or continued, the "UCC Statements"). [R-15 ¶ 9; R-39-54] The UCC Statements were initially filed on November 30, 2016, October 29, 2017, and August 10, 2018, and assigned to Worthy on October 12, 2019. [R-15 ¶ 9] Worthy has maintained the UCC Statements without interruption from the date they were filed through the present. [R-15 ¶ 10]

Of critical import, Checkmate authorized Worthy to provide account debtors, i.e. Checkmate's customers, notice of Worthy's security interest in Checkmate's accounts receivable and an instruction to make payments only to Worthy. [R-14-15 ¶ 7; R-24] Specifically, Section 4(k) of the Financing Agreement provides that Checkmate authorizes Worthy to:

> at any time and from time to time in its discretion, notify and instruct account debtors of [Checkmate] (including pursuant to a notice of assignment in form and substance satisfactory to [Worthy]) of the interest of [Worthy] in the Accounts and to remit payment of Accounts and other Collateral directly to [Worthy]… [R-24]

B. Events of Default Under the Financing Agreement

Events of default exist and are continuing under the Financing Agreement, including, without limitation, the failure of Checkmate to pay when due principal, interest, and other amounts owing by Checkmate to Worthy under the Financing Agreement. [R-15 ¶ 11] By letter dated April 9, 2020 (the "Default Letter"), Worthy notified Checkmate of such defaults and, in accordance with the Financing

Agreement, Worthy accelerated all indebtedness, liabilities and obligations of Checkmate under the Financing Agreement (the "Obligations") and demanded immediate repayment of all such Obligations. [R-15 ¶ 12; R-55-56] Checkmate continues to be in default of its Obligations to Worthy in an amount in excess of $3,271,292, plus interest, fees, costs and attorneys' fees [R-16 ¶ 13], and Checkmate has filed for bankruptcy in the United States Bankruptcy Court for the District of New Jersey. *In re Checkmate Communications, LLC,* (No. 20-21872-JKS).

C. The New Style Accounts and the Notice of Assignment

The parties do not dispute that New Style hired Checkmate as a subcontractor on two public construction projects in New York City. [R 6] According to Worthy's books and records, and according to documents and information Worthy received from Checkmate, New Style has failed to pay Worthy at least $1,473,581.42 for its services (the "New Style Accounts"). [R-16 ¶ 15]

On October 2, 2019, in accordance with the Financing Agreement and Section 9-406 of the Uniform Commercial Code, Worthy sent New Style a notice of its security interest and collateral assignment in the New Style Accounts (the "Notice of Assignment") which stated:

> [Checkmate] has granted to [Worthy] a security interest in, and [Checkmate] assigned to [Worthy] as collateral security, the full amount of all accounts and other amounts now or hereafter owing by [New Style] to [Checkmate] (collectively, the "Accounts"). Notice is hereby given to [New Style] of such security interest and such collateral

assignment. All remittances for Accounts shall be made payable only to [Worthy] . . . [R-15 ¶ 8; R-37-38]

Thereafter, as it had become clear that Checkmate was in financial difficulty, on March 24, 2020, Worthy sent a letter to New Style (the "March 24 Letter") enclosing another copy of the Notice of Assignment and explaining that "pursuant to Section 9-406 of the [UCC], payments of Accounts made by [New Style] to Checkmate or to anyone other than Worthy in accordance with the enclosed notice will not discharge any of [New Style's] obligations with respect to such Accounts and, notwithstanding any such payments, [New Style] shall remain liable to Worthy for the full amount of such indebtedness." [R-16 ¶ 17; R-57-58] Counsel for Worthy sent another letter to New Style on April 8, 2020 requesting an accounting of all payments made by New Style to Checkmate from October 1, 2019 forward. [R-17 ¶ 18; R-59-60]

D. Defendant's Failure to Remit Payment to Worthy

As of the date hereof, New Style has not remitted payment to Worthy of the New Style Accounts. [R-17 ¶ 19] As described by the Supreme Court, despite the Notice of Assignment, New Style continued to pay Checkmate rather than Worthy. [R-7; R-10] It is undisputed that Worthy was not paid by New Style.

E. The Prior Proceedings and Order

Worthy commenced this action by filing a Summons and Complaint with Exhibits on July 27, 2020. [R-12-60] On October 19, 2020, New Style filed a Motion

to Dismiss the Complaint ("Motion to Dismiss") with prejudice pursuant to CPLR 3211(a)(1) and 3211(a)(7). [R-61-65] Worthy filed a Memorandum of Law in Opposition to the Motion to Dismiss [R-66] and New Style filed a Reply Memorandum of Law. [R-66] On November 18, 2020, the Supreme Court entered a Decision and Order granting New Style's Motion to Dismiss, based on its erroneous findings that a security interest is not treated as an assignment under Section 9-406 and that Worthy does not have a cause of action under Section 9-607 because of a non-existent and non-pleaded dispute between Worthy and Checkmate.[1] [R-5-11]

On December 10, 2020, Worthy timely filed a Notice of Appeal. [R-3-4]

ARGUMENT

POINT I

THE SUPREME COURT WRONGLY HELD THAT THE NOTICE OF ASSIGNMENT WAS INEFFECTIVE

The Supreme Court's holding that Worthy's security interest should not be treated as an assignment under UCC Section 9-406 is just plain wrong. The holding ignores PEB Commentary No. 21 and Official UCC Comment 26 to Section 9-102, directly on point, in addition to well-settled precedent in New York and other states interpreting the UCC. To state it directly: a security interest is treated as an

[1] The failure of a borrower to pay a loan is not a "dispute." And even if it were, it is no excuse for New Style to ignore the Notice of Assignment, ignore the UCC, and pay Checkmate in violation of the express written instruction.

assignment under UCC Section 9-406, and New Style became obligated to make payments to Worthy (and only to Worthy) on the New Style Accounts as soon as it received the Notice of Assignment. N.Y. UCC Section 9-607.

A. N.Y. UCC Section 9-406 Requires that the Customer Pay Only the Secured Creditor after Receipt of Notice in Order for the Debt to be Discharged

The words of the statute are straightforward:

> [A]n account debtor on an account, chattel paper, or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor. N.Y. UCC § 9-406(a).

Therefore, under UCC Section 9-406, once an account debtor receives a notice that accounts it owes to a debtor have been assigned, it cannot discharge its obligations to the debtor by paying the debtor or anyone else, but rather, only by paying the assignee. *Clifton-Fine Cent. Sch. Dist.*, 85 N.Y.2d at 236 (citing N.Y. UCC Section 9-318(3), the predecessor provision to Section 9-406) ("Generally, after the account debtor receives notification that the right has been assigned and the assignee is to be paid, and it continues to pay the assignor, the account debtor is liable to the assignee and the fact that payment was made to the assignor is not a defense in an action brought by the assignee.").

The Court of Appeals rule applies here. Checkmate assigned the New Style Accounts to Worthy by granting it a security interest in all of its Accounts. [R-14 ¶ 6; R-23; R-27] Therefore, once New Style received the Notice of Assignment in October of 2019, it became obligated to make payments directly to Worthy instead of to Checkmate. New Style, however, failed to do so, and therefore still owes the money to Worthy.

B. According to Both PEB Commentary and Official Comments to the UCC, there is no Distinction Between a Security Interest and an Assignment under Article 9

The purpose of the Uniform Commercial Code is to be just that—uniform. *See* UCC § 1-103(a)(3) ("[The Uniform Commercial Code] must be liberally construed and applied to promote its underlying purposes and policies, which are…(3) to make uniform the law among the various jurisdictions."). To this end, the drafters of the UCC provided their comments to guide contracting parties and courts on how its provisions were to be applied and interpreted. And, to ensure continued uniform application throughout the country, the Permanent Editorial Board was established. *See* PEB Commentary No. 21 (defined below) [2], *Preface to PEB Commentary* ("The Permanent Editorial Board for the Uniform Commercial Code acts under the authority of the American Law Institute and the Uniform Law

[2] PEB Commentary No. 21 can be found on the American Law Institute's website https://www.ali.org/media/filer_public/a1/67/a167ba0e-8983-4ec4-9ad0-8c77899c3c06/commentary-21-final.pdf

Commission (also known as the National Conference of Commissioners on Uniform State Laws). In March 1987, the Permanent Editorial Board resolved to issue from time to time supplementary commentary on the Uniform Commercial Code to be known as PEB Commentary. These PEB Commentaries seek to further the underlying policies of the Uniform Commercial Code by affording guidance in interpreting and resolving issues raised by the Uniform Commercial Code and/or the Official Comments.")

Both this Court and the Court of Appeals cite to the PEB Commentary as an authoritative source on the UCC. *See, e.g.*, *Albany Disc. Corp. v. Mohawk Nat'l Bank of Schenectady*, 28 N.Y.2d 222, 227, 321 N.Y.S.2d 94, 98 (1971) (citing PEB commentary on former UCC § 9-302); *Receivers of Sabena SA v. Deutsche Bank A.G.*, 142 A.D.3d 242, 246-47, 254, 257-60, 36 N.Y.S.3d 95, 98-99, 104, 106-08 (1st Dep't 2016) (interpreting and applying PEB Commentary No. 16).

The PEB has addressed the very question presented on this appeal and has unambiguously and unabashedly explained that a security interest is as an assignment under UCC Section 9-406, and that any holding to the contrary is incorrect. Permanent Editorial Board of the Uniform Commercial Code, Commentary No. 21 (March 11, 2020) [PEB Commentary No. 21]. As the PEB explained, the use of the terms "assignment," "assignee," and "assignor" as used in former versions of Article 9, has historically been understood to refer to "an outright

transfer of ownership of a specified payment right or a [security interest that secures an obligation] in a specified payment right." *Id.* at 2.

The PEB explained that there is no sound policy for limiting (as the Supreme Court did here) the term "assignment" to exclude a security interest under Article 9, including Section 9-406. First, to do so would place on the account debtor the "heavy and unjustifiable" burden of "determin[ing] whether the assignment was a sale or a [security interest that secures an obligation] in order to know whether, for example, the obligations and rights in Part 4 apply to the account debtor." *Id.* at 3 ("Given the difficulty that courts often have in determining whether an assignment of a payment right is a sale or a [security interest that secures an obligation], an account debtor should not be expected to make that determination."). The ruling below, if affirmed, would also place a burden on assignees to determine whether their rights will be adjudicated under Section 9-406 or contractual common law, which uncertainty would "have a negative effect the availability of financing." *See id.*

Second, treating assignments and security interests differently under the UCC would also undermine "one of the purposes of the UCC [] 'to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties.'" *Id.* at 4 (citing UCC § 1-103(a)(2)). While "[t]he narrow interpretation [as found by the Supreme Court here] would leave to other law whether the account debtor may discharge the account debtor's payment obligation by paying the debtor

or by paying the secured party…[t]he broader interpretation creates greater certainty for both the secured party and the account debtor and is consistent with expectations in commercial practice." *Id.*

PEB Commentary No. 21 has also been incorporated into Official Comment 26 to Section 9-102 of the UCC. That Comment to the definitions of "Assignment" and "Transfer" states "[t]his Article generally follows common usage by using the terms 'assignment' and 'assign' to refer to transfers of rights to payment, claims, and liens and other security interests…Except when used in connection with a letter-of-credit transaction (see Section 9-107, Comment 4), no significance should be placed on the use of one term or the other. Depending on the substance of the transaction, each term as used in this Article refers to the assignment or transfer of an outright ownership interest, to the assignment or transfer of a limited interest, such as a security interest, or both." UCC § 9-102, Official Comment 26 (citing PEB Commentary No. 21).[3]

As one of the (if not the) leading commercial courts in the nation, this Court cannot sustain a ruling that runs contrary to the words and very purpose of the

[3] Official Comment 5 to UCC Section 9-406 also suggests a security interest and an assignment should be treated the same. It explains "Former Section 9-318(4) rendered ineffective an agreement between an account debtor and an assignor which prohibited assignment of an account (whether outright or to secure an obligation) or prohibited a security assignment of a general intangible for the payment of money due or to become due. Subsection (d) essentially follows former Section 9-318(4), but expands the rule of free assignability to chattel paper (subject to Sections 2A-303 and 9-407) and promissory notes and explicitly overrides both restrictions and prohibitions of assignment.".

Uniform Commercial Code. This Court cannot sustain a ruling that is directly contrary to the express direction of the PEB. This Court cannot sustain a ruling that does precisely what the PEB warns against—indeed the PEB says that Courts that rule as the Supreme Court did here are just plain wrong. Thus, the Supreme Court's holding that a security interest is not the same as an assignment under UCC Section 9-406 contradicts both the PEB Commentary and the UCC Official Comments.

C. Worthy's Security Interest is an Assignment under Section 9-406

The Supreme Court's holding also disregards precedent in New York, as well as other states, finding a security interest, like Worthy's, is to be treated as an assignment under Article 9. For example, in *Community Bank v. Newmark & Lewis, Inc.*, the Eastern District of New York rejected the defendant's argument on a motion for summary judgment that the plaintiff did not have standing to sue on certain invoices because it did not have a formal assignment of them, where the "plaintiff acquired a security interest through its security agreement with [the debtor], 'in all accounts, [and] accounts receivable . . .' of [the debtor] 'now existing or hereafter arising,' and not merely the specific accounts on which plaintiff loaned [the debtor] money." *See* 534 F. Supp. 456, 460 (E.D.N.Y. 1982) (citing former UCC § 9-502(1),

the predecessor provision to Section 9-607).[4] Similarly, in *ImagePoint, Inc. v. JPMorgan Chase Bank, National Association*, the court found that the plaintiff could bring a cause of action against an account debtor to collect on accounts, where the original lender assigned the plaintiff its security interest in all of its Collateral. *See* 27 F. Supp. 3d 494, 497, 503-04 (S.D.N.Y. 2014), report and recommendation, adopted and objections overruled sub nom. *ImagePoint, Inc. v. JPMorgan Chase Bank*, No. 12-CV-7183 LAK, 2014 WL 3891326 (S.D.N.Y. Aug. 8, 2014) ("ImagePoint's grant to Wachovia of a 'continuing first priority security interest in, and a continuing Lien upon, [ImagePoint's] Collateral,' Loan & Security § 7.1(a), falls squarely within the scope of Article 9.").

Moreover, many courts in other jurisdictions have come to the same conclusion that a security interest must be treated as an assignment under UCC Section 9-406 for purposes of collection from an account debtor. *See*, *e.g.*, *Lake City*

[4] The Second Circuit also cited favorably to *Community Bank* in an analogous maritime lien case wherein the Court offered a comparison with the provisions of the UCC, stating in pertinent part:

> Article 9 of the UCC gives the secured party two distinct remedies for enforcing this security interest, only one of which is available to the holder of a maritime lien on subfreights. First, upon default by the primary debtor, the secured party is entitled to notify account debtors that they are to make payments directly to it, rather than to the primary debtor. *See* UCC § 9–502(1); *Community Bank v. Newmark & Lewis, Inc.*, 534 F.Supp. 456, 460 (E.D.N.Y.1982). In effect, notice to the account debtor under section 9–502(1) subrogates the secured party to the rights of the primary debtor—the remedy that is available to enforce a shipowner's lien.

Cornish Shipping Ltd. v. Int'l Nederlanden Bank, 53 F. 3d 499, 505 (2d Cir. 1995).

Bank v. R.T. Milord Co., No. 18 C 7159, 2019 WL 1897068, at *3 (N.D. Ill. Apr. 29, 2019) (affirming the applicability of UCC Section 9-406 to the plaintiff secured creditor's claim where it sufficiently pled that the defendant was an account debtor and the money owed was an account); *ARA Inc. v. City of Glendale*, 360 F. Supp. 3d 957, 967 (D. Ariz. 2019) (analyzing a notice and proof of assignment under Ariz. Rev. Stat. Ann. § 47-9406 and finding "[t]here is 'no meaningful difference between a security interest and an assignment…' That ARA was claiming a security interest in the payments, rather than an assignment, does not render the notice insufficient.") (quoting *In re Apex Oil Co.*, 975 F.2d 1365, 1369 (8th Cir. 1992), reh'g denied and opinion modified (Nov. 19, 1992).[5]

[5] The list of cases whose holdings are consistent with the PEB's instruction is extensive. *See, e.g.*, *Magnolia Fin. Grp. v. Antos*, 310 F. Supp. 3d 764, 765-67 (E.D. La. 2018) (analyzing a pledge and security agreement giving a lender the right to payment of proceeds of a settlement agreement as an assignment under La. Rev. Stat. Ann. Section 10:9-406); *Swift Energy Operating, L.L.C. v. Plemco-South, Inc.*, 157 So. 3d 1154, 1161-62 (La. Ct. App. 2015) (citing to La. Rev. Stat. Ann. Section 10:9-102, Official Comment 26 and reversing the lower court's holding that a security interest in accounts receivable was not the same as an assignment under La. Rev. Stat. Ann. Section 10:9-406); *Garber v. TouchStar Software Corp*, No. 2009CV1189, 2011 WL 12526062, at *4 (Colo. Dist. Ct. Nov. 10, 2011) (Trial Order) ("[I]n order to secure its debt to SVB, TouchStar gave SVB a security interest in its accounts receivable[.] SVB thus stands in TouchStar's shoes, just as an assignee of TouchStar's accounts receivable would."); *Rockland Credit Fin., LLC v. Fenestration Architectural Prods., LLC*, No. 06-3065, 2008 WL 1773234 (R.I. Super. Mar. 12, 2008) (Trial Order) (rejecting defendant's argument that the plaintiff's notice of assignment was ineffective under R.I. Gen. Laws Section 6A-9-406 because the plaintiff "had not specifically purchased this set of receivables; rather, it held a security interest in them."); *see also LFG Nat'l Capital, LLC v. Gary, Williams, Finney, Lewis, Watson, & Sperando P.L.*, 874 F. Supp. 2d 108, 120 (N.D.N.Y. 2012) (denying counterclaims under California law for unlawful conduct against secured lender where the secured lender's letters to account debtors "seeking to collect sums upon the [borrower's] default, were permitted under the terms of the Loan Agreement and the UCC.").

A recent decision by the Supreme Court of Nebraska, *First State Bank Nebraska v. MP Nexlevel, LLC*, is directly on point and illustrative of the proper uniform application of the Uniform Commercial Code as in effect in New York and other jurisdictions. 948 N.W.2d 708 (Neb. 2020). In *First State Bank Nebraska*, the borrower, like Checkmate, was a subcontractor of construction services and granted to its lender a security interest in receivables and other amounts due from the general contractor to the borrower. *Id.* at 714-15. The lender sent a notice of assignment to the general contractor. *Id.* at 715. After the general contractor, like New Style, continued to pay the borrower despite having received the notices of assignment, the lender sued the general contractor. *Id.*

The Nebraska lower court had wrongly held, like the Supreme Court did here, among other things that Neb. Rev. Stat. UCC Section 9-406(a) only applies to transfers of ownership and not to security interests, and therefore, the notice of assignment sent after the debtor's default was insufficient to require that the general contractor remit payment to the plaintiff. *Id.* at 717. The Nebraska Supreme Court reversed the lower court's decision, and, finding in favor of the secured lender, held that the holder of a security interest is an "assignee" for purposes of Section 9-406, and that Section 9-406 prevents the account debtor from claiming it satisfied its payment obligation by paying the debtor. *Id.* at 719-22.

Just like the notice of assignment in *First State Bank Nebraska*, the Notice of Assignment that Worthy sent to New Style, which was supported by Worthy's perfected security interest in the New Style Accounts, was sufficient to require that New Style remit payments only to Worthy. As the precedent above demonstrates, whether Worthy purchased those accounts is irrelevant, because Worthy has a security interest in all of Checkmate's present and future collateral, including its accounts. Thus, the Supreme Court's finding that the Notice of Assignment was ineffective because a security interest is not an assignment is erroneous and should be reversed.

D. The Supreme Court Mischaracterized and Misapplied the Holding of *IIG Capital LLC v. Archipelago, L.L.C.*, Which is Not Applicable to this Case

The Supreme Court incorrectly supported its holding that a secured party with a security interest is not the same as an assignee, by citing [R 10] to *IIG Capital LLC v. Archipelago, L.L.C.*, which is not applicable to the facts here. 36 A.D.3d 401, 829 N.Y.S.2d 10 (1st Dep't 2007). In *IIG Capital LLC*, this Court found that, despite the defendant's arguments to the contrary, a factor did have a cause of action against an account debtor on accounts which the factor had purchased from the debtor. *See id.* at 403. Later in its opinion, after it had already denied the defendant's motion to dismiss, this Court also noted that the plaintiff's security interest could not serve as the basis for its cause of action for collection—as an alternative to its purchase of the accounts—since the factoring agreement "expressly conditioned" the plaintiff's

right to collect on an event of default, which was not alleged (and which is not a condition in this case). *See id.* at 404. Finally, in dicta, again after its decision to deny the motion to dismiss, the Court appeared to discount the plaintiff's argument that a secured party is the equivalent of an assignee under Section 9-406, where the cases the plaintiff cited for support of its argument only dealt with defenses available to the account debtor against the assignee under former UCC Section 9-318(1), now Section 9-404 (not Section 9-318(3), the predecessor to Section 9-406). *See id.*

First, the portion of this Court's opinion in *IIG Capital LLC* cited by the Supreme Court has no bearing on the holding of that case. The *IIG* court had determined that the defendant failed to clearly refute the plaintiff's allegation that it had purchased all of the defendant's accounts under the factoring agreement and thus, the plaintiff's ability to collect did not rely on its security interest in the same accounts. *See id.* at 403. The Court therefore had no need to determine whether an assignment is the same as a security interest. *See id.*; *see also First State Bank Nebraska*, supra, 948 Neb. at 721 (discussing and ultimately declining to apply this portion of the *IIG Capital LLC* opinion as dicta).

Second, as the *IIG* Court pointed out, the factoring agreement in that case had expressly conditioned plaintiff's right to collect on an event of default, which the plaintiff did not allege. *See id.* at 404. That is not the case here, because under Section 4(k) of the Financing Agreement between Worthy and Checkmate,

Checkmate "irrevocably authorizes [Worthy] to, at any time and from time to time in its discretion, notify and instruct account debtors of [Checkmate] (including pursuant to a notice of assignment in form and substance satisfactory to [Worthy]) of the interest of [Worthy] in the Accounts and to remit payment of Accounts and other Collateral directly to [Worthy] . . .". [R-24] Moreover, Section 9-607 of the UCC permits collection at any time, including before default, where the parties have so agreed. N.Y. UCC § 9-607, Official Comment 4. Official Comment 4 to N.Y. UCC Section 9-607 provides that, "this section also applies to the collection and enforcement rights of secured parties even if a default has not occurred, as long as the debtor has so agreed. It is not unusual for debtors to agree that secured parties are entitled to collect and enforce rights against account debtors prior to default." *Id.*

Notably, the PEB explained that any court that relied on *IIG* for the interpretation found by the Supreme Court here was wrong. *See* PEB Commentary No. 21 at 2 ("This narrow reading of the term 'assignment' is contrary to the use of the term in Article 9 and the holding of other courts, and is incorrect."). Accordingly, the holding in *IIG Capital LLC* is not only irrelevant to the issue of whether a security interest is an assignment, it is also inapplicable to the facts of this case and to the extent any court were to rely on it for the proposition cited below by the Supreme Court, that court is "incorrect". Therefore, the Supreme Court, disregarding a plethora of binding as well as persuasive authority on this issue, erred in holding

that Worthy's allegations of a security interest and Notice of Assignment were not sufficient on a motion to dismiss.

POINT II

THE SUPREME COURT WRONGLY HELD THAT PLAINTIFF DOES NOT HAVE A CAUSE OF ACTION FOR COLLECTION AGAINST DEFENDANT

The Supreme Court's holding that Plaintiff does not have a cause of action for collection against New Style under the UCC is erroneous. [R-10] Worthy sued New Style based on New Style's existing and future obligations to Checkmate at the time that Checkmate granted Worthy a security interest in those obligations, as permitted by Section 9-607 of the UCC. Any suggestion that a "dispute" exists between Worthy and Checkmate as to Checkmate's obligations to Worthy (i.e., Checkmate has defaulted on its loan), does not change New Style's obligations to Checkmate under its subcontract agreements, and therefore, has no effect on Worthy's cause of action against New Style or the requirement of UCC Section 9-406 that New Style remit payments directly to Worthy. Thus, the Supreme Court's Order should be reversed.

A default is not a dispute; it is just a failure to pay when due. If a failure of the borrower to pay excused the account debtor from complying with the instruction in the Notice of Assignment to pay the lender, then the security interest and collateral would be meaningless and worthless. The most important time to get payment from the account debtor is when the borrower stops paying the loan.

A. Worthy has Stated a Cause of Action to Enforce New Style's Obligations to Checkmate

N.Y. UCC Section 9-607(a)(3) is clear. A secured party, like Worthy:

> may enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor ... to make payment or otherwise render performance to the debtor, and with respect to any property that secures the obligations of the account debtor or other person obligated on the collateral . . .

As courts in this State as well as in other states applying the UCC have found, Section 9-607 provides a mechanism for the secured party to bring suit against an account debtor that fails to remit payments to the secured party. *See ImagePoint, Inc.*, 27 F. Supp. 3d at 507 ("[C]ase law routinely recognizes that secured creditors have the right to collect from account debtors pursuant to § 9–607(a)(3)") (citing *Agri-Best Holdings, LLC v. Atlanta Cattle Exch., Inc.*, 812 F. Supp. 2d 898, 901 (N.D. Ill. 2011); *Wells Fargo Bank Nat'l Ass'n v. Kal-Rich, Inc.*, 2010 Mass. App. Div. 103, 2010 WL 174603, at *3 (Mass. App. Div. Apr. 26, 2010); *Mecco, Inc. v. Capital Hardware Supply, Inc.*, 486 F. Supp. 2d 537, 546 (D. Md. 2007)). Here, Worthy has stated a cause of action against New Style to collect the New Style Accounts, since New Style failed to remit payments to Worthy in accordance with Section 9-406 of the UCC after its receipt of the Notice of Assignment.

The PEB explains the interplay of Sections 9-607 and 9-406. *See* PEB Commentary No. 21 at 3 ("In other words, Sections 9-607 and 9-406 address

different rights. Section 9-607 addresses the rights of a secured party vis-à-vis the debtor to collect a specified payment right. Section 9-406 addresses a secured party's rights against the account debtor to collect a specified payment right. If Section 9-406—and Part 4 of Article 9 more generally—did not apply to an assignment constituting a [security interest that secures an obligation], there would be a gap in Article 9: nothing in Article 9 would address the rights, claims, duties, and defenses of an account debtor with respect to that type of assignment.").

This principle is illustrated by the holding in *ImagePoint*. In that case, Wachovia Bank ("Wachovia") and ImagePoint entered into a Loan and Security Agreement, under which Wachovia agreed to make loans to ImagePoint and in exchange, ImagePoint granted Wachovia a security interest in ImagePoint's collateral, including its accounts. *Id.* at 497-98. ImagePoint and JP Morgan Chase Bank ("JP Morgan") subsequently entered into a Procurement Agreement, "in which [JP Morgan] agreed to pay ImagePoint for performing various services and supplying certain materials." *Id.* at 498. Wachovia's rights were later assigned to the plaintiff, Martin. *Id.* JP Morgan failed to pay the amounts due under the Procurement Agreement, and Martin and ImagePoint sought to collect payments from JP Morgan pursuant to Wachovia's assignment of its security interest. *See id.* at 499-500.

JP Morgan challenged Martin's entitlement to recourse under Section 9-607, arguing that Section 9-607(e), which states that "[t]his section does not determine

whether an account debtor, bank, or other person obligated on collateral owes a duty to a secured party," prevents a secured creditor from collecting from an account debtor. *Id.* at 505. The court rejected this argument, holding first that Section 9-607(a)(3) "by its terms gives the secured party . . . the right to sue the account debtor . . . to enforce the obligations that the [account debtor] owes to the debtor . . .". *Id.* The court further explained that:

> [o]n its face, the language of § 9–607(e) imposes no limitation on the remedy provided in § 9–607(a)(3). It merely states that § 9–607 does not create any obligation to a secured party. But the obligation that Martin purports to sue on was not created by Article 9 but rather consists of an obligation contained in the original contract between ImagePoint and [JP Morgan]—that is, [JP Morgan's] debt to ImagePoint under the Procurement Agreement. *Id.*

Here, just like the plaintiff Martin in *ImagePoint*, Worthy's suit is based on New Style's obligation to pay money to Checkmate arising from the subcontract agreements between New Style and Checkmate. The Notice of Assignment allows Worthy to step into Checkmate's shoes to enforce New Style's obligations to Checkmate under those agreements. *See id.*; *see also Mecco, Inc.*, supra, 486 F. Supp. 2d at 546 (finding that a bank with a perfected security interest in a debtor's collateral could, upon the debtor's default, "step into [the debtor's] shoes and enforce the obligations of its account debtors."). Therefore, Worthy has stated a cause of action for collection under the UCC.

B. Checkmate's Default Under the Financing Agreement Does Not Prevent Worthy from Collecting on the New Style Accounts

The Supreme Court did not deny an assignee's use of Section 9-607 as a mechanism to enforce an account debtor's obligations generally, nor could it because case law clearly permits such a cause of action. *See* supra, Section II.A. Rather, the Supreme Court found that Worthy does not have a cause of action because a "dispute" between Worthy and Checkmate exists regarding *Checkmate's*, not *New Style's*, obligations to Worthy. [R 9-10] The Supreme Court's holding represents a misinterpretation of the case law it relies on and is plain error.

The Supreme Court relied on two cases for its holding, *ImagePoint*, and an unpublished opinion from the Court of Appeals of Michigan which the court in *ImagePoint* specifically distinguishes its facts from. [R 9-10]; *see Buckeye Ret. Co., LLC v. Meijer, Inc.*, No. 279625, 2008 WL 4278038 (Mich. Ct. App. Sept. 18, 2008). Reliance on *Buckeye* is wrong for several reasons. First, *Buckeye* is not precedential authority under Michigan Court of Appeals Rule 7.215(c). *See* Mich. Ct. R. 7.215 ("An unpublished opinion is not precedentially binding under the rule of stare decisis."). Second, the analysis is flawed and the facts are different. In *Buckeye Ret. Co.*, a bank lent money to a shoe repair business, "Pells", and in exchange, Pells granted the bank a security interest in its collateral, including its accounts. 2008 WL 4278038 at *1. Pells operated within the defendant's physical stores, and delivered its receipts and cash to the defendant at the end of each business day. *Id.* The

plaintiff, Buckeye, later acquired rights to the loan with Pells from the bank, and when Pells defaulted on the loan, Buckeye brought suit against Pells to enforce its obligations. *Id.*

After bringing suit against Pells, Buckeye sent a letter to the defendant, requesting that it hold Pells' accounts receivable in escrow until there was a resolution of the litigation between Buckeye and Pells. *Id.* at *2. When the defendant requested clarification of the dispute from Pells, Pells responded that it did not believe Buckeye was entitled to any payment from the defendant of any amounts owed by the defendant to Pells, and none of the documents provided by Buckeye referenced an assignment of money held by defendant on behalf of Buckeye. *Id.* Buckeye then sued defendant alleging three causes of action, including one under UCC Section 9-607. *Id.* at 3. The court held that Buckeye had not provided sufficient notice of assignment and further, that Buckeye did not have a sufficient cause of action under Section 9-607(5) of the Michigan Commercial Law—the equivalent of N.Y. UCC Section 9-607(e)—because Section 9-607 establishes only the baseline rights of the secured creditor and the debtor. *Id.* at 6.

The court in *ImagePoint* distinguished its facts from those of *Buckeye*, explaining that in "situations like *Buckeye*, where there is a dispute between the secured creditor and the debtor as to who has the right to collect from an account debtor, the secured creditor cannot be said to be 'exercis[ing] the rights of the debtor

with respect to the obligation of the account debtor.'" *See* 27 F. Supp. 3d at 506 (citing N.Y. UCC § 9–607(a)(3)). The court went on to explain that the plaintiff Martin's case was different from Buckeye's, because Martin "is not asking us to look to § 9–607 to find that [JP Morgan] owes any independent duty to Martin to allow him to enforce ImagePoint's rights under the Procurement Agreement." *See id.* "Rather, Martin is asking [JP Morgan] to simply fulfill its obligations to ImagePoint under the Procurement Agreement—an action which is explicitly permitted by N.Y. UCC § 9–607(a)(3)." *Id.*

Worthy's case is analogous to the facts of *ImagePoint* and not *Buckeye*. Unlike Pells in *Buckeye*, Checkmate has not disputed that Worthy is entitled to payment from New Style (nor could it), nor has Checkmate disputed that Worthy has a valid assignment of the New Style Accounts (nor could it). The only dispute which the Supreme Court believed exists is Checkmate's failure to pay its own obligations to Worthy. This "dispute" is not tantamount to a denial by Checkmate of Worthy's right to collect from New Style, nor does it change New Style's obligations to Checkmate, as a denial of the right to collect did in *Buckeye*. Indeed, if the law were otherwise, (or as the Supreme Court suggested here) then any borrower could interfere with a secured creditor's collateral by feigning a "dispute"—this is not and cannot be the law.

Moreover, the Supreme Court's concern as to Checkmate's failure to pay Worthy incorrectly suggests that Worthy is limited to recovering from either New Style or Checkmate, and can only collect from New Style in the event there is a judgment of default under the Financing Agreement. In fact, a dispute between Checkmate and Worthy over whether an event of default exists under the Financing Agreement would be irrelevant here, because Section 4(k) of the Financing Agreement and UCC Section 9-607 expressly permit Worthy to enforce New Style's obligations to Checkmate at any time, not just in the event of default. *See* supra, Section I.D; [R-24]. Moreover, "under the UCC, a secured creditor's rights and remedies upon a debtor's default" which has occurred here "are cumulative and may be pursued simultaneously or in whichever order the creditor chooses." *Reading Co-Op. Bank v. Suffolk Constr. Co.*, 464 Mass. 543, 549 (Mass. 2013) (finding an assignee was not required to seek recovery under a guaranty of its borrower before pursuing recovery against the account debtor).

Thus, Worthy is entitled, under Section 9-607, to enforce New Style's obligations to Checkmate, existing and about to exist at the time Checkmate granted Worthy a security interest in all of its accounts.

C. New Style has Failed to Comply with Article 9 by Disregarding the Notice

The Supreme Court's decision that Worthy cannot collect from New Style while a "dispute" between Worthy and Checkmate exists rests on its concern that

New Style would be required to pay for the New Style Accounts twice. [R 10] However, New Style is liable to Worthy, regardless of whether it has already paid Checkmate, because New Style failed to follow the statutory requirements of UCC Article 9, which would have prevented such a result. *See Reading Co-Op. Bank*, 464 Mass. at 549 (explaining that "Article 9 contains a comprehensive scheme for enforcement of rights and allocation of losses…" and finding the account debtor was obligated to pay the assignee all payments wrongfully misdirected to the assignor despite mistakenly paying the assignor).

First, Section 9-406 requires the account debtor to pay the secured creditor after receipt of a notice of assignment, and even provides a defense to the account debtor against the debtor-assignor, after it has already paid the secured creditor. *See Clifton-Fine Cent. Sch. Dist.*, supra Section I.A.; *Gen. Motors Acceptance Corp. v. Albany Water Bd.*, 187 A.D.2d 894, 896, 590 N.Y.S.2d 312, 313 (3d Dep't 1992) ("After notice of the transfer, however, the debtor is put on his guard, and if he pays the assignor any money which, under the assignment belongs to the assignee, or if he does anything prejudicial to the rights of the latter, he is liable for the resulting damage.") (quotations omitted) (citing Section 9-318(3)); N.Y. UCC § 9-406, Official Comment 2 (Section 9-406 "makes explicit that payment to the assignor before notification, or payment to the assignee after notification, discharges the obligation.").

Second, if New Style had any doubt as to the sufficiency of the Notice of Assignment—which clearly New Style did since it ignored it and argued it is insufficient in its Motion to Dismiss—it should have inquired about the assignment. *IIG Capital LLC*, supra, 36 A.D.3d at 403 ("[I]f defendants or their employees had any doubt as to the import of the assignment notices and invoices they signed for, the UCC provides a mechanism whereby the account debtor may require that the assignee 'furnish reasonable proof that the assignment has been made'") (quoting N.Y. UCC § 9-406(c)); *Platinum Funding Servs., LLC v. Magellan Midstream Partners, Ltd. P'ship*, No. CV095029911, 2010 WL 2383786, at *3 (Conn. Super. Ct. Apr. 30, 2010) (unpublished opinion) ("§42a-9-406(c) puts the burden on the account debtor to inquire as to the assignee upon receipt of a notice of assignment that the account debtor questions."). Finally, UCC Section 9-406(a) expressly provides that the account debtor (New Style) "may not discharge the obligation by paying the assignor [Checkmate]".

Thus, upon receipt of the Notice of Assignment, New Style had the burden of following the guidelines of Article 9, but failed to do so. The Supreme Court's holding that Worthy does not have a cause of action against New Style because this might result in double payment by New Style is erroneous and contrary to the legislative scheme of Article 9.

CONCLUSION

The holding below is an outlier, which, if not reversed, sets a very dangerous non-commercial, non-uniform precedent. It would open the floodgates to precisely the type of mischief the UCC is designed to prevent—a financially troubled borrower pressuring its customer to pay it directly (or to pay some other entity), in violation of the secured creditor's rights. Unless the account debtor (i.e., New Style) is held to the notice of assignment and liable to the secured creditor, it would have no incentive—zero—to honor the notice of assignment or comply with the Uniform Commercial Code. This is bad policy, bad precedent, and a bad outcome.

By reason of all of the foregoing, Worthy respectfully requests that this Court reverse and vacate the dismissal of the Complaint. In the alternative, to the extent this Court believes that there is a pleading deficiency or omission, Worthy respectfully requests leave to re-plead to remedy any such issue.

Dated: New York, New York
March 22, 2021

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STATEMENT PURSUANT TO CPLR § 5531

New York Supreme Court

Appellate Division—First Department

WORTHY LENDING, LLC,

Plaintiff-Appellant,

– against –

NEW STYLE CONTRACTORS, INC.,

Defendant-Respondent.

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1. The index number of the case in the court below is 653406/20.

2. The full names of the original parties are as set forth above. There have been no changes.

3. The action was commenced in Supreme Court, New York County.

4. The action was commenced on or about July 27, 2020 by filing of a Summons and Complaint. In lieu of an Answer, Defendant filed a Motion to Dismiss on October 19, 2020.

5. The nature and object of the action involves breach of contract.

6. This appeal is from the Decision and Order of the Honorable Arlene P. Bluth, dated November 17, 2020, and entered on November 18, 2020, which granted Defendant's Motion to Dismiss.

7. This appeal is on the full reproduced record.