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The Market View

Don't Wait for Accounting Changes to Take Effect — Focus on Customers Now

By Michael J. Fleming

Speed, smart speed, still wins in competition. Unfortunately, I find too many company executives are not heeding this reality when it comes to the changes in financial accounting for leases. Their outside accounting firms tell them something to the effect that this new proposed standard is going to take a while to finalize and make effective. This is the technical view, the compliance side. Finance and leasing company executives should pay attention to the market view.

Lessees are already receiving information about the proposed standard from the business media and their accounting firms. Again, this input will be on the technical side — you must do this, and you cannot do that, and this is what you will look like, and so on. This kind of input causes alarm and may lead to push-back against leases and lease-like products. Some observers are already stating the self-fulfilling prophecy that there will be a reduction in leasing. That reduction may happen, and it certainly will happen unless finance and leasing company executives become proactive in the marketplace and do it now.

Let's accept three realities.

1. There will be a new standard, and lessors and lessees will have to comply.

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Lease Accounting, Financial and Other Covenants

By Gian-Michele a Marca and Barry A. Graynor

In August 2010, the FASB and IASB issued a joint exposure draft — Leases. The exposure draft creates a new accounting model for both lessees and lessors, and eliminates the concept of operating leases. All outstanding leases will be subject to the new lease accounting rules — there will be no grandfathering of existing leases. The boards are expected to issue a final standard in June 2011, but they have not yet decided on an effective date for the new rules. This article summarizes the new accounting model for lessees and addresses the impact the new model may have on financial and other covenants typically found in financing agreements, where the lessee is the borrower. (The new accounting model for lessors is beyond the scope of this article.)

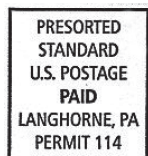
SUMMARY OF THE NEW ACCOUNTING MODEL FOR LESSEES

- Lessees will recognize a right-of-use asset for the lease term and a liability for their obligation to make lease payments. "Off-balance-sheet" leases will no longer exist.
- Except for short-term leases (leases with a term of 12 months or less), the present value of the lease payments will be used in the initial measurement of the obligation to make lease payments, discounted by using the lessee's incremental borrowing rate or the rate the lessor charges the lessee, if it can be readily determined. The right-of-use asset will initially be measured at the same amount plus any recoverable initial direct costs, such as commissions and legal fees.
- If the lease includes renewal options or early termination options, the lessee will need to estimate the probability of occurrence for each possible term in determining the lease term.
- Under an expected outcome approach, the lessee will recognize contingent rentals and residual value guarantees as part of the lease liability.
- Under the new rules, a purchase option will be accounted for only when it is exercised. The exercise price will not be considered a lease payment but

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Lease Accounting

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- part of the cost of acquiring the underlying asset. However, purchase options do factor into the analysis of whether the lease represents a purchase or sale of the underlying asset. If the lease contains a bargain purchase option, it generally would be treated as a purchase and sale under existing GAAP and therefore it would be excluded from the new accounting rules.
- For leases previously classified as operating leases, rent expense will be replaced with amortization expense and interest expense. Amortization of the right-of-use asset will generally be on a straight-line basis. Interest expense will be front-end loaded, like interest on an amortizing mortgage. Therefore, net income could be lower in the first years of the lease under the new accounting rules than it would have been under current operating lease accounting. However, EBITDA would be higher because rental expense is not recorded.
 - For leases previously classified as capital leases, the existing capitalized assets and lease obligations, which are based on the greater of the

present value of minimum lease payments and fair value, will be replaced with the right-to-use measurement and the present value determinations described above.

- The new rules will require the lessee to periodically reassess the carrying amount of the obligation each reporting period "if facts or circumstances indicate that there would be a significant change in the liability since the previous reporting period."
- The new rules will result in additional temporary differences for income tax accounting purposes. State and local taxes may also be affected.

EXAMPLE

Company A enters into an equipment lease. The lease term is non-cancelable for five years, with no renewal options. The agreement is for quarterly lease payments of \$100,000 per quarter. Company A's incremental borrowing rate is 8%. The agreement does not include a purchase option or a residual value guarantee.

The first step is to estimate the lease payments over the five-year lease term. The lessee estimates that the present value of the lease payments will equal \$1,635,143. This is what gets recorded on the balance sheet on day one as the "right-to-use asset" and the corresponding obligation.

Table 1, on page 4, compares the income statement impact in the first year. Under the proposed approach, the expense is front-ended and therefore higher in the first year than what it would have been under current operating lease accounting.

EFFECT ON FINANCIAL AND OTHER COVENANTS

The effect of the new accounting rules on financial and other covenants is manifold. The first thing to check is whether the applicable financing agreement addresses changes in GAAP. If GAAP is "frozen" as of the date of the financing agreement, then the lessee-borrower is protected.

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Gian-Michele a Marca (gmamarca@cooley.com) is a partner and **Barry A. Graynor** (graynorba@cooley.com) is a special counsel in the San Francisco office of Cooley LLP. a Marca represents issuers, private equity firms and banks in various financing and corporate transactions, including bank financings, structured financings, convertible and high-yield bond offerings, equity offerings and mergers, acquisitions and dispositions. Graynor is a member of this newsletter's Board of Editors and specializes in credit finance and equipment leasing, in particular shipping containers and other transportation equipment.

Equipment Leasing

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Exposure Draft Accounting

Equipment Lessor and Lessee IT System Challenges

By Joseph Moore

It is not news that the proposed new lessor and lessee accounting rules as laid out in the recent exposure draft present a variety of challenges to equipment lessors and lessees. In our experience so far, the bulk of attention has been paid to the implications of the new rules on financial reporting, capital requirements and market acceptance of equipment leasing as a product. This emphasis is understandable — both lessors and lessees want to know what their books are going to look like, and what effect that new look will have on their need for and ability to raise capital. Further, especially among equipment lessors, there are varying degrees of anxiety over the degree to which equipment leasing will continue to be viable.

Since August, the large lessors with whom we work have concluded that the proposed reporting requirements and the resulting capital issues are not, for the most part, intolerable, and that leasing will remain a viable product. While the proposed rules will exact a price in increased operating costs and marketing uncertainty as lessees reassess their equipment financing decisions, business will not cease, the sky will not fall. On the lessee side, the new rules add some economic friction costs to leasing. Whether

Joseph Moore is Director of Sales & Marketing at Ivory Consulting Corporation. Over the last 13 years, Moore has worked with large lessors around the world on pricing and portfolio issues, and trained hundreds of equipment finance professionals in the intricacies of equipment finance pricing. He has given a number of presentations at ELFA events, most recently on the Portfolio and Marketing implications of the Exposure Draft Accounting.

such costs are sufficient to drive business away from leasing as a finance option to borrowing or cash remains to be seen, but the emerging consensus among large equipment lessors is that leasing will remain a viable product.

SECOND-TIER ISSUES

With those primary, corporate life-or-death issues at least contingently resolved for now, companies can turn their attention more to second-tier issues. Among these secondary issues are several key operational issues. The exposure draft's movement away from "bright line" accounting will, at least in the short- and mid-term, require lessors to create new classification rules specific to their businesses and products. For example, in order to properly forecast and budget, a company creates financial products that fit a certain accounting profile. Historically, that meant that a firm would define offerings as Operating Leases, Direct Finance Leases or Loans — every product had to fit one and only one of these classifications, forecasts for which then flowed through from quoting to pricing to credit to booking and on through to the financial statements, which then feed into Treasury's borrowing plans. Ultimately, a lessor's ability to forecast profits, taxes and funding needs hinges to a large extent on knowing what characteristics its various financial product offerings will have once they reach the books. Then, when real transactions do hit the books, they must be processed correctly according to how they are classified. "Bright lines," whatever their theoretical drawbacks, provide certainty to the operational task of classifying each transaction correctly.

Under the proposed new rules, there are no bright lines. Lessors can classify a lease transaction as either a Performance Obligation or a Partial Derecognition lease. These two products perform very differently on the balance sheet, in a way similar to the different performance of Operating leases and Direct Finance leases. Keep in mind also that the huge bulk of equipment finance transactions are smaller "cookie-

cutter" deals — the amount of profit associated with them precludes the possibility of having an accountant make a classification ruling on each deal individually. The classification process must be automated. IT Systems must be able to accommodate classification rules automatically.

Each lessor is faced with creating and defending principle-based classifications that are unique to that lessor. This requirement has two parts. First, management must decide what the rules will be: Is 10% residual risk "insignificant"? Fifteen percent? Five percent? For this line of business only, or for all lines of business? And so on. Then, whatever the decision, IT systems must embody it. For example, whenever my sales force quotes lease financing to a prospective lessee, the system must know that the quote is for a Partial Derecognition lease, and that classification information must flow through to the accounting system. The accounting system must then be able to generate accounting streams according to the new rules for Partial Derecognition leases, and allow for rebooking to account for any mid-term changes, again under the new rules.

While life is to some extent simpler for lessees insofar as they do not need to classify the lease and do not need to track its sales process, they still must now account for it under the proposed new rules, which it is safe to say are at least an order of magnitude more complex than existing rules. Many lessees are used to the utter simplicity of accounting for an operating lease under the old rules — those days are numbered.

THE FIRST CHALLENGE

So the first IT systems challenge is: Can my systems handle the new accounting? The accounting system itself is rightly the biggest concern, but, for lessors, the origination system that handles the flow of potential business from quoting to pricing to credit to documentation and booking must also be able to accommodate the new rules to at

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IT System

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least some extent. The major players in lessor accounting are, of course, working to make sure their systems can perform under the new rules. It behooves lessors to make sure their providers can, in fact, meet their requirements.

We have heard much less about how lessee accounting systems are planning to accommodate the proposed rules. It is not safe to assume the new requirements will be met on the lessee side. They are extensive and, to a large extent, dissimilar from other lessee accounting processes — the expected term, present value calculations and rebooking requirements are all very different from what an off-the-shelf lessee accounting system is required to provide today. Lessees need to make sure their providers are on top of these requirements, and to be specific about them — do not accept vague promises that it will be there when you need it. Trust, but verify.

NO GRANDFATHERING

Next, the proposed rules do not allow for grandfathering. Lessors and lessees are expected to retrospectively rebook all lease transactions on their books under the new rules in a “Big Bang.” Companies

must make sure their systems can provide this function.

As hinted at above, a number of other, less obvious systems will be affected by the proposed rules. Are company executives compensated on book returns? If so, the compensation committee and HR will very much want to see how the new rules affect ROA. Our preliminary review of pro forma portfolios shows that, depending on classification, the new rules can add or subtract as much as 10 basis points to an ongoing portfolio's quarterly yield over that same portfolio under current accounting rules. Portfolios less homogenous and well-behaved than our test cases might yield larger variances.

SYNDICATION AND SECURITIZATION

Another systems area likely to be affected is syndication and securitization. Some lessors, especially captives, will need to take a much closer look at the portfolio they are holding in order to find and benefit from syndication opportunities. For example, the proposed rules do not generally allow the manufacturer to recognize a sale if the captive provides lease financing. However, if the captive is able to creatively syndicate such transactions, it can potentially recognize full sales income

for the manufacturer while potentially retaining some of the servicing and residual upside potential revenue. To do this, IT systems must be able to handle such syndications routinely, including pricing sales and purchases of portfolios.

BUDGETING, FORECASTING AND FUNDING

Finally, the budgeting, forecasting and funding processes will be affected. Especially in the early years, the ability to “what-if” various product mixes and sales levels will be critical, as no one knows or can know how the mix and level of sales will pan out under the proposed rules.

KEY POINTS

The key points we've gathered working with our large lessors and industry experts: Do not take system compliance with the new rules for granted — verify with your suppliers. Second, don't think only of accounting systems. Investigate implications for other systems as well, including origination, pricing, portfolio management, syndication, funding and compensation. Indications are that we all have about two- to three-years to get this right — enough time, but not by much.



Lease Accounting

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An example of such a provision is as follows (emphasis added):

If at any time any change in GAAP would affect the computation of any financial ratio or requirement set forth in any Loan Document, and either the Borrower or the Required Lenders shall so request, the Administrative Agent, the Lenders and the Loan Parties shall negotiate in good faith to amend such ratio or requirement to preserve the original intent thereof in light of such change in GAAP (subject to the approval of the Required Lenders); *provided that, until so amended, (i) such ratio or requirement shall con-*

tinue to be computed in accordance with GAAP prior to such change therein and (ii) the Borrower shall provide to the Administrative Agent and the Lenders financial statements and other documents required under this Agreement or as reasonably requested hereunder setting forth a reconciliation between calculations of such ratio or requirement made before and after giving effect to such change in GAAP.

Assuming the financing agreement does not have such a provision: What is the impact of the new accounting rules in that situation?

FINANCIAL COVENANTS

The new accounting rules may affect compliance with existing financial covenants. The following are some examples:

- Leverage (Debt to Net Worth or Debt to EBITDA may not exceed x:1.0). As indicated above, the present value of the

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Table 1

	Proposed Accounting	Current Accounting
Amortization expense	\$327,029*	
Interest expense	\$122,628	
Rent payment -- expense		\$400,000
Total	\$449,657	\$400,000

*\$1,635,143/5 = \$327,029.

Lease Accounting

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future lease payments must be set forth as an obligation on the balance sheet. “Debt” or “indebtedness” is typically defined to include those obligations arising under capital leases that are required to be capitalized on the balance sheet. Under the new rules, the impact on the typical “debt” definition would be twofold: 1) formerly “off-balance-sheet” operating leases would now be considered to be “debt,” and 2) the capitalized obligations relating to former “capital leases” would change due to the revised method for determining the present value of future lease payments. Therefore, on the day the new rules go into effect, the amount of “debt” would likely increase and the leverage ratio may be violated. Net worth is unlikely to be affected because the right-to-use asset will equal the obligation (assuming no initial direct costs). EBITDA is likely to be higher as explained below.

- EBITDA (EBITDA must equal at least \$x at the end of each fiscal period). EBITDA is typically defined as earnings before interest, taxes, depreciation and amortization, and often includes various other adjustments for non-cash and extraordinary items. Under the new accounting rules, rent expense (which reduces consolidated net income) will no longer be recorded. Instead, the lessee will record amortization and interest expense, which typically get added back in the calculation of EBITDA. Therefore, under the new accounting rules, unless rent expense was separately included as an “add-back” in the EBITDA definition (*i.e.*, “EBITDAR”), EBITDA should be higher than it would have been under the current rules.

This will help the lessee-borrower meet a minimum EBITDA financial covenant.

- Fixed Charge or Interest Coverage (EBITDA to Fixed Charges or Interest Expense must equal at least x:1.0). As indicated above, the new accounting rules should result in a higher EBITDA. However, the interest expense (which will now include additional interest expense for operating leases) will also be higher. In addition, the “front-end” loading of interest expense will impact the ratio. For some financing agreements, only cash interest expense is included for purposes of calculating the ratio, in which case, the impact of the new rules may be minimized. For the broader fixed charge coverage ratio, the impact will depend on whether the fixed charge definition includes rental payments (little impact), capital expenditures (see below), principal repayments (potential for impact if the lease obligation is deemed a principal payment) and tax liabilities.
- Capital Expenditures (Capital Expenditures not to exceed \$x). “Capital expenditures” are typically defined to include the aggregate of all expenditures of plant, property and equipment, and any other capital asset that is set forth in the consolidated statement of cash flows. Under the new rules, a lessee will be required to present right-of-use assets as if they were tangible assets within property, plant and equipment separately from non-leased assets. Hence, “capital expenditures” should increase under the new rules.

NEGATIVE COVENANTS (DEBT; LIENS)

Financing agreements typically place restrictions on the incurrence of indebtedness and liens, subject to various carve-outs and “baskets” or dollar thresholds. Reclassifying oper-

ating leases as “Debt” or “Indebtedness” may result in a violation of the indebtedness covenant, depending on how broad the carve-outs are and the amount in question. But even if the lessee-borrower is “saved” by a basket/carve-out, this may not be a good result when the original intent of the basket was to allow the lessee-borrower to incur other indebtedness without counting in operating leases. If the lessee-borrower has a significant number of operating leases, it seems likely that reclassifying these leases as indebtedness will result in a breach of the covenant.

The answer is less clear for the liens covenant. Again, the answer will depend on the exact wording of the carve-outs and baskets. A typical carve-out reads as follows:

Borrower shall not ... create, incur, assume or suffer to exist any Lien upon any of its property, whether now owned or hereafter acquired, except for ...:

Liens securing Indebtedness of the Borrower or any other Subsidiary incurred pursuant to [the carve-out for purchase money indebtedness and capital leases up to a specified dollar amount] to finance the acquisition of fixed or capital assets, *provided* that (i) such Liens shall be created substantially simultaneously with the acquisition of such fixed or capital assets, (ii) such Liens do not at any time encumber any property other than the property financed by such Indebtedness or the proceeds thereof and (iii) the amount of Indebtedness secured thereby is not increased;

Let’s assume the carve-out fails because the newly reclassified operating leases exceed the specified dollar amount. Has the lessee-borrower violated the covenant?

The answer may depend on whether the lessee-borrower has created or incurred a lien on its property in

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Lease Accounting

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the case of an operating lease that is now reclassified as a capital lease under the new rules. If the lease is a real property lease, this seems like a strange result. Presumably, the accounting rules change does not result in a change in status of the underlying real property, such that now the lessee-tenant is deemed to be the owner and the landlord is deemed to have a "lien" on the property like a mortgagee. In

the equipment leasing world, however, the answer may not be so clear. We are accustomed to thinking of capital leases as the equivalent of secured debt, with the lessor holding a security interest in the leased equipment. But does this make sense where nothing has changed except the accounting treatment? Whether or not the lessor has a security interest or a "true lease" should be governed by § 1-203 of the Uniform Commercial Code, not the accounting rules. But once the new accounting rules take effect, it is perhaps

anyone's guess how a court will apply § 1-203 in practice.

CONCLUSION

The new accounting rules, if and when adopted, will require a close look at the GAAP definition and the financial and other covenants contained in the lessee-borrower's financial agreements. It would be wise for counsel to lessees to begin this process now, rather than wait until the lessee finds itself — unexpectedly — in default.



Market View

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2. The amount of actual Fair Market Value ("FMV") leasing, operating leasing, however it is labeled, has been in decline for years as the industry has commoditized and matured. Most business is already a secured loan product. FMV and similar solution-oriented products will continue to be available and have benefits for lessees and lessors.
3. Change creates opportunity! A reality that accompanies this is that not all can or will seize opportunity; that is the opportunity, and opportunity does not wait.

Change is creating an opportunity for you and your company. This must be the first thought on each executive's mind. Why? Because change puts in place a proactive state of mind that leads to review, innovative thinking and eventually to action. For equipment leasing and finance company executives, this state of mind should lead quickly to address these big three questions:

Michael J. Fleming is a principal of The Alta Group, LLC, a global consultancy serving equipment leasing and finance companies, investment professionals, manufacturers, banks, and government organizations. For more information visit www.thealtagroup.com.

WHAT BUSINESS DO I WANT TO BE IN AND WITH WHAT CUSTOMERS?

Companies should review this frequently as a routine matter. A declining number of companies want to be or can be in the actual leasing business and offer a leasing product. Do you want to be in the lending/margin business? Do you want to be in the leasing/residual and services business? Those companies that are in leasing have selected customers that value the benefits of leasing. Those benefits are worth something to the customer and channel partners, and most will continue to exist. Your customers and channel partners need to understand this and how the benefits will work, and they have to get that message! We know that most lessees value other benefits well ahead of off-balance-sheet financing. Cash flow, flexibility, tax liability management, asset-related services, and other benefits provide and can continue to provide value to customers and channel partners.

The risk and rewards mix may be adjusted in your business model, but if you are going to offer the lease solution, a new accounting standard does not prevent it. In fact, capitalization of leases may offer some unintended financial benefits that should be discussed with customers.

Many equipment finance companies have decided that retaining asset risks related to offering a product in the leasing business is simply not worth it any longer. The new required lessor financial accounting compliance may reinforce that

view, and more companies may opt for being in an equipment lending business. This decision by some will create opportunities for others.

Another part of this discussion involves the market segments you are in. For a small-ticket company, a certain level of compliance must be planned, but the market will not be affected very much. For a middle-ticket company, compliance must be planned, but also the marketplace must be addressed. Many transactions in this size segment are residual oriented. Finally, companies in the large-ticket size segment will lose the leveraged lease classification with its beneficial lessor accounting. Many of the latter may exit the leasing business if they have not already done so for other reasons. However, lessees of large equipment still value benefits such as tax incentive realization and residuals from their side of the transaction, and the creative companies here will find the structures that can deliver those benefits and still allow the leasing company to remain within its capital requirements.

What business will you be in is a key decision.

WHAT DOES THE CUSTOMER NEED AND VALUE?

Focus on the customer and channel partner. When was the last time your sales team members were out there having a meaningful discussion with each customer? The time to have these meetings is now. It would be a mistake to let customers and channel partners receive pessimistic or wrong information

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What's New In the Law

By Robert W. Ihne

FORUM SELECTION, JURISDICTION AND CHOICE OF LAW

Frontier Leasing Corporation v. Hunt, 2010-2813781 (N.C.App. July

Robert W. Ihne is an attorney with 25 years of experience in commercial financing, primarily in the areas of secured transactions and equipment leasing. Such experience has included drafting, negotiating and providing advice related to direct transactions, syndications, vendor financing arrangements, and various forms of credit enhancements such as guarantees and letters of credit. He may be reached at robert.ihne@gmail.com. The author gratefully acknowledges the assistance of **Erin Staton** and **Ed Gross** of Vedder Price Kaufman & Kammholz, P.C. in the preparation of this update. This update is dedicated to **Ed Groobert**, soon-to-be ELFA General Counsel Emeritus.

20, 2010) (unpublished disposition — see North Carolina rules before citing)

This North Carolina appellate decision affirms a trial court's order granting a motion by the original lessor's assignee to enforce a default judgment entered by an Iowa state court against the lessee, a golf professional in North Carolina. The lessee had signed a lease containing a consent to personal jurisdiction and venue in Iowa courts. (The facts underlying the litigation are common to many other cases involving the leasing of golf beverage carts with respect to which the lessees were told that payments to them for advertising on the carts would equal the payments owing under the leases. After the advertising payments stopped, many of the lessees stopped making payments under their leases.) This court finds that Iowa law would hold the forum selection clause enforceable notwithstanding the lessee's claims that the clause was not prominently displayed on the lease form and that he was not a sophisticated businessman. The court

distinguishes the facts in this case from those in a Pennsylvania case in which that court declined to enforce the forum selection clause against a lessee who was an immigrant with limited understanding of the English language.

WAIVERS OF TRIAL BY JURY

Key Equipment Finance Inc. v. Poag & McEwen Lifestyle Centers, LLC, 2010 WL 2696195 (U.S. Dist. Ct. W.D. Tenn. July 6, 2010)

Applying a four-factor test used by courts to determine whether a waiver of the right to a jury trial was knowing and voluntary, the court rejects the lessee's arguments that the waiver should not be enforced. With regard to one of the factors — whether the clause was inconspicuous — the court notes that although the lessee had argued that the waiver was in fine print in a form agreement, the waiver provision in fact appeared in all-capital typeface, making it distinct within the text of the relatively short agreement.

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Market View

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about the business implications of the changes to lease accounting. Let them hear from you first. In addition, don't let them concentrate only on compliance. Actually, compliance for the lessee is much easier than for the lessor.

Your company's message to its customers and channel partners must show that comparisons between compliance with the new standard and the benefits received from the lease can still favor the benefits of the lease. Will specific provisions of leases change to deliver the benefits? Most likely, yes.

- Lease terms may be shorter in some situations to minimize capitalization.
- Customers are going to pay much closer attention to options and end-of-lease provisions. Business models that

are based on the expectation of the whole evergreen family of lease extensions or renewals should be adjusted.

- The automatic use of contingent rents, particularly at the start of the lease, will receive closer attention and some push-back from lessees who want the regular lease term to begin at the inception of the lease rather than at a quarter or some other date convenient to the lessor.

Representatives of leasing companies must be out there with their customers and channel partners explaining how the solutions to their needs are still available. In fact, some of the opportunities that will be available include services related to assisting the lessee with its compliance requirements, particularly on issues related to the lease term — longest possible term that is more likely than not to occur. In addition, lessors can offer assistance with the

required periodic review of an asset's value. Lessors also should be prepared to provide billing that can separate the lease component cost and any service component cost for the lessee. Provide what is important to the customer and your channel partner.

There is no question that the new accounting standard will remove some of the "smoke and mirrors" from how lessors go to market. There will be greater transparency; lessees may even get "smarter," but they still want the premium product value-add that the lease can offer them.

In relation to the last point is the probable shift in contact person(s) and decision making in the customer. The decisions now are capital expense decisions; and personnel on the financial side, a CFO or other, will make or be directly involved in making the acquisition and financing decisions.

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IN THE MARKETPLACE

TD Bank has named **Thomas C. Murray** the managing director of TD Equipment Finance in New York. He will be responsible for leading all of TD's equipment financing and capital markets initiatives. Murray has more than 26 years of experience in structure leasing and commercial lending, and previously served as a partner at Fieldstone Partners in New York. He has also held senior-level management positions at CIT and GE Capital.

U.S. Bank Equipment Finance of Portland, OR, has announced **Michael Ash** as the vice president and manager of syndications for its capital markets group. Ash will man-

age the syndications activity across all U.S. Bank Equipment Finance business units. He was previously vice president, syndications manager with Wells Fargo Equipment Finance.

SNR Denton announced that **Thomas A. Parachini** has joined the firm as a partner in its Banking & Finance Department. He will reside in the London office. Parachini joins from the Ford Motor Credit Company LLC's European subsidiary FCE Bank plc, where he was the Managing Attorney for Treasury/Capital Markets and Assistant Company Secretary. At Ford Credit, Parachini was responsible for overseeing

all aspects of the company's European treasury funding programs, in particular its extensive securitization programs. He has worked on a wide variety of transactions, with an emphasis on securitization of retail auto loans, retail auto leases, and dealer floor plan finance receivables. Parachini has extensive experience with public offerings, domestic and cross-border offerings, term note and variable funding note offerings, and existing asset and future flow transactions. Prior to Ford Credit, he was a member of the Structured Finance team at Thacher Proffitt & Wood LLP in New York, where he represented issuers and underwriters in residential mortgage-backed securities transactions.



Market View

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HOW CAN OUR COMPANY MAKE MONEY IN THIS BUSINESS AND WHAT WILL WE HAVE TO DO?

Your company has to make money. Your revenue and profit are the value you get back from the value you have delivered to your customer. They have to match. Leases can provide the value-add to customers and receive value in return. See Table 1, below.

However, your company must decide whether you want to do, and can do, what will be necessary to make money as shown in the "value received" column of Table 1. This is the Performance Obligation Lease, and while the Exposure Draft does provide some rigorous record keeping, calculations and financial accounting, it is required if you want to be in a business where you make money from more than just the margin that goes with simple secured lending.

Provide higher perceived value, receive higher value — provide nominal value, receive nominal val-

ue. The choice is yours. In addition to working with clients on how to engage customers and channel partners, I see people in the industry evaluating their capabilities now to do what they will have to do under the new lease accounting standard. This includes:

- Asset management capabilities, including asset value assessments; lease term probability related to technology; maintenance and supply channel management; and re-marketing;
- Business practices, including use of contingent rent; and end-of-lease practices;
- Document audits and business processes, including pricing models, risk assessment, booking and billing/invoices; and
- Funding strategy.

CONCLUSION

Assuming that your company can and is willing and able to do what is necessary to offer a competitive leasing or lease-like value to your customers and channel partners, you should engage your customers and channel partners now. If you do not, they may receive negative or misinformation about the full impact of the new financial accounting standard. Even worse, your competitor may be out there now showing your customers and channel partners how it can continue to provide value.

Speed to market is respected. Customers and channel partners are shown you are on top of things and care. There is no substitute for that in the marketplace.



Table 1

Value Delivered	Value Received
Access to cash/cash flow management	Pricing margin
Tax liability management	Use of tax incentives
Convenience and flexibility	Premium in pricing
Asset risk management	Fees and remarketing
Packaged services supplies	Fees
Compliance services	Fees

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