

Notes

Classifying the Right to Rental Payment Streams Stripped Off a Lease: An Examination of the Issues Not Discussed in *Commercial Money Center**

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I. Introduction

Assignee beware: those securitized payment streams stripped off equipment leases may have already been sold to another purchaser. Take no comfort in the seller having the underlying lease documents in hand or in your diligent search for a notice filing. These carry no assurance after the Bankruptcy Appellate Panel (B.A.P.) of the Ninth Circuit's recent holding that payment streams stripped off equipment leases are payment intangibles and not chattel paper.¹ Classified as payment intangibles, assigned rental payment streams automatically perfect under Article 9 of the Uniform

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1. *In re Commercial Money Ctr., Inc.*, 350 B.R. 465, 475–76 (B.A.P. 9th Cir. 2006).

Commercial Code (U.C.C.).² As a result, the parties involved in typical lease-assignment transactions—where numerous lease rental payment streams are securitized or pooled into new marketable securities³—are excused from the administrative burden of perfecting by filing or possession. Vocal participants in the lease-securitization industry viewed this task of perfection as onerous and applauded the automatic-perfection outcome of the *Commercial Money Center*⁴ opinion.⁵

Although a victory for the lease-securitization industry, the *Commercial Money Center* opinion did not adequately consider the ostensible-ownership ramifications of classifying lease rental payment streams as automatically perfecting payment intangibles.⁶ Nor did the opinion undertake the necessary inquiry into the bundle of rights that the various classification categories represent within the Article 9 scheme—an analysis that would have revealed the error in classifying lease rental payment streams as payment intangibles. Instead, the *Commercial Money Center* opinion relied solely on the literal (and misapplied) language of the definition of chattel paper.⁷

In light of the opinion's circumscribed analysis and negative ostensible-ownership ramifications, this Note presents an in-depth examination of the proper classification of lease rental payment streams. The analysis takes a rights-based approach and considers the putative classification categories of chattel paper, payment intangibles, and accounts (a category not considered in *Commercial Money Center* because it was not raised by either party at the trial level⁸). The definitions of these classification categories, as representative of sets of rights, along with the sets of rights transferred in transactions prototypical of the particular classification categories are used as benchmarks against which to compare the rights actually transferred in the assignment of lease rental payment streams. This analysis reveals that through the appropriate, but previously overlooked, application of the “collateral follows right to payment rule,” the rights transferred in the assignment of lease rental payment streams match, in all functional respects, those transferred in the assignment of an entire lease—a classic chattel-paper transaction. Based primarily on this comparison, and augmented by a review of the Article 9 drafters' intentions in creating the alternatively considered classifications of

2. U.C.C. § 9-309(3) (2000).

3. BOND MKT. ASS'N, AN INVESTOR'S GUIDE TO ASSET-BACKED SECURITIES 1 (2004).

4. 350 B.R. 465 (B.A.P. 9th Cir. 2006).

5. Dan Schechter, *Outright Sale of Payment Intangibles May Be Automatically Perfected, but Sale that Allocates Credit Risk to Debtor May Be Recharacterized as Disguised Loan*, COM. FIN. NEWSL., Sept. 6, 2006, at 68, 70.

6. See *In re Commercial Money Ctr.*, 350 B.R. at 479 (dismissing summarily the policy concern of secret-lien interests).

7. *Id.* at 476. The court's analysis misinterprets the “records” element of the chattel-paper definition. See *infra* notes 31–35 and accompanying text.

8. *In re Commercial Money Ctr., Inc.*, 56 U.C.C. Rep. Serv. 2d (CBC) 54, 60 (Bankr. S.D. Cal. 2005), *rev'd in part and aff'd in part*, 350 B.R. 465 (B.A.P. 9th Cir. 2006).

payment intangibles and accounts, this Note concludes that chattel paper (or, as a second-best alternative, accounts) is the analytically and functionally preferable classification for lease rental payment streams.

This Note starts with a brief overview of the *Commercial Money Center* case and its significance. Part II begins the analysis with an examination of the rights represented by U.C.C. Article 9's definition of chattel paper. These rights are then illustrated in a transaction that indisputably creates chattel paper, the assignment of an *entire* lease.⁹ Although this transaction differs from the *Commercial Money Center* transaction, where only the lease rental payment streams were assigned, the rationale underlying why the assignment of an entire lease creates chattel paper provides the necessary basis for arguing that the functionally similar assignment of lease rental payment streams should also constitute chattel paper.

This Note suggests that the assignment of an entire lease traditionally and appropriately constitutes chattel paper because lease rights mimic the secured-interest element unique to chattel paper. For instance, if a lessee fails to pay rent, the assignee of the lease can repossess the leased goods, just as a secured lender can seize secured assets upon a debtor's default. This basic suggestion, however, appears to conflict with the views of previous commentators who have proposed that the assignees of leases (commonly known as lease financiers) are not secured because they lack the reversionary interest at the expiration of the lease that is retained by the lessor, and thus, their interest in the leased goods is limited.¹⁰ To the contrary, this Note finds that even without the reversionary interest at the expiration of the lease, a lease financier's interest in the leased goods is significant—consisting of the right to repossess and re-lease the leased goods through the date of the lessor's reversion.¹¹ Because this right provides a lease financier with many of the benefits a traditional secured lender attains under Article 9, Part II concludes that the ability to repossess and re-lease satisfies chattel paper's secured-interest element and is the salient right that explains why Article 9 has always included assigned leases in the chattel-paper classification category.

Part III builds on the prior examination of an assignment of an entire lease by proposing that if an assignee of lease rental payment streams receives the same bundle of rights as a lease financier—specifically the right to repossess and re-lease the leased goods—then assigned lease rental payment streams should also be classified as chattel paper. Part III specifically suggests that Article 9's adoption of the collateral follows right to payment rule—and its underlying policy of avoiding obligor double liability—results in the transfer of repossession rights to an assignee of lease rental payment streams. The collateral follows right to payment rule requires that the

9. See U.C.C. § 9-102(a)(11) (2000) (defining "lease chattel paper").

10. See *infra* notes 41–42 and accompanying text.

11. See *infra* notes 68–73 and accompanying text.

transfer of a monetary obligation also transfers the covenants enhancing the monetary obligation.¹² Accordingly, lease covenants that support the right to rental payments remain locked up with and must follow the right to the payments—including the covenant right to repossess and re-lease the leased goods upon the lessee’s breach and until the expiration of the lease. This is the same salient right that explains why assigned leases constitute chattel paper, and therefore, why assigned lease rental payment streams should also constitute chattel paper.

Part IV augments the prior rights-based analysis by reviewing the revised Article 9 drafters’ intentions in creating payment intangibles as a new and narrow classification category in revised Article 9. Clear evidence exists that the drafters added the payment-intangibles classification for the purpose of bringing loan participations under the auspices of Article 9.¹³ Based on this clear intent, the *Commercial Money Center* opinion not only overlooked the proper classification of chattel paper but also improperly squeezed lease rental payment streams into a classification category meant for loan participations.

Moreover, Part IV notes that the traits of lease rental payment streams resemble accounts considerably.¹⁴ Lease rental payment streams are excluded from accounts only to the extent that they are recognized as chattel paper because the accounts definition expressly excludes chattel paper.¹⁵ But, if a court, such as in *Commercial Money Center*, expressly decides that assigned lease rental payment streams are not chattel paper, this disqualifying attribute disappears and lease rental payment streams fit comfortably within the accounts classification. Thus, if courts refuse to classify lease rental payment streams as chattel paper, the next best classification is accounts, not payment intangibles.

Finally, Part V considers the consequences of classifying lease rental payment streams under each of the viable classification categories. Classifying lease rental payment streams as payment intangibles invites the problems of ostensible ownership, which Article 9 generally seeks to avoid.¹⁶ Payment intangibles automatically perfect, which, in the context of lease

12. The collateral follows right to payment rule is codified in article 9 of the U.C.C. See U.C.C. § 9-203(g) (“The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.”); see also *id.* § 9-203 cmt. 9 (“Collateral Follows Right to Payment or Performance. Subsection (g) codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien.”).

13. See *infra* notes 109–10 and accompanying text.

14. See U.C.C. § 9-102(a)(2) (defining “accounts”); *In re Commercial Money Ctr., Inc.*, 350 B.R. 465, 476 (B.A.P. 9th Cir. 2006) (recognizing that most monetary obligations are accounts, unless evidenced by chattel paper); see also *infra* notes 111–12 and accompanying text.

15. See U.C.C. § 9-102(a)(2) (defining “accounts” to exclude a right “to payment evidenced by chattel paper”).

16. See *infra* notes 131–34 and accompanying text.

rental payment streams, would allow an assigning lessor to both maintain possession of the lease documents *and* choose not to file.¹⁷ With lease documents in hand and no filing to indicate the lease payments were already assigned, a nefarious lessor is tempted to double-dip either by borrowing against the previously assigned lease rental payment streams or by selling them to an unknowing purchaser.¹⁸ Because of this secret-lien risk, the classification of lease rental payment streams as payment intangibles does not comport with Article 9's policy of allowing automatic perfection only in limited and well-defined circumstances that minimize secret-ownership risks.¹⁹ In contrast, classification as either chattel paper or accounts upholds Article 9's notice policy in assignments of lease rental payment streams by requiring lessees to perfect by filing or by taking possession of the lease documents.

The following table highlights the statutory arguments that will be made for classifying securitized lease rental payment streams as either chattel paper or accounts instead of as payment intangibles. The table also shows the policy implications of each classification.

17. See *infra* notes 126–30 and accompanying text.

18. See *infra* note 130 and accompanying text.

19. For a list of these circumstances, see *infra* notes 132–34 and accompanying text.

	Statutory fit	Policy implications
Chattel paper § 9-102(a)(11)	Statutory elements: <ul style="list-style-type: none"> • Records: <i>satisfied by the mere existence of lease documents</i> • Monetary obligation: <i>satisfied by the payment streams owed under the lease</i> • Security interest: <i>satisfied by the right to repossess and re-lease, which is transferred with the payment streams through the operation of the “collateral follows right to payment rule”</i> 	Upholds Article 9’s notice policy by requiring filing or possession
Accounts § 9-102(a)(2)	Statutory elements: <ul style="list-style-type: none"> • Right to payment of a monetary obligation: <i>satisfied by the payment streams</i> • Property that has been leased: <i>satisfied by the leased equipment</i> • Excludes rights to payment evidenced by chattel paper: <i>satisfied if a court expressly holds securitized lease rental payment streams are not chattel paper, making this disqualifying attribute disappear</i> 	Upholds Article 9’s notice policy by requiring filing or possession
Payment intangibles § 9-102(a)(61)	Statutory element: <ul style="list-style-type: none"> • Monetary obligation other than the enumerated list (i.e., a residual category): <i>not satisfied if payment streams meet the statutory elements of chattel paper or accounts</i> Drafters’ intent: <ul style="list-style-type: none"> • The classification was added specifically for loan participations, not assigned lease rental payment streams 	Invites ostensible-ownership problems without the usual automatic-perfection safeguards

A. The Commercial Money Center Transaction and Why the Ruling Is Significant

Commercial Money Center, Inc. (CMC) originated equipment leases, packaged leases together, and sold the rights to the lease rental payment streams to financiers, such as NetBank.²⁰ In the NetBank transaction, CMC also granted NetBank a security interest in the underlying leases.²¹ Upon CMC’s bankruptcy, the trustee in bankruptcy (Trustee) sought the return to the bankruptcy estate of the lease rental payment streams CMC had

20. *In re Commercial Money Ctr., Inc.*, 350 B.R. 465, 469 (B.A.P. 9th Cir. 2006).

21. *Id.* As Part III suggests, however, the grant of the security interest was superfluous because the leases’ relevant ancillary covenants would follow the right to payment.

previously assigned to NetBank using two theories.²² First, the Trustee asserted that the lease rental payment streams were chattel paper and not payment intangibles.²³ According to the Trustee, because NetBank had failed to file U.C.C.-1 forms to perfect its security interest in the lease rental payment streams, its security interest was unperfected and thus avoidable.²⁴ Second, the Trustee asserted that, in the alternative, the transaction was not a true sale of the lease rental payment streams, but rather a secured loan using the payment streams as collateral.²⁵

The *Commercial Money Center* court ultimately accepted the Trustee's second argument and held the transaction was a loan and not a sale.²⁶ Because the transaction was a loan and NetBank had not filed to perfect its security interest in the lease rental payment streams, NetBank lost to the Trustee regardless of whether the court classified these streams as payment intangibles or chattel paper.²⁷ Notably though, while the *Commercial Money Center* court's ruling relied on recharacterizing what the parties had labeled a sale as a loan, true-sale legislation in at least seven states precludes this recharacterization.²⁸ Without the luxury of sidestepping the payment-intangibles-versus-chattel-paper debate through recharacterization, future courts in true-sale states will have to grapple head-on with the classification of assigned lease rental payment streams.

22. *Id.* at 473.

23. *Id.* at 475.

24. *Id.* at 472. Payment intangibles automatically perfect. U.C.C. § 9-309(3) (2000). But, chattel paper requires filing for perfection. *Id.* § 9-310. Without having filed, NetBank would be an unsecured creditor, and a Trustee takes priority over an unsecured creditor by avoiding an unsecured interest. *Id.* § 9-317(a)(2).

25. *In re Commercial Money Ctr.*, 350 B.R. at 481. Both the sale of chattel paper or payment intangibles and the use of chattel paper or payment intangibles as collateral for a loan fall within the parameters of Article 9. U.C.C. § 9-109(a)(1), (3). However, unlike a sale, a secured loan requires filing to perfect a security interest. *Id.* § 9-309.

26. *In re Commercial Money Ctr.*, 350 B.R. at 483.

27. Sales of payment intangibles automatically perfect. U.C.C. § 9-309(3). But, a loan transaction using payment intangibles as collateral requires filing. *Id.* § 9-310.

28. Although in-depth analysis of true-sale statutes is outside the scope of this Note, true-sale legislation seeks to facilitate securitization by ensuring the securitized assets are bankruptcy remote from the seller. See Steven L. Schwarcz, *Securitization Post-Enron*, 25 CARDOZO L. REV. 1539, 1543 (2004) (discussing the possibility that the investors' right of repayment could be suspended in the event of the originator's bankruptcy unless the transfer of assets from the originator to the special-purpose vehicle constitutes a true sale). The legislation accomplishes this by forbidding courts from looking at the economics of a transaction, making the sale label given by the parties determinative. See, e.g., DEL. CODE ANN. tit. 6, § 2703A(a)(1) (2005) ("Any property, assets or rights purported to be transferred, in whole or in part, in the securitization transaction shall be deemed to no longer be the property, assets or rights of the transferor."). The states adopting this safe-harbor legislation include Alabama, Delaware, Louisiana, Ohio, North Carolina, South Dakota, and Texas. Edward J. Janger, *The Death of Secured Lending*, 25 CARDOZO L. REV. 1759, 1760-61. Interestingly, though, the Fifth Circuit has disregarded Texas's true-sale statute. See Elizabeth Warren & Jay L. Westbrook, *A Little Peripheral Vision*, AM. BANKR. INST. J., Feb. 2004, at 26, 26 (quipping that the Fifth Circuit gave Texas's true-sale statute "the back of its collective hand" in *Reaves Brokerage Co. v. Sunbelt Fruit & Vegetable Co.*, 336 F.3d 410 (5th Cir. 2003)).

Perhaps realizing the issue's importance, or simply cognizant that its sale-versus-loan decision would likely be appealed, the *Commercial Money Center* court also fully addressed the classification dispute.²⁹ Despite its secondary treatment in the case, the court's classification of lease rental payment streams as payment intangibles is garnering considerable interest,³⁰ and the issue is likely to arise in future litigation. Unfortunately, the classification ruling does not provide solid precedent or in-depth analysis for future cases. Instead, the *Commercial Money Center* analysis employs a myopic focus on the records element in the definition of chattel paper, concluding in cursory fashion that lease rental payment streams cannot constitute chattel paper because as monetary obligations they are not evidenced by records.³¹

This conclusion is a misreading of the definition of chattel paper and a misapplication of the records element. While literal evidentiary records—namely, the leases—may or may not physically change hands in a given transaction, the records element of chattel paper is not dependent on the technical movement of documents; it merely serves to make possible the benefits of possession and negotiability.³² And, the existence of lease documents does make these benefits possible in assignments of lease rental payment streams. For instance, if an assignee of lease rental payment streams takes possession of the lease documents as representative of the rights transferred, subsequent transfer of the lease documents would serve to transfer the assignee's rights.³³ In the only slightly different situation where

29. See *In re Commercial Money Ctr.*, 350 B.R. at 475–81 (discussing the characterization of lease rental payment streams). Parties in future litigation can argue that the classification portion of the ruling is dicta, however, because the sale-versus-loan issue resolved the case.

30. See, e.g., Schechter, *supra* note 5, at 70 (“This is one of those ‘good news/bad news’ opinions.”); Barkley Clark & Barbara Clark, *Ninth Circuit BAP Holds that Payment Intangibles May Be “Stripped Out” of Equipment Leases*, CLARKS’ SECURED TRANSACTIONS MONTHLY, Sept. 2006, at 1, 1 (analyzing the *Commercial Money Center* case); Edward Janger et al., Remarks at Jay L. Westbrook Bankruptcy Conference: Revised Article 9—Current Developments 9, 9–14 (Nov. 17, 2006) (unpublished presentation, on file with the Texas Law Review) (noting the “advanced problem” presented by the *Commercial Money Center* case); Posting of Donald J. Rapson, derapson@infionline.net, to ucclaw-l@lists.washlaw.edu (Sept. 29, 2006) (on file with author) (forwarding an e-mail from Bob Ihne, Vice President and Associate Chief Counsel for CIT Group Inc. Specialty Finance Division, saying the *Commercial Money Center* case “has generated a good deal of interesting and spirited discussion on this listserv”).

31. *In re Commercial Money Ctr.*, 350 B.R. at 476. Clarks’ treatise on secured transactions agrees with the court’s conclusory decision but offers no compelling analysis of their own, simply relying on the catchy phrase (oddly reminiscent of criminal courtroom drama) that lease rental payment streams “seem to fit the definition of ‘payment intangibles’ like a glove.” 2 BARKLEY CLARK & BARBARA CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 10.08(8)(c) (rev. ed. 2007).

32. See *infra* notes 49–50 and accompanying text.

33. See U.C.C. § 2A-303(5) (2003) (“A transfer of ‘the lease’ or of ‘all my rights under the lease[.]’ or a transfer in similar general terms, is a transfer of rights and, unless the language or the circumstances, as in a transfer for security, indicate the contrary, the transfer is a delegation of duties by the transferor to the transferee.”). The transfer of the lease documents does not deprive the lessor of the reversionary interest in the lease goods, and therefore, when transferred, the lease

the assignee does not take possession of the lease documents, instead leaving possession with the assigning lessor, the proper classification of the assignee's interest nevertheless remains chattel paper because the mere existence of documents makes *possible* the benefits of possession and negotiability. That an assignee's interest remains chattel paper notwithstanding failure to transfer documents is made clear by the non-movement of documents in a transaction that indisputably creates chattel paper—the “plain vanilla”³⁴ assignment of retail installment contracts. In the assignment of retail installment contracts, an assignor's retention of the contracts does not alter the chattel-paper classification of the assigned rights.³⁵ Similarly, in assignments of lease rental payment streams, records—i.e., the lease documents—exist to satisfy the definitional requirement of chattel paper regardless of whether the assignee actually takes possession of the lease documents.

The *Commercial Money Center* court's sole basis for rejecting a chattel-paper classification rested on the absence of records.³⁶ With the records element putatively satisfied, the remaining and heretofore unaddressed issue in determining whether lease rental payment streams constitute chattel paper is whether the payment streams satisfy chattel paper's monetary-obligation and secured-interest elements.³⁷ These elements require investigating the nature of the rights transferred in an assignment of lease rental payment streams. Accordingly, the following two Parts compare the rights transferred in the assignment of lease rental payment streams with the rights represented by Article 9's definition of chattel paper.

documents only represent the right to rental payments and the supporting covenants. *See infra* notes 45–48 and accompanying text.

34. As used throughout this Note, “plain vanilla chattel paper” refers to the situation in which a seller takes a security interest in goods sold on credit—an example of a purchase-money security interest—and then assigns the right to payment. *See* U.C.C. § 9-102(a)(11) (2000) (defining “chattel paper” as a “record or records that evidence both a monetary obligation and a security interest in specific goods”); *id.* § 9-103 (defining “purchase-money security interest”). The classic example is a department store selling goods to a customer on credit (e.g., “Sears card”) and retaining a security interest in the goods until the customer fully pays. Instead of waiting for the customer to pay down the credit card, the department store sells the right to payment to a third party.

35. *See id.* § 9-330(b) (providing a priority rule for the situation where previously assigned chattel paper is purchased from the assignor and the purchaser takes possession—meaning that the original assignee did not have possession but was nevertheless assigned chattel paper); *Borg-Warner Acceptance Corp. v. C.I.T. Corp.*, 679 S.W.2d 140, 141 (Tex. App.—Amarillo 1984, writ ref'd n.r.e.) (ruling that an assignee of a retail installment contract had priority over an inventory financier where the assignee perfected its interest in the retail installment contract by filing, leaving possession with the assignor).

36. *In re Commercial Money Ctr.*, 350 B.R. at 476–77.

37. *See* U.C.C. § 9-102(a)(11) (defining “chattel paper” and its elements).

II. Dissecting Lease Chattel Paper

The argument that lease rental payment streams are chattel paper requires an initial inquiry into the definition of chattel paper—specifically, chattel paper involved in lease transactions—and how it functions in Article 9. Lease chattel paper is comprised of the documents created in a lease transaction.³⁸ The documents are born in the transaction between a lessor and lessee, but they do not grow to usefulness or become an Article 9 concern until used as collateral in a subsequent transaction with a financier.³⁹ This transaction between lessor and financier usually involves the financier exchanging consideration for the transfer of the entire lease, but as seen in the *Commercial Money Center* case, it may involve the transfer of merely the lease rental payment streams—the monetary obligation alone stripped off the lease. The classification issue in the latter transaction is the focus of this Note, but a preliminary examination of the rights transferred in the assignment of an entire lease illustrates why assigned leases are traditionally and properly included in the definition of chattel paper.

A. *The Lack of an Expiration Reversion Causes Lease-Chattel-Paper Confusion*

The Article 9 definition of lease chattel paper entails the existence of a “record or records that evidence” two components: (1) a “monetary obligation” and (2) a “lease of specific goods.”⁴⁰ While assigned lease rental payment streams clearly satisfy the monetary-obligation component of lease chattel paper, the lease component results in conceptual difficulty. The difficulty arises because the underlying lease, unlike the purchase-money sale involved in plain vanilla chattel paper, does not create an Article 9 security interest in the underlying goods.⁴¹ More importantly, though, and what creates the key difference between plain vanilla chattel paper and lease chattel paper, the transfer of a lease does not transfer an interest in the reversionary right of the underlying leased goods at the expiration of the lease—the right remains with the transferring lessor.⁴²

38. *See id.* (defining “lease chattel paper” as the “records” evidencing rights in a “lease of specific goods”).

39. *See id.* (referring to “records that evidence both a monetary obligation and . . . a lease of specific goods”); Thomas H. Jackson, *Embodiment of Rights in Goods and the Concept of Chattel Paper*, 50 U. CHI. L. REV. 1051, 1053 (1983) (explaining that chattel paper serves no Article 9 purpose until it is used as collateral).

40. U.C.C. § 9-102(a)(11).

41. *See* U.C.C. § 1-201(b)(35) (2001) (excluding a lessor’s right to repossess leased goods from the definition of security interest).

42. *See* U.C.C. § 2A-103(1)(w) (2003) (defining “lessor’s residual interest” as a “lessor’s interest in the goods after expiration, termination, or cancellation of the lease contract”).

U.C.C. Article 2A's definition of a lease makes clear that a lease assignee lacks the expiration reversion.⁴³ Under the definition, a lease represents the lessee's covenant to pay rents in exchange for the present right to possession and use of goods, plus any additional covenants between the parties.⁴⁴ A lease does not in any way encompass or limit the lessor's future right to possession of the goods at the termination of the lease, which exists "outside and independently of the lease."⁴⁵ The often-cited *Leasing Consultants*⁴⁶ case reinforces this point, holding that filing a security interest in a lease does not result in a perfected security interest in the underlying leased equipment, which requires a separate filing.⁴⁷ Accordingly, the lessor's right to possess the leased goods at the expiration of the lease continues even after the lease is assigned. Thus, when the lease ends, it is the lessor and not the assignee of the lease that owns and has the right to possess the leased goods. This right to possession following the expiration of a lease is so cogent that a lessor can even grant a security interest in the expiration-reversion right of an assigned lease.⁴⁸

This distinction between lease rights and expiration-reversion rights introduces an apparent contradiction between the purpose of chattel paper and the use of leases as chattel paper. Chattel paper exists to "'paperiz[e]' the obligation otherwise represented by an account."⁴⁹ Paperization creates the benefits of possession and negotiability, such that transfer of the document transfers the rights embodied therein.⁵⁰ But, to attain the negotiability

43. *See id.* § 2A-103(1)(p) (defining "lease" as a means of "transfer of the right to possession and use of goods for a period in return for consideration" (emphasis added)).

44. *Id.*

45. Amelia H. Boss, *Lease Chattel Paper: Unitary Treatment of a "Special" Kind of Commercial Specialty*, 1983 DUKE L.J. 69, 76.

46. *In re Leasing Consultants*, 486 F.2d 367 (2d Cir. 1973).

47. *Id.* at 372. For an explanation of this principle, see Joseph H. Levie, *Security Interests in Chattel Paper*, 78 YALE L.J. 935, 940 (1969), which explains: "Where *F* purchases equipment leases, he takes only an assignor's interest in the equipment lease itself. If *F* wishes to be secured by an interest in the goods as well, he must obtain a security interest from *D* and perfect it." *But see In re Atl. Computer Sys., Inc.*, 135 B.R. 463, 466 (Bankr. S.D.N.Y. 1992) (distinguishing a unique situation where notification to the debtor-lessor's lessee sufficed to perfect a security interest in the leased goods). Official Comment 4 to U.C.C. § 9-313, explicitly rejecting the reasoning in the *Atlantic Computer Systems* case, also contributes to this point. *See* U.C.C. § 9-313 cmt. 4, para. 3 (2000). The comment establishes that a lessee's acknowledgement of notification of a secured party's interests in the leased goods does not suffice for perfection of the secured party's interest in the goods by possession. *See id.* (establishing that acknowledgement of notification under § 9-313(c) by a lessee in the ordinary course of business does not suffice for possession).

48. *See* Boss, *supra* note 45, at 75 ("A lessor under pre-Code law could always convey its interest in the leased goods themselves or assign its rentals in return for financing.").

49. Jackson, *supra* note 39, at 1058.

50. *See* U.C.C. § 9-103 cmt. 2 (1962) ("[T]he property right or claim evidenced by . . . chattel paper is thought of as being merged in or symbolically represented by the piece of paper, whose indorsement or delivery is a prerequisite to a transfer of the underlying claim or right."); *In re Commercial Mgmt. Serv., Inc.*, 127 B.R. 296, 302 (Bankr. D. Mass. 1991) ("[A] lease is treated as the embodiment of the rights it represents such that these rights are transferred by a transfer of the lease document."); Levie, *supra* note 47, at 942 ("[T]he entire thrust . . . of the Code's treatment of

benefits of chattel paper, there must be more than an intangible right to payment. The chattel-paper classification requires the existence of tangible goods to secure and enhance the value of the right to payment.⁵¹ In contrast, rights to payment not secured by tangible goods, such as accounts or payment intangibles, are not negotiable⁵² and are specifically excluded by definition from classification as chattel paper.⁵³

With this distinction between “secured interest equals chattel paper” and “unsecured interest equals account” in mind, the assignment of an entire lease appears at first blush to transfer an unsecured right to payment, more akin to an account than to chattel paper.⁵⁴ After all, by definition, a lease does not create an Article 9 security interest in the leased goods.⁵⁵ But, despite this disinheritance from Article 9’s security-interest label, a lessor remains protected by both common law and Article 2A, which provide the lessor with strong remedies for repossessing leased goods upon a lessee’s default.⁵⁶ Wielding this repossession right, the lessor is effectively secured, even though this particular repossession right is not recognized as an official Article 9 security interest.⁵⁷ The strength of the lease repossession right is demonstrated by U.C.C. § 2A-307, which provides that a lease financier’s

security in chattel paper is to assimilate it to a ‘commercial specialty,’ i.e., a negotiable instrument.”).

51. See U.C.C. § 9-102(a)(11) (2000) (defining the monetary-obligation portion of lease chattel paper as “a monetary obligation secured by the goods or owed under a lease of the goods”); Jackson, *supra* note 39, at 1086 (“In creating chattel paper, however, the concept of collateral ultimately must embody not only the intangible right, but also, to some extent, rights in tangible objects known as goods.”).

52. See U.C.C. § 9-313 cmt. 2, para. 2 (describing accounts and payment intangibles as “property not ordinarily represented by any writing whose delivery operates to transfer the right to payment”).

53. See *id.* § 9-102(a)(2) (excluding from the definition of accounts “rights to payment evidenced by chattel paper”); *id.* § 9-102(a)(42) (describing payment intangibles as “other than . . . chattel paper”).

54. Professor Boss argues precisely this theory. See Boss, *supra* note 45, at 87 (“Conceptually and functionally, the assignment of a true lease resembles an account far more than it resembles chattel paper.”). Moreover, as Boss notes, chattel paper requires a security interest in specific goods. See *id.* at 91 (“[T]he definition of chattel paper requires a lease of goods . . .” (internal quotation marks omitted)). Thus, as Boss points out, the literal definition of goods would prevent chattel paper from including true leases because goods are defined as “all things which are movable at the time the security interest attaches.” U.C.C. § 9-102(a)(44) (emphasis added); see Boss, *supra* note 45, at 91. No security interest attaches to the underlying goods in a true lease, however. U.C.C. § 1-201(b)(35) (2001). Boss ultimately abandons this argument as overly technical. See Boss, *supra* note 45, at 91.

55. See U.C.C. § 1-201(b)(35) (excluding a lessor’s right to repossess leased goods from the definition of security interest).

56. See U.C.C. § 2A-523 (2003) (outlining a lessor’s remedies upon a lessee’s breach of the obligation to pay).

57. In fact, many security interests exist outside the auspices of Article 9. See U.C.C. § 9-109(d) (listing interests to which Article 9 does not apply—many of which are specific liens).

rights in leased goods are *superior* to a competing Article 9 security interest.⁵⁸

The lessor's right to repossess leased goods upon default—which this Note terms default-reversion rights—supplements a lessor's expiration-reversion rights. While default-reversion rights transfer with the lease when it is assigned to a financier,⁵⁹ expiration-reversion rights remain with the lessor.⁶⁰ As previously noted, commentators have argued that it is the lack of the expiration reversion that makes the lease financier's interest more similar to an unsecured account than to secured chattel paper.⁶¹ To flesh out this argument, an illustration is helpful to compare the relative positions of an unsecured account financier and a lease financier. An unsecured account financier purchases the right to payment arising out of a sales contract, under which the account debtor holds title in the goods and neither the seller nor the financier has a security interest. In this situation, the financier's recovery depends solely on the ability of the account debtor to pay because the financier cannot seek any direct recourse through the goods. A lease financier, the argument goes, is in a similar position because without the expiration-reversion interest the lease financier cannot exercise U.C.C. § 9-610 rights to repossess and dispose of (i.e., sell) the goods if the lessee defaults⁶² because such action would deprive the lessor of its right to the leased goods upon the lease's expiration. As a result, this argument proposes that a lease financier, unless also holding a separate security interest in the underlying goods, is unsecured, looking only to the lessee's ability to pay. Based on this argument, the lease financier's unsecured interest should be classified as an account and not as chattel paper.

Adhering to this argument begs the question of why true leases are included in the definition of chattel paper and not in the definition of accounts. Addressing this inconsistency, Professor Boss, in her article on lease chattel paper, argues that true leases are included as chattel paper to provide “unitary treatment” of true leases and security interests in a world where distinguishing between the two is prohibitively burdensome.⁶³ For example, the typical purchase-money security interest—a sale in which the sold goods serve as collateral—clearly produces plain vanilla chattel paper because there is both a monetary obligation and a security interest in specific

58. See U.C.C. § 2A-307(1) (“[A] creditor of a lessee takes subject to the lease contract.”); *id.* § 2A-307(2) (“[A] creditor of a lessor takes subject to the lease contract unless the creditor holds a lien that attached to the goods before the lease contract became enforceable.”).

59. See *infra* notes 68–73 and accompanying text.

60. See *supra* note 42 and accompanying text. Of course, the lessor can specifically assign the expiration-reversion interest. See *In re Leasing Consultants*, 486 F.2d 367, 372 (2d Cir. 1973) (holding that a separate filing perfects a security interest in the leased equipment).

61. See, e.g., Boss, *supra* note 45, at 87.

62. See U.C.C. § 9-610 (providing for the secured party's disposition of collateral after debtor default).

63. Boss, *supra* note 45, at 89.

goods.⁶⁴ This remains true even if the parties to that sale characterize it as a lease, denominating the loan payments as rent and the collateral as leased goods. Thus, Professor Boss suggests that in order to ensure such sales cannot masquerade as leases and sneak out of Article 9 treatment, the chattel-paper definition includes leases.⁶⁵

The problem with the unitary treatment explanation, however, surfaces in the U.C.C.'s differing treatment of recharacterization scenarios. The U.C.C. is willing to recharacterize security interests as leases but *not* to recharacterize security interests as sales—avoiding recharacterization issues in the arena of sales versus security interests⁶⁶ but tackling head-on the issue of whether a transaction constitutes a security interest or a lease.⁶⁷ The unitary treatment theory does not (and cannot) explain why the U.C.C. invites courts to distinguish between security interests and leases when looking directly at a transaction but would find it necessary to include leases as chattel paper for the sole purpose of preventing courts from undertaking this same analysis at the financing level.

B. True Leases Are Chattel Paper Because of the Lease Financer's Substantial Interest in the Leased Goods

In search of a more satisfying answer for why the definition of chattel paper includes leases, this Note suggests there is a significant difference in the relative positions of an account financier and a lease financier. Namely, a lease financier obtains an interest that while still short expiration-reversion rights, is more secured and more dependent on the value of the underlying goods than the interest an account financier obtains, and it is thus more comparable to the interest of a chattel-paper financier.

A lease financier assigned a lease obtains all the assigning lessor's rights under the lease that are ancillary to the lease financier's right to payment.⁶⁸ Notably, the lease covenants that protect the expiration reversion (such as the right to dispose of the leased goods at the end of the lease) remain with the lessor and do not transfer to the lease financier because these covenants are

64. See U.C.C. § 9-102(a)(11) (defining "chattel paper" as both a monetary obligation *and* one of several things, including either a security interest in specific goods *or* a lease of specific goods).

65. See Boss, *supra* note 45, at 89; see also *id.* (defining "chattel paper").

66. See *id.* § 9-318 cmt. 2 ("Neither this Article nor the definition of 'security interest' . . . provides rules for distinguishing sales transactions from those that create a security interest securing an obligation.").

67. See U.C.C. § 1-203 (2001) (providing a stand-alone section to deal with distinguishing between a security interest and a lease).

68. See U.C.C. § 2A-303(5) (2003) ("A transfer of 'the lease' or of 'all my rights under the lease[.]' or a transfer in similar general terms, is a transfer of rights and . . . the transfer is a delegation of duties by the transferor to the transferee."); *In re Commercial Mgmt. Serv., Inc.*, 127 B.R. 296, 302 (Bankr. D. Mass. 1991) ("[A] lease is treated as the embodiment of the rights it represents such that these rights are transferred by a transfer of the lease document.").

not ancillary to the right to rental payments.⁶⁹ Conversely, rights that do transfer to the lease financier as ancillary to the right to rental payments include the lessor's remedies upon the lessee's default, specifically the right to bring suit to collect the debt⁷⁰ and the right to repossess the leased goods,⁷¹ which this Note has termed the default reversion. Repossession, although important, is limited to the extent that the repossession right is ancillary to ensuring or coercing payment, and repossession cannot infringe on the lessor's expiration-reversion right.⁷² Accordingly, the lease financier cannot repossess for the purpose of disposition—even if a lease covenant allows the lessor that right—because such use of the repossession covenant would be incidental to protecting the lessor's expiration-reversion right and, therefore, would not transfer to the lease financier.⁷³

Notwithstanding these limitations, the lease financier benefits from the ancillary covenants that transfer with the right to payment in two readily apparent ways, both of which increase the importance of the value of the leased goods to the lease financier. First, upon a lessee's failure to make rental payments, the lease financier can repossess the leased goods and, instead of disposing of them, can re-lease them at market rent for the time remaining before the lessor's expiration reversion kicks in.⁷⁴ This right reduces the lease financier's focus on the lessee's ability to satisfy the rent obligation by placing importance on the market rental value of the leased goods. For example, even in the situation where a defaulting lessee is completely judgment proof, the lease financier can take comfort in the value of the leased goods—specifically, the market rent for the leased goods—which becomes relevant through the lease financier's ability to repossess and re-lease.⁷⁵

A second, and more nuanced, benefit stemming from the repossession right is a lease financier's ability to influence the lessee's business actions.

69. See Boss, *supra* note 45, at 78 (distinguishing between covenants protecting a chose in action and covenants preserving the leased chattel).

70. See 9 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 878 (interim ed. 2002) (explaining that an assignment of legal rights includes the privilege of bringing suit to enforce them).

71. A lessor's rights include repossession upon default. See U.C.C. §§ 2A-523(1)(e), -525 (allowing repossession without judicial process, provided it is done without a breach of the peace). This right transfers to the lease financier. See Boss, *supra* note 45, at 78 (concluding that assignment of a lease transfers—among the benefits of covenants in the lease—the right to repossess because “the assignee of [a] chose in action also acquires all incidental rights and remedies to which the assignor was entitled”).

72. See Jackson, *supra* note 39, at 1085 (discussing a chattel-paper financier's right to use leased goods only as ancillary to the right of payment).

73. See Boss, *supra* note 45, at 78 (dividing the rights incidental to the lease financier's right to lease payments and those incidental to the lessor's expiration-reversion interest).

74. See *Truck, Tractor & Forwarding Co. v. Baker*, 281 Pa. 145, 147–48 (1924) (holding that upon the lessee's default, the assignee of a lease had a right to take possession of the leased goods within a reasonable time and that if done, the assignee's right to the leased goods could not be disturbed).

75. See U.C.C. § 2A-527(2) (providing a formula for damages upon a lessee's breach that is similar to a seller's resale damages under U.C.C. § 2-706 (2003)).

Empirical evidence reveals that a secured creditor seeks, even above the ability to liquidate collateral, the strategic advantages of control over the debtor—the ability to influence decisions that increase the probability of payment.⁷⁶ By analogy, the right to repossess leased goods gives the lease financier many of the same control powers that a secured party wields over a debtor. Just as a secured party is able to limit a debtor's future borrowing by encumbering assets as collateral, a lease financier similarly limits a lessee's future borrowing because a future creditor will be reluctant to lend against leased equipment. Here, too, the lease financier's focus on the value of the leased goods is evident—the greater the value of the leased equipment as a percentage of the lessee's total assets, the more control a lease financier has over the lessee's future borrowing.

Moreover, in at least one respect, a lease financier wields *more* control over a lessee's future borrowing than a secured party wields over a debtor. While creditors frequently lend subordinate debt against assets encumbered by previous security interests,⁷⁷ creditors are loath to lend to lessees using leased assets as collateral.⁷⁸ Creditor unwillingness to lend against leased assets is attributable to the lessor's expiration reversion, which combined with U.C.C. § 2A-307 gives the lessor priority in the entire leased asset, leaving no available collateral for subordinate creditors. In comparison, a secured party has priority in a secured asset only up to the amount due on the loan, meaning subordinate interests receive any surplus from the disposition of the collateral over the amount due to the first secured party.⁷⁹ Because of this difference, creditors are less likely to lend to lessees against leased assets than to debtors against assets with senior security interests. In this respect, lease financiers maintain an enviable position for limiting the lessee's future borrowing.⁸⁰

Yet another way a lease financier can influence a lessee's business actions is by using the threat of costly legal remedies (which, hopefully for the lease financier, exceed any savings for the lessee from early termination of the lease) as leverage to increase a lessee's incentive to pay rents.⁸¹ The greater the value of the leased equipment as compared to the rent remaining

76. See Ronald J. Mann, *Strategy and Force in the Liquidation of Secured Debt*, 96 MICH. L. REV. 159, 233–37 (1997) (exploring the role of control in secured lending).

77. In fact, subordinate lenders are the reason for U.C.C. § 9-322, which provides priorities among conflicting security interests. See U.C.C. § 9-322 (2000) (providing priority rules among conflicting security interests in, and agricultural liens on, the same collateral).

78. This is because the lender would be subordinate to the lessor. See U.C.C. § 2A-307 (“[A] creditor of a lessee takes subject to the lease contract . . .”).

79. See U.C.C. § 9-615 (providing for the distribution of proceeds of a disposition, including the application of a surplus over the amount due on the secured loan to subordinate creditors).

80. Of course, a lease only encumbers the leased asset, whereas a creditor can have a blanket lien on all of a debtor's assets—a major benefit for the creditor seeking to limit future borrowing.

81. Cf. Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 645–49 (1997) (explaining that a secured party's right to repossess collateral often inflicts upon the borrower a loss greater than the offsetting benefit from debt reduction).

to be paid and the more integral to the lessee's business the leased equipment is, the more control the lease financier will have over the lessee. Simply put, the greater the value of the leased goods, the more a lessee will be willing to sacrifice to pay rents to avoid a costly default—where the cost of default is defined by the value of the equipment lost less the savings in future lease payments. Again, the cost of default is directly tied to the value of the leased goods.

To some extent, this leverage imparts even another similar, but distinguishable, benefit on the lease financier: a large cost of default may reduce the lessee's incentive to use the leased assets to engage in excessively risky ventures. The debtor strategy, known to lenders as asset substitution,⁸² where the debtor obtains low-cost financing based on a low-risk business plan only to clandestinely invest the proceeds in a high-risk venture, concededly imposes less risk on lessors than on secured creditors. For a debtor, borrowed cash is fungible and is easily used to engage in new and riskier business (such as a producer of a consumer staple stealthily using borrowed cash in the pursuit of a commercial space flight), whereas a lessee receives not cash but equipment that is specially tailored for a certain use in a certain business. Nevertheless, a concern similar to asset substitution exists in the lease context to the extent that a lessee can switch into a riskier business venture while still utilizing the same leased equipment.⁸³ The leverage implicit in an expensive default reduces the likelihood of such a switch by causing a lessee to think twice before using leased equipment to engage in higher risk business that increases the probability of default.

These two benefits, the right to repossess and re-lease and the related ability to influence a lessee's business actions, demonstrate that a lease financier's interest in the lease is considerably more secured than an account financier's right to payment. Unlike an account financier that looks only to the account debtor's ability to pay for its recovery, a lease financier's return depends heavily on the value of the leased goods. Although the lease financier does not have expiration-reversion rights and cannot dispose of repossessed assets like a secured party, the right to re-lease and the control over the lessee that stems from having strong default rights enhance the lease financier's right to payment in a way very similar to a security interest. This similarity to a secured party and dissimilarity to an unsecured account financier provides a viable explanation for why lease assignments constitute chattel paper and not accounts under Article 9.

82. See Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1, 22–25 (1981) (examining the role of risk aversion and uncertainty in the creation of security interests).

83. Schwartz gives the example of changing from making lathes to making amphibious cars. *Id.* at 11. This change would require quite an extraordinary piece of manufacturing equipment.

III. Assignment of Lease Rental Payments

Based on the proposed theory that leases are included in the definition of chattel paper because of a lease financier's substantial interest in the leased goods, the proper Article 9 classification of assigned lease rental payment streams can be analyzed by comparing the lease financier's interest in leased goods to the interest received by an assignee when lease rental payment streams alone are transferred. If an assignee of lease rental payment streams receives the same bundle of rights in the leased goods as a lease financier, then lease rental payment streams should also be classified as chattel paper, and not as payment intangibles (the classification assigned these streams in *Commercial Money Center*). Specifically, the relevant right an assignee of lease rental payment streams must receive in order for the transaction to create chattel paper is the repossession right, previously termed the default-reversion right, that enhances the covenant to pay rents. With this right, the assignee of lease rental payment streams obtains the salient interest in the underlying goods that explains why leases are included in the definition of chattel paper.

A. § 9-203(g) Governing Attachment and Its Perfection Sidekick § 9-308(e)

Article 9's adoption of the common law collateral follows right to payment rule⁸⁴ operates to lock up the right to rental payments with ancillary covenants enhancing those payments.⁸⁵ Notably, the *Commercial Money Center* opinion did not account for this important rule, which, in statutory language, requires that "[t]he attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien"⁸⁶ and that "perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien."⁸⁷

The best way to translate this statutory language is by application to a traditional transaction involving plain vanilla chattel paper. In a typical car sale, the car dealer retains an interest in the car securing the right to payment. The transaction creates chattel paper, with the loan documents representing both the right to payment and the security interest.⁸⁸ When the dealer sells or borrows against the chattel paper, the financier, in addition to obtaining an intangible right to payment, also obtains the dealer's security interest in the car. Article 9 makes the transfer of the security interest in the car mandatory

84. The phrase "collateral follows right to payment" is the heading to U.C.C. § 9-203 cmt. 9.

85. See U.C.C. § 9-203 cmt. 9 (noting that when a secured obligation is transferred, the security interests are also transferred).

86. *Id.* § 9-203(g).

87. *Id.* § 9-308(e).

88. See *supra* note 34.

for both attachment (U.C.C. § 9-203(g)) and perfection (U.C.C. § 9-308(e)) purposes.⁸⁹

While obviously applicable to the car sale, a careful parsing of the statutory language reveals that by their literal terms, these provisions may not apply to the transfer of rights to lease rental payment streams. As laid out above, the language in U.C.C. §§ 9-203(g) and 9-308(e) requires two elements before ancillary covenants are locked up with a right to payment: (1) a security interest in a right to payment and (2) a security interest in a security interest, mortgage, or lien. The first element, a security interest in a right to payment, is easily satisfied; regardless of whether the sale of lease rental payment streams constitutes a sale of chattel paper or a sale of payment intangibles, either of these transactions create an Article 9 security interest.⁹⁰

Satisfaction of the second element is less clear. The question is whether ancillary lease covenants providing for repossession fit into any of the three interests that U.C.C. § 9-203(g) operates to transfer with the right to payment—namely, a security interest, a mortgage, or a lien.⁹¹ The first two possibilities are easily dismissed. Basic statutory interpretation makes untenable any argument that the lease repossession covenant is a security interest because the ambit drawn by the definition of security interest expressly excludes “the right of a . . . lessor of goods . . . to retain or acquire possession of the goods.”⁹² Similarly, mortgages have a specific definition and use involving fee simple interests, a type of interest inapposite to repossession covenants in leases.⁹³

Whether such repossession covenants fit within the lien interest securing the right to payment is a closer call. Liens are defined in U.C.C. Article 2A as “a charge against or interest in goods to secure payment of a debt or performance of an obligation.”⁹⁴ This definition seems, at least, to be broad enough to encompass lease repossessions. Arguably, the statute’s

89. The Bankruptcy Appellate Panel of the Ninth Circuit Court of Appeals has applied the collateral follows right to payment rule in case law. *See, e.g., In re Leisure Time Sports, Inc.*, 194 B.R. 859, 861 (B.A.P. 9th Cir. 1996) (“[T]he lien is an incident of the debt and passes with it by operation of law, that an express assignment of the security interest is not required.”). It bears noting that deeming that a transaction transfers certain rights for attachment and perfection purposes does not restrict how parties can actually structure transactions. Deeming that a transaction takes a certain form in order to *impose* Article 9 treatment can be theoretically perceived as the inverse of true-sale statutes, which deem that a transaction takes a hypothetical form to *avoid* certain legal requirements. For a brief discussion of true-sale statutes, see *supra* note 28.

90. *See* U.C.C. § 9-109(a)(3) (providing that a sale of chattel paper and a sale of payment intangibles are both within the scope of Article 9).

91. *See id.* § 9-203(g) (providing that attachment of a security interest in a right to payment in personal or real property also constitutes attachment of a security interest in “the security interest, mortgage, or other lien”).

92. U.C.C. § 1-201(b)(35) (2001).

93. *See* *Garrison v. Garrison*, 460 A.2d 945, 947 (Conn. 1983) (describing a mortgage as “a vested fee simple interest subject to complete defeasance by the timely payment of the mortgage debt”).

94. U.C.C. § 2A-103(1)(x) (2003).

format, which lists three varieties of security-type interests, possibly as examples, supports this broad reading of “lien.” Additionally, liens are generally viewed as being more comprehensive than mortgages or security interests.⁹⁵ Thus, even though the definition of security interest technically excludes lease covenants, the inclusion of liens in U.C.C. § 9-203(g) could be viewed as intending to broaden the provision’s scope. On the other hand, a lease financier’s interest in a lease is governed by a separate body of lease law, and treating the lease financier’s interest as a lien may unnecessarily impose lien laws on leases. In sum, with multiple plausible statutory interpretations, based strictly on its language, § 9-203(g) is ambiguous as to whether it requires lease covenants supporting the right to payment to transfer with assigned lease rental payment streams.

B. The Policy Behind §§ 9-203(g) and 9-308(e)

Whether or not U.C.C. § 9-203(g) by its technical language operates to transfer lease covenants supporting the right to rental payments with assigned lease rental payment streams, the policy behind the collateral follows right to payment rule indisputably supports this outcome. The B.A.P. of the Ninth Circuit, the same court that decided the *Commercial Money Center* case, had previously discussed the rationale behind the collateral follows right to payment rule in *Leisure Time Sports*.⁹⁶ In that case, the B.A.P. espoused the concern that separating a security interest and its right to payment could “expose the obligor to a double liability.”⁹⁷ If an obligor defaulted, the assignee of a right to payment could sue the obligor to recover payment at the same time the holder of the security interest repossessed the collateral, leaving the obligor fully paid but without the collateral.⁹⁸

This obligor-double-liability conundrum could, in many situations, be straightened out by the obligor requesting joinder of all parties.⁹⁹ With all parties joined, the obligor avoids double liability under one of two scenarios:

95. 51 AM. JUR. 2D *Liens* § 4 (2000).

96. *In re Leisure Time Sports, Inc.*, 194 B.R. 859, 861 (B.A.P. 9th Cir. 1996).

97. *Id.* (quoting *In re Belize Airways, Ltd.*, 7 B.R. 604, 607 (Bankr. S.D. Fla. 1980)). In fact, avoiding obligor double liability is only one of potentially many rationales underlying the collateral follows right to payment rule. Other rationales can be seen by analogizing to recent research exploring the challenges to current regulatory and disclosure regimes posed by the financially engineered decoupling of economic rights from various rights of control in both equity and debt contexts. See Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) (analyzing “empty voting”—the decoupling of a shareholder’s economic ownership and voting rights); Henry T.C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1402 (2007) (expanding the analytical framework of shareholder decoupling to the creditor context, in which an “empty creditor” uses derivatives to decouple its economic interest from contractual covenant rights or bankruptcy rights).

98. *Id.*

99. *Cf.* RESTATEMENT (SECOND) OF CONTRACTS § 326 (1981) (reporting that in a partial assignment of a right to payment—which necessarily separates a security interest and the right to payment—the obligor is protected by a rule requiring joinder of all parties).

(1) the secured party loses its security interest or (2) the assignee of the right to payment loses its action to recover payment. If the secured party loses its security interest, then the collateral effectively follows the right to payment by default. This is because the assignee of the right to payment could then seek a successful judgment lien on the collateral, unimpeded by what would otherwise have been the secured party's senior security interest.¹⁰⁰ In the second (and unlikely) scenario in which the assignee of the right to payment loses its cause of action, the secured party would receive a windfall. The secured party would collect both the monetary obligation, in the form of the prior payment from the assignee made in exchange for the assignment of the loan payments, and the proceeds from disposition of the collateral—resulting in double payment for the secured party and no recovery for the assignee. While a transaction bearing these payout traits could have been contemplated between the assignor and assignee, it would represent the exception to the rule and would conspicuously advertise itself to courts through a low price in the original assignment.¹⁰¹ Barring this unique situation, requiring security to follow the right to payment is a rational policy because in order to avoid either obligor double liability or an assignor windfall, the secured party must lose its security interest—resulting, *de facto*, in collateral following the right to payment.

The policy of avoiding obligor double liability that underlies the collateral follows right to payment rule applies to assignments of lease rental payment streams just as it applies to assignments of secured-loan payments, even if the literal language of U.C.C. § 9-203(g) does not.¹⁰² A debtor-obligor and a lessee-obligor are in analogous positions, except that a lessee lacks expiration-reversion rights. But, the expiration reversion is immaterial to the crux of the double-liability analysis; the lessee-obligor risks repossession of the leased asset upon nonpayment, just as the debtor-obligor risks repossession of the financed asset. As a result, upon a default, the lessee could face both the repossession of the leased goods by the lessor and continuing demands for rent payment by the assignee. In order to protect the lessee-obligor from double liability, the assignee of lease rental payment streams, and not the lessor, should receive the right to repossess and re-lease the goods for the period prior to the expiration reversion, just as the assignee of a monetary obligation receives the right to repossess and dispose of

100. See U.C.C. § 9-322(a)(3) (2000) (granting priority, as between unperfected security interests, to the first security interest—such as a judgment lien—to attach to the property).

101. For example, the assignee could have intended to enter into a high-risk, high-reward transaction, paying an appropriately discounted rate for an unsecured position. In this situation, the assignee's risky investment pays off only if the lessee diligently pays, while the assignor's investment pays off if the obligor defaults and he recovers the collateral. Thus, retaining the security interest would not constitute a windfall in relation to the discounted rate paid in exchange for an unsecured payment stream.

102. See *supra* subpart III(A) for an interpretation of the literal language of U.C.C. § 9-203(g) and its application to the assignment of lease rental payment streams.

collateral. Thus, even though it is ambiguous whether the literal language of U.C.C. § 9-203(g) applies to lease rental payment streams, the policy behind the provision of preventing obligor double liability validates its application in these transactions.

When the collateral follows right to payment rule is applied to the assignment of lease rental payment streams, the collateral—here the default-reversion interest providing for repossession and re-leasing of the goods—transfers to the assignee. These default rights, following this Note’s subpart II(B) analysis, satisfy the secured-interest element of chattel paper. Together with the monetary obligation and at least some evidence of a record, the elements of chattel paper are met.¹⁰³ And, once a transaction satisfies the elements of chattel paper, Article 9 requires the transferred rights be classified as chattel paper, not as payment intangibles, because intangibles are a residual category that applies only to property “other than accounts, chattel paper, commercial tort claims . . . or . . . minerals before extraction.”¹⁰⁴ Accordingly, the *Commercial Money Center* court’s failure to consider the collateral follows right to payment rule led to a flawed result.

C. *Official Comment to the Definition of Payment Intangibles*

In the event future courts fail to apply the collateral follows right to payment rule to the assignment of lease rental payment streams, Article 9 provides an alternative basis for finding that covenants enhancing the right to lease payments transfer with the right to payment. The Official Comment to the definition of payment intangibles in U.C.C. § 9-102 recognizes that ancillary covenants “frequently buttress[]” rights to the payment of money and states that “an assignment of a right to payment of a monetary obligation . . . also carries these ancillary rights.”¹⁰⁵

This is powerful ammunition for the argument that lease covenants enhancing payment are locked up with the right to payment. Indeed, the Official Comment says exactly that, echoing the language of the collateral follows right to payment rule. Unfortunately, though, the location of the Official Comment confuses the argument. The Official Comment containing this language is discussing payment intangibles, not chattel paper, possibly suggesting that even when a right to payment carries certain ancillary rights, it remains a payment intangible. However, while this may be true for certain types of ancillary rights, it does not require conceding that the Official Comment brings *all* rights to payment carrying ancillary rights within the payment-intangibles classification. In fact, the narrow terms of the Official Comment make clear that the payment-intangibles classification does not

103. See U.C.C. § 9-102(a)(11) (defining “chattel paper” as a record or records evidencing both a monetary obligation and a security interest in specific goods or a lease of specific goods).

104. *Id.* § 9-102(a)(42); see *id.* § 9-102(a)(61) (defining “payment intangibles” as general intangibles under which the account debtor’s principal obligation is a monetary obligation).

105. *Id.* § 9-102 cmt. 5(d), para. 4.

extend to many types of ancillary rights, including lease covenants. By its terms, the Official Comment does not contemplate ancillary covenants giving an assignee an effectively secured interest in goods, such as the repossession rights transferred to an assignee of lease rental payment streams.¹⁰⁶ Instead, the Official Comment only considers restrictive covenants that do not give an assignee of payment rights an interest in collateral—“covenants to preserve the creditworthiness of the promisor, such as covenants restricting dividends and the like.”¹⁰⁷ Thus, coupled with merely restrictive covenants, a payment intangible remains an unsecured interest.

In contrast, in the special situation of assigned lease rental payment streams, transferred covenants establish a secured interest by giving the assignee an interest in the underlying goods, such as the right to repossess and re-lease the goods. The resulting effectively secured position falls plainly within the turf of chattel paper; the Official Comment cannot conceivably function to bring rights to payment carrying secured-interest covenants within the payment-intangible classification. Such an interpretation would prove too much, requiring even traditional chattel-paper transactions, such as assignments of retail installment contracts, to be classified as payment intangibles. Thus, the best interpretation of the Official Comment is that it simply restates the universal point that whether dealing in chattel paper with collateral covenants or payment intangibles with restrictive ancillary covenants, Article 9 requires that “an assignment of a right to payment of a monetary obligation . . . also carries these ancillary rights.”

The Official Comment contains additional language buttressing the classification of assigned lease rental payment streams as chattel paper: “In classifying intangible collateral, a court should begin by identifying the particular rights that have been assigned.”¹⁰⁸ The prescribed exercise of identifying the rights assigned, an exercise that the *Commercial Money Center* court did not do, requires the classification of lease rental payment streams as chattel paper based on the transfer of a substantial interest in the leased goods through either the collateral follows right to payment rule, as discussed in subpart III(B), or the more general “right to payment carries ancillary rights” language of the Official Comment reviewed above. Of course, there is again the lurking objection that the Official Comment prescribes this examination only within the intangible categories. But surely the Article 9 drafters intended that if upon examination of particular assigned rights a court discovers rights conforming more to chattel paper than intangibles, the court would be free—no, required—to venture beyond intangibles and properly classify an assignment of lease rental payment streams as chattel paper.

106. See *supra* note 57 and accompanying text.

107. U.C.C. § 9-102 cmt. 5(d), para. 4.

108. *Id.* § 9-102 cmt. 5(d), para. 3.

IV. If Not Chattel Paper, Lease Rental Payments Should Be Accounts, Not Payment Intangibles

If assigned lease rental payment streams are not chattel paper, they should be accounts (a classification not considered by the *Commercial Money Center* court) and not payment intangibles. The payment-intangibles classification was introduced in revised Article 9 solely as a concession to and in order to provide clarity for loan participations.¹⁰⁹ All monetary obligations other than loan participations were intended to fit within the greatly expanded definition of accounts.¹¹⁰

Consistent with this intention, lease rental payment streams—if adjudged not chattel paper—fit the expanded definition of accounts. Prior to being stripped off a lease, the rental payment obligation would constitute an account but for the accounts definition’s exclusion of “rights to payment evidenced by chattel paper.”¹¹¹ If it is explicitly held, as in *Commercial Money Center*, that a payment stream is not chattel paper, then it is contradictory to maintain both that the payment stream is not evidenced by chattel paper and also that the payment stream cannot be an account solely because it is “evidenced by chattel paper.” Thus, if not chattel paper, lease rental payment streams satisfy the definition of accounts and *must* be classified accordingly, and not as payment intangibles, because as previously noted intangibles are a residual category.¹¹²

Further, leapfrogging the accounts classification to classify lease rental payment streams as payment intangibles ignores the Article 9 drafters’ intentions in expanding the definition of accounts and in creating the payment-intangibles classification for a narrow purpose only. The drafters’ intentions are well documented. The Permanent Editorial Board (PEB) recommended revised Article 9 include sales of general intangibles for the payment of money so as to facilitate securitizations.¹¹³ In the same breath, the PEB noted its concern that Article 9 should not regulate loan participations by financial institutions, which already had existing legal structures and smooth market operation.¹¹⁴ Both financial institutions and the drafters

109. Paul M. Schupack, *Making Revised Article 9 Safe for Securitizations: A Brief History*, 73 AM. BANKR. L.J. 167, 176 (1999); see JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 22-5 (4th ed. Supp. 2000) (surmising that banks “argued that [loan participations] were so tightly controlled within a limited number of creditors and debtors that filing was unnecessary”).

110. WHITE & SUMMERS, *supra* note 109, § 22-5; Schupack, *supra* note 109, at 176.

111. U.C.C. § 9-102(a)(2).

112. See *id.* § 9-102(a)(42) (defining “general intangible” as a veritable catchall of various categories).

113. PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, PEB STUDY GROUP UNIFORM COMMERCIAL CODE ARTICLE 9 REPORT 44–48 (1992).

114. See *id.* at 47 (explaining that “the Committee sees little to be gained by applying Article 9 to the sale of loan participations or other loan sales by financial institutions” and “the Article’s filing requirements would be obstructive in the high volume, high velocity loan-participation market”).

recognized, though, that loan participations needed to be included in Article 9 to clarify uncertainty as to whether non-U.C.C. perfection requirements applied to loan participations.¹¹⁵ So, to bring loan participations within the ambit of Article 9 without interrupting the autonomy of the loan-participation market, a proposal was suggested allowing automatic perfection of sales of monetary obligations where a financial institution was on both sides of the transaction.¹¹⁶ Inability to reach a satisfactory definition of financial institution ultimately caused this suggestion to be abandoned.¹¹⁷ Instead, the classification of payment intangibles was added to provide special treatment, including automatic perfection, to loan participations, while the definition of accounts was expanded to cover all other imaginable monetary obligations.¹¹⁸ The intent of the revised Article 9 drafters in creating payment intangibles was not to allow automatic perfection for any monetary obligation that lawyers could argue are not accounts¹¹⁹ but merely to provide an exception to filing requirements for loan participations. Because they do not fit within the limited purpose intended for payment intangibles, lease rental payment streams are properly classified as accounts if they cannot be chattel paper.

A potential contrary position is that assignments of lease rental payment streams bear sufficient similarity to loan participations to earn treatment as such. But, lease rental payment streams cannot be analogized to loan participations as a ploy to sneak them into a payment-intangibles classification. A true loan participation involves a contract between a lead lender and a participant in which the participant advances money to the lead lender and the “participant’s right to repayment only arises when the lead lender is paid.”¹²⁰ Unlike an assignment of lease rental payment streams, “[t]he [loan] participant’s only contractual relationship is with the lender; the participant has no ability to seek legal recourse against the borrower.”¹²¹

115. *See id.* at 44 (explaining that the exclusion of sales of general intangibles from Article 9 resulted in the transactions being governed by unclear non-U.C.C. common law).

116. *See* Schupack, *supra* note 109, at 174–75 (describing this suggestion, as mentioned in the 1995 Report to Members of the Task Force on Securitized Asset Financing).

117. *Id.* at 176.

118. WHITE & SUMMERS, *supra* note 109, § 22-5.

119. Only casual or isolated assignments of accounts automatically perfect. *See* U.C.C. § 9-309(2) (2000) (providing for perfection upon attachment of an assignment of payment intangibles, “which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor’s outstanding . . . payment intangibles”). Lease financing often involves packaging a large number of leases together such that the assignment is no longer casual or isolated. *See supra* note 3 and accompanying text.

120. *In re Autostyle Plastics, Inc.*, 269 F.3d 726, 736–37 (6th Cir. 2001); *see also* 2 MICHAEL T. MADISON ET AL., THE LAW OF REAL ESTATE FINANCING § 11:2 (rev. ed. 2007) (“A loan participation is a shared loan arrangement among two or more institutional lenders whereby one of the lenders, called the lead, parcels out portions of the loan into shares In most cases, the participants have no direct legal relationship with the borrower.”); 9C AM. JUR. 2D *Bankruptcy* § 2549 (2007) (“Participants in loan participation agreements are not generally creditors of borrowers; thus any collections . . . should be made by the party to whom the underlying obligation is owed, namely the lead lender.” (citation omitted)).

121. *In re Autostyle Plastics*, 269 F.3d at 736.

Interestingly, it appears that this loan-participation element—that a participant has no recourse against the borrower—violates the collateral follows right to payment rule because it prevents recourse covenants from transferring with the right to payment. But, the Official Comment to U.C.C. § 9-203(g) resolves the inconsistency. The Official Comment cites the *Restatement (Third) of Property* relating to mortgages,¹²² which allows retention of the mortgage by a transferor when the obligation is bifurcated.¹²³ For example, if the originator of a mortgage assigns a right to a fraction of the mortgage payment stream but retains the unassigned portion of the payment stream, the right to repossess the mortgaged property upon default can remain with the mortgage originator. Similarly, a loan participation bifurcates the right to payment, and thus, the lead lender is justified in retaining any security, including legal recourse. In contrast, in the assignment of lease rental payment streams, the lessor generally assigns the lease rental payments in full, so the covenants enhancing the right to payment must transfer to the assignee.¹²⁴

Finally, as already noted, loan participations, unlike the assignment of lease rental payment streams, exist in a well-defined, autonomous market that is governed by established laws.¹²⁵ These stark differences between the nature of loan participations and the nature of assignments of lease rental payment streams reinforce that lease rental payment streams were not intended to fit within the new payment-intangibles classification, which the revised Article 9 drafters included to facilitate loan participations.

V. The Importance of the Classification: Perfection, Priority, and Protecting Securitization

The categorization issue does not exist in a vacuum; it affects both perfection requirements and priority rights. Classifying lease rental payment streams as payment intangibles gives an assignee or a purchaser of the rental streams an automatically perfected interest.¹²⁶ In contrast, classification as chattel paper requires the filing of a U.C.C.-1 form to perfect.¹²⁷ Classification as an account also requires filing with the exception of “casual or isolated assignments” for “which no one would think of filing.”¹²⁸ The

122. U.C.C. § 9-203 cmt. 9 (citing RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 5.4(a) (1997)).

123. RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 5.4(a).

124. *See supra* notes 68–73 and accompanying text for a discussion of the covenants enhancing the right to payment that transfer to the assignee of lease rental payment streams.

125. *See supra* note 114 and accompanying text.

126. *See supra* note 119.

127. *See* U.C.C. § 9-310(a) (requiring that a financing statement must be filed to perfect all security interests not otherwise exempted from the filing requirement).

128. *Id.* § 9-309 cmt. 4, para. 1. The language of U.C.C. § 9-309(2) provides for perfection upon attachment of an assignment of accounts, “which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor’s outstanding

typical transaction assigning lease rental payment streams involves the sale of the combined rental streams of a large number of pooled leases.¹²⁹ A transaction of such a size is not “casual or isolated” and, thus, would not fit within the accounts exception providing automatic perfection. The primary difference, then, between a payment-intangible classification and a classification as either chattel paper or accounts is that payment intangibles automatically perfect.

The classification of lease rental payment streams as automatically perfecting payment intangibles introduces the problems of ostensible ownership. Because of automatic perfection, the assignee can leave possession of the lease documents with the lessor while also choosing not to file, effectively giving no public notice of its nonpossessory interest in the leases. This situation invites the lessor to double dip, borrowing against or even selling the leases multiple times while third party creditors or purchasers unknowingly obtain an interest subordinate to the first assignee¹³⁰ (with one caveat, discussed below).

Such secret liens have been “universally castigated” as “repugnant to the law” and epitomized as “that rat in Denmark.”¹³¹ Such vehement condemnation is inconsistent with simply handing a pass to the assignee of lease rental payment streams. To the contrary, revised Article 9 limits non-consumer automatic perfection to three specific circumstances: payment intangibles, as representing loan participations or transactions between financial institutions;¹³² promissory notes, which are transferred by delivery;¹³³ and isolated assignments of accounts.¹³⁴ In each of these circumstances, the risk of ostensible ownership is at a minimum—loan participations occur between sophisticated institutions in a self-regulating and defined market; the required delivery of promissory notes leaves a potential double-dipper

accounts.” *Id.* § 9-309(2). But, the Official Comment makes clear that the purpose is not to exclude from filing assignments of large numbers of accounts. *See id.* § 9-309 cmt. 4, para. 1 (“Any person who regularly takes assignment of any debtor’s accounts or payment intangibles should file.”). Thus, classification as an account puts the secured party back in the ambit of U.C.C. § 9-310(a), requiring filing to perfect. *See* U.C.C. § 9-310(a) (requiring that a financing statement must be filed to perfect all security interests not otherwise exempted from the filing requirement).

129. *See, e.g., In re Commercial Money Ctr., Inc.*, 350 B.R. 465, 469 (B.A.P. 9th Cir. 2006) (describing a transaction involving the pooling of rental streams from seventeen leases, for which the purchaser paid \$47 million).

130. *See* U.C.C. § 9-322(a)(1) (providing that the first-perfected security interest takes priority over security interests later perfected).

131. Jonathan C. Lipson, *Secrets and Liens: The End of Notice in Commercial Finance Law*, 21 EMORY BANKR. DEV. J. 421, 425 (2005).

132. *See supra* notes 113–19 and accompanying text.

133. *See* U.C.C. § 9-102(a)(47) (defining “instrument” as a negotiable instrument of a type that is transferred by delivery in the ordinary course of business with any necessary indorsement or assignment); *id.* § 9-309(4) (providing for perfection upon attachment of a sale of a promissory note). Transfer by delivery reduces the opportunity for ostensible ownership because the potential double-dipping assignor is without possession—and thus without the ability to double dip.

134. *See supra* note 128 and accompanying text.

without possession with which to feign ownership; and the casual nature of isolated assignments of accounts puts potential lenders on notice (with an additional warning from the Official Comment to U.C.C. § 9-309 that “[a]ny person who regularly takes assignments of any debtor’s accounts or payment intangibles should file”¹³⁵).

A large securitization of lease rental payment streams is not comparable to any of these narrow automatic-perfection situations, and the transactions in no way limit the risk of ostensible ownership. The upshot, then, of extending automatic perfection to the assignment of lease rental payment streams is consenting to the risks of ostensible ownership, allowing the assignor to keep possession of the lease documents while the assignee chooses not to file, resulting in no public notice. Thus, classifying lease rental payment streams as payment intangibles is inconsistent with revised Article 9’s policy of avoiding secret interests.¹³⁶

Even so, the securitization industry is heralding the *Commercial Money Center* ruling as a victory.¹³⁷ The securitization market, which allows the originators of loans and leases to pool original loans into new marketable securities, is a burgeoning segment of the debt market, issuing over \$479.4 billion of asset-backed securities in 2003.¹³⁸ Commentators sympathetic to industry participants have lamented that revised Article 9’s perfection requirements would function as an insuperable barrier, chilling the growing lease rental payment stream segment of the securitization market.¹³⁹ These concerns may be justified *if* Article 9 perfection required the assignee to take possession of the leases. Possession conceivably introduces (moderate) difficulties because a transaction securitizing lease rental payment streams can involve cabinets full of lease documents, multiple purchasers, and many additional parties, including financial intermediaries and sureties. But, because of revised Article 9’s ease of filing as a means of perfection, making possession optional, these concerns are unfounded. Moreover, revised Article 9 allows for “supergeneric” notice filing¹⁴⁰ and does not require the signature of the debtor on the financing statement,¹⁴¹ meaning classification as chattel paper merely requires a purchaser of lease rental payment streams

135. U.C.C. § 9-309 cmt. 4, para. 1.

136. Professor Schwarcz, in discussing *Commercial Money Center*, considers solving the secret-lien problem by eliminating the automatic perfection of payment intangibles. See Steven L. Schwarcz, 68 OHIO ST. L.J. 273, 278, 277–78 (2007) (suggesting that elimination of the automatic-perfection rule would solve myriad problems if replaced by the U.C.C.’s “perfection-by-filing rule”). This solution, however, undoes the drafters’ intentions in creating the classification for loan participations. See *supra* Part IV (discussing this intent).

137. See Schechter, *supra* note 5, at 70 (weighing the benefits and downsides of the decision).

138. BOND MKT. ASS’N, *supra* note 3, at 2.

139. *Id.*

140. See U.C.C. § 9-504 (providing that a financing statement only needs to contain a description of the collateral or an indication that it covers all assets).

141. See *id.* § 9-502(a)(1)–(3) (listing the requirements of a sufficient financing statement).

to endure a painless, inexpensive filing in the secretary of state's office¹⁴²—a marginal expense in a large transaction.

One caveat, however: while filing suffices to perfect an interest in lease rental payment streams, a subsequent ordinary-course purchaser of chattel paper may take priority even over a filing assignee's perfected interest in lease rental payment streams.¹⁴³ If perfection is by filing (or automatic perfection) and not by taking possession of the lease papers, an ordinary-course purchaser of the leases can take priority over an assignee of lease rental payment streams by meeting the requirements of U.C.C. § 9-330(b).¹⁴⁴ One of these requirements—that the purchaser take “without knowledge that the purchase violates the rights of the secured party”¹⁴⁵—does not require the purchaser to search filings.¹⁴⁶ Moreover, even if a search is undertaken, unless the purchaser actually “sees” a statement alerting the purchaser of the secured party's rights, the purchaser remains “without knowledge.”¹⁴⁷ This specific and counterintuitive statutory standard precludes commonly recognized notions of constructive notice in U.C.C. § 9-330(b) situations.

This “ignorance is bliss” standard for ordinary-course purchasers of chattel paper encourages secured parties to perfect by possession rather than by filing (or automatic perfection).¹⁴⁸ U.C.C. § 9-330(b) offers a clear example of how revised Article 9 discriminates amongst perfection methods, giving differing treatment to interests based on method of perfection. As demonstrated by U.C.C. § 9-330(b), revised Article 9 reveres possession as the ultimate perfection method. Other provisions in Article 9 show that perfection by filing holds a slightly less preferred position, and automatic perfection is at the least preferred end of the spectrum.¹⁴⁹

While U.C.C. § 9-330(b) is interesting because it evidences Article 9's perfection-method favoritism, it does not add to a policy argument for classifying lease rental payment streams as chattel paper over payment intangibles. The U.C.C. § 9-330(b) priority issue encouraging possession over filing

142. *Id.* § 9-501(b).

143. *Id.* § 9-330(b).

144. The requirements include that the purchaser must be in the ordinary course, give new value, take possession, and take without knowledge that the purchase violates the rights of the secured party. *Id.*

145. *Id.*

146. *Id.* § 9-330 cmt. 6, para. 2.

147. *Id.*

148. An alternative to possession under U.C.C. § 9-330(b) would be to impose knowledge on a subsequent purchaser by legending the lease documents. *See* Schechter, *supra* note 5, at 70. But, in a complex securitization of a large pool of lease rental payment streams, legending the large volume of documents may present a difficult task. *Id.*

149. Permissive filing for purchase-money security interests in consumer goods is an example of revised Article 9 giving preferential treatment to filed security interests over automatically perfected security interests. *See id.* § 9-320(b)(4) (protecting a filed security interest in consumer goods from a subsequent purchaser, whereas a consumer buyer takes free of an automatically perfected interest in the goods).

arises whether lease rental payment streams are classified as chattel paper or as payment intangibles. An accounts classification, on the other hand, offers a filing assignee the safeguard of requiring a subsequent ordinary-course purchaser to have undertaken a search in order to gain priority.¹⁵⁰ Accordingly, if policy interests favor protecting a filing financier over a subsequent purchaser, then an accounts classification is advisable for lease rental payment streams. If, however, a policy encouraging possession of the lease documents is desired, then a chattel-paper classification is the better option. Analyzing the policy interests governing filing versus possession as perfection methods is outside the scope of this Note, but it is clear that both options (accounts or chattel paper) offer policy benefits. In contrast, the classification of automatically perfecting payment intangibles serves no useful policy function for assigned lease rental payment streams—only creating nefarious ostensible-ownership issues—and therefore policy counsels that the payment intangibles classification should be avoided for these transactions.

VI. Conclusion

The *Commercial Money Center* case impacts the growing securitization market, simplifying the perfection process for securitizations of lease rental payment streams. But, by classifying lease rental payment streams as payment intangibles, thereby allowing automatic perfection, the opinion consents to the problems of ostensible ownership in the market for lease rental payments. Classification of lease rental payment streams as either chattel paper or accounts requires possession or filing to perfect, both of which provide public notice, thus eliminating secret-lien interests and conforming to a principal policy goal of Article 9.

Classification as chattel paper is possible by arguing that lease rental payment streams are locked up with the lease rights that support payment. These rights, including the right to repossess and re-lease the underlying goods, effectively operate as a security interest. When this secured interest is combined with the monetary obligation of the lease rental payments and the existence of lease documents, the elements of chattel paper are met.

If classifying lease rental payment streams as chattel paper poses too big a step, classification of the payment streams as accounts is preferable over classification as payment intangibles. An accounts classification is supported by the intent of the Article 9 drafters in expanding the definition of accounts while adding the classification of payment intangibles for the limited purpose of bringing loan participations and related transactions between financial institutions within Article 9. Lease rental payments meet all the definitional elements of accounts, potentially disqualified only by the definition's exclusion of "rights to payment evidenced by chattel paper."¹⁵¹ But, if a court

150. *Id.* § 9-331 cmt. 5, paras. 1–2.

151. *Id.* § 9-102(a)(2).

decides lease rental payment streams are not chattel paper, then the disqualifying attribute disappears and the payment streams are properly classified as accounts.

Both the accounts and chattel-paper categories present viable options for the classification of lease rental payment streams. Both options offer significant policy improvements over the *Commercial Money Center* court's classification choice of payment intangibles. Because of the growing securitization industry, future courts, likely in true-sale states, will be forced to address, and hopefully correct, this classification issue.

—Anthony N. Kaim