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## Mysteries Of The Uniform Commercial Code: Leases Of Goods That Become Installed In, Affixed To, Or Mixed With Other Goods

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The relative priorities in leased goods of a lessor vis-à-vis other lessors and secured creditors impacts the amount that the lessor will recover from an insolvent lessee. Where the leased goods are to become installed in, affixed to, or mixed with other goods, it is not always possible for the lessor to obtain complete protection from the claims of others in those goods.

Uniform Commercial Code Article 2A governs leases of goods. Broadly speaking, anything movable is a “good” and can be leased. Many leases are straightforward, for example, the lease of a discrete piece of manufacturing equipment. There may be detailed financial, default, and other provisions in such a lease, but there is one easily identified machine. Things become a bit more complicated where leased goods become installed in, affixed to, or mixed with other goods. In these situations, analysis of the competing interests of other lessors and/or secured creditors may be important. The UCC provides guidance on this subject, but only up to a point.

Goods installed in or affixed to other goods are called “accessions.” The rights of lessors, lessees, and their respective creditors in accessions are governed by UCC Section 2A-310. With limited exception, as long as the lessor’s and lessee’s interests in the goods are identified to the lease

contract before the goods become accessions, the interests of the lessor and lessee are superior to all interests in the whole. Goods are deemed identified to a lease contract when the lease is made, if the goods are in existence at that time. Otherwise, identification occurs when the goods are shipped or designated by the lessor as being subject to the lease. UCC Section 2A-217. For example, a bulk mail printing company enters into a lease contract for an insert to be used to produce certain types of mailers. The insert is installed by the lessee printing company in a printing press and may be considered an accession under the literal language of the Code. As long as the lease contract is in effect as to the insert before it is shipped to the printing company, the interests of the leasing company and those of the printing company in the insert will be superior to those of the lender that financed the printing company’s acquisition of the printing press itself.

There are two principal exceptions to this rule of priority. First, the interests of the lessor and the lessee in the leased accession will be subordinate to the interests of buyers and lessees of the whole in the ordinary course of business. In this example, the printing company is not in the business of selling printing presses, so it is unlikely that the ordinary course exception will apply. Second, the interests of the lessor and the lessee under the lease will be subordinate to those of holders of pre-existing perfected security interests in the whole who make subsequent advances without knowledge of the lease contract. In the printing insert



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example, this exception presents a risk for the insert lessor, unless that lessor notifies the lessee’s lender of the lease before the lender makes additional advances to the lessee. If a lender with a lien on the printing press provides additional financing secured by the press before learning of the lease, the lessor’s interests will be subordinate to those of the lender.

Sometimes leased goods are mixed with identical or equivalent goods. Not surprisingly, the UCC calls such goods “fungible” goods. Read literally, the UCC permits fungible goods to be the subject of a lease, as the definition of “goods” in the statute is broad, including nearly “all things that are movable at the time of identification to the lease contract.” UCC Section 2A:103(h). A simple example of fungible goods in the leasing context is a lease of ball bearings. Questions would arise if the lessee has multiple ball bearing suppliers, and the ball bearings provided under the subject lease are mixed by the lessee with other ball bearings that are leased from others. Because the leased ball bearings are indistinguishable from those from other lessors, they are considered fungible. By analogy to the law of bailments, the lessee’s obligation at the termination of each lease logically would be to return to each lessor the same quantity of ball bearings as were provided under the lease with that lessor. However, if some of the ball bearings become lost or damaged, there may not be enough good ball bearings to satisfy the claims of every ball bearing lessor. Do the lessors share proportionally in the available ball bearings or does the outcome depend upon the timing of the leases, i.e., do earlier lessors have priority over subsequent lessors? Does the relative price for the bearings under the various leases matter? What if some of the ball bearings are the subject of security interests?

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Although Article 2A makes specific provision for the priority of interests in leased goods that become accessions, it does not include a specific provision addressing priorities in the case of leased fungible goods. Moreover, the general priority rule set forth in UCC Section 2A-307 does not provide guidance on the question of multiple lessors of fungible goods. Under that general rule, a creditor of a lessee takes subject to the lease contract, and, if the creditor holds a properly perfected lien on the assets of the lessee, the lien will attach only to the les-

rights of the multiple ball bearing lessors. For example, does it matter at what point in time a lessor provided ball bearings in relation to when other lessors did so? If the timing is widely disparate, some of the ball bearings may already be worn when the latter group of bearings is provided to the lessee. Moreover, by that point, the earlier lessors may have already realized significant economic benefit from having leased the bearings.

Leases of precious metals used as catalysts often present these issues. Plati-

a great deal. If the lessee is solvent and paying its bills, these issues are likely to be academic, as priority issues most often arise where the lessee is faced with insolvency or files a petition in bankruptcy or a general assignment for the benefit of creditors. Under those circumstances, the relative priorities in goods subject to leases and security interests will impact how much each lessor or secured creditor ultimately will receive. Those lessors and secured creditors unable to recover possession of all of their leased goods or their collateral or the value thereof will end up as unsecured creditors, in all likelihood receiving at most a portion of the value of the goods they leased or against which they loaned.

Accordingly, lessors of goods that may become installed in, affixed to, or commingled with other goods should take steps to limit priority uncertainty. Among other things, where the leased goods are likely to become accessions: (i) the lessor should make sure the lease contract is effective as to the goods before they are shipped to the lessee; (ii) the lessor should include language in the lease contract to prohibit the attachment of the leased goods to other goods, except as expressly otherwise agreed or consented to by the lessor; (iii) the lessor should, where feasible, require the lessee to mark the goods as leased from the lessor; and (iv) the lessor should provide notification to any secured creditors with liens on the goods in which the leased goods will be installed or to which the leased goods will be attached. Where the goods are fungible, the lessor may want lease language by which the lessee covenants that during the term of the lease, it will not enter into lease or financing arrangements with other suppliers for similar goods. Whether or not the leased goods are fungible, if commingling is inevitable, the lessor should seek agreement in advance with the lessee's other lessors and secured creditors specifying their relative priorities in the commingled mass.

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see's leasehold interest in the leased goods. In effect, the creditor will be subordinate to the lessor. However, this does not answer the fungible goods question raised by the ball bearing example.

Accordingly, the extent to which a lessor will be entitled to the return of ball bearings after they have been mixed with other ball bearings is uncertain. A lessor could argue by analogy that the outcome should be similar to the treatment under UCC Section 9-336(f) of the priorities of multiple security interests in commingled goods. Under that provision, security interests in goods that become commingled rank equally in proportion to their original value. In the ball bearing example, this analogy would give back to each lessor the same portion of the remaining ball bearings that lessor's bearings contributed to the initial total number of the bearings, assuming an equal per unit value. However, there are other factors that may impact the relative

num, palladium, and rhodium are among the metals used for catalysis in certain chemical syntheses and processes. Some catalysts, called "heterogeneous" catalysts, are insoluble in the reactant and are easily separated from the product for post-processing recovery and recycling. Other catalysts, known as "homogeneous," are soluble in the reaction mixtures, and recovery is more difficult. Depending on the process in which they are used, heterogeneous catalysts often become accessions or commingled goods, while homogeneous catalysts are by their very nature commingled in use. Determining the relative priorities in the commingled mass of catalyst lessors and secured creditors can be challenging and uncertain.

Does any of this really matter given that a lessor who is unable to recover all of the leased goods likely will be entitled to recover the value of the goods from the lessee? The answer is that it may matter