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The Collection of Assigned Receivables

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THE COLLECTION OF ASSIGNED RECEIVABLES

By Harold R. Taylor*

For many years it has been a familiar practice of various business concerns to assign their accounts receivable as collateral for money borrowed. During the past several decades there has developed the further practice of selling such receivables outright and at a discount to finance companies, either with or without, but generally with, a guarantee by the seller that the receivables or the proceeds thereof will be paid to or received by the assignee within specified times.

In either case the assignee may collect the accounts and exercise full and exclusive dominion over them. This being done, and absent failure of consideration, usury or other questions outside this discussion, the assignment, if in proper form and descriptive of the specific accounts assigned, is undoubtedly valid.

However, collection of the assigned accounts by the assignee, requiring notice to the account debtors and subsequent collection procedure, is more work than the lender, in the case of an assignment for collateral purposes, usually desires to perform. A finance company may undertake to collect accounts purchased by it, but only for compensation contained in an increased discount rate. In both cases, moreover, the assignor, to avoid possible reflection on its capital position and loss of contact with its customers, generally prefers not to have its account debtors notified of any assignment. The assignee assumes that if necessary it can reach the accounts or their proceeds directly at any future time, even though it does not undertake direct collection immediately upon assignment.

Accordingly it is common practice for an assignor and assignee of accounts receivable to agree orally or in writing, or by custom established between them, that the assignor shall collect the receivables under one or more of the following provisions:—

1. That the assignee refrain from giving notice of the assignment, and of its consequent ownership of the accounts, to account debtors.

2. That the assignor, in collecting the accounts, (a) shall remit

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the proceeds forthwith to the assignee; or, (b) shall remit the proceeds periodically to the assignee; or (c) may retain the proceeds or a part thereof for its own use; or (d) may retain the proceeds subject to a condition that the assignor repay its loan or honor its guaranty, or otherwise perform some obligation, either from such proceeds or from any other funds.

3. That the assignor, upon collection of any account and before remittance of the proceeds to the assignee, shall (a) place such proceeds in a trust or other account to which it has no access for withdrawals, or (b) hold the same under its control in such accounts or places as it may prefer.

4. That the assignor mark or stamp its records showing that certain of its accounts have been assigned to the assignee.

5. That in lieu of turning over to the assignee in cash all proceeds of collection, the assignor may, at the time of accounting therefor, assign to the assignee additional accounts receivable in the same amount as proceeds previously collected and not remitted.

Do such arrangements affect the validity of the assignment? The question may readily arise in bankruptcy or insolvency proceedings. Unenforceable assignment cases involving receivables have been placed in the fraudulent conveyance category.[1] If the assignment is a conveyance fraudulent in law, a creditor of the assignor might, in an action against the assignor with an account debtor as garnishee, reach an assigned receivable as money due the assignor from the account debtor, notwithstanding the previous assignment; or, if the account receivable has been paid and the proceeds received by the assignee, such creditor might attempt to reach the funds as money of the assignor in the hands of the assignee.

The point of inquiry in any given instance is whether the particular facts involved show an actual or implied agreement for such "unfettered use" of collection proceeds by the assignor as will void the assignment, or such "fetttered use" as will meet any imputation of fraud.

The "unfettered use" rule was announced and applied to the assignment of receivables by the Supreme Court of the United States in *Benedict v. Ratner*.[2] The effect of the rule is that if an assignee of receivables permits the assignor to have dominion

[1]Benedict v. Ratner, (1925) 268 U. S. 353, 45 Sup. Ct. 566, 69 L. Ed. 991.

[2](1925) 268 U. S. 353, 45 Sup. Ct. 566, 69 L. Ed. 991.

over assigned receivables inconsistent with effective disposition of title thereto, and to have the "unfettered use" of the proceeds of such receivables, the assignment is fraudulent in law.

The *Benedict Case* makes clear that of itself "an agreement that the assignor of accounts shall collect them . . . will not invalidate the assignment which it accompanies;" also that title to an account good against creditors of the assignor may be transferred without notice to the debtor or record of any kind.[3]

If the assignor may use the collection proceeds as he sees fit, the use is unfettered and the assignment is fraudulent in law. In the *Benedict Case* the assigned receivables were to be collected by the assignor; the assignee could audit the assignor's books at pleasure and could require that all amounts collected be remitted to him, but until the assignee did so require the assignor could retain collections and use the proceeds, and was not required to replace the accounts collected nor to account in any way to the assignee. The assignment was declared void.

In *Irving Trust Co. v. Finance Service Co.*,[4] the assignor was allowed to collect assigned receivables; of the amounts collected the assignor could, if he wished, retain forty per cent and apply sixty per cent on its notes held by the assignee; and the assignee further assured the assignor that all collections could be for the free use and disposal of the assignor and that the assignor's business would not be interfered with so long as the assignor paid its notes when due, either from collections or from any other funds. Such facts were declared similar to those in the *Benedict Case* and the assignment held void. The decision reached was correct, but obiter dicta in the opinion anent *Parker v. Meyer*,[5] is not consistent with the decision or in accord with the *Benedict Case.*

In *Parker v. Meyer*,[6] the assignor collected installments of assigned conditional sales contracts under an agreement, fully complied with, to remit every sixty days the full amount of all collections made. The court noted the facts in the *Benedict Case* and said:

"The difference between those facts and the facts in this case are obvious. Here the bankrupt was required to apply all collections made within every sixty day period . . . and, while it is true it had the use of the money collected between the date

[3]See also Mason's 1927 Minn. Stats., sec. 8472.
[4](C.C.A. 2d Cir. 1933) 63 F. (2d) 694.
[5](C.C.A. 4th Cir. 1930) 37 F. (2d) 556.
[6](C.C.A. 4th Cir. 1930) 37 F. (2d) 556.

of collection and maturity . . . , it was as of the latter date required to pay it over. . . . I cannot say the evidence here shows such 'unfettered dominion' over the accounts or their proceeds" as to invalidate the assignment.

The effect of an agreement that a collecting assignor may use the proceeds of assigned receivables as he sees fit, is not off-set by marking or stamping the records of the assignor to show the assignment to and dominant interest of the assignee in the accounts.[7] Such marking is valuable practice in any situation, but not determinative.

Permission to a collecting assignor to pay over to his assignee proceeds of assigned receivables at periodic intervals, instead of immediately upon collection, is not permission to the assignor to use such proceeds as he sees fit. It furnishes no basis for an assumption that the assignor will convert such proceeds to his own use, or that he has express or implied permission to do so. The permission to remit at intervals does not establish a reservation to the assignor of such dominion over the accounts and such "unfettered" use of their proceeds as to invalidate the assignment.[8] Reservation of dominion by an assignor must be established by an actual agreement creating or an acquiescence affirming that power, and any imputation of fraud in law is met if the actual and real agreement is that the assignor must turn over the money to the assignor in due course.[9] The controlling factor is whether the agreement permits the assignor to retain any part of the proceeds to the exclusion of the assignee, and not the time when such proceeds must be remitted.

Where new receivables are assigned by a collecting assignor in payment of proceeds collected on previously assigned receivables, all that is contemplated or done is to permit the assignor to retain cash upon making payment with new receivables.[10] The assignor of course has use of the money collected, but the use is conditioned on substituting new accounts for the money. The assignor's use is not thereby "unfettered." He is not permitted to use proceeds without accounting therefor.[11]

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[7]See Manufacturer's Finance Co. v. Armstrong, (C.C.A. 4th Cir. 1935) 78 F. (2d) 289.

[8]See Parker v. Meyer, (C.C.A. 4th Cir. 1930) 37 F. (2d) 556.

[9]See Lee v. State Bank & Trust Co., (C.C.A. 2d Cir. 1930) 38 F. (2d) 45.

[10]See Manufacturer's Finance Co. v. Armstrong, (C.C.A. 4th Cir. 1935) 78 F. (2d) 289.

[11]See Bernard v. Katz, (C.C.A. 2d Cir. 1930) 38 F. (2d) 40; Lee v. State Bank & Trust Co., (C.C.A. 2d Cir. 1930) 38 F. (2d) 45. Also Bene-

It will frequently be found, in practice, that assignees of receivables either permit their assignors to collect the receivables with such unfettered use of the proceeds as to indicate invalidity of the assignment, or go to the other extreme and require that collecting assignors pay over collections immediately either in original or substituted form, or forthwith deposit the same in a trust or other fund to which the assignor has no access. The latter requirements, as methods of doing business, are generally considered undesirable, if not impractical, of performance. It is submitted that such requirements are not necessary to sustain the validity of the assignment.

There being an agreement that all collections are the property of the assignee and must be paid or accounted for to him, it is immaterial whether the collecting assignor, in an interval between accounting dates, places the proceeds, with or without other funds, in a cash box, or in his general bank account, or in a separate account or fund to which he has access, provided the assignee does not surrender the right to receive them when and as agreed. In *Sexton v. Kessler,*[12] cited in the *Benedict Case,* the court said:

"So a depositor in a grain elevator may have a property in grain in a certain elevator although the keeper is at liberty to mix his own or other grain with the deposit and empty and refill the receptacle twenty times before making good his receipt."

In *Chapman v. Emerson,*[13] a collecting assignor agreed to collect assigned receivables and pay the proceeds to the assignee; the same individual was a representative of the assignee and an active officer of the assignor; the assignor did not always turn over cash proceeds to the assignee, but usually replaced collected accounts by others of a later date, and in some instances not even that was done. The court held the assignment valid, saying: "Although the [assignees] have not always insisted on the full measure of their rights, they have never intended to surrender, and have not in fact surrendered to the [assignor] anything approaching 'unfettered dominion' over the accounts or their proceeds."

dict v. Ratner, (1925) 268 U. S. 353, 45 Sup. Ct. 566, 69 L. Ed. 991; Sexton v. Kessler, (1912) 225 U. S. 90, 32 Sup. Ct. 657, 56 L. Ed. 995; Chapman v. Emerson, (C.C.A. 4th Cir. 1925) 8 F. (2d) 353; Clark v. Iselin, (1874) 21 Wall. (U.S.) 360, 22 L. Ed. 568.

[12](1912) 225 U. S. 90, 32 Sup. Ct. 657, 56 L. Ed. 995.

[13](C.C.A. 4th Cir. 1925) 8 F. (2d) 353.

By comparison in *In re Almond-Jones,*[14] it appeared that the collecting assignor was required to deposit collection proceeds in his active bank account with the assignee bank, from which he was free to withdraw in the usual course of business; there was no agreement that proceeds were to be paid to the assignee, and the assignee bank asserted no right to such proceeds except such as it might have if it chose to exercise a lien on or set-off against any account balance of the assignor. In holding the assignment invalid the court cited *Chapman v. Emerson,*[15] saying: "There was no agreement [in this case], as in *Chapman v. Emerson,* that the proceeds of the accounts receivable should be paid to the lender."

The "unfettered use" rule does not call for full, complete and exclusive dominion by the assignee over assigned receivables. There are degrees of dominion that may be exercised over assigned receivables by the assignor thereof without invalidating the assignment. Permission to use the proceeds of assigned receivables as the assignor sees fit is "unfettered" dominion.[16] It is "fettered" dominion if the actual agreement of the parties is that, although the assignor may collect the receivables, he must, forthwith upon collection or at specific and stipulated intervals, pay over to, or fully account to the assignee for, all the proceeds arising from the collection of the assigned receivables, without further restriction upon his custody of the money before remitting. If such be the real, sole and continuing agreement, to it all other facts are subordinate and incapable of establishing reservation of dominion in the assignor inconsistent with the title of the assignee to the assigned receivables. Any imputation of fraud in law is met by the actual agreement stated.[17]

Of course the agreement to pay over collections must not be abandoned or used as a cover for other practices. As the Court remarked in *In re Saxon Coffee Co.,*[18] "the agreement to pay collections might be of more importance were it not for the fact that neither party paid any attention to it."[19]

[14](D. Md. 1926) 13 F. (2d) 152, aff'd (C.C.A. 4th Cir. 1927) 16 F. (2d) 986.

[15](C.C.A. 4th Cir. 1925) 8 F. (2d) 353.

[16]See Benedict v. Ratner, (1925) 268 U. S. 353, 45 Sup. Ct. 566, 69 L. Ed. 991.

[17]See Lee v. State Bank & Trust Co., (C.C.A. 2d Cir. 1930) 38 F. (2d) 45.

[18](D. Md. 1927) 22 F. (2d) 999.

[19]See also In re Almond-Jones, (C.C.A. 4th Cir. 1927) 16 F. (2d) 986.

The courts having occasion to consider it have generally applied the unfettered use doctrine in the light of the common understanding of the meaning of the words "fettered" and "unfettered." An assignment of receivables with an agreement containing reasonable provisions made in good faith and assuring to the assignee title to, and the right to receive, in due time and manner, all the proceeds of such receivables, whatever the manner of collection or remittance, should be in no danger of being deemed fraudulent in law if actually complied with.