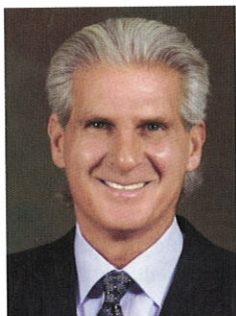


'Foreseeability' — Conducting Effective Leasing Transaction Interpretations

BY ANTHONY L. LAMM, ESQUIRE

Anthony Lamm continues his discussion on issues that arise from the Dodd-Frank Act and how local, state and federal laws apply to different lease transactions. Of particular importance is determining the nature of the lease as an entity and which state statutes apply to the transaction to help govern the transaction's characterization as either commercial or consumer.



ANTHONY L. LAMM, ESQ.
Managing Partner,
The Lamm Group

There have been changes in local, state and federal laws effecting the leasing industry that arise from the Dodd-Frank Act,¹ which require scrutiny of due diligence processes before funding a lease transaction to ensure it is considered commercial in nature and not consumer.

If the Federal Reserve Board determines a matter to be a consumer transaction, then a lessor must comply with the Consumer Leasing Act (CLA), 15 U.S.C. 1667, 1667(e), which amends the Truth in Lending Act (15 U.S.C. 1601 et seq.) (TILA) and regulates personal property leases exceeding four months in duration and are made for "primarily personal, family or household purposes." However, "primarily" remains undefined. Further, since the purpose of the Dodd-Frank Act and its cousin acts is to protect consumers from risky and speculative conduct of financial firms, as well as potentially fraudulent and unequal bargaining power conduct, the state and federal authorities have broad strength in their interpretations of lessees by the relatively new technical definitions for consumers engaging in "primarily personal, family or household purposes." Therefore

a leasing company must very carefully examine the particular state statutes governing consumers that apply to a lease transaction at the outset of the due diligence process and anticipate by examining the kind of equipment being financed and the nature of the lessee's motives. It may not be too far reaching to closely examine what "personal use" encompasses.

The CLA requires certain lease costs and terms to be disclosed, such as up-front costs, clear statements of the overall lease balance, payment schedules, maintenance, and insurance responsibilities. Limitations on penalty sizes for delinquency, default or termination are imposed, and the size of residual liabilities and certain disclosures in lease advertising are required.

A consumer lease is a lease or bailment for the use of personal property by a natural person for a period of time exceeding four months, and for a total contractual obligation not exceeding \$50,000 primarily for personal, family or household purposes, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease, except that such term shall not include any credit sale nor a lease for "agricultural, business, or commercial purposes." Before feeling completely secure, please note that it is unclear from this language alone whether a transaction falls under a state installment sales act if the lessee purchases the personal property at the expiration of the lease term. The importance of excluding state installment sales acts in the definition of the term or any case law is that only some state installment sales acts apply to commercial vehicles and dealers requiring certain leasing and dealer licenses.

¹ The "Dodd-Frank Wall Street and Consumer Protection Act" P.L. 111-203, 120 S. C. 5301, "Dodd-Frank Act"

When underwriting the nature and credit-worthiness of the proposed lessee, it is useful to examine the lessee in depth to make sure that if it is a commercial transaction, the lessee is not a sole member LLC, a sole shareholder corporation or a sole proprietor.

The CLA under 15 U.S.C. 1667 (a) requires that lessors give lessees, prior to the lease's consummation, a dated written statement on which the lessor and lessee are identified, setting out in an accurate, clear and conspicuous manner the following information with respect to the lease:

"... (4) The amount of other charges payable by the lessee not included in the periodic payments, a description of the charges and that the lessee shall be liable for the differential, if any, between the anticipated fair market value of the leased property and its appraised actual value at the termination of the lease, if the lessee has such liability;

... (9) The number, amount, and due dates or periods of payments under the lease and the total amount of such periodic payments;

... (10) Where the lease provides that the lessee shall be liable for the anticipated fair market value of the property on expiration of the lease, the fair market value of the property at the inception of the lease on expiration, and the differential between them; and

... (11) A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the term and the amount or method of determining any penalty or other charge for delinquency, default, late payments, or early termination."

It seems clear that the first order of business for commercial lessors to ensure that their lease is not a consumer transaction is to take precautions during the underwriting process and subsequently at the documentation stage. When underwriting the nature and credit-worthiness of the proposed lessee, it is useful to examine the lessee in depth to make sure that if it is a commercial transaction, the lessee is not a sole member LLC, a sole shareholder corporation or a sole proprietor.

Since the Federal Reserve Board is empowered to examine these transactions under the Dodd Frank Act to determine whether the underlining transaction is consumer, one has to be concerned with the nature of the lessee "at the time of the consummation of the transaction."²

When entering into a lease transaction, it is imperative to determine whether the purpose for the lease transaction is commercial or consumer. If the transaction starts out commercial but is really consumer in nature, there will be a violation of the CLA unless the disclosures thereof were met at the inception of the lease. However, if the lease transaction starts out as a consumer lease and the disclosures required are met despite the lease being used for commercial purposes, no violation of the CLA would apply as long as the transaction truly becomes commercial in nature.

In the case of *Heaven v. Trust Co. Bank* (1995 U.S. Dist. Lexis 22059), the court held that the time for determining whether the lease constituted a consumer or commercial lease is the time of the transaction.³ The *Heaven* court also stated that, "while it is true that the overall purpose of the lease is to be considered, and the mere checking of a box cannot be dispositive, the overall purpose of the lease should not legally be considered in view of unforeseen events that may have transpired subsequent to the transaction. The teeth of the TILA and the CLA statutes are found in their disclo-

It should be emphasized that the consequences of a lease transaction identified as a consumer transaction and governed by the CLA requires the leasing company to explore when structuring the transaction whether any consumer use could be anticipated.

sure provisions. These disclosures, of course, have relevance at the time of the transaction, not during the course of the lease or the extension of credit. It follows, therefore, that the purpose of the transaction should be researched at the time the disclosures occur, which is at or about the time the transaction is consummated. To the extent that subsequent actions are relevant to determining the overall purpose of the transaction, the relevance inheres in the ascertainment of the motives of the lessor."

In other words, the determination of whether the CLA applies is based on "foreseeability" and whether at the time of the transaction it could be foreseen what purpose the lessee put the equipment to use. It should be emphasized that the consequences of a lease transaction identified as a consumer transaction and governed by the CLA requires the leasing company to explore when structuring the transaction whether any consumer use could be anticipated. For example, the CLA would apply when leasing to an accountant for business purposes when it could be foreseen that the vehicle would likely be used for personal, family or household purposes. Therefore, where the purpose of the equipment subject to the lease transaction is ambiguous and could be used for personal or commercial purposes, a further examination should be conducted to determine the lessee's motives at the time of the transaction.

Other changes in the law related to leasing and equipment finance are acts similar to Pennsylvania's Motor Vehicle Sales Finance Act (MVSFA), also known as Act 98. Act 98 is important for motor vehicle dealers

CONTINUED ON PAGE 52

² Moreover, if the lessee is a corporation with multiple shareholders, but has a minimum gross revenue that supports the charge that the transaction is consumer, the CLA and the multiple disclosures 15 U.S.C. 1667 (a) would apply.

³ 12 C.F.R. Supp. I, P2(a)(6) subsection 1 ("The primary purpose of a lease is generally determined before or at a consummation and a subsequent change in usage is governed by 213.4(e) which applies to lease disclosures, not the purpose of the lease").

'Foreseeability' —

CONTINUED FROM PAGE 41

and retail sellers of consumer goods and services located in Pennsylvania or making sales online to Pennsylvania customers that provide financing through the use of installment sales agreements and by sales finance companies that purchase such agreements.

The methodology of providing equipment financing has changed so much in the past three to five years by documenting financing in the form of equipment finance agreements (EFAs), which are in substance, installment sales agreements. Therefore, an examination of the disclosures and licenses (which are outside the scope of this vehicle) required should be conducted to determine Act 98's and similar acts' application, and if so, when they should be applied to commercial leasing transactions documented through EFAs.

Pennsylvania's MVSA applies to a purchase by a business entity of a motor vehicle under an installment sales contract for its business use.⁴ In reaching its conclusion, the *Genesis Leasing Co. v. Minchoff* court relied upon the MVSA's definition of "installment buyer" or "buyer" as, "the person who buys, hires or leases a motor vehicle under any installment sales contract, MVSA Section 603(3)." Person's definition includes "an individual partnership, association, business corporation...or any other group of individuals however organized."⁵

Accordingly, if a lease is determined to be a disguised security agreement, or an EFA is truly an installment sale contract, then the MVSA applies to both financial institutions and motor vehicle dealers.

The CLA and MVSA draw our attention to the fact that if a lease transaction is determined to be consumer instead of commercial, there are limitations to the lessor and compliance issues, as well as documentation requirements that must be met. Both statutes warn us to be very careful in our due diligence before funding a leasing transaction and to undergo an analysis that judiciously anticipates what the use of the equipment will be at the time of the consummation. Determining the nature of the lease as an entity and what state statutes apply to the transaction also help to govern the characterization of the transaction. ■

TONY LAMM is managing partner of The Lamm Group and has more than 25 years of experience in secured lending including equipment leasing and asset-based finance, loan workouts, bankruptcy and litigation.

⁴ *Genesis Leasing Co. v. Minchoff* 315 Pa. super 437, 462 A.2d 274, 1983 Pa. Super. Lexis 3396 (1983).

⁵ Id. 603(2).

Employment Opportunities

monitor
monitordaily

Are You Ready to Move Your Sales Career into the Fast Lane?

We are looking for Regional Sales Managers who are ready to move ahead.

Element Financial, one of the fastest growing equipment lessors in North America, has immediate opportunities for experienced leasing Sales Executives with vendor and end-user relationships.

Our U.S. based Vendor and Commercial Finance business focuses on building long term partnerships in Transportation, Construction & Industrial, Energy, Franchise, and Technology Finance.

We place high value on the industry's most successful talent – those with:

- A proven track record of originating lease and loan volume through channel partners or directly with end users
- Individuals with proficiency closing new business, within the existing customer base and with new customers
- Sales professionals with established industry expertise and a network of contacts within the focus industry

We offer a strong compensation package that rewards production and includes salary, commission, expense reimbursement, a 401k and health benefits.

Rapid Growth Means Unprecedented Opportunity

We are building a team of individuals who thrive in a fast-paced, growing organization.

- ✓ **New Business Development Specialist.** Are you a big game hunter? We are searching for a star performer; a highly energetic individual looking for fast-paced career growth. The ideal candidate will have at least 10 years of leasing finance sales experience and a strong "hunter" mentality. This is a highly visible position within the organization with an attractive compensation plan and advancement opportunities.
- ✓ **Territory Manager.** Can you generate sales? We are looking for Territory Managers who can build profitable sales volume through prospecting in a dedicated territory of assigned lease/financing programs.
- ✓ **Sales Support Specialists.** Grow your career learning from the best. Sales Support Specialists assist in originating equipment financing contracts through dealers, vendors and other programs.
- ✓ **Senior Credit Analyst.** Analyze this! The ideal position for a Senior Credit Analyst who has experience analyzing, underwriting, and structuring middle ticket deals and ensuring strict adherence to credit policies and procedures.
- ✓ **Credit Analyst.** Small ticket, big job! Ideal position for a Credit Analyst who has experience analyzing small ticket deal flow and ensuring strict adherence to defined credit policies and procedures.
- ✓ **Portfolio Manager.** Do you have an established track record? Element Financial is looking for a Portfolio Manager to manage and collect delinquencies within the established company guidelines.

Element Financial is a rapidly growing dynamic leasing finance company that places a strong emphasis on employees. Element offers exceptional benefits and opportunity for career development and advancement. If you thrive in a fast-paced entrepreneurial environment and you're looking for a company where you can see and feel the impact of your work, Element is the place for you!

The first step in joining the Element team is to email your resume to
Deirdre Zirn at dzirn@leaserv.com.



655 Business Center Drive | Horsham, PA 19044 | 267.960.4000 | www.elementcorp.com

VISIT MONITORDAILY.COM FOR COMPLETE JOB OPPORTUNITY LISTINGS