SECURED TRANSACTIONS II.D, IV.J, V.A.1; SALES VI.C, VII. B

Question 7 Analysis

Legal Problems:

(1) Did Finance Co.’s letter to Buyer informing it of the assignment of the purchase agreement to Finance Co. obligate Buyer to make future payments under the contract directly to Finance Co.?

(2) Can Buyer reduce the amount it owes Finance Co. by subtracting the expenses it incurred to add the attachments to the excavator?

DISCUSSION

Summary: Once Finance Co. notified Buyer of the assignment of the right to receive payment and demanded payment of the balance, Buyer was obligated to pay Finance Co., notwithstanding Seller’s instruction to the contrary. However, Buyer had the right to offset against Finance Co. its damages for Seller’s breach of contract, even though Buyer had accepted delivery of the excavator.

Point One: Once Finance Co. properly notified Buyer of the assignment of the purchase agreement and instructed Buyer to make payments directly to Finance Co., Buyer was obligated to make all payments under the contract to Finance Co.; Buyer’s payments to Seller did not discharge that obligation.

As a result of the security agreement signed by Seller, Finance Co. had a security interest in all of Seller’s accounts and chattel paper. Moreover, the security agreement expressly provided that payments arising from Seller’s “accounts and chattel paper” had been assigned to Finance Co. Under Article 9 of the Uniform Commercial Code, a security interest in “accounts” covers any “right to payment of a monetary obligation, whether or not earned by performance, . . . for property that has been or is to be sold.” UCC § 9-102(a)(2). Consequently, Finance Co.’s security interest covered the amount owed by Buyer to Seller pursuant to Buyer’s agreement to purchase the excavator.

Article 9 gives a secured party or assignee of an account (i.e., Finance Co.) the right to collect directly from the account debtor (i.e., Buyer) in the event of a default by the debtor (i.e., Seller). UCC § 9-607(a)(1). To exercise that right effectively, Finance Co. must send an authenticated notification to the account debtor informing the account debtor that the amount due has been assigned and that payment is to be made to the assignee. The facts state that Finance Co. properly notified Buyer of the assignment of Seller’s right to receive payment and directed Buyer to make future payments to Finance Co. See UCC § 9-406(a), cmt. 2. See generally James J. White & Robert S. Summers, UNIFORM COMMERCIAL CODE § 25-5 (5th ed. 2000).
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Once an account debtor receives proper notification to make future payments directly to an assignee, the account debtor may discharge its payment obligation only by payment to the assignee. Payments made to the assignor do not result in discharge. UCC § 9-406(a).

The fact that Seller told Buyer to disregard the notice from Finance Co. is no defense. Proper notice from Finance Co. (assignee) is all that is required to obligate Buyer to make payment directly to Finance Co., and nothing in the UCC allows an assignor like Seller to interfere with the rights of the assignee in this way. Rather than ignoring the assignment and relying on Seller for instructions, Buyer should have demanded proof of the assignment from Finance Co. Had it done so, Buyer could have safely paid Seller until reasonable proof was offered. See UCC § 9-406(b)(c). What Buyer cannot do is what it did here—ignore the notification of the assignment and continue to pay Seller.

Consequently, Buyer was obligated to make the March and April payments to Finance Co., and it remains liable for those payments. Buyer was not discharged by reason of its payment to Seller. Buyer is also obliged to make the May payment to Finance Co., subject to an offset, as discussed below.

Point Two: Buyer can assert Seller’s breach of contract as a defense to payment and offset its (45-55%) damages against the amount it owes Finance Co.

The rights of an assignee of an account (Finance Co.) are subject to “any defense or claim in recoupment arising from the transaction that gave rise to the contract.” UCC § 9-404(a)(1). The account debtor may, of course, waive the right to assert defenses against an assignee, but there is nothing in the facts to suggest that Buyer waived this right.

Here, the facts establish that Buyer has a defense against full payment of the contract price. Seller agreed to supply Buyer with an excavator that was specially equipped. Moreover, Seller agreed to supply the excavator by a particular date, when Seller knew that Buyer needed it to begin work. When that date arrived, the excavator had not been equipped as required by the contract. Buyer nevertheless took delivery of the excavator, despite its failure to conform to the contract.

When a buyer takes goods in spite of a known nonconformity with the contract, the buyer has accepted the goods for the purposes of sales law. UCC § 2-606. Acceptance ordinarily obligates a buyer to pay the contract price. UCC § 2-607. However, acceptance of nonconforming goods does not bar a remedy for breach, so long as the buyer notifies the seller of the breach within a reasonable time of its discovery. Here, Buyer notified Seller of the nonconforming nature of the excavator at the time it took possession of the equipment and told Seller it intended to offset its costs for the attachments. As a result, Buyer is entitled to assert its remedies for breach, despite its acceptance of the goods.

In general, Buyer’s remedy is the recovery of damages for the nonconformity, defined as “the loss resulting in the ordinary course of events from the seller’s breach as determined in any manner which is reasonable.” UCC § 2-714(1). Moreover, Buyer “may deduct all or any part of the damages . . . from any part of the price still due,” so long as Buyer notifies Seller of the intention to do so. UCC § 2-717. Here, Buyer notified Seller of its intention in this regard.
Buyer’s contract claims against Seller may be asserted against Finance Co., as assignee of the contract, to reduce the amount owed by Buyer. UCC § 9-404(b).

Under the contract, Buyer owes $75,000 to Finance Co. (the amount of the March and April payments, which Buyer improperly sent to Seller, and the amount of the upcoming May payment). Buyer claims $30,000 in damages from Seller’s breach, and it may deduct that amount from the amount owed under the contract. See generally James J. White & Robert S. Summers, UNIFORM COMMERCIAL CODE § 10-2 (5th ed. 2000)(techniques for measuring damages under UCC § 2-714). Consequently, Buyer owes Finance Co. $45,000.