

Practical information about bankruptcy for the commercial equipment lessor

By Glen Nordt



The purpose of this article is to help the commercial equipment lessor understand its rights, roles and remedies as a creditor in a bankruptcy proceeding. The article will discuss

what a leasing company needs to do in order to help protect its assets and mitigate its damages.

One of the first considerations is to determine whether the lease is a "true lease" as opposed to a "disguised sales transaction." Remember that just because the documents may be entitled "Lease" does not necessarily make it one. It is important to note that generally the Lessor will be treated more favorably in a bankruptcy proceeding if the lease is a true lease, than when it is a sale.

The main test for differentiating between whether a contract is held to be a true lease or a sale, is whether or not the lease has a purchase option, and if so, the amount of the purchase option.

Criteria the courts consider

Following are some general criteria for determining if a contract will be construed as a true lease or a sale:

No purchase option: If the lease does NOT contain a purchase option of any kind, the lease will always be held to be a true lease.

Fair market value purchase option:

If the lease contains a fair market value purchase option, it is highly probable (but not always guaranteed) that the lease will be construed as a true lease. During any negotiations with any bankruptcy Debtor, the Lessor should always take the position that any fair market value purchase option

contract should be treated as a true lease, and negotiate from a position of strength.

One dollar purchase option (or other nominal purchase option price): If the lease contains a one dollar purchase option, it will almost always be held to be a sale. That will be true of any lease with a nominal purchase option price.

Ten Percent Purchase Option price: If the lease contains a 10% purchase option price (10% of its original value), or some other percentage of the original purchase price, then the test for determining if the lease is a "true lease" or a "sale" gets much more complicated. Expert witness testimony on such things as the useful life of the equipment will be needed.

Remedies for a True Lease

If the contract is construed as a true lease, then the Lessor is really in the driver's seat as far as the remedies the Lessor wants to pursue in bankruptcy court. Remedies include:

Motion to assume or reject an executory contract: The Lessor can file a motion to force the Debtor to assume or reject an executory (true lease) contract. If the Debtor wants to keep using the leased equipment, assumption of the executory contract (lease) requires the Debtor to become current on its arrears, or else to reject the lease, and return the equipment.

Of course, the Debtor and Lessor are free to negotiate a different deal that benefits both parties, but if the Lessor does not like the Debtor's proposal, the Lessor can force the Debtor to either reject the lease, and return all equipment, or else assume the lease, and become completely current on all past due payments (arrears).

Motion to Modify Stay: A downside to a motion to assume or reject, is that in some locales, it may take between 60-90 days to get a hearing on this type of motion. Thus, the lessor may also want to file a Motion to Modify Stay, which is usually heard approximately 30 days after filing.

A Motion to Modify Stay contends that since the Debtor is not making its monthly payments, or has arrears, then the bankruptcy stay should be lifted, so the Lessor can take back its equipment. Usually a

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Welcome to Lease Enforcement Analysis & News

LEAN, the only national network of law firms dedicated to providing collection, enforcement and recovery services for leasing companies, welcomes you to the inaugural issue of Lease Enforcement Analysis & News. This quarterly newsletter is provided free of charge to leasing professionals engaged in the legal, credit, collections and operations aspects of leasing firms. LEAN consists of experienced attorneys who assist leasing companies and lease funding entities. What sets LEAN law firms apart is that in addition to being experts in the enforcement of lease obligations including collections, asset recovery, and bankruptcy representation, LEAN members know leasing.

Each issue of the newsletter will feature an article that gives you practical tactics and tips about collection, bankruptcy or other lease enforcement issues. In addition, we will provide a calendar of events of interest to the leasing community. Updates about LEAN members and a useful directory of LEAN law firms are included.

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You can refer to the enclosed directory to find a LEAN attorney to assist you anywhere in the United States or use our searchable database on the LEAN web site at www.leasecollect.org. Contact LEAN directly by email at info@leasecollect.org or by calling its toll free number at 877-LEASELAW or 877-532-7352.

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settlement is reached that calls for the Debtor to pay the Lessor in a restructured fashion both parties agree to, with language in the Agreed Order stating that should the Debtor default in making payments under the newly agreed to terms, the automatic stay will no longer protect the Debtor, and that no further court order would be necessary.

In the event a settlement cannot be reached, a Debtor has at least two common defenses to a motion to modify stay.

- The Debtor can argue that it has sufficient equity in the collateral, to offset the amount of arrears. This defense contends that the stay should not be lifted at this time, and should remain in effect until a Plan is confirmed. It is rare that a Debtor will have equity in commercial equipment that is being leased. This defense is more common when the collateral is real property.
- The Debtor can argue that it needs the equipment to make any proposed Chapter 11 or Chapter 13 Plan have a realistic chance of working (the legal terminology is the "equipment is necessary for an effective reorganization").

If the Debtor truly does have equity in the equipment, and/or can make a solid argument that the equipment is needed for an effective reorganization, the Lessor may have difficulty in prevailing at a full blown hearing. If it becomes obvious the Lessor has these defenses to contend with, it may be time for the Lessor to try and cut a deal with the Debtor.

Please note that the Debtor can only assert these two defenses when the Lessor files a Motion to Modify Stay. Those defenses are NOT available to the Debtor who wants to contest a Motion to Assume or Reject an Executory Lease Contract.

This is another example of why a Lessor will be better off in bankruptcy proceedings if the contract is a true lease, rather than a sale. It also explains why a Lessor, whenever

possible, argue vehemently that its lease is a true lease, not a disguised sales transaction.

Administrative Proofs of claims: If the contract is a true lease, then the Lessor can file an administrative proof of claims for lease payments that became due after the date the Debtor filed bankruptcy (referred to as post petition arrears). The advantage to filing an administrative proof of claim is that the Lessor increases its chances of receiving more monies in any bankruptcy proceeding, than a similarly situated Lessor who does not file an administrative proof of claim.

"An attorney who knows the ins and outs of leasing is invaluable when the lessee files bankruptcy."

Objections to the Debtor's Plan:

A Debtor may file a Chapter 11 or Chapter 13 plan that proposes to restructure the lease contract terms. A typical Plan would greatly reduce the principal amount due and owing, because of the low value the Debtor assigns to the equipment, extend the term of the lease, and propose a much lower interest rate than the original contract required. The result is the Lessor would receive monthly payments that are significantly reduced from their original amount, and a lower overall payment than the lease originally stated.

If the lease is a true lease, then the Lessor can object to any Plan that restructures the lease term.

Thus, a Lessor should usually object to this type of Plan, by contesting the value assigned to the equipment, and arguing the extended lease term would exceed the life expectancy of the equipment's value. That is, if the lease term is restructured, so that the term of the lease extends beyond the point that the equipment retains any meaningful value, then the Debtor could easily decide later in the Plan to stop making payments. The Lessor's sole remedy at that point

would be to ask the Court to lift the bankruptcy stay, so that the Lessor could take back the now worthless equipment. For that reason, no Lessor ever wants its payout under any Plan to exceed the useful life of the equipment.

If there is no danger of the Lease being construed as a sale, then an objection based upon a low value and/or long term payout may not be necessary. Instead, the Lessor should file a motion to force the debtor to assume the lease contract under its original terms, and become current, or else reject the lease and return the equipment to the Lessor.

Remedies for a Disguised Sales Transaction

If the contract is construed as a sale, then determine immediately if the Lessor perfected its security interest, by having filed a UCC-1, or having perfected a Purchase Money Security Interest (PMSI).

If the Debtor has another secured lender, who filed a blanket UCC-1 prior in time to when the Lessor filed its UCC-1, then the other lender may have a superior lien claim to the Lessor's equipment. If, however, the Lessor had perfected its PMSI (the Lessor financed the specific purchase of some specific equipment, and then perfected its security interest which specifically referenced said equipment), then the Lessor's PMSI lien rights in the leased equipment will be superior to any lien rights of any other secured Lender, even if the other secured Lender had a blanket security interest filed prior in time to the Lessor's PMSI.

If the Lessor perfected its security interest:

If the Lessor perfected its security interest, then the Lessor will be a secured creditor up to the value of its equipment. A secured proof of claim should be filed. The debtor has to object to any proof of claim, so unless the Debtor does so, the type of claim filed by the Lessor (secured, administrative, etc.) and the amount of the claim asserted by the Lessor, will automatically be allowed.

LEAN Members In The News

Robert S. Bernstein of the Pittsburgh, Penn. based **Bernstein Law Firm** was appointed a vice president of the Pittsburgh Leasing Association. The PLA is a not-for-profit trade association that provides a forum for equipment leasing professionals in the western Pennsylvania area to exchange information and to attend educational programs in a cooperative social environment. Bob can be reached at 412-456-8101 or by e-mail at rbernstein@bernsteinlaw.com.

LEAN member firm **Glassberg, Pollak & Associates** recently added a new associate to the firm's litigation department. **Ryan D. Krohn** joined the San Francisco based firm. The firm can be reached at 415-291-8320 or by e-mail at gpa@glassberg-pollak.com.

Robert B. Liddell of **Hiscock & Barclay, LLP** located in Syracuse, NY recently won a lease enforcement case in the appellate court which covers all of Central and Western New York. The case involved the lease of an ATM machine supplied by Credit Card Center, a company that filed for bankruptcy. The appellate court in New York determined that the allegations of fraud and collusion

If the Lessor did not perfect its

security interest: If the Debtor has a good lawyer, the Lessor should expect to be listed as an unsecured creditor, and should say goodbye to the equipment the lessor leased to the lessee.

An unsecured Lessor will NOT be able to recover its leased equipment: If the lease is construed as a sale, and the Lessor did not perfect and file its UCC-1 security interest, then the bankruptcy court will treat the lease as an unsecured loan. The Lessor would not be able to recover its equipment, as the Court would generally rule that the equipment is the property of the Debtor, and the Lessor should have perfected its lien in said equipment.

Deadlines should be determined

immediately: Even if the Lessor receives prompt notice of a bankruptcy filing, the employee of the Lessor who handles the Debtor's specific file does not always learn of the bankruptcy filing until much later. For that reason, the employee should immediately determine if there are any key deadlines fast approaching. On rare occasions, I have known clients who were barred from any recovery in the bankruptcy proceedings, because they missed a proof of claim deadline or objection to Plan deadline, before they ever forwarded the file to their outside legal counsel. A motion to extend time can be filed, but it may or may not be granted. If a Lessor is aware of a pending deadline, it should make its outside counsel aware the matter is time sensitive in its forwarding letter.

Determine if the Plan discharges the Lessee's Guarantors:

Many Lessors assume that even though the actual Lessee has filed bankruptcy, but the guarantors have not, the Lessor can still sue any guarantors for the balance due under the lease. While that is generally true, from time to time a Lessee's Chapter 11 or Chapter 13 Plan will call for the discharge of any guarantors. The rationale given is that the guarantor is critical to the effective reorganization of the Debtor, and the guarantor is only willing to

against the leasing company were contradicted by the clear terms of the lease agreement, and therefore, granted the leasing company's motion for summary judgment. The decision is reported at *Unistar Leasing v. Lipkin*, 12 A.D.3d 1166 (4th Dep't 2004). Robert can be reached at 315-422-2131 or by e-mail at rliddell@hiscockbarclay.com.

Three members of LEAN have been elected to serve as officers or Board members of the American Board of Certification. **Robert L. Pollak** of San Francisco based **Glassberg, Pollak & Associates** will serve on the Board of Directors of the ABC. Bob can be

LEAN Industry Calendar of Events**April 2005 through September 2005**For more information about individual events, visit the LEAN website at www.leasecollect.org**April 5, 2005 (EAEL)**Regional Business Luncheon
Cleveland, Ohio**April 6 -7, 2005 (ELA)**National Funding Exhibition
Chicago, Illinois**April 10-12, 2005 (ELA)**Captiv and Vendor Leasing
Conference
Kiawah Island, SC**April 11-13, 2005 (ELA)**Principles of Leasing Workshop
Philadelphia, PA**April 14 - 17, 2005 (EAEL)**EAEL Annual Conference
Charleston, South Carolina**April 18-20, 2005 (ELA)**Principles of Leasing Workshop
San Francisco, CA**April 17-19, 2005 (ELA)**Large Ticket Conference
Henderson, NV**April 21-24, 2005 (UAEL)**2005 Spring Conference
Scottsdale, Arizona**May 4 - 6, 2005 (CLL & SRI)**Global Debt Collection Summit
Atlanta, Georgia**May 10, 2005 (EAEL)**Regional Business Luncheon
New York City, New York**May 10-11, 2005 (ELA)**Capitol Hill Day
Washington, DC**May 12 - 15, 2005 (NAELB)**NAELB Annual Conference
St. Louis, Missouri**May 15-17, 2005 (ELA)**Legal Forum
Miami Beach, FL

LEAN will host a cocktail reception on Saturday, May 14 from 6 p.m. until 8 p.m. To RSVP, visit the **LEAN** website at www.leasecollect.org or return the form on the back page of this newsletter.

May 16-18, 2005 (ELA)Principles of Leasing Workshop
Chicago, IL**June 6-7, 2005 (ELA)**Bank Leasing Conference
Chicago, IL**June 6-8, 2005 (ELA)**Tax Executives Roundtable
San Francisco, CA**June 6-8, 2005 (ELA)**Principles of Leasing Workshop
Baltimore, MD**June 9, 2005 (EAEL)**Crabfeast as Gunning's Crabhouse
Baltimore, Maryland**June 12-14, 2005 (ELA)**Credit & Collections Management
Conference & Exhibition
Palm Harbor, FL

LEAN will host a cocktail reception on Saturday, June 11 from 6 p.m. until 8 p.m. To RSVP, visit the **LEAN** website at www.leasecollect.org or return the form on the back page of this newsletter.

June 22-24, 2005 (ELA)Business Technology Solutions
Conference & Exhibition
San Diego, CA**July 11-13, 2005 (ELA)**Principles of Leasing Workshop
Philadelphia, PA**July 12, 2005 (EAEL)**Regional Business Luncheon
Stamford, Connecticut**September 12-14, 2005 (ELA)**Principles of Leasing Workshop
(Advanced)
Dallas, TX**September 13-14, 2005 (ELA)**Healthcare Finance Summit
Arlington, VA**September 19, 2005 (EAEL)**Annual EAEL Expo
Teaneck, New Jersey**September 19-21, 2005 (ELA)**Lease Accountants Conference
New Orleans, LA**September 22-25, 2005 (UAEL)**2005 ACE Fall Conference
Caesars Tahoe
Lake Tahoe, Nevada**September 26-28, 2005 (ELA)**Municipal Leasing Forum
Sunny Isles Beach (Miami), FL

CLL & SRI = Columbia Law List and Strategic Research Institute

EAEL = Eastern Association of Equipment Leasing

ELA = Equipment Leasing Association

NAELB = National Association of Equipment Leasing Brokers

UAEL = United Association of Equipment Leasing

stick around to try and make a go of the reorganization, if the Bankruptcy Court will absolve the guarantor of his personal liability under his personal guaranty. The Lessor should always check the Plan for such language, to afford the Lessor the chance to object to this provision of any Plan.

Objecting to the Discharge of an

individual Debtor: In the event of fraud (such as the Lessor's equipment is sold out of trust by the individual Debtor), a Creditor can object to the discharge of an individual.

Even after the discharge, the Creditor can file a motion to revoke the discharge if the Creditor learns the Debtor committed fraud in its bankruptcy filings (for example, the Debtor fails to list all of its property in its schedules, or it is later learned that the Debtor spent a significant sum of money repairing his homestead and paying off his mortgage just before filing bankruptcy. Note that this is not meant to be an exhaustive list of when a Creditor can object to

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reached at 415-291-8320 or by e-mail at Ripollak@glassberg-pollak.com. **Rudy Cerone** of New Orleans office of **McGlinchley Stafford PLLC** was elected to serve as Chair of the American Board of Certification. He can be reached at 504-596-2786 or by e-mail at rcerone@mcglinch.com.

Robert S. Bernstein of **Bernstein Law Firm** in Pittsburgh, Penn. has been named President-elect of the national organization that certifies attorneys as specialists in creditors' rights and bankruptcy. He can be reached at 412-456-8101 or by e-mail at rbernstein@bernsteinlaw.com.

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discharge.). A motion to vacate must be filed within one year of the Discharge Order.

However, an adversary complaint objecting to discharge should not be done lightly, as it can be expensive, and if the Creditor is unsuccessful, the Court can require the Creditor to pay the Debtor's defense costs incurred in the discharge litigation.

Please note that only individuals can receive discharges. Business entities are not eligible to receive a discharge.

CONCLUSION

This article is in no way meant to be a complete discussion of bankruptcy law, but is offered strictly as an educational device to help Lessors understand the chief legal issues that come into play in a bankruptcy filing, the remedies, and the issues that most commonly come up

Glen Nordt is a member of LEAN in Houston, Texas. He practices in the business litigation section of Coats, Rose, Yale, Ryman & Lee, emphasizing the representation of financial institutions, including commercial equipment leasing companies. Glen's work includes enforcing commercial equipment leases, promissory notes, defending lender liability claims, including usury, Deceptive Trade Practices Act violations, fraud, breach of contract, etc. Glen has been an author and lecturer for both the State Bar of Texas, and the national organization, Equipment Leasing Association (ELA). You can contact Glen by phone at 713.653.7359 or by e-mail at gnordt@coatsrose.com.