

# MARKS & WEINBERG, P.C.

## DISPATCHES FROM THE TRENCHES

### An Update on the "Payment Intangibles" Holding of *In re Commercial Money Center*; and More (bad) Case Law regarding a Lessor's rights as an Additional Insured

This edition of *Dispatches from the Trenches*: (1) provides an update regarding the holding of *In re Commercial Money Center* regarding payment intangibles; and (2) analyzes a recent case that may make you question your reliance on certain certificates of insurance.

*In re Commercial Money Center, Inc.*, 350 B.R. 465 (B.A.P. 9<sup>TH</sup> CIR. 2006).

Proposed revisions to Article 9 of the Uniform Commercial Code (the "UCC") attempt to counteract the holding of *In re Commercial Money Center*. In that case, Net Bank, an assignee of an equipment lease transaction originated by Commercial Money Center ("CMC"), had failed to perfect its interest in the assigned leases by either taking possession of the original counterparts of the leases or by filing a financing statement against CMC, as debtor.

On appeal, Net Bank argued that the rent stream due under the assigned leases could be "stripped" from the lease itself and that, once detached from the lease, the payment stream constituted a "payment intangible" under the UCC. Net Bank pursued this argument because §9-309 of the UCC provides that an outright sale of payment intangibles is automatically perfected without any additional action by the assignee.

The Court found that the transaction between Net Bank and CMC constituted a loan and not an outright sale of the rental stream. As such, the automatic perfection provided by §9-309 was inapplicable. Nonetheless, the Court stated that a party could "strip" chattel paper into two obligations (a payment stream and a property interest in the goods itself) and sell just the payment stream. This conclusion, which is likely dicta given the court's holding that §9-309 did not apply, created outrage and concern within the syndication and origination industry. If the holding in the case were allowed to stand, assignees of leases could find their interest trumped by a secret lien afforded to an outright assignee of payment intangibles. There would be no public UCC filing or other evidence of such secret assignee's rights.

The Uniform Law Commissioners (formerly known as the National Conference of Commissioners on Uniform State Laws, or NCCUSL) intends to expressly address this

issue in its proposed Amendments to Article 9 of the UCC. After several committee meetings and much discussion, the proposed resolution is to add some language to the Official Comments to the definition of a "payment intangible" contained in §9-102. *See*, Official Comment 5D. The focus of the original commentary to that Section is to distinguish general intangibles from payment intangibles, stating:

In classifying intangible collateral, a Court should begin by identifying the particular rights that have been assigned. The account debtor (promisor) under a particular contract may owe several types of monetary obligations as well as other, non-monetary obligations. If the promisee's right to payment of money is assigned separately, the right is an account or payment intangible, depending on how the account debtor's obligation arose. When all the promisee's rights are assigned together, an account, a payment intangible, and a general intangible all may be involved, depending on the nature of the rights.

That section also discusses how a right to the payment of money may be buttressed by ancillary covenants, stating:

A right to the payment of money is frequently buttressed by ancillary covenants, such as covenants in a purchase agreement, note, or mortgage requiring insurance on the collateral or forbidding removal of the collateral, or covenants to preserve the creditworthiness of the promisor, such as covenants restricting dividends and the like. This article does not treat these ancillary rights separately from the rights to payment to which they relate. For example, attachment and perfection of an assignment of a right to payment of a monetary obligation, whether it be an account or payment intangible, also carries these ancillary rights. *Id.*

The Uniform Law Commissioners intends to add the following language:

Among these ancillary rights are the lessor's rights with respect to leased goods that arise upon the lessee's default. *See* § 2A-523. Accordingly, and contrary to the opinion in *In Re Commercial Money Center, Inc.*, 350 B.R. 465 (B.A.P. 9<sup>th</sup> Cir. 2006), if the lessor's rights under a lease constitute chattel paper, an assignment of the lessor's right to payment under the lease also would be chattel paper, even if the assignment excludes those ancillary rights.

Whether or not this new language fully resolves the potential backlash of the CMC case remains to be seen. It is worth noting that the new commentary specifically references only a lessor's rights under an Article 2A "true lease" but not a lessor's rights under a lease intended as security governed by Article 9. There is arguably no business reason to "strip" rent payments from the other rights under a lease intended as security since there is no meaningful residual upside or risk in such transactions. However, there is no technical reason why a form of assignment document could not be drafted in a manner which purports to do so. It remains to be seen how a court would apply the new commentary to payment rights which have been "stripped" from an Article 9- lease

intended as security. In any event, the revisions are helpful to avoid and contradict the explicit holding of the CMC case.

Columbia River Rentals, LLC, Ronald Gary Phillips, Safeco Insurance Company of America, et al., 2009 US Dist. LEXIS 24789 (January 14, 2009)

As has previously been written about on many occasions, verifying that a proper insurance policy is in place and adequately protects a lessor's interest is often difficult and time consuming, particularly for smaller transactions. Consider, for example, standard disclaimers that are contained on a "Certificate of Property Insurance" which state that:

This Certificate is issued as a matter of information only and confers *no rights* upon the Certificate holder. This Certificate does not amend, extend or alter the coverage afforded by the policies below.

Similarly offensive language is contained on a "Certificate of Liability Insurance" as well.

Although a better "Evidence of Property Insurance" certificate is available for physical damage, better form Certificates are generally not available for proof of liability insurance. This is one reason that many lessors of potentially dangerous equipment purchase an umbrella policy or other form of liability insurance which covers them directly instead of relying only on policies provided by their lessees.

Another reason, as evidence by the recent Columbia River Rentals case, is that the underlying policy covering the Lessee may have exceptions or other language which prevents the lessor from having coverage even if properly added as an additional insured.

In that case, a lessee named Penny Creek Quarry ("Lessee") leased a Terex Off-Highway Dump Truck with an option to purchase the vehicle from Columbia River Rentals, LLC ("Lessor"). The lease required Lessee to provide liability insurance which listed Lessor as an additional insured.

The evidence of liability insurance provided by Lessee stated that Lessor was an additional insurer on the liability policy to the extent required by written contract. However, the insurance company issuing the policy refused to defend and indemnify Lessor when the truck's brakes failed and it injured the Lessee's owner, Gary Phillips, and its employee, Leann Berkom. Both Phillips and Berkom sued Lessor alleging that its negligence caused the accident resulting in injuries. In order to determine whether the insurance company rightfully denied coverage to Lessor, the Court analyzed the language of the insurance policy/contract. The policy itself only covered obligations which the insured (Lessee) was legally obligated to pay, stating:

[The insurance company] will pay those sums that the insured becomes *legally obligated* to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. [The insurance company] will have the right and duty to defend the insured against any

ōsuitō seeking those damages. However, [the insurance company] will have no duty to defend the insured against any ōsuitō seeking damages for ōbodily injuryö or ōproperty damageö to which this insurance does not apply . . . .

An endorsement to the policy provided coverage to Lessor and any other party for whom the named insured was required in writing to provide insurance but was also expressly subject to the provisions, terms and exclusions and conditions of the policy, stating:

The person or organization added as an insured by this endorsement is insured *only to the extent [Lessee is] held liable* due to . . . . the maintenance, operation or use *by [Lessee]* of equipment leased to [Lessee] by such person or organization [provided that, among other things t]his insurance does not apply to ōbodily injuryö or ōproperty damageö arising out the sole negligence of such person or organization . . . .

Analyzing these provisions, the Court found that Lessor satisfied the first part of the test to be an insured under the policy since it was a person or organization for whom Lessee was required by written contract to provide insurance. However, the Court found against Lessor for the reasons described below.

The Court did not distinguish between Lessee and its owner, Phillips, and it is possible that Penny Creek Quarry is a sole proprietorship making them one and the same. In any event, the insurance company argued that because Phillips could not be liable to himself or his employee for use of the leased equipment, Lessor was not an insured under the policy for purposes of the accident in question. It also argued that Lessor was not an insured under the policy because the allegation from injured parties was that Lessor's sole negligence caused the injuries. Since the Court agrees with the first argument (that since Phillips is not liable for his own injury or the injury of his employees, Lessor cannot be an insured) it does not address the second argument about the sole negligence of Lessor.

The Court acknowledges that the term ōliableö is not defined in the insurance policy and holds that it must be given its plain, ordinary and popular meaning. Referring to dictionaries, the Court determines that the term ōliableö means ōto have a legal obligation.ö The Court further notes that the potential contributory negligence of Phillips would not render him ōliableö for his own damages but would merely constitute a defense to his claim against Lessor. Lastly, the Court summarily concludes that Lessee's indemnity obligations under the lease create only a contractual liability but not the type of ōliabilityö required by the insurance policy. The Court's theory is that the policy only covers sums the insured becomes legally obligated to pay as damages because of bodily injury or property damage but not contractual obligations.

Lessor faces a similar problem with respect to the claim by Berkom since state law grants employers immunity from law suits arising in their workplace in exchange for giving employees no-fault recovery for such insurance for such injuries. This type of Worker's Compensation Insurance protection is frequent.

At the end of the day, the Court found for the insurance company, holding that it owes no obligation to Lessor with respect to the current claims even though Lessor was an additional insured on the liability policy. The protection afforded to Lessor as an additional insured is only in accordance with the policy terms. The policy provides that the insurance is only available to the extent that Lessee is liable for the damages. Lessee could not be liable to itself for injuries caused and also cannot be liable to its employees for injuries cause to them during the scope of their employment due to no-fault (Workers Compensation) insurance laws.

This case serves as a lesson to Lessors receiving Certificates of Liability Insurance that the policy terms and conditions can have a drastic affect on coverage (or the lack thereof).

Kenneth P. Weinberg is a founding partner of Marks & Weinberg, PC. He and co-founder, Barry Marks, have significant experience in dealing with virtually every type of equipment and facility lease financing, have participated in leasing financings for more than a billion dollars of equipment and are recognized throughout the industry. Weinberg has written *Dispatches from the Trenches* since 2002, routinely writes articles in a variety of equipment leasing and financing journals, and has participated in numerous seminars on equipment leasing issues. If you would like more cases or articles on leasing, or have any questions or comments about this column or other leasing issues, please visit [www.leaselawyer.com](http://www.leaselawyer.com) or contact Weinberg at 205-251-8307.



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