Equipment Leases Under the U.C.C. Article 2A—Analysis and Practice Suggestions

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THE SUBSTANTIVE RESULTS

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I. BACKGROUND AND SCOPE

The Uniform Commercial Code ("U.C.C.") now has an article that directly covers equipment leases—Article 2A—although many states have not enacted it yet. Article 2A's scope extends to leases of "goods" (e.g.,

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equipment and vehicle leases, but not leases of real estate, intangibles, or other nongoods).  

Article 2A compiles and codifies the best of the common law of leases, and reduces the uncertainty created by inconsistent decisions under pre-2A law. Pre-2A leasing law was hampered by uncertainties in the following areas in particular: (1) definitional (distinguishing a lease from a secured sale or loan), (2) applicability of U.C.C. Article 2 (e.g., implied warranties, parol evidence, unconscionability), and (3) nonbankruptcy enforcement and remedies. Article 2A and the related amendment to U.C.C. section 1-201(37), which address these uncertainties and others, were approved by the American Law Institute in May 1987. They have since been adopted in about twenty states, and have been proposed in about half the other state legislatures. Considering that an estimated thirty percent of capital equipment in the United States is acquired through leasing, it is surprising that this aspect of commercial finance had not previously been covered in the U.C.C.

California and some of the other states that have adopted Article 2A modified the 1987 Official Text when they adopted it. In response to those changes, the Standby Committee of the National Conference of Commissioners on Uniform State Laws for Article 2A proposed amendments to the 1987 Official Text that the American Law Institute approved. Those changes were incorporated into the Official Text in December 1990. All references in this article are to the 1990 Official Text unless otherwise specified. Of course, the changed text will become effective only to the extent it is adopted by the states.

This article analyzes the "competing" versions of Article 2A, and suggests how practitioners in Article 2A jurisdictions should change their forms and procedures from their pre-2A practices. The discussion in this article applies only to commercial (nonconsumer) leases.

II. COMPARISON WITH ARTICLE 2

As its name implies, Article 2A is based on U.C.C. Article 2, and it follows Article 2 except where differences are dictated by fundamental differences between sales and leases, and except in a few instances where the drafting committee thought that changes were necessary because of

2. Article 2A's original impetus was Charles W. Mooney Jr.'s article in 36 Bus. LAW. 1605 (July 1981) entitled Personal Property Leasing: A Challenge, which on pages 1610-20 identified the uncertainties referred to in the text.
3. Approval previously was obtained from the Permanent Editorial Board for the Uniform Commercial Code and from the National Conference of Commissioners on Uniform State Laws.
flagrant deficiencies in Article 2. As with Article 2 and the rest of the
U.C.C., freedom of contract prevails and most of the provisions of Article
2A can be “drafted out” of an agreement, so with a few exceptions Article
2A serves mainly to fill gaps that the parties did not expressly cover.
As with Article 2, this fact is more important to the practitioner than the
text of the U.C.C. itself.

In addition to the more significant differences discussed below, Article
2A differs from Article 2 in the commercial (nonconsumer) area by (1)
omitting Article 2’s “battle of the forms” provision; (2) increasing the
lessor’s potential damages after justifiable nondelivery in commercial
leases; (3) modifying the statute of frauds provision so that a merchant
lesser/lessee does not lose the statute of frauds defense by failing to ob-
ject to the other party’s letter or memo; (4) eliminating any implied war-
ranty of merchantability or fitness, or against infringement, in finance
leases; (5) changing the starting point for the statute of limitations
to the time of discovery or default, whichever is later.

III. DEFINITION OF TRUE LEASE

Without guidance from Article 2A and revised section 1-201(37), courts
have relied on numerous subjective, extraneous, and contradictory criteria
to determine whether a purported lease should be recognized as a true
lease or recharacterized as a security interest (i.e., secured loan or secured
installment sale). For example, in finding a “lease” to be an unperfected
“security interest”, many courts have ignored inherent economic indicia
such as the property’s estimated useful life at lease-end and instead have
given weight to external indicia showing that the transaction “looked”
like a secured sale; for example, that the lessor was not in the leasing
business, that a full-payout lease was involved, or even that a third-party
 guarantees were obtained. To understand why those criteria are mislead-
ing, assume that First National Leasing leases to Big Corporation, and
that the transaction’s inherent economic and legal attributes make it a
“true lease”. An identical transaction should remain a lease even if the
lesser is my grandmother, or if the rent is higher, or if the lessee is my

5. U.C.C. § 2-207 (1962).
10. See, e.g., Guardsman Lease Plan, Inc. v. Gibraltar Transmission Corp., 494 N.Y.S.2d
59 (Sup. Ct. 1985); In re Mesa Refining, Inc., 52 B.R. 359 (Bankr. D. Colo. 1985); Citizens &
S.E.2d 243 (1978).
grandmother but Big Corporation guarantees the lease. None of those "factors" provides any substantive reason to transform a lease into a loan, or a sale, or anything else.

The test should be one of commercial reality. A long-term net lease is economically similar to a secured installment sale, and "rent" similar to principal plus interest, if the "lessee" will use and maintain the property for all or most of its useful life or if the present value of the "lessor's" end-of-term reversion is relatively insignificant. For example, a ten-year lease of a car or a high-tech computer generally is functionally equivalent to a sale or loan, because the asset's physical depreciation or technological obsolescence during the lease term probably will leave almost no value or useful life at the end of the lease term. The U.C.C. values reality over formalities, so it should treat that transaction as a sale or loan despite its being labeled "Lease".

If a "lease" is recharacterized as a secured loan or installment sale, the possible consequences include: (1) the "ownership" interest becomes an unperfected or subordinate security interest upon bankruptcy of the "lessee", (2) the equipment may be sold in a bankruptcy proceeding free of any interest of the "lessor", even if the "lease" was terminated before the bankruptcy filing, (3) the remedies are limited due to the application of Article 9, (4) the lessor is subject to warranty liability, ineffectiveness of liability disclaimers, and variance in acceptance and revocation standards because of U.C.C. Article 2, and (5) the lessor becomes unexpectedly subject to laws as to usury, strict tort liability, consumer protection; sales and use taxes, and property taxes.

Under pre-2A law, the "true lease" issue generally becomes a question of whether the lease is one "intended as security" within the limited guidelines supplied by the section 1-201(37) definition of "security interest". An amended definition of "security interest" is included with Article 2A, and as amended the definition provides considerably more guidance in determining whether or not a "lease" should be recharacterized. The new definition enumerates various tests to determine whether, in economic reality, the lessor has retained any meaningful residual interest: the "lease" is a security interest if the lessor did not.11 The new definition also states that a lease is not a security interest merely because it is a full-payout lease or a net lease, or because the lessee has renewal or purchase options or nonbargain fixed-price renewal or purchase options. Note that these standards focus on the transaction's economics, not on the parties' "intent" (except to the extent that their intent is reflected in the transaction's economics). Furthermore, the definition of "lease" in

section 2A-103(1)(j) makes clear that a sale or security interest cannot also be a "lease" for Article 2A purposes.

Many automobile leases contain a terminal rental adjustment clause ("TRAC") requiring that, at the end of the lease term, the "lessee" pay the "lessor" for any shortfall in the resale price below the stipulated residual value, and perhaps vice versa if there is any excess. For example, a five-year TRAC lease of a $15,000 car might stipulate a $6,000 assumed residual value, independent of charges for "excess mileage". Assume that the lessee returns the car, without excess mileage, when the five-year term expires, and that the lessor then sells the car for $5,000. The lessee then will owe a $1,000 "terminal rental adjustment" payment to the lessor. The common law and section 1-201(37) almost invariably would consider TRAC leases to be security interests, because the "lessor" has no residual risk and perhaps no residual upside. Some states that have adopted Article 2A also enacted companion legislation that permits a TRAC "lease" of a motor vehicle to qualify as a true lease. This author believes that those TRAC lease amendments should be rejected.

Revised section 1-201(37) is not a provision that the parties can draft around or vary by agreement. The economic facts and circumstances of the transaction control. Typically, however, a cautious lawyer will recommend that economic conclusions be supported by a contemporaneous independent appraisal (at least in larger transactions) and will file a precautionary UCC-1 financing statement under section 9-408.

IV. WARRANTY LIABILITY OF LESSORS; TREATMENT OF "FINANCE LESSORS"

Without Article 2A, courts and practitioners would continue to try to resolve questions of express and implied warranties, and exclusion of warranties, by applying the law of bailment (which is ill-suited to modern leasing), or by attempting to apply Article 2 by analogy. Article 2 applies to transactions in goods "[u]nless the context otherwise requires . . . ." Courts have decided all different ways on whether the personal property leasing context "otherwise requires". Some courts apply the Article 2 "implied warranty" provisions to leases generally, other courts apply Article 2 provisions when the transaction is "analogous to a sale", others imply lessor warranties (in the absence of a disclaimer) if a merchant les-

12. Id. § 2-102 (1962).
sor rather than a finance lessor is involved, and still others hold that Article 2 does not apply to true leases at all.

Under Article 2A, warranty treatment depends on whether a "finance lease" is involved. If a finance lease is not involved, then essentially the same warranty rules apply to leases as to Article 2 sales. In many cases, of course, the sales warranties rather than the lease warranties will be the important ones to the user. As a result, in states that have adopted the most restrictive privity provision from among the three section 2-318 alternatives, lessees under leases that are not finance leases will continue to be without warranties and without recourse to the manufacturer in many cases. If a finance lease is involved, section 2A-209 automatically extends the seller's warranties (and their exclusions) to the lessee, to the extent of the lessee's leasehold interest, and automatically excludes any implied warranties of fitness or merchantability by the lessor.

A "finance lease", as defined in the 1987 Official Text of Section 2A-103(1)(g), consists of an overall three-party transaction in which (1) the lessor does not select, manufacture, or supply (in the inventory sense) the goods, (2) the lessor did not own the goods before the lease was arranged, and (3) the lessee approves the purchase contract before the lease becomes effective. Note that, by focusing on the transaction rather than the identity of the parties, this definition can include lessors who are not financial institutions and lessors who operate or repair the leased property after the lease begins. A lessor whose lease does not qualify as a finance lease can achieve the same result contractually by properly disclaiming warranties and other drafting.

These new rules have several practical implications. First, commercial lessors should continue to disclaim warranties "conspicuously" and should continue to include express "hell or high water" clauses, if for no other reason than to avoid arguments about whether a finance lease is involved. Second, a leveraged lessor should conspicuously note in the lease agreement that its secured lender has rights in the equipment and

21. See infra text accompanying notes 61-62.
the lease.\textsuperscript{22} Third, in order to preserve the benefit of pass-through warranties, a lessee should notify the equipment supplier of the finance lease, thereby preventing warranty amendments without the lessee's consent.\textsuperscript{23} Fourth, an equipment supplier who provides customer lease financing through a leasing affiliate should ensure that the sale contract to its affiliate conspicuously disclaims all implied warranties—otherwise, implied warranties may be passed from the supplier through to the lessee even if the affiliate-lessee conspicuously disclaims all implied lessor warranties.\textsuperscript{24} Fifth, a lessor engaged in vendor financing should continue to take precautions to avoid assuming any warranties or representations made by the vendor’s equipment sales representative.\textsuperscript{25}

V. NONBANKRUPTCY ENFORCEMENT, REMEDIES, AND DAMAGES FOR LESSORS AND LESSEES

As stated by Al Reisman and Charles (Chuck) Mooney:

[t]here is, perhaps, no topic related to equipment leasing transactions that has yielded more confusing, inconsistent authorities and poorly conceptualized and articulated analyses than the subject of true lease remedies. As a group, the reported decisions on the remedies of bailors for hire (true lessors) reflect a hopeless morass of analogies to real estate, contract, and personal property security laws, including such doctrines and theories as election of remedies, mitigation of damages, liquidated damages, termination, acceleration of rents, and alternative and cumulative remedies.\textsuperscript{26}

Among the more serious errors that courts periodically have made in the remedies area are (1) measuring the lessor’s damages as the difference between (undiscounted) accelerated future rent and the entire net recov-

\begin{itemize}
\item \textsuperscript{22} See U.C.C. §§ 2A-211(1), -214 (1990).
\item \textsuperscript{23} Id. § 2A-209(3).
\item \textsuperscript{24} For example, assume that XYZ Manufacturing Company sells the to-be-leased equipment to XYZ Leasing Company and that XYZ Leasing Company leases the equipment to the customer under a finance lease. Such an “all in the family” transaction could tempt XYZ Manufacturing to avoid what appears to it to be red-tape formalities. XYZ Manufacturing therefore might avoid using a bill of sale that conspicuously disclaims the implied warranties of fitness and merchantability. Under U.C.C. §§ 2-314, -315, and -316, a merchant seller automatically gives such warranties to the buyer unless the seller conspicuously disclaims them or meets another § 2-316 exception. Once the manufacturer-seller legally gives those warranties to the buyer-lessee, U.C.C. § 2A-209 automatically passes them along to the lessee.
\item \textsuperscript{25} For an example of the problem, see Potomac Leasing Co. v. Thrasher, 181 Ga. App. 883, 354 S.E.2d 210 (1987).
\item \textsuperscript{26} 1 ALBERT F. REISMAN & CHARLES W. MOONEY, JR., EQUIPMENT LEASING—LEVERAGED LEASING 80 (Bruce E. Fritch, et al. eds., 3d ed. 1988).
\end{itemize}
tery after a post-repossession sale, thereby depriving the lessor of its residual interest but simultaneously overcompensating the lessor for future rentals," (2) measuring the lessor's damages by the difference between scheduled termination value and the net proceeds from a post-repossession sale, thereby including the increase or decrease in residual value in the computation of damages for breach of the lease, (3) improperly deciding whether and how to allow acceleration of future rent, (4) invoking the "election of remedies" doctrine to prevent the lessor from both repossessing and recovering damages, (5) permitting the lessor both to repossess and to recover (undiscounted) accelerated rent, and (6) applying the section 9-504 "commercially reasonable sale" requirement to post-repossession sales. Even in states whose courts have not created such analytical errors, statutory clarity still would be helpful to judges and practitioners.

Essentially, Article 2A's statutory pattern for a lessee default partakes of Article 2, Article 9, and the common law. The parties generally may agree to their own default and remedies sections even if different from the Article 2A standards, although over time the validity of such provisions may increasingly be tested against the Article 2A framework. If the lease agreement is silent as to default or remedies, or if its remedies are invalid, Article 2A will provide a safety net.

Under Article 2A, notice of default or enforcement generally is unnecessary unless required by the lease agreement. The lessor may repossess, may dispose of the leased property by sale, re-lease, or otherwise, and may recover incidental damages based on the present value of the rental shortfall under the re-lease, if the re-lease is substantially similar to the lease, or based on the present value of the remaining lease rent.

34. Id. § 2A-502.
35. Id. § 2A-525.
36. Id. § 2A-527(1).
37. Id. § 2A-527(2).
minus market rent (or, if greater, the lessor’s expected profit). Section 2A-507 provides standards for determining market rent. Section 2A-529 permits the lessor to recover accelerated rents (discounted to present value), without any express requirement in the Official Text (subject, perhaps, to the U.C.C.’s general “reasonableness” requirement in section 1-203) that the lessor mitigate damages, and with a mitigation requirement for this section in the California version. The discount rate for determining present value in damages calculations may be specified in the lease agreement in advance, provided that the rate chosen was not “manifestly unreasonable” on the lease execution date.

Even if actual damages could be ascertained without difficulty, the lease agreement may provide for liquidated damages, including loss of tax benefits or damage to the lessor’s residual interest, provided that the liquidation or formula is reasonable in light of the anticipated harm. Article 2A has no general requirement that dispositions of repossessed equipment be made in a commercially reasonable manner as does section 9-504(1), although recoverable damages generally are computed as if mitigation had occurred. The 1990 amendments make clear that the foregoing remedies are exercisable only after the occurrence of a material lessee default of the type described in amended section 2A-523. A lessor’s exercise of remedies for an immaterial default would be subject to the “reasonableness” requirement of section 1-203 even under the 1987 Official Text.

Article 2A also sets forth lessee remedies for a lessor’s predelivery or postdelivery default, essentially modeled after a buyer’s rights under Article 2 following a seller’s default.

Some commentators have concluded that the remedies provisions in the “uniform” version of Article 2A include several deficiencies and ambiguities, such as whether a lessor has any duty to dispose of repossessed equipment.
equipment. However, the California version expressly negates any such duty.

When drafting the default and remedies sections in an Article 2A jurisdiction, lessors should continue to draft full default and remedies sections rather than merely incorporating Article 2A by reference. Lessors also should continue to reserve all remedies provided by law, and should continue to specify lessor rights to terminate, repossess, accelerate rents, and sell or re-lease equipment, all at the lessor's option. The lessor will want to specify a low but reasonable discount rate for accelerated rent, keeping in mind both its economic desires and the maxim that "hogs get slaughtered". If the lessor's bargain is based in part on factors that might not be apparent to a court, the lessor should consider noting them in the lease agreement, thereby preventing a re-lease that does not include those factors from being considered "substantially similar to the original lease contract". In drafting any measure of damages that compares market rent with contract rent for the remaining lease term, lessor's counsel should ensure that market rent "credits" do not begin to accrue until after the lessor has repossessed the equipment and had a reasonable opportunity to remarket it. Lessors should continue to include liquidated or "formula" damage clauses.

VI. FIXTURES AND ACCESSIONS

Section 2A-309 addresses the lessor's rights in fixtures. They are similar to a secured party's rights under U.C.C. section 9-313, with some variations. Section 2A-309 essentially provides that a lessor will have priority over a landlord or mortgagee if the lessor files a UCC-1 fixture filing before the landlord or mortgagee files in the real estate records (or, for "purchase money leases", if the lessor files within 10 days after the goods

43. See id. §§ 2A-527(1), -527(3), -529(1)(b) (these sections being generally similar to the 1987 Official Text). These issues are well presented in Donald J. Rapson, Deficiencies and Ambiguities in Lessors' Remedies Under Article 2A: Using Official Comments to Cure Problems in the Statute, 39 ALA. L. REV. 875 (1988).
44. See CAL. COM. CODE § 10528(1) (West 1990).
45. Cf. In re United Am. Fin. Corp., 55 B.R. 117, 119 (Bankr. E.D. Tenn. 1985) ("the injured party . . . is not entitled to be placed in a better condition by the recovery of damages than he would have been had the contract been fully performed").
46. The Official Comment to § 2A-527 describes several factors that should be considered in determining whether the re-lease is "substantially similar" to the original lease; the list does not purport to be comprehensive. U.C.C. § 2A-527 cmt. (1990).
47. See id. § 2A-528(1)(b). The 1987 Official Text of § 2A-528 starts market rent credits upon default, and the California Version and 1990 Official Text start those credits upon repossession, in each case subject to § 2A-528(2) (which states that, if the statutory formulas are inadequate, then the lessor is entitled to recover its lost profit (whatever that means)). See CAL. COM. CODE § 10528(1)(a), (b) (West 1990); U.C.C. § 2A-528(1) (1990).
become fixtures and there is no prior construction mortgage).\textsuperscript{48} Thus, a prudent lessor will continue to make a fixture filing in the real estate records if the leased equipment is or might become a fixture.

Regardless of whether the lessor files, the lessor will have priority over the landlord or mortgagee if the fixtures are "readily removable" (unless the fixtures are primarily used to operate the real estate, as with heating and air conditioning equipment, in which case the landlord or mortgagee would have priority absent a consent or disclaimer to the contrary), or if the lessee has the right to remove the goods.\textsuperscript{49} The lessor also will have priority over judgment liens obtained after the lease begins.\textsuperscript{50} Finally, a lessor having priority has the express right to remove fixtures after the lease ends or goes into default, but must reimburse the landlord or mortgagee for physical damage to the premises caused by the removal.\textsuperscript{51}

Section 2A-310 addresses the lessor's rights in accessions in a manner almost identical in substance to a secured party's rights under section 9-314. That is, if the leased goods become an accession after the lease begins, the accession lessor's interests are superior to all others except (1) the interest of a buyer (or lessee) in the ordinary course of business buying (or leasing) after the accession lease began, and (2) the interest of a creditor with a prior perfected security interest in the "whole" (i.e., the equipment to which the accession is attached) who makes future advances without knowledge of the accession lease.\textsuperscript{52} A lessor having priority has the express right to remove accessions under standards substantially identical to those for fixture removal.\textsuperscript{53}

\section*{VII. Filing Requirements}

Article 2A does not have any general filing requirement for true leases. As noted above, however, a lessor must make a fixture filing to protect against landlord or mortgagee claims if the equipment becomes "fixtures".\textsuperscript{54} Article 2A also defers to any filing requirements in state or federal certificate-of-title statutes.\textsuperscript{55} Article 9, of course, still requires filing for perfection as to any lease that is recharacterized as a security interest under section 1-201(37), and cautious lessors generally will continue to

\begin{footnotes}
\item[48] U.C.C. § 2A-309(4)(a), (b) (1990).
\item[49] Id. § 2A-309(5)(a), (d).
\item[50] Id. § 2A-309(5)(b).
\item[51] Id. § 2A-309(8).
\item[52] Id. § 2A-310(2), (4).
\item[53] See id. § 2A-309(8), -310(5).
\item[54] See supra text accompanying notes 48-53.
\end{footnotes}
make precautionary filings under U.C.C. section 9-408 to defuse the issue.\textsuperscript{56}

VIII. LIMITS ON ASSIGNMENT AND SUBLEASING

The 1987 Official Text of section 2A-303(7) requires that language prohibiting “the transfer of an interest of a party under a lease contract” be “specific” and “conspicuous”.\textsuperscript{57} Besides requiring lessors and lessees to boldface, capitalize, or underline their anti-assignment clauses, this section also requires lessors to put at least one anti-subleasing sentence in conspicuous type. The conspicuousness requirement applies to finance lessors as well as others. The 1990 amendments delete the conspicuousness requirement for nonconsumer leases, but that requirement currently is the law in several 2A states.

Unlike the 1987 Official Text, the 1990 Official Text also invalidates prohibitions on security assignments of a party’s interest in the lease or the equipment, except to the extent that an actual transfer occurs and is harmful to the other party.\textsuperscript{58} This prohibition goes further than the U.C.C. section 9-318(4) rule that invalidates prohibitions on security assignments of accounts, and to the extent that it does, it is an unreasonable restriction on the parties’ freedom of contract and an unwarranted departure from the U.C.C.’s general principle that parties should be able to reach their own agreements.\textsuperscript{59}

Finally, the 1990 Official Text (but not the 1987 Official Text) for section 2A-303 makes clear that a prohibited transfer may be effective as to third parties, even if making the transfer causes the transferor to be in default under the lease agreement.\textsuperscript{60}

IX. MISCELLANEOUS PROVISIONS

After the lessee has accepted the property under a finance lease, the lessee essentially has no right to revoke.\textsuperscript{61} In commercial leases, sections 2A-407 and -508(6) create a statutory “hell or high water” clause by making the lessee’s (payment) obligations irrevocable, and independent of the lessor’s obligation.\textsuperscript{62} These provisions are merely codifications of standard commercial leasing practices that currently are achieved by contract
rather than by statute. However, it is hard to understand why a statute should do so. Since the lessor can achieve the same result by express contractual language, this aspect of Article 2A is a trap for the unwary: it allows a lessor to defeat the ordinary business expectations of an unsophisticated lessee through silence. For example, it allows a computer lessor to promise vital services to the lessee, then to breach this promise entirely, yet require the lessee to continue paying rent without recoupment or set-off, all without any express clause in the lease agreement. In the author's opinion, section 2A-407 should not be enacted in its present form, even though lessors almost universally will achieve the same result by adding the necessary clauses to their lease agreements.

In addition, section 2A-308(3) overrides vendor-in-possession laws that treat sale-leasebacks as per se or prima facie frauds, but this override applies only if the lessor bought for value and in good faith.63

X. PROVISIONS UNDULY FAVORABLE TO LESSORS BUT OF LIMITED PRACTICAL SIGNIFICANCE

Perhaps because of an absence of organized input by any commercial lessee contingent during the drafting stages, Article 2A includes several provisions that are improperly slanted in favor of lessors and against lessees. Besides those described in the two preceding sections of this article,64 Article 2A has several pro-lessor provisions that do not necessarily have enough practical impact to require nonuniform amendments.

First, section 2A-211(1) limits the lessor's implied warranty of title by excluding third-party acts, such as a lien created by the lessor's predecessor. As between the lessor and the lessee, it would seem fairer that the lessor take responsibility for such a lien if the lease contract is silent, as the seller does under section 2-312(1). The lease contract generally will cover this point, however, and section 2A-307(3) will protect a "lessee in the ordinary course of business".

Second, if the lease agreement is silent, section 2A-502 states that a defaulting party is not entitled to notice of default or of enforcement, except as otherwise provided in Article 2A's Part 5 (the part covering defaults). Part 5 then requires the lessee to notify the lessor of most important defaults and enforcement and provides a statutory cure opportunity for lessors.65 Lessees have many duties besides payment, and they should have similar rights of notice and cure; transplanting the Article 2 seller-buyer standards to a lessor-lessee relationship is unjust. However, the parties can contract around the problem; most lessors assume few

63. Id. § 2A-308(3).
64. See supra text accompanying notes 57-63.
continuing duties; and even if one-sided, giving notice and, the right to
cure usually are not burdensome to lessees.

XI. PROVISIONS APPLICABLE TO PORTFOLIO LENDERS

If a lessee effectively prohibits the lessor from transferring its interest
in the lease (including a prohibition in a related agreement or side letter),
then section 2A-303(1)(a) of the 1987 Official Text prevents the lessor
from assigning lease rentals to a lender. This result is contrary to many
interpretations of section 9-318(4) under pre-2A law. Therefore, prudent
portfolio lenders will include a lessee consent provision in its lessor-
debtor’s forms, by which the lessee conspicuously consents to the lender’s
security interest, notwithstanding any other provision to the contrary.
The 1990 Official Text of section 2A-303 permits a lessor to grant a secur-
ity interest in the leased equipment even if the lease agreement prohibits
it, but would validate a prohibition on the foreclosure of such a security
interest in certain circumstances. As noted above, the 1990 Amendments
go too far, because they permit security interests to be granted and fore-
closed upon even if sophisticated parties have unambiguously bargained
for the opposite result. 66

Even if the lease agreement does not prohibit lessor transfers, section
2A-303(1)(b) of the 1987 Official Text invalidates a transfer that materi-
ally changes the lessee’s rights or duties if, promptly after the lessee
learns of the transfer, the lessee demands that the transferee essentially
guarantee the lessor’s performance and the transferee refuses to do so.
Some commentators have expressed concern that a lessee could attempt
to invoke this provision to defeat a lessor’s security assignment, although
this provision would seem inapplicable to most security interests. Section
2A-303(3) and (4) of the 1990 Official Text requires the lessee to make a
more specific showing of harm in order to resist such a lessor transfer.

Finally, since Article 2A is silent on whether the lessor’s lease rights
(including rent) are “proceeds” under section 9-306, and since some of
the meager case law concludes that those rights are not proceeds, lenders
still should expressly include chattel paper and lease rights (including
rent) in their collateral descriptions.

XII. UNRESOLVED ISSUES

As with any new law, Article 2A may be expected to introduce unfore-
seen problems to the leasing arena that, when identified, will need to be
dealt with by practitioners’ draftsmanship, judicial interpretation, legisla-

66. See supra text accompanying notes 58-60.
tive change, or supplementation to the Official Comments. For example, it is difficult to anticipate the exact effects of section 2A-108's express prohibition of unconscionability, because few courts or practitioners previously applied unconscionability standards to nonconsumer leases. In assessing which lease clauses might become unenforceable under the unconscionability standard, practitioners should pay special attention to the reasonableness of waivers and other limitations on lessee rights, particularly those appearing in inconspicuous type in printed, unnegotiated lease forms.

Article 2A does not deal with leases that are Article 9 security interests under section 1-201(37), but in which the lessor has a residual interest, such as an eight-year lease of a computer or a lease having a ten percent purchase option for equipment expected to retain most of its original value at lease end. It has been suggested that this issue could be addressed by adding a “Part 6” to Article 9, dealing with such items as the calculation of (imputed) interest or discount, or calculation of the amount that the “lessor”-creditor is owed, or other remedial matters.

Finally, perhaps because Article 2A was modeled after Article 2, Article 2A does not cover a number of leasing issues that do not have analogues in the sales context, such as (1) in the 1987 Official Text, explicit protection of the lessor's reversionary interest, (2) explicit coverage of the lessee's obligation to return the leased equipment, (3) the amount of care that the lessee must exercise, and (4) the distribution of responsibility for maintenance and repair. In each case, of course, the parties may cover those points by contractual agreement.


