

BANKING ALERT

January 2023

New York Court of Appeals Determines That Assignee Includes Holder of Exercisable Security Interest in Assignor's Accounts Receivable

In *Worthy Lending LLC v. New Style Contractors, Inc.*, the New York Court of Appeals found that, for purposes of Section 9-406 of New York's Uniform Commercial Code ("UCC"), an "assignee" includes the holder of a presently exercisable security interest in an assignor's receivables.

As alleged, New Style Contractors, Inc. ("New Style") engaged Checkmate Communications LLC ("Checkmate") as a subcontractor. Pursuant to a Promissory Note and Security Agreement dated October 11, 2019 (the "Agreement") between Checkmate and Worthy Lending LLC ("Worthy"), Checkmate borrowed up to \$3,000,000 from Worthy. Section 3 (a) of the Agreement granted Worthy, among other things, a security interest in Checkmate's assets. The Agreement further provided that Worthy could "notify and instruct account debtors [of Checkmate]...to remit payment of Accounts and other Collateral directly to Lender" prior to a default, and that Checkmate would not "interfere with [Worthy's] collection of Collateral."

Worthy then later filed a UCC-1 Financing Statement against Checkmate with the Secretary of the State of New Jersey, perfecting its security interest in the collateral. Worthy sent New Style a notice of its security interest and collateral assignment in the New Style accounts and advised New Style that "[a]ll remittances for Accounts shall be made payable only to Worthy."

Upon Checkmate's default on the loan, Worthy accelerated the entire amount due and owing and demanded immediate repayment. Thereafter, Checkmate filed for bankruptcy. After the default, Worthy learned that New Style "may have remitted payment of one or more New Style Accounts to Checkmate contrary to such notices of assignment."

As a result, Worthy commenced an action against New Style, alleging that pursuant to UCC Section 9-607, Worthy was entitled to recover from New Style all amounts New Style paid to Checkmate after New Style's receipt of the notice of assignment. New Style filed a motion to dismiss, which the Supreme Court granted, finding

In This Issue

New York Court of Appeals Determines That Assignee Includes Holder of Exercisable Security Interest in Assignor's Accounts Receivable

Pg 1

Appellate Division Reaffirms Basic Principle That Unrecorded Mortgages are Effective Between Borrower and Lender

Pg 2

Office Locations

New Jersey

210 Park Avenue
2nd Floor
Florham Park NJ 07932
973.302.9700

New York

1185 Avenue of the Americas
3rd Floor
New York NY 10036
212.763.6464

Follow Sherman Atlas on
LinkedIn 

that: (1) UCC Section 9-607 “does not determine whether an account debtor, bank, or other person obligated on collateral owes a duty to a secured party;” (2) the Agreement was “a security interest and was not an assignment;” and (3) UCC Section 9-607 applies to assignments, not security interests. The Appellate Division affirmed.

On appeal, the Court of Appeals reversed the Supreme Court’s determination. In so doing, the Court of Appeals explained that Worthy was a secured party with the authority to enforce the rights of its debtor, *i.e.*, Checkmate, against Checkmate’s account debtor, New Style. Further the Agreement granted Worthy the right to direct Checkmate’s debtors to pay Worthy directly, and barred Checkmate from interfering with Worthy’s efforts to enforce its right to the collateral. The Court of Appeals noted that Section 9-607 (a) (3) expressly provides that “in any event after default,” a secured party may obtain collateral directly from an account debtor, and the secured party and debtor may agree that the secured party may do so by agreement, without regard to default, which is what the parties did here.

The Court of Appeals also rejected New Style’s contention that UCC Section 9-406 allows only assignors - not holders of security interests -- to rely on the payment-redirection provisions, finding that the definition of “security interest” in the UCC does not distinguish between a security interest and an assignment.

Finally, while both the Appellate Division and Supreme Court expressed concern that New Style may have paid Checkmate and now may be forced to pay double, the Court of Appeals explained 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.

Appellate Division Reaffirms Basic Principle That Unrecorded Mortgages Remain Effective Between Borrower and Lender

In *Deutsch v. IEDU Technology, LLC*, A-1541-21 (N.J. App. Div. Nov. 23, 2022), the New Jersey Appellate Division reaffirmed the principal that, in some circumstances, an unrecorded mortgage is enforceable and subject to the statutory caps on the maximum interest permitted under law.

The case involved a \$500,000 loan made by plaintiff, Jacob Deutsch (“Plaintiff”), to IEDU Technology, LLC, Ziu Quin Liu, and Jijun Wang (collectively, “Defendants”) in 2016 (the “Loan”). The Loan, evidenced by a promissory note, required Defendants to pay 18% interest per annum, with the entire unpaid principal balance due on August 30, 2017. The Loan was also evidenced and secured by mortgages that Defendants delivered to Plaintiff for five properties located in Jersey City (collectively, the “Mortgages”). Critically, none of the Mortgages were recorded. Defendants timely made the required payments on the Loan through March 2017. Sometime thereafter, Defendants were advised by their counsel that the note was usurious in view of the interest rate and, as a result, Defendants stopped making any further payments.

In March 2020, Plaintiff filed suit seeking judgment on the outstanding amount of the Loan, including all accrued interest, late fees, attorneys’ fees and costs of suit. Defendants filed an answer which asserted, among other things, that the Loan was usurious and contrary to law. Plaintiff moved for summary judgment, which was granted by the trial court. In granting the motion, the trial court determined that the Mortgages were of “no force and effect,” citing NJSA 46:26A-12, which states that “[a] deed or other conveyance of an interest in real property shall be of no effect against subsequent judgment creditors without notice...” As a

result of the trial court's finding that the Mortgages were not valid, the trial court declined to find the Loan usurious under NJSA 31:1-1.

Defendants appealed the decision, arguing that the trial court erred in not finding that the Loan was usurious under NJSA 31:1-1, which provides, among other things, the maximum allowable interest a lender may charge a borrower for loans in excess of \$50,000 that are secured by a first lien on real property used for residential purposes. The Appellate Division first analyzed whether the Mortgages were valid, and stated that it disagreed with the trial court's application of NJSA 46:26A-12. In particular, the Appellate Division noted that the statute cited by the trial court was enacted to protect third parties, such as subsequent judgment creditors and bona fide purchasers, from unrecorded mortgages, and not, as the trial court found, to render such instruments ineffective as between a lender and borrower. The Appellate Division determined that the trial court's reading of the statute would "render[] it meaningless," and that unrecorded mortgages are still effective between their parties.

Because the Mortgages were valid between Plaintiff and Defendants, the Appellate Division agreed with Defendants that NJSA 31:1-1 applied and that the Loan was "usurious" as (1) it was in excess of \$50,000, and (2) was secured by first liens on residential properties. As a result, the Appellate Division held that Plaintiff could only recover the principal without interest or costs.

Attorney Contact Information

Anthony J. Sylvester

Partner

973.302.9713

asylvester@shermanatlas.com

Craig L. Steinfeld

Partner

973.302.9697

csteinfeld@shermanatlas.com

Anthony C. Valenziano

Counsel

973.302.9696

avalenziano@shermanatlas.com