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September 18, 2009

VIA ELECTRONIC MAIL

Ed Smith
Chairman
Article 9 Drafting Committee
Bingham McCutchen LLP
One Federal Street
Boston, MA 02110-1726

Steven L. Harris
Reporter
Article 9 Drafting Committee
565 West Adams Street
Chicago, IL 60661

Dear Ed and Steve:

This letter is to request that the Article 9 Drafting Committee clarify the treatment under Article 9 of the obligation of a payment card acquiring bank (the “Acquiring Bank”) to pay its merchant customer (the “Merchant”) for settlement of card (“Card”) transactions submitted by the Acquiring Bank on behalf of the Merchant to the card associations’ systems for authorization, clearing and settlement (the “Acquiring Bank Payment Obligation”). Specifically, for the reasons discussed below, we hereby request that the Official Comments to Article 9 clarify that the Acquiring Bank Payment Obligation is for purposes of Article 9 a payment intangible.

Before addressing the Article 9 issue, let us provide some background about the Card payment systems. Depository institutions and other issuers (the “Issuer”) issue Cards to their cardholders (the “Cardholders”). The Card may be a credit card (Card transactions are funded by credit provided by the Card Issuer), a debit card (Card transactions are funded by a deposit account maintained by the Cardholder with the Card Issuer) or a prepaid card (Card transactions are funded by funds previously provided by the Cardholder to the Card Issuer). Merchants in turn enter into arrangements with one or more Acquiring Banks or their agents,¹ pursuant to which the Merchant submits Card transactions for authorization, clearing and settlement as described below.

¹ Acquiring Banks often uses third party agents, certain of which are commonly referred to as Independent Sales Organizations or ISOs, to perform certain of the functions described in this letter. The Acquiring Bank and its third party agents are referred to herein collectively as the Acquiring Bank.

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Cardholders use their Cards to purchase goods or services from Merchants. Upon presentation of the Card to the Merchant, the Merchant typically submits the card transaction to its Acquiring Bank, and the Acquiring Bank in turn submits the card transaction to the card system, for authorization. The card system then typically transmits this authorization request to the Issuer. If the Issuer provides authorization for the card transaction, the Issuer generally becomes obligated at that time under its agreement with the card system to pay the card system for the card transaction when it is presented by the card system to the Issuer for settlement. Upon receiving authorization for the card transaction, the Merchant completes the purchase/sale transaction (e.g., provides the goods or services) to the Cardholder. Upon completion of the purchase/sale transaction, the Merchant then submits the card transaction to its Acquiring Bank, and the Acquiring Bank in turn submits the card transaction to the card system, for settlement. The card system submits the card transaction to the Issuer for settlement, and as indicated above the Issuer is obligated under its agreement with the card system to pay the card system for the previously authorized card transaction. The card system in turn pays the Acquiring Bank for the card transaction. Pursuant to the Acquiring Bank Payment Obligation, the Acquiring Bank pays the Merchant for the card transaction.

Acquiring Banks have inquired of us whether, when they have received notice that the Merchant has assigned² to a third party (the "Assignee") a portion or all of the Merchant's Acquiring Bank Payment Obligation, the Acquiring Bank is obligated under Article 9 to pay the Assignee rather than the Merchant, notwithstanding that the Acquiring Bank's agreement with the Merchant (the "Acquiring Bank/Merchant Agreement") prohibits the Merchant from selling, pledging as collateral, assigning any interest in or otherwise encumbering the Acquiring Bank Payment Obligation.

As we understand Article 9, if the UCC 9-406(a) notification rule is applicable, the Acquiring Bank after receipt of the foregoing notification would not be permitted to pay the Merchant but rather may discharge the Acquiring Bank Payment Obligation by paying the Assignee, notwithstanding a provision in the Acquiring Bank/Merchant Agreement prohibiting the Merchant assignment to the Assignee (see UCC 9-406(d)(2)). However, under UCC 9-406(b)(2), a notification is ineffective "to the extent that an agreement between an account debtor and a seller of payment intangible limits the account debtor's duty to pay a person other than the seller and the limitation is effective under law other than this article [9]." If the Merchant's assignment of rights in the Acquiring Bank Payment Obligation constitutes the sale of a payment intangible, then UCC 9-408(a) and (d) -- and not UCC 9-406(a) -- would apply. UCC 9-408(d)(6) provides that to the extent a term prohibiting or restricting the sale of a payment intangible, or requiring that the person obligated consent to the sale, is effective under

² Assume for this purpose that the Merchant has signed or otherwise authenticated a security agreement that describes the Acquirer Bank Payment Obligation as required under UCC 9-203(b).

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law other than Article 9 but would be ineffective under UCC 9-408(a), the sale “does not entitle the [Assignee] to enforce [its] interest” in the payment intangible. See also UCC 9-408(d)(1), (2) and (3).³ Accordingly, the Acquiring Bank’s obligation to pay the Assignee under Article 9 or the Merchant under the Acquiring Bank/Merchant Agreement appears to depend on whether the Acquiring Bank Payment Obligation to the Merchant is a “payment intangible” for purposes of Article 9.

UCC 9-102(a)(61) defines a “payment intangible” as “a general intangible under which the account debtor’s principal obligation is a monetary obligation.” UCC 9-102(a)(42) defines a “general intangible” as “any personal property, including things in action, other than [inter alia,] accounts, chattel paper or instruments.” Accordingly, the category of “payment intangible” is a residual category under Article 9; if the Acquiring Bank Payment Obligation is an account, chattel paper or a promissory note under Article 9, then it cannot be a payment intangible. We do not believe the status of the Acquiring Bank Payment Obligation is clear under Article 9.

Although the term “account” is defined in UCC 9-102(a)(2)(vii) to include a right to payment of a monetary obligation “arising out of the use of a credit or charge card or information contained on or for use with the card,” the history of this provision suggests that it was designed to refer to the Cardholder’s obligation to pay the Card Issuer.⁴ Indeed, under the rules of the credit card systems and the Acquiring Bank/Merchant Agreements of which we are aware, the Acquiring Bank is considered to be the agent of the Merchant for purposes of clearing and settling credit card transactions and the Cardholder’s obligation to pay for the goods or services is extinguished when the Card Issuer or the credit card system pays the Acquiring Bank.⁵ In any event, the Cardholder’s obligation to pay the Merchant for the goods or services purchased with the Card is not dependent on the Acquiring Bank’s payment of the Acquiring Bank Payment Obligation. Rather, the Acquiring Bank Payment Obligation arises from the Acquiring Bank’s contractual obligation to the Merchant, as well as the card system rules which require the

³ Assume for this purpose that the Merchant’s agreement with the Assignee constitutes a “sale” of the Acquiring Bank Payment Obligation.

⁴ See PEB Study Group, Uniform Commercial Code Article 9, Report 48-49 (December 1, 1992) (observing that the issuers of credit cards often sell them and recommending that “Article 9 be revised to include within its scope sales of credit card receivables and to define credit card receivables as a new type of collateral”; referring to a nonuniform amendment to Delaware law that defines “credit device account” as a “right to payment for money due or to become due under any agreement or plan relating to a credit card”).

⁵ See e.g., Section 6.3.A., Visa U.S.A. Inc. Operating Regulations (November 15, 2008) (final payment by Visa of the amounts due in settlement to the Acquirer for Merchant transactions submitted by the Acquirer discharges and satisfies all obligations in connection with such settlement). In addition, Cardholders typically sign the Merchant’s Card sales slip that obligates the Cardholder to make payment in accordance with the terms of the Cardholder’s Card Agreement with the Issuer. The Cardholder’s payment to his or her Card Issuer discharges this contractual payment obligation to the Merchant.

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Acquiring Bank to pay the Merchant for the settlement of the Merchant's card transactions. Additionally, over half of Card transactions currently are not credit card transactions, but rather are debit card or prepaid card transactions. UCC 9-102(a)(2)(vii) by its terms does not apply to debit cards or prepaid cards.

For the foregoing reasons, we do not believe the Acquiring Bank Payment Obligation should be viewed for purposes of UCC 9-102(a)(2) as arising out of the use of a credit or charge card or otherwise "for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of" or "for services rendered or to be rendered." Like a bank deposit account that is treated separately under Article 9 from the transactions giving rise to the deposits to that account (see UCC 9-102(a)(29) and (a)(2)), we believe the Acquiring Bank Payment Obligation similarly should be categorized independently under Article 9 from the Card transactions whose settlement gave rise to the Acquiring Bank Payment Obligation.

The Acquiring Bank Payment Obligation also does not appear to constitute chattel paper or a promissory note for purposes of Article 9. The Acquiring Bank Payment Obligation does not evidence both a monetary obligation and a security interest in specific goods or a lease of specific goods and license of software used in the goods (see UCC 9-102(a)(11)), nor does it appear to be a negotiable instrument or of a type that in the ordinary course of business is transferred by delivery (see UCC 9-102(a)(47)).

If it is not an account, chattel paper, or a promissory note, then the Acquiring Bank Payment Obligation would be a payment intangible, and the UCC 9-406(b)(2) notification rule would be ineffective if its assignment is prohibited under the Acquiring Bank/Merchant Agreement. However, as indicated above, an obligation of the nature of the Acquiring Bank Payment Obligation is not expressly addressed in Article 9, and the application of the UCC 9-406(b)(2) notification rule to the Acquiring Bank Payment Obligation is not free from doubt.

We hereby request that the Drafting Committee clarify that status of the Acquiring Bank Payment Obligation under Article 9 as a payment intangible. A draft revision to the Article 9 Official Comments is attached to this letter for the Drafting Committee's review. As indicated above, a clarification that the Acquiring Bank Payment Obligation is a payment intangible would not adversely impact the purposes for which the credit or charge card references were included in UCC 9-102(a)(2). Indeed, such a clarification would have no impact on Cardholders. Rather, it would clarify that two sophisticated business entities – the Acquiring Bank and the Merchant – are accorded under Article 9 the flexibility to determine in the Acquiring Bank/Merchant Agreement whether the Merchant is permitted to assign (e.g., sell, pledge as security for a loan) the Acquiring Bank Payment Obligation. In this regard, there are many Acquiring Banks and the market for Acquiring Bank services is highly competitive. Some Acquiring Banks

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may determine to agree to permit such assignments in an effort to obtain additional Merchant business, and some may not—but in any event we believe these parties should be free to structure their own business arrangement relative to Article 9 and the UCC 9-406(b)(2) notification rule as they see fit.

Please contact me, at 202-776-0707, if you have any questions concerning the foregoing, or we otherwise can be of further assistance. We would be pleased to attend an upcoming Drafting Committee meeting to discuss this issue further with the Drafting Committee, if that would be helpful.

Very Truly Yours,

A handwritten signature in black ink, appearing to read "Robert G. Ballen", written in a cursive style.

Robert G. Ballen

Thomas A. Fox, Esq. (Schwartz & Ballen LLP)

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PROPOSED AMENDMENT TO ARTICLE 9 OFFICIAL COMMENTS

Amend the second sentence of Official Comment 9-102(5)(d) to read as follows:

(Bracketed text to be deleted, underlined text to be added)

Examples are various categories of intellectual property, [and]the right to payment of a loan of funds that is not evidenced by chattel paper or an instrument, and the contractual obligation of a payment card acquiring bank or its agent to pay its merchant customer for settlement of credit card, debit card, prepaid card or other payment card transactions submitted by the acquiring bank or its agent on behalf of the merchant to the card systems for settlement.