

**SALE OF GENERAL INTANGIBLES**  
**FOR MONEY DUE AMENDMENTS**

**Reporters' Prefatory Note**

In Recommendation 1.A. the Study Committee proposed revision of Article 9 to include within its scope sales of general intangibles for the payment of money. The following suggested revisions reflect that recommendation. The draft is marked to show changes from existing Article 9.

**Scope Provisions and Definitions**

**§ 1-201. General Definitions.**

\* \* \*

(37) "Security interest" means . . . . The term also includes any interest of a buyer of accounts <sup>^</sup> chattel paper <sup>^</sup> or a general intangible that is subject to Article 9. . . .

**§ 9-102. Policy and Subject Matter of Article.**

(† a) Except as otherwise provided in Section 9-104 on excluded transactions, this Article applies

(~~a~~ 1) to any transaction (regardless of its form) ~~which~~ that is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts; ~~and also~~

(~~b~~ 2) to any sale of accounts or chattel paper; and

(3) to any sale of a general intangible for money due or to become due if the general intangible is subject to an effective election.

A general intangible for money due or to become due is subject to an effective election when either (i) the account debtor and the

[seller/debtor] agree [in writing] that a sale of the general intangible is covered by this [Article] or (ii) the [seller/debtor] and the buyer agree [in writing] that a sale of the general intangible is covered by this [Article].

**§ 9-104. Transactions Excluded From Article.**

This Article does not apply

\* \* \*

[(xx) \_\_\_\_\_ to a sale of a general intangible, except as provided with respect to a general intangible for money due or to become due that is subject to an effective election (Section 9-102);]

**§ 9-105. Definitions and Index of Definitions.**

(1) In this Article unless the context otherwise requires:

\* \* \*

(c) "Collateral" means the property subject to a security interest. The term, and includes accounts, and chattel paper and general intangibles that ~~which~~ have been sold;

\* \* \*

**§ 9-106. Definitions: "Account"; "General Intangibles";  
"General Intangible for Money Due or To Become Due".**

"Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by

performance. "General intangibles" means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, and money. "General intangible for money due or to become due" means a general intangible under which the account debtor's principal obligation is to pay money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts.

### **Attachment and Enforceability Provisions**

#### **§ 9-201. General Validity of Security Agreement.**

Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this Article (i) validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales, or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto, (ii) affects the rights of a person who acquired an interest in a general intangible for money due or to become due before the general intangible became subject to an effective election (Section 9-102), or (iii) affects the rights or duties of an account debtor on a general intangible for money due or to become due unless the account debtor has agreed to an effective election (Section 9-102).

## Reporters' Explanatory Notes

1. Draft § 9-102 implements the Study Committee's Recommendation 1.A. It includes within the scope of Article 9 some sales of general intangibles for money due or to become due. The inclusion is limited to those general intangibles for the payment of money that are made subject to an "effective election." This limitation is intended to address the concerns expressed by the Study Committee (and also expressed during the November, 1993, Drafting Committee meeting) about including certain general intangibles, such as bank-originated "loan participations," for which the application of Article 9 (and especially its filing rules) would be impractical and unwise.

2. The Drafting Committee discussed several approaches for limiting the scope of Article 9's application to general intangibles for the payment of money. The consensus view was that it would not be fruitful to pursue an exclusion based on the character of the account debtor (e.g., a borrower from a "bank"), the sale transaction (e.g., a "participation"), or the debtor/seller (e.g., a "bank" or "regulated financial institution"). The approach taken in the definition of "effective election" reflects two other approaches that found more favor with the Drafting Committee. An effective election occurs when either (i) the account debtor and the debtor/seller agree that the sale of the general intangible is subject to Article 9 or (ii) the debtor/seller and the buyer so agree.

3. New § 9-104(xx) would make it clear that the sale of a general intangible for the payment of money is not covered by Article 9 unless the transaction is made subject to an effective election under draft § 9-102(a). We have bracketed the new subsection because we think it is superfluous. Unlike the subjects of the other exclusions, the excluded sales of general intangibles are not within the scope of Article 9 in the first instance. However, the Drafting Committee may wish to include an exclusion in § 9-104 in the interest of clarity.

4. A definition of "general intangible for money due or to become due" in draft § 9-106 is necessary in order to distinguish sales of commercially valuable "receivables" from the vast array of transfers of interests in intangible rights that should be subjected to Article 9 only when the transfer secures an obligation. The defined term is borrowed from the undefined reference in § 9-318(4). We recognize that virtually any intangible right could be "for money due" once one hypothesizes, for example, that the account debtor is in breach of its obligation. The definition proposed in draft § 9-106 would embrace general intangibles "under which the account debtor's principal obligation is to pay money." (Emphasis added.) We can imagine some difficult cases at the margin, but we doubt that attempting a more precise statutory line would be worthwhile. As with any classification issue, from a planning standpoint it may

be necessary for counsel to make alternative assumptions (i.e., inclusion and exclusion from Article 9).

5. Draft § 9-201 underscores the inherent limitations on the role of Article 9 that would result from permitting parties to opt out of Article 9 (more accurately, to choose not to opt in) by failing to make an effective election. Draft § 9-201 provides that Article 9 does not affect the rights or interests of those who acquired interests in general intangibles before the general intangibles became subject to an effective election. Nor would Article 9 affect the rights of an account debtor who has not agreed to an effective election.<sup>1</sup>

A potential buyer of a general intangible for the payment of money can determine (e.g., by relying on representations and warranties of the seller/debtor) the underlying terms of the general intangible, including whether the account debtor and the debtor have made an effective election. If the election has been made, then the prospective buyer would know that a search of the applicable Article 9 filing records would reveal any filings that could perfect competing security interests (whether arising out of a sale or a secured loan).

The ability of the seller and buyer to choose not to make an effective election could be problematic. A prospective buyer would run the risk that an earlier-in-time buyer failed to make an effective election. In that event, neither a search of the Article 9 records nor an examination of the terms of the general intangible would uncover the earlier sale. However, the identical risk exists under current law, which excludes all sales of general intangibles. As under current law, a prospective buyer would find it necessary to rely on the seller's assurances that the seller had not sold the general intangible previously.

6. Notwithstanding these limitations, the effective-election approach does offer many of the benefits of Article 9, including its filing system. Once an effective election has been made, a buyer can perfect its security interest by filing in

---

<sup>1</sup> We believe that the proposed revision of § 9-201 to deal with general intangibles merely reflects a specialized example of the correct interpretation of § 9-201 in a more general sense. Properly interpreted, the "collateral," as used in § 9-201, means whatever interest the debtor (or seller) may have in the property, subject to all limitations and defects that exist at the time the security interest is created. As stated in § 9-201, exceptions to that rule must be "otherwise provided by this Act." Examples of exceptions are the priority of a later-in-time but first-filed security interest under § 9-312(5)(a) and the priority of a secured party who is a holder in due course of a pledged instrument under § 9-309 and Article 3. We suggest that the Drafting Committee consider the more general issues under § 9-201 at a later time.

order to ensure its seniority to a later-in-time lien creditor (read: trustee in bankruptcy) under § 9-301(1)(b) or a later-filed secured party.

In its Report, the Study Committee identified the following problems that flow from excluding all sales of general intangibles from Article 9:

First, the transactions are governed by non-UCC law (presumably the common law dealing with the assignment of choses in action), which may be hard to find and unclear. Second, because determining whether a transaction should be characterized as a true sale or as a secured transaction often is difficult, parties must proceed based on alternative assumptions. Similarly, classifying certain types of property as accounts, chattel paper, general intangibles, or instruments may be difficult. Fourth, the excluded sale transactions do not receive the benefit of the repeal of the *Benedict v. Ratner* doctrine. Although the Committee is not aware of any application of *Benedict* to an outright sale, the opinion's reasoning would seem to support avoidance of the interest of a buyer at least to the same extent as the interest of a secured lender. Finally, and probably most important, exclusion from Article 9 excuses assignees from compliance with the public notice (filing) requirements of Article 9.

Report, at 44-45 (footnotes omitted). Although the approach taken in draft § 9-201 is not a perfect or a comprehensive one, it would go far in addressing these problems. In addition, the draft also would enable the buyer to enjoy the benefits of § 9-318 in cases where the account debtor has agreed to an effective election.

7. It may be useful to consider an example of the operation of the priority rules that emanate from draft § 9-201 when read with the rest of Article 9. Consider the following hypothetical:

On 4/1 D sells a general intangible for the payment of money (GI) to SP-1. D and the account debtor (AD) on the GI failed to make an effective election and SP-1 and D, similarly, did not make an effective election. On 5/1, LC-1, a judgment creditor of D, serves a garnishment on AD. On 5/15, D sells the same GI to SP-2, D and SP-2 make an effective election in the sale (security) agreement, and SP-2 immediately files a financing statement. On 6/1, LC-2, another judgment creditor of D, has another garnishment served on AD. On 6/15, D sells the same GI to SP-3, but D and SP-3 do not make an effective election. SP-3 does not file a

financing statement. On 7/1, D files a petition under the Bankruptcy Code.

Article 9 does not apply until 5/15, when SP-2 and D made an effective election. Consequently, the rights and relative priorities of SP-1, LC-1 and the trustee in bankruptcy (TIB) are governed by non-Article 9 law. Assuming SP-1 complied with any applicable perfection steps under other law, SP-1's interest is senior to that of LC, a lien creditor who probably could reach no more than the debtor's rights (here, nothing) under applicable law. The rights of SP-1 also are senior to those of the TIB under the strong-arm clause (Bankruptcy Code § 544(a)). If we assume SP-1 never entered the picture, then LC-1's lien also would be senior to the TIB, but its lien may be avoidable as a preference under Bankruptcy Code § 547. (Of course, because SP-1 was in the picture, the GI should not even be considered property of the estate.) The rights of SP-1 and LC-1 (assuming it has any rights, given the sale to SP-1) also are senior to those of SP-2, LC-2, and SP-3. Under draft § 9-201, the fact that Article 9 applies from and after 5/15 would not affect the pre-existing rights of SP-1 and LC-1.

If we assume away the existence of both SP-1 and LC-1, then the Article 9 priority rules, applicable from 5/15, would afford SP-2 first priority. Again, since the GI was sold and SP-2 has perfected by filing, the GI is not property of the estate. Were it not for the sale to SP-2, LC-2 would be senior to both the TIB (but subject to possible preference avoidance) and SP-3, who bought the GI later in time. § 9-301(1)(b). Because Article 9 already applied by virtue of the effective election made by SP-2 and D, SP-3's failure to make an effective election has no effect. SP-3, here, should have searched and investigated. If SP-2 is assumed away, then SP-3 is junior to LC-2 but senior to the TIB, because SP-3's failure to file is meaningless inasmuch as Article 9 would not be applicable. On the other hand, the TIB might preserve LC-2's avoided (§ 547) lien and assert it against SP-3. See Bankruptcy Code § 551.

8. Including certain sales of general intangibles within the scope of Article 9 will require conforming revisions to a number of Article 9 sections. We have presented some of these revisions already, see, e.g., draft § 9-105(1)(c); draft § 9-502, and will systematically make them at a later date.