



## Dealing with a Notice of Assignment of Accounts

There seems to be a continuing rise in UCC lien notices and litigation by “factors” and “cash advance” companies that purchase accounts receivable from subcontractors. UCC liens are legal forms that a creditor files to give notice that it has an interest in the personal or business property of a debtor. These companies often purchase the accounts receivable, or a percentage of those accounts, from subcontractors and others in the construction industry. A “factor” is a company that purchases invoices, usually at a discounted rate, in order for the subcontractor to obtain financing or improve cash flow.

A general contractor that receives a UCC Lien Notice, usually accompanied by a Notice of Assignment, needs to proceed cautiously when processing the next invoice or application for payment. These notices come from someone that has entered into a “Secured Merchant Agreement” with a subcontractor or supplier. The general contractor could end up being required to pay the same invoice twice if they are not careful. Once to the subcontractor and again to the factor.

Once a general contractor receives a signed notification that payments due to a subcontractor have been assigned to the factor or entity purchasing the account, the general contractor is required to make payments directly to the factor. While there are a few exceptions, these exceptions are typically not applicable in the commercial construction context.

When an invoice or account receivable is sold or assigned, the subcontractor selling the receivable to the factor is no longer entitled to receive the payment from the general contractor under the subcontract. The notice to the general contractor may come as a letter from the subcontractor, a letter from the factor, or it may simply be a notice that is included somewhere in the body of the invoice from the subcontractor. When notice of the assignment is properly provided to the general contractor, payment must be made to the factor / purchaser in the amount otherwise due the subcontractor. After the general contractor receives proper notice of assignment, payment to the assigning subcontractor, or to any person other than the factor, is made at the general contractor’s peril and does not discharge the general contractor from liability to the factor.

But wait, the problem in paying the factor or purchaser quickly becomes apparent if any sub-subcontractor or supplier has filed a timely lien or bond claim. Payment to the factor will not get the lien or bond claim released. Further, a payment to the factor may also expose the general contractor, officers, and directors to a claim under the Texas Construction Trust Fund Act. Construction payments are trust funds if the payments are made to a contractor under a

construction contract for the improvement of specific real property in this state. A contractor, or owner or an officer, director, or agent of a contractor, who receives trust funds or who has control or direction of trust funds, is a trustee of the trust funds. Subcontractors, suppliers and materialman who labor or who furnish labor or material for the construction or repair of an improvement on specific real property in this state is a beneficiary of any trust funds paid or received in connection with the improvement. The factor is not a beneficiary of these trust funds under the Trust Fund Act.

Section 9-404 of the Texas Business and Commerce Code provides that unless the general contractor has made an enforceable agreement not to assert defenses or claims, the rights of the factor or assignees of the accounts or invoices are subject to:

- (1) all terms of the agreement between the general contractor and the subcontractor and any defense or claim in recoupment arising from the transaction in the contract;
- (2) any other defense or claim of the general contractor against the subcontractor that accrues before the general contractor receives a notification of the assignment authenticated by the subcontractor or the assignee.

Similar to the payment assignments, there are a few exceptions, but they are most likely not applicable in the commercial construction context. The factor or purchaser is only entitled to receive what the subcontractor would have received. Unless the general contractor waives its rights of offset and other rights under the subcontract it will be able to rely on the provisions in the subcontract such as the right to make payments direct to unpaid sub-subcontractors and suppliers, and offset for excess completion costs or defective work. A general contractor should be careful to not waive any rights under the subcontract, when corresponding with the factor.

Once notice of an assignment is received, do not issue or release payment directly to the subcontractor. Do not sign and return a copy of the notice to the subcontractor or the factor. These acknowledgment requests often contain a waiver of the general contractor's rights to offset and similar rights. The general contractor should seek authentication of the assignment if it the notice is not authenticated. The general contractor should immediately determine the status of the subcontract funds, work remaining, and which sub-subcontractors/vendors might have claims against the project. Pursuant to the typical subcontract, the general contractor should have the right to make direct payments to unpaid sub-subcontractors, vendors and suppliers. This will keep them working and hopefully the project moving forward. If full progress payments are made to the purchaser of the account, the general contractor will quickly have issues with the subcontractor, and its unpaid sub-subcontractors and suppliers. This will lead to lien and bond claims, and possible claims for Trust Fund violations.

Payment of lien and bond claims by sub-subcontractors and vendors is protected in the Texas Property Code. This section of the Texas Property Code provides in part, that "a creditor of a subcontractor may not collect, enforce a security interest against, garnish, or levy execution on the money due the subcontractor, to the prejudice of the subcontractors, mechanics, laborers, materialmen, or their sureties." This protects the general contractor's authority to retain any funds withheld, without the factor being able to take any action against those funds.

With respect to the funds on progress payments that remain after applicable offsets under the subcontract, and unpaid sub-subcontractors and suppliers have been paid in exchange for the applicable releases, payment is not due under most subcontracts until proper releases are provided by the subcontractor. This should provide incentive for both the factor and the subcontractor to agree on how to disburse the remaining funds.

Hopefully, any subcontractors that factor or sell their accounts will use the money to pay their employees, subcontractors and suppliers, while forwarding to the factor whatever they are owed as progress payments are made. When that happens, the factor may not send notices of assignment. However, when there are competing claims for amounts due on progress payments that cannot be resolved and all other avenues have been exhausted, the general contractor may have no option but to file an interpleader action and deposit the funds into the registry of the court. When that happens, the subcontractor will often pull off the job leaving the general contractor in the position of supplementing the subcontractor's work or replacing them.

If a proper, authenticated notice of assignment is received, the first thing the general contractor should do is determine the rights and remedies it has under the subcontract, in particular the right to make payments direct to unpaid sub-subcontractors and vendors. Once that right is confirmed, determine who has not been paid for equipment, labor and materials used on the project, the amounts due, and begin the process of getting the proper releases of lien and bond claims, in exchange for payment. After that and any other offsets that may be properly due, the remainder can be sent to the factor, so long as the subcontractor provides the proper release for that payment.

**For more information, please contact [Bill Davidson](#).**