FACTORS BEWARE: COURT RULES THAT ACCOUNT DEBTOR CAN'T BE ESTOPPED FROM DENYING RECEIPT OF GOODS

In a recent decision interpreting Article 9 of the UCC, a federal district court in Kansas has thrown some tacks in the road of accounts financing. *Maple Trade Finance, Inc. v. Lansing Trade Group, LLC,* 2011 WL 1060961 (D. Kan. 2011). Factors who buy trade receivables need to be aware of this decision and adjust their practices to ensure that they don't have a blowout in their own journeys.

Factor facts. The saga begins in 2007, when Maple Trade started financing the receivables of Greenfield Products Canada, Inc. Pursuant to the parties' agreement, Maple Trade would finance some of Greenfield's receivables and Greenfield would assign those receivables to Maple Finance.

Maple Finance financed five receivables arising from Greenfield's transactions with Lansing Trade Group. The amounts Maple Trade advanced on the receivables ranged from $16,000 to $378,000, and totaled over $825,000. For each receivable, Greenfield issued an invoice that instructed Lansing to pay Maple Trade. Lansing signed the invoices,

each of which expressly acknowledged receipt of the goods sold.

With respect to the first invoice, a Maple Trade representative contacted a Lansing representative, who confirmed receipt of the goods and the obligation to pay Maple Trade directly. Maple Trade did not contact Lansing to confirm receipt with respect to the other invoices and did not follow its own procedures in demanding a copy of the contract between the debtor and the account debtor before advancing any funds.

Lansing paid the two smallest invoices but failed to make any payment on the three largest invoices, against which Maple Trade had loaned a total of more than $780,000. Lansing claimed never to have received the goods referenced in the three largest invoices and claimed that it acknowledged receipt based on Greenfield's representation that the goods had been drop-shipped in line with Lansing's instructions. Unhappy with this state of affairs, Maple Trade sued.

The UCC issue. Lansing claimed a defense to payment under UCC § 9-404(1)(1), which provides that "[u]nless an account debtor has made an enforceable agreement not to assert defenses," the rights of a secured party are subject to any defense arising from the transaction that gave rise to the account debtor's obligation. Lansing argued that since it had not received the goods, it had a defense to the duty to pay and it had never agreed to waive this defense.

Maple Trade countered that Lansing should be estopped from denying receipt of the goods—and hence estopped from asserting its defense—because Lansing had signed the invoices acknowledging receipt and Maple Trade had relied on these representations. Both parties moved for summary judgment.

The court's decision. The Kansas court looked closely at UCC § 1-103(b), which provides that "[u]nless displaced by the particular provisions" of the Code, principles of law and equity, including estoppel, supplement the UCC. Thus, according to the court, the issue was whether UCC § 9-404(a), by expressly indicating that an account debtor retains defenses unless it has entered an agreement to the contrary, displaced the law of estoppel. The court concluded that it did. As a result, Maple Trade's estoppel argument was invalid and Lansing was entitled to summary judgment. The court went on to note that, even if the law of estoppel were available to Maple Trade, the fact that it had not followed its own procedures created a material issue of fact relating to the reasonableness of Maple Trade's reliance, and thus would preclude summary judgment in its favor.

Critique. The decision is clearly wrong. The common law supplements the UCC unless displaced by the text, purposes, or policies of a particular UCC provision. See Comment 2 to UCC § 1-103. While it can occasionally be difficult to discern whether a particular Code provision displaces a common-law rule, there should have been no difficulty in this case. Section 9-404 Comment 2 expressly acknowledges that an account debtor may waive its right to assert defenses against an assignee under UCC § 9-403 "or other applicable law." Section 9-403 Comment 6 is even more clear, providing that it "does not displace an assignee's right to assert that an account debtor is estopped from asserting a claim or defense." Thus, far from displacing the law of estoppel, Article 9 expressly acknowledges that estoppel remains applicable. The Kansas court did not cite either of these Comments.

No matter how unfortunate the decision is, however, it remains out there. Factors would therefore be well-advised to take heed of this decision and adjust their behavior accordingly. If possible, they should not merely have the account debtors acknowledge receipt of the goods or services provided by the debtor; they should have the account debtors agree not to assert defenses. If the account debtors are unwilling to waive all their defenses—and they may legitimately be unwilling to waive those relating to quality of the goods or services—they should at least be willing to waive a defense based on non-delivery. Moreover, it may be a fairly simple matter to include language to that effect in the debtor's invoice and to have the account debtors sign those invoices.

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CLARKS' SECURED TRANSACTIONS MONTHLY (ISSN 0895-5492) is published monthly by A.S. Pratt & Sons, 805 15th St. NW, Third Floor, Washington, DC 20005. **EDITORIAL INQUIRIES:** Direct to Adam McNally, Managing Editor, A.S. Pratt & Sons. POSTMASTER: Send address changes to CLARKS' SECURED TRANSACTIONS MONTHLY, A.S. Pratt & Sons, 805 15th St. NW, Third Floor, Washington, DC 20005.