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Commercial Money Center, Inc. v. NetBank, FSB

2005 WL 1365055; 56 UCC Rep. Serv.2d 54

(Bankr. S.D. Cal. Jan. 27, 2005)

This action arose in bankruptcy court to determine the legal status of payment streams due under commercial equipment leases. A Chapter 7 bankruptcy debtor named Commercial Money Center, Inc. (öCMCö) originated equipment leases with sub-prime end users. CMC then obtained surety bonds guaranteeing the lease payments and assigned the insured payment streams due under the leases to third party "investors." NetBank was a third party investor who paid \$47 million to obtain certain rights associated with these "lease pools," namely, the right to receive the lease payments due under the leases. The documentation between NetBank and CMC was labeled as a Sale and Servicing Agreement.

NetBank did not take possession of the underlying leases or file a UCC Financing Statement to öperfectö its interest in the associated lease pools. The Trustee challenged NetBank's interest, arguing that NetBank's interest in the lease pools constituted an interest in Chattel Paper and that NetBank was therefore required to perfect its interest by either taking possession of the underlying leases or filing a Financing Statement. Since Article 9 of the Uniform Commercial Code (the öUCCö) requires perfection regardless of whether Chattel Paper is sold outright or assigned as security, NetBank could not afford to have the lease pools considered to be öChattel Paperö by the court. *See* UCC §9-109



and comments (noting that Article 9 covers *a security interest in chattel paper as well as the sale of chattel paper*); see also UCC §9-102(71)(D)(defining "Secured Party" to include a person to whom chattel paper has been sold).

Since Article 9 of the UCC does not impose the same restrictions with respect to the sale of "Payment Intangibles" under Article 9 as special type of general intangible where the obligor's principal obligation is a monetary obligation, NetBank argued that the lease pools constituted payment intangibles and that the Sale and Servicing Agreement accomplished an outright sale of such payment intangibles.

The bankruptcy court analyzed the applicable UCC provisions and other relevant sources of authority to determine whether the lease pools should be considered chattel paper or "payment intangibles under the UCC and whether the payment streams assigned to NetBank constituted a true sale or a loan. Resolution of these issues would determine whether CMC's bankruptcy trustee could use his strong arm powers pursuant to 11 U.S.C. § 544 to avoid any monetary obligations incurred by CMC.

NetBank and CMC both agreed that the underlying equipment leases constituted chattel paper under the UCC since that term is defined as "a record or records which evidence both a monetary obligation and a security interest in . . . or a lease of specific goods. . . ." See UCC §9-102(11). However, NetBank claimed that the monetary obligations that were actually assigned to it by CMC should still be considered payment intangibles under the UCC. The trustee argued conversely that the payment streams still constitute chattel paper since they arise from chattel paper (the underlying equipment leases).

The United States Bankruptcy Court, Southern District of California, agreed with the trustee's position and found that the lease payment streams were considered chattel paper under the UCC. The Court noted that the definition of payment intangibles clearly excluded chattel paper. As such, if the payment streams fell within the definition of



chattel paper, they could not be considered payment intangibles. The Court then noted that the definition of chattel paper included three elements: (1) the presence of a record or writing; (2) evidence of a monetary obligation; and (3) a security interest in or lease of specific goods. According to the Court, characterizing the monetary obligation as a payment intangible "would essentially delete the monetary obligation requirement from the definition." As such, the Court held that the payment streams constituted chattel paper.

The Court further supported its holding by analyzing the Official Commentary in the UCC (which is persuasive, although not binding, authority) as well as experts in the industry who have analyzed this issue in treatises and law review articles.

The Court's conclusion that the payment stream constituted chattel paper rendered moot the issue of whether or not the Sale and Servicing Agreement affected a sale of the payment stream or merely evidenced a loan secured by the payment stream. The lack of relevance stems from the fact that, either way, NetBank was required to perfect. Nonetheless, the Court provided some analysis of the outright sale versus loan issue as well.

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