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LIEN PROTECTION

Perfecting a First Lien and Establishing Priority

By Anthony L. Lamm

In the typical business lease transaction, by the time a lessee contacts an equipment lease or finance company, it already has secured financing with a bank. Frequently this obligation is in the nature of a warehouse line of credit or a promissory note and a security agreement. Given this scenario, should an equipment lessor or equipment finance company elect to do business with such a lessee, the issue of lien priority becomes paramount. This article will focus on how an equipment lessor can perfect a first lien and establish priority in the individual items of equipment it leases or finances when a floor plan secured creditor or blanket-lien holder has already filed a blanket lien.

The security agreements of most blanket-lien holders typically describe collateral as follows:

"(a) All furniture, fixtures, machinery, supplies and other equipment. (b) All motor vehicles, tractors, trailers, implements, service parts and accessories and other inventory of every kind. (c) All accounts, contract rights, chattel paper and general intangibles. (d) All new and used tractors, equipment and other merchandise now owned or hereafter owned or hereafter acquired by debtor and in the proceeds, in whatever form, of any sale or other disposition thereof."

This language may create a problem in perfecting a lien for any subsequent equipment lessor or finance company. Since the financing state-

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INDUSTRY UPDATE

Trouble on the Horizon: Portfolios Are Growing, but New Business Is Not

Overall, the numbers presented by the fourth-quarter 1999 Equipment Leasing Association's Quarterly Performance Indicators Report (PIR) should be viewed with cautious optimism. Although portfolio growth continues at a steady pace, new business volume has been flat. With charge-offs at a relatively high level and the credit approval ratio decreasing throughout 1999, this could give some cause for concern.

According to the PIR, total net portfolio growth for the fourth quarter of 1999 increased by a total of 13.1 percent from the fourth quarter of 1998 and by 15.7 percent from the first quarter of 1999. New-business volume also ended 1999 on a positive note, having climbed back to the \$8.7 billion mark achieved after the fourth quarter of 1998.

The figures for new business for 1999, however, differ significantly from the same period in 1998. There was an impressive increase of 57.5 percent in new-business volume in 1998, compared with zero growth overall in 1999. The most positive news in this regard, however, is that new-business volume completely recovered from the 32.2 percent drop suffered between the fourth quarter of 1998 and the first quarter of 1999.

Total net portfolio for the fourth quarter of 1998 was \$57.2 billion, which then dropped slightly by 2.3 percent to \$55.9 billion in 1999's first quarter. After that, portfolio growth made up this lost ground by increasing to \$57.8 billion at the close of 1999's second quarter. This category then made its biggest quarterly jump of the past year, 7.1 percent, rising to \$61.9 billion at the end of the third quarter. Total net portfolio growth closed 1999 by increasing 4.5 percent to \$64.7 billion, resulting in an overall gain of 13.1 percent for the year.

Total new-business volume took a ride that was common to a number of categories this past year. After taking a precipitous drop between the end of the fourth quarter of 1998 and the first quarter of 1999, this category spent the rest of the year making up lost ground. New-business volume stood at \$8.7 billion at the close of 1998's fourth quarter, then dropped a hefty 32.2 percent to \$5.9 billion in the first quarter of 1999. New-business volume then jumped up 22 percent to \$7.2 billion in the second quarter of 1999. Volume increased again during the third quarter, rising by 4.2 percent to \$7.5 billion. New-busi-

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ment filed by the floor plan secured creditor perfects a security interest in "all new and used equipment and other merchandise now owned or hereafter owned or hereafter acquired and in the proceeds, in whatever form of any sale or other disposition thereof," can an equipment lessor or finance company find a safe harbor in leasing specific items of equipment to a borrower or lessee who is already financed by a floor plan secured creditor?

Initially, the analysis must begin with an examination of the pertinent Uniform Commercial Code sections. Article 2A-307 addresses the "Priority of Liens Arising by Attachment or Levy on, Security Interest in, and Other Claims to Goods." Subsection (a) provides in pertinent part that, "Except as otherwise provided in § 2A-306 (relating to priority of certain liens arising by operation of law), a creditor of a lessee takes subject to the lease contract. (emphasis supplied). Under subsection (b) of § 2A-307, "[A] creditor of a lessor takes subject to the lease contract unless: (1) the creditor holds a lien that attached to the goods before the lease contract became enforceable; (2) the creditor holds a security interest in the goods and the lessee did not give value and receive delivery of the goods without knowledge of the security interest; or (3) the creditor holds a security interest in the goods which was perfected (§ 9-303) before the lease contract became enforceable."

Since the security interest in favor of the floor plan secured creditor can only be perfected by the secured party taking possession of the leased goods, there is no interference with the lessee's leasehold interest unless the goods delivered to, and received by, the lessee were subject to a lien of the same floor plan secured creditor before the lessee received delivery, or if the lessee received the equipment or goods without consideration.

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Accordingly, Article 2A of the UCC gives equipment lessors the freedom and security to lease goods in the ordinary course of business to lessees who already have blanket-lien financing.

However, the situation would not be as simple if (1) the equipment lease agreement were deemed to be a disguised security agreement or an installment sales contract, or (2) the equipment financing was a purchase-money financing arrangement from the outset. In both of these situations, UCC § 9-312 governs.

For a clearer illustration of this situation, the facts of *In re McClure*, 108 BR 468 (U.S. Bankr. Ct., MD. Pa. 1989), are helpful. In *McClure*, Ford Motor Credit and the debtor executed a tractor and equipment wholesale plan application for wholesale financing and security agreement on or about Oct. 16, 1984, with the following collateral description: "[T]he merchandise (new and used tractors, equipment and other merchandise) now owned or hereafter acquired by dealer and in the proceeds, in whatever form, of any sale or other disposition thereof."

On June 16, 1986, Ford filed a UCC-1 financing statement in the office of the appropriate county clerk and, on July 21, 1986, in the secretary of state's office. Thereafter, on June 9, 1988, and June 13, 1988, Kubota (a manufacturer and financier of tractors) filed a UCC-1 financing statement in the secretary of state's office and in the county clerk's office covering tractors and inventory. On June 16, 1988, Kubota and the debtor also executed a security agreement describing the particular collateral subject to their financing statements. Kubota never notified Ford of its purchase money inventory financing pursuant to UCC § 9-312 (3)(b).

Prior to the Oct. 16, 1984, tractor and equipment wholesale financing and security agreement with its after-acquired property clause, Ford and the debtor entered into two additional security agreements March 12, 1980, and Jan. 3, 1983, describing the collateral as follows: "(a) All furniture, fixtures, machinery, supplies and other equipment. (b) All motor vehicles, tractor, trailers, implements, service parts and accessories and other inventory of every kind. (c) All accounts,

contract rights, chattel paper and general intangibles." The court ruled that a novation did not take place and that the 1984 tractor and equipment wholesale financing and security agreement did not eliminate the general, blanket-lien security interest created by the 1980 and 1983 security agreements. Therefore, since Kubota did not deny that it failed to send Ford an inventory financing notice pursuant to UCC § 9-312(c)(2) and Kubota's financing statements were filed subsequent to the time that Ford filed its UCC-1s, the court ruled that Ford had a perfected prior security interest in the disputed collateral in which Kubota also claimed a security interest.

Sec. 9-312(3)(b) provides, in pertinent part, as follows:

"[A] perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if... (b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the twenty-one day period where the purchase money security interest is temporarily perfected without filing or possession...."

If an equipment lessor or finance company with purchase money security interest status intends to provide equipment lease financing to a customer for items of equipment that could be determined under the UCC (including Article 2A) to be inventory, an equipment lessor or finance company should do the following to protect its interest before acquiring equipment on behalf of a customer and advancing monies:

Perform a UCC search and obtain the actual collateral description related to the financing statements filed by other lenders and lessors to determine whether a prior lender is advancing and perfected in equipment that could be classified as inventory of the customer and that would be the same type of equipment you wish to lease

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In the Marketplace

ALFA Corp. of Montgomery, Ala., has signed a definitive agreement to acquire the leasing portfolio and assets of **OFC Capital**, an Atlanta-based business unit of **First Liberty Bank** providing financing for commercial equipment leases. The transaction involves a cash purchase price of approximately \$23.1 million, which is primarily for the portfolio of leases. OFC was founded in 1984 by **Chip Leas**, who will continue to manage OFC, which will operate as a business unit of Alfa Financial Corp., a subsidiary of Alfa Corp.

AIRTRAN Airways Inc. of Orlando, Fla., has completed a leveraged lease financing agreement with a commercial investor, **ICX Corp.** of Cleveland, involving the sale and leaseback of two Boeing 717 aircraft. AirTran has 10 717s in service and has firm orders for 40 additional aircraft.

CYPRESS Leasing Corp. of San Francisco has announced that **James A. Kaylor** has joined the company

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or finance for the customer, and

- If there is a prior in-time financing statement filed by a secured party as to the same type of equipment that you, as an equipment lessor, wish to finance, provide the prior secured creditor with notice of your intent before the beginning of the 21-day period where your purchase money security interest is temporarily perfected without filing or possession.

Any equipment lessor who writes leases that are not compliant with FASB-13 for "true lease" status should (i) perform a UCC search for similar types of equipment covered by inventory financing if this equipment lessor will also be financing equipment that could be considered inventory, and, (ii) provide the 21-day notice to the prior-filed blanket-lien holder.



and will be responsible for securing rail, maritime, intermodal and industrial transactions. Mr. Kaylor will be based in Stamford, Conn.

DVI of Doylestown, Pa., has reorganized a portion of its business and will close its wholesale leasing business, **DVI Capital**. The company cited narrowing spreads and the indirect nature of the business relationships found in the wholesale lease business. The company expects to reposition all the affected DVI Capital employees. DVI will continue to expand its direct retail and vendor business with healthcare providers in the hospital and outpatient markets.

FIRST Fleet Corp. of Fort Lauderdale, Fla., has appointed **Frederick R.H. Witherby, Jr.** to the position of executive vice president, administration and general counsel. He joined the company in 1998 after leaving private practice in Boston, where he specialized in equipment leasing and related tax law.

In a separate announcement, First Fleet also named **Victor Johnson** as assistant controller. Previously, he was senior vice president and controller of First Bankers Mortgage Services Inc.

HELLER Financial Inc. of Chicago has named **William W. Jenks** executive vice president and chief information officer. Previously, he was executive vice president and chief information officer of the Chicago Mercantile Exchange.

LAKELAND Bancorp Inc. of Oak Ridge, N.J., has reached an agreement to acquire **NIA National Leasing Inc.** of Paramus, N.J. NIA is a 13-year-old privately held leasing company that originates more than \$30 million of commercial leases annually to small and middle-market companies. NIA will be operated as a division of Lakeland Bank and will move its offices to Montville, N.J. The president

and founder of NIA, **Steven Schachtel**, will remain as divisional president.

LINC Capital Inc. of Chicago has begun downsizing selected leasing activities after being unable to sell the company as a complete unit. LINC expects to report a loss for the fourth quarter of 1999 that will result in a default of its bank loan and securitization covenants. LINC has already exited the portfolio finance business and shut down its vendor leasing unit, formerly known as LINC Connor Capital. Negotiations are now being held to sell or finance other components of LINC's business in select growth leasing and vendor finance, with the intention to use these proceeds to reduce bank debt.

The company further announced that **Martin E. Zimmerman** has resigned as chairman and chief executive officer, but will continue as nonexecutive chairman of the board. **Bert Laing** (president and chief operating officer) and **Allen P. Palles** (executive vice president and chief financial officer) will assume the day-to-day operations. The board of directors has elected to de-emphasize LINC's traditional leasing activities and substantially reduce overhead and debt. The company will instead focus on its profitable distribution/rental business, LINC Quantum, which just launched a new business-to-business web site (www.lincquantum.com) and Internet Finance + Equipment (IF + E).



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