**Special Attachment Rules II: Sales of Accounts, Chattel Paper, Promissory Notes, and Payment Intangibles**

Welcome to this podcast on Special Attachment Rules II: sales of accounts, chattel paper, promissory notes, and payment intangibles brought to you by CALI. I am Professor Jennifer S. Martin. This podcast is the second of two podcasts that focus on when a security interest attaches to collateral under Article 9 due to the nature of the transaction even where there’s is not an explicit statement granting a security interest.

Recall that Article 9 applies to transactions that create security interests “regardless of form.” See § 9-109(a)(1). In this podcast we will focus on certain sale transactions that might not satisfy § 9-203’s elements for attaching a security interest but nevertheless fall within the definition of a security interest. These transactions create a security interest due to the *form of the transaction*, in this case sales of accounts, chattel paper, promissory notes, and payment intangibles. Notably, these transactions are true sales and not collateralized loans, but are treated as security interests in order to avoid confusion over whether there is a security interest. Other transactions, such as leases that are not true leases, retentions of title, and consignments also create Article 9 security interests, but are covered in other podcasts.

Importantly, the UCC’s definition of "security interest" includes any interest of a buyer of accounts, chattel paper, payment intangible, or promissory note in a transaction that is subject to Article 9. Section 9-109 specifically includes within the scope of Article 9 many sales of accounts, chattel paper, payment intangibles and promissory notes (excluding those that are part of a sale of a business, for collection only, or single sales as satisfaction of a preexisting indebtedness). The effect of this is many sales of accounts, chattel paper, payment intangibles and promissory notes are considered as creating security interests. Once brought within the scope of Article 9, the buyer should be aware that there may be priority problems downstream just as with any security interest.

Let’s look at three examples involving accounts, all of which create a security interest in the accounts.

Example 1. Dentist provides services to clients, who pay later through insurance or direct billing. Dentist’s rights to payment are accounts. Dentist is in need of funding to operate the practice and borrows $100,000 from First Bank and signs a security agreement granting First Bank a security interest in the accounts, including after acquired accounts. This transaction meets the traditional elements of § 9-203 creating a security interest in the accounts of Dentist. Dentist is obligated to pay First Bank the $100,000 whether or not the accounts are actually collected. Dentist is the debtor and First Bank is the secured creditor with a security interest in accounts.

Example 2. Dentist provides services to clients, who pay later through insurance or direct billing. Dentist’s rights to payment are accounts. Dentist is in need of funding to operate the practice and sells the existing accounts to First Bank for $100,000. This transaction is a sale of accounts and does not meet the traditional elements of § 9-203. However, it is a sale of accounts under § 9-109 and as such is within the definition of a security interest in the accounts of Dentist. First Bank owns the accounts, whether or not it is able to collect on them. Dentist, as the seller of the accounts, is the debtor and First Bank, as the buyer of the accounts, is the secured creditor with a security interest in accounts. The significance of this characterization is that First Bank may have to compete with other secured creditors for priority in the accounts.

Example 3. Same facts as Example 2, except Dentist agrees to pay First Bank for any accounts that it is unable to collect. With Dentist bearing the risk on accounts that have been sold, this transaction is a hybrid transaction that looks both like secured financing and a sale of accounts. To avoid any confusion, this transaction is within the definition of a security interest in the accounts of Dentist. First Bank owns the accounts. Dentist, as the seller of the accounts, is the debtor and First Bank, as the buyer of the accounts, is the secured creditor with a security interest in accounts.

Recall, however, that the definition of security interest only includes sales of accounts that are within Article 9. Let’s look at some examples of transactions involving accounts that are not within Article 9.

Example 4. Dentist provides services to clients, who pay later through insurance or direct billing, creating accounts. Dentist retires and sells the dental practice, including the accounts, to Apprentice. As it is part of the sale of the dental business, the sale of accounts is not within the scope of Article 9 pursuant to § 9-109 and as such there is no security interest in the accounts of Dentist.

Example 5. Dentist provides services to clients, who pay later through insurance or direct billing, creating accounts. Dentist assigns the unpaid accounts to Speedy Finance for the purpose of collection. As this is a transfer of accounts solely for collection, the sale of the accounts is not within the scope of Article 9 pursuant to § 9-109 and as such there is no security interest in the accounts of Dentist.

Financings and sales with respect to promissory notes, chattel paper and payment intangibles will be treated the same as the sale of accounts. With respect to sales of promissory notes, it is common for the buyer to take possession of a promissory note upon sale. Let’s look at three examples with promissory notes.

Example 6. Hotel agreed to rent a portion of Borrower’s facility for two years for events sponsored by its nearby hotel. Hotel signed a promissory note agreeing to make monthly payments of $10,000 to Borrower for 24 months. Borrower borrowed $200,000 from Second Bank and Borrower signed a security agreement granting Second Bank a security interest in "all of Borrower's negotiable instruments." This transaction meets the traditional elements of § 9-203, creating a security interest in the promissory note. Borrower is obligated to pay First Bank the $200,000 whether or not the note is actually collected. Borrower is the debtor and Second Bank is the secured creditor with a security interest in the promissory note.

Example 7. Same facts as Example 6, but Borrower sells the contract and note with Hotel to Uncle for $175,000 in cash. Uncle immediately took possession of the promissory note. Uncle did not know about any of Borrower's bank loans. This transaction is a sale of a promissory note and does not meet the traditional elements of § 9-203. However, it is a sale of a promissory note under § 9-109 and as such is within the definition of a security interest in the promissory notes of Borrower, including the Hotel note. Uncle owns the promissory note, whether or not he is able to collect on that. Borrower, as the seller of the note, is the debtor and Uncle, as the buyer of the note, is the secured creditor with a security interest in the promissory note. As a secured creditor, Uncle would be wise to establish priority over other secured parties who may have an interest in the note.

Example 8. Same facts as Example 6, but Borrower owes Uncle $175,000 which has been unpaid. Borrower assigns the Hotel note to Uncle in satisfaction of the preexisting debt. As this is an assignment of a single promissory note in satisfaction of a preexisting indebtedness, the assignment of the Hotel promissory note is not within the scope of Article 9 pursuant to § 9-109 and as such there is no security interest in the Hotel note.

At this point, you should be able to describe and identify the types of sale transactions that create security interests even though the parties don’t explicitly provide for one: sales of accounts, chattel paper, promissory notes, and payment intangibles. Despite the lack of compliance with traditional attachment elements under § 9-203, many sales of accounts, chattel paper, promissory notes, and payment intangibles create a security interest because they fall within the definition of a security interest in order to avoid confusion about the nature of the transaction. Whether the transaction creates a security interest is dependent upon whether it is within the scope for sales of accounts, chattel paper, promissory notes, and payment intangibles brought within Article 9 pursuant to § 9-109.

I hope you’ve enjoyed this podcast on Special Attachment Rules II.

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