MARKS & ASSOCIATES, P.C.

NEWSLETTER

August 2013

September 1
is our
Seventh Anniversary

NEWS

We are excited to welcome to the firm Matthew Evans, who has previously served as in-house counsel at BBVA Compass Bank. Matt has a good headstart on finance and banking work and we think he will bring a welcome perspective and skills to our practice.

On a sadder note, as was originally planned, Patti Reid has completed her tenure with us and will be moving on to head up a new equipment finance operation at Renasant Bank. We anticipated that Patti would be with us for 1 to 2 years and, now that she has had a good taste of the legal side of the equipment finance business, she is in a position to wreck havoc on her competition (as well as to drive her attorneys crazy). Life is a learning experience and both Patti and I have gained a lot from her months with us.

In other news, Bill Phillips has completed a review of the leasing portion of the National Association of Credit Managers Handbook and continues his work reviewing licensing and usury laws across the country. Every time we look into these laws for a different client, we learn something new about their application to specific facets of the equipment finance business.

This is the last communication you will be getting from Marks & Weinberg or, if you are a glass-half-full sort, the first from Marks & Associates, P.C. After 12 years of working with me, Ken Weinberg is moving on. He will be working for our old law firm, Baker, Donelson, Bearman, Caldwell & Berkowitz, PC, where he will continue to develop his energy finance practice. Ken has worked with me since the day he walked out of law school and, along with the rest of attorneys and staff, we wish him all the best.

As always, we would appreciate your comments and feedback. As we gear up for what I expect to be a particularly business fourth quarter, everyone at our firm wishes all of you good health, prosperity and every happiness.

BSM

IN THIS ISSUE

Matthew Evans, a long time Birmingham native, attended Gardner-Webb University on a football scholarship where he obtained his Finance degree. Upon graduation, Matthew attended BB&T's Leadership Development Program, a highly rated credit training program, where upon completion worked for three years as a lender in the Charlotte, North Carolina market prior to attending law school at Cumberland School of Law. Matthew gained valuable experience working as loan officer and managed an extensive loan portfolio.

Matthew graduated with honors while earning Scholar of Merit for Contracts and Civil Procedure. While in law school he had the opportunity to clerk for the 18th Judicial Circuit of Alabama and a Birmingham area based firm, specializing in corporate and commercial areas of law. Prior to joining Marks and Weinberg, Matthew worked at Gibbons Graham serving as lender's counsel on commercial real estate transactions and various credit requests and at BBVA Compass researching an array of legal issues regarding the complex world of commercial banking. Matthew is married to a 5th Grade teacher and enjoys spending time with his family (which is soon to have a baby girl) playing golf, fishing, and watching college and professional football.

PURCHASE MONEY SECURITY: WHEN FORM TRUMPS SUBSTANCE

By: Barry Marks

One of the most important weapons in the arsenal of any equipment finance company is the purchase money security interest or "PMSI". Unfortunately, it is often the victim of people who know too much for their own good.

The purpose of including PMSI's in the UCC makes perfectly good sense: if a debtor pledges all of its assets, including those acquired in the future, to its bank it will be unable to finance any new equipment purchases even if it arranges to buy them on time. This is bad for business and business is what the UCC is all about. The "fix" is found in UCC §9-324(a), which provides that a security interest in collateral is given super priority over an existing blanket security interest if it qualifies as a PMSI.

The logic continues when we recognize that this process does not hurt the original lender. None of the original lender's money is being used to finance new equipment and the has precisely the same collateral after the new equipment is acquired as it did before.

So far so good, but many of us think we know the rules for qualifying as a PMSI: file a UCC finance statement before or within 20 days after the equipment is delivered to the borrower. While that is correct in general, one immediate observation is that the UCC-1 must be "authorized" under current Article 9 §9-509(a)(1) in order for the secured party to file it. For that reason, it is safest to file the UCC-1 either (1) with the debtors signature, which is no longer required generally, (2) after the borrower signs a security agreement authorizing filing, or (3) at any time, but with the security agreement authorizing filings both prospective and prior to execution. The good news is that specific authorization is not required. Section 9-509(b) provides that signing a security agreement itself constitutes authorization. We recommend, however, that specific authorization be included in the lease or loan document so that counsel does not need to spend extra time explaining §9-509 to a judge.

Even as to the 20 day filing, the standard understanding has a potential hole in it. The UCC says, in §9-324(a) that the 20 days begins to run when the debtor acquires "possession" of the equipment. Technically, this means physical possession, not the date of acceptance or even the date testing is completed. In answer to a question often asked, official comment No. 3 to UCC §9-324 provides that a lessee who exercises a purchase option does not receive "possession" for purposes of calculating the 20-day period until the lessee actually purchases the equipment under the purchase option. In other words, a financed purchase option can have PMSI protection if a financing statement is filed within 20-days after title transfers from lessor to lessee in a true lease.

Trivia Challenge:

You know it's only rock and roll...
Got some good answers after last issue so let's try these:
What Rolling Stones song was based on a short story by a famous Russian novelist?

Which of these did not die in an airplane accident:

A. Buddy Holly
B. Sam Cook
C. Ricky Nelson
D. Stevie Ray Vaughn

What actress was discovered in a Bruce Springsteen video?

Name the members of Nirvana at the time of Kirk Cobain's suicide.

On which rock star did Johnny Depp base a movie role characterization?

Answers, complaints, counter-challenges are welcome. Barry@leaselawyer.com

This leaves one final and most-overlooked requirement for PMSI. The loan must enable the borrower to acquire the equipment. §9-103 (a)(2) This means that reimbursements, even if they occur shortly after the borrower pays for the equipment, are probably not covered by PMSI protection. It means that things become a bit complicated where the borrower makes a down payment which is reimbursed.

Under prior law in many states, even a partial repayment to a borrower destroyed PMSI protection. Under revised Article 9, however, a kinder, gentler approach is taken and that portion of the loan that is actually purchase money (paid to the vendor) qualifies for PMSI protection, meaning that an apportionment of sales proceeds from the collateral may take place.

Note that there are special rules for inventory (9-324(b)) and software.

Unlike some of our more conservative friends, we have no problem relying on PMSI and advise clients that, like some of the products advertised on television years ago, PMSI is "100% effective when correctly applied." Like so many things, however, receiving the benefit of this important creation of the Uniform Commercial Code requires education and diligence.

THE DIRTY DOZEN

By: Bill Phillips

These states are particularly troublesome where usury and licensing are concerned.

California: Willful violation of the finance lender licensing laws is punishable by a fine of up to $10,000 and imprisonment for up to one year. Violators can be subject to a civil penalty of $2,500 per violation.

Colorado: Charging over 45% interest is a felony and carries a minimum one year prison sentence and a fine of $1,000.00.

Florida: Charging an interest rate exceeding 25% is a second degree misdemeanor and charging an interest rate exceeding 45% is a third degree felony.

Kentucky: Failure to obtain the loan license when necessary is a misdemeanor. The statute also provides that any loan contract made in violation of this statute shall be void and the lender shall have no right to collect any principal, charges or recompense whatsoever."

Maryland: Failure to obtain a required lending license is a misdemeanor subject to fines and/or imprisonment not exceeding 3 years.

Massachusetts: The criminal usury rate is 20%. Violation of the criminal usury statute is punished by imprisonment in the state prison for not more than ten years or by a fine of not more than ten thousand dollars, or by both such fine and imprisonment.

Michigan: Any person guilty of criminal usury may be imprisoned for up to 5 years and/or fined up to $10,000.00. Possession of usurious loan records may also result in imprisonment and a fine. If the borrower is a "business entity" but the lender is not a bank, credit union or similar institution, the maximum interest rate is 25% and that rate is subject to criminal penalties.

Minnesota: Any person who violates the loan licensing statute is guilty of a "gross misdemeanor" and loans made without a license are void. The borrower is not liable to pay any amount under the loan and can obtain a refund of any money paid on the loan.

Montana: Persons who fail to obtain a necessary license for the purchase of installment sale contracts are guilty of a misdemeanor and punishable by a fine and/or imprisonment.

New Jersey: In addition to its civil usury rates New Jersey's criminal usury rates are: (a) 50% for to loans to corporations, limited liability companies and limited liability partnerships; and (b) 30% to other borrowers Violation of criminal usury laws subjects the lending party to criminal usury liability and a fine up to $250,000.

Rhode Island: The maximum interest rate any entity may charge may not exceed the greater of 21% per annum or 9% above a published index. Violation of the usury statute can result in forfeiture of the entire principal and interest and imprisonment for not more than five years.

Tennessee: Tennessee's usury rate is a variable published "formula rate". The willful collection of usury is a misdemeanor punishable by up to eleven (11) months, twenty-nine (29) days in jail or a fine not to exceed two thousand five hundred dollars ($2,500), or both.

State usury and licensing laws differ significantly from state to state. These are just a few examples. Your transactions may not be impacted by the laws referenced above even if you have customers in these states. Factors include your type of financing product, interest rate, type of customers, size of transactions, collateral and whether you are a bank, credit union, unaffiliated financing company or broker. It is important to understand the risks as well as the rewards of entering into a transaction in a new state.

STAYING SECURE:
PITFALLS IN ASSIGNMENT OF LEASES

By: Matthew Evans

As a funder in a lease assignment transaction, protecting your security interest in the lease, as well as the equipment, is critical. Not being aware of your rights under the Uniform Commercial Code could possibly leave rent payments in the hands of a third party. This article highlights some critical legal concerns while providing insight into best practices for protection under lease assignment transactions.

When a lease itself is sold or used as collateral, the lease constitutes "chattel paper." *See* § 9-102(11) (defining chattel paper as 'a record or records which evidence both a monetary obligation and . . . a lease of specific goods. . .'). All assignments of leases fall into one of two categories. (1) The assignment can be an outright sale of the lease, or (2) the lease may serve as collateral on a loan from a funder (often referred to as a "collateral assignment of lease"). Under both scenarios, each will be defined as chattel paper and receive identical treatment under the law. *See*. UCC § 9-109 (stating Article 9 governs a security interest in chattel paper as well as the sale of chattel paper).

Perfection of a security interest in an assigned lease (as collateral or as assurance of sole ownership if an outright sale) can be achieved by:

- Filing a UCC-1 financing statement that names assignor of the lease as "debtor" and the purchaser as "secured party" (UCC § 9-312); ***OR***
- (2) Taking "possession" of the chattel paper (UCC § 9-313).

HOWEVER, when choosing between perfection by filing and perfection by possession one must remember UCC § 9-330(b). This section states:

> "A purchaser of chattel paper has priority over a security interest in the chattel paper . . . if the purchaser gives new value and takes possession of the chattel paper . . . in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party."

In plain English, a party who is in possession of chattel paper takes priority over a filing as long as the party is not aware its interest violates the rights of an adverse secured party. Even if a prior UCC-1 was filed, the party in possession wins to the extent it did not know of the other's interest. Possession of chattel paper keeps your collateral secured and your rent stream in your bank account.

Luke Lessor assigns a lease to Frank Funder as collateral for a loan. Luke Lessor and Frank Funder execute an assignment and Frank files UCC financing statement. Billy Buyer then enters into an assignment for the same lease for value, AND Billy is given a signed copy of the lease marked "sole original counterpart." Who has priority: Frank Funder or Billy Buyer?

Remember POSSESSION, POSESSION, POSSESSION. Even if Frank Funder files a proper UCC-1, the rules regarding possession make it ineffective against Billy Buyer to the extent that Billy Buyer was not aware of Frank Funder's interest. Frank Funder would have been the clear winner if he was in possession of the chattel paper but possession by Billy Buyer trumps filing by Frank Funder.

One final note: file the UCC-1 as well as taking the original. There might be more than one "original" out there!

Should We Be Worried About Western Sky Usury Case?

By: Bill Phillips

Editor's Note: As many of you know, we routinely advise clients on state usury and licensing issues. The Western Sky litigation resulted in several questions from clients and other readers of this Newsletter and we thought we would weigh in with our thoughts. Other information on usury is included elsewhere in this issue. Please email Bill or me if you have any questions.

BSM

As reported by numerous publications including the Monitor Daily, on August 13, 2013 New York Attorney General Eric Schneiderman filed against Western Sky Financial for violations of that state's usury laws, licensing laws and fraud claims.

Western Sky is a well known consumer lender in the business of making short term, high interest rate loans. It advertises on television and the internet. According to the petition filed by the Attorney General, Western Sky has made at least 17,970 loans to New York consumers since 2010 in amounts between $400 and $9,925. The interest rates on these loans ranged between 89.26% and 342.86%. Consumers were also assessed a "loan fee" that was added to the principal of the loan in as much as 70% to loans of $500 and 50% to loans of $1,000.

In New York, as in many states, the issues of lender licensing and usury are related. The basic civil law usury rate in New York is 16% per annum. With a lender's license the finance company can offer rates above 16%. However, interest rates above 25% are violations of the criminal usury rate except for some specific exceptions. So, New York is pursuing not only usury violations but also the failure of Western Sky to obtain the lender license.

New York is just the latest state to go after Western Sky. It seems that Western Sky ignored many state lending licenses. According to the Petition, the unlicensed high interest lending activities of Western Sky and related companies has been the subject of legal enforcement action by twelve states including Maryland, New Hampshire, Kansas, Massachusetts, Illinois, Oregon, Washington, Colorado, Missouri, Minnesota, Georgia and West Virginia.

Usury and licensing laws vary significantly from state to state. Some state laws apply to all loans made in a state. But our research has shown that lenders that offer small loans are much more likely to be subject to state usury and licensing laws than a lender that offers only large or medium size commercial loans. Clients that have adopted minimum loan amounts of $25-30,000 have avoided most of these laws. If, as alleged, Western Sky has made a high volume of high interest consumer loans without regard to the licensing and usury laws of the states their actions were reckless.

It appears that Western Sky has been relying on a position that they are not subject to the licensing and usury laws of the states because the business is operating within the Cheyenne River Sioux Reservation. According to the Petition each page of the online application form for loans with Western Sky has the following message which the A.G. described as "misleading":

Western Sky Financial, LLC is a Native American-owned business operating within the boundaries of the Cheyenne River Sioux Reservation, a sovereign nation located within the United States of America. By using our website, you are conducting business on the Cheyenne River Indian Reservation and are subjecting yourself exclusively to the laws and jurisdiction of the Cheyenne River Sioux Tribe, a Sovereign Native American Nation.

The Attorney General has taken the position that Western Sky has conducted "deceptive business practices" and "fraudulent business conduct" in part because it (a) represented to its customers that New York law does not apply to the transactions and (b) misrepresented that the interest rates are legal. The A.G.'s position may concern our clients that rely on their contractual choice of law provisions that stipulate that the law of their chosen state will apply rather than the law of their customer's residence. In relying on a choice of law provision aren't you also representing (or misrepresenting?) that the lessee's home state laws do not apply? Here are a few comments.

The statement Western Sky relies on is not like the typical choice of law provision and is may well be misleading to a consumer. Choice of law provisions generally state that the parties agree that the law of a certain state applies. The choice of law provision may be supported by an acknowledgement that the lender is located in that state and is accepting the contract in that state. However, Western Sky states is that by doing business on their website the consumer is considered to be conducting business on the reservation and thereby subjecting yourself to the tribal laws. This statement seems legally in accurate and probably misleading to the consumer. Western Sky may have been trying to get around some state restrictions on the enforceability of typical choice of law provisions in consumer contracts.

It would not be surprising even with a normal contractual choice of law provision that a state would take the position that its usury laws apply to its transaction. Despite little published case law on this point, we have cautioned clients about the risks of relying on a choice of law provision to lend in states with a problematic criminal usury statute or civil usury statutes with severe penalty provisions. Despite generally broad state statutory and case law support for contractual choice of law provisions you may not want to be litigating this issue with a significant possible downside to your company and its officers/employees. It will be interesting to see how the New York court views this issue if it goes to trial.

As we stated above, this case is in part a licensing case. A lender cannot avoid the licensing statutes of its customer's state with a choice of law provision. If the licensing statute applies, the lender cannot circumvent the license with a contractual provision. The New York lender license is applicable to persons or entities that solicit loans within New York and, in connection with such solicitation, make loans of under $25,000 to New York consumers and under $50,000 to New York businesses and charge these customers over 16% interest. Additionally, if you become a licensee in a foreign state then you may become subject to certain laws of your customer's state despite your contractual choice of law.

Keep the following in mind: The Uniform Commercial Code, the Restatement of Conflict of Laws and a significant amount of case law support the right of parties to a commercial contract to choose the law applicable to their contract, as long as the chosen state has a reasonable or substantial relation to the transaction. The best approach to your licensing and usury risks is to be informed about the laws of the states where you have customers so that you can make informed business decisions about the actions to take.

Western Sky is an aggressive consumer lender with a high profile. Consequently, it is an inviting target for states to pursue. It remains to be seen where the actions by New York and the other states against Western Sky portend similar actions against commercial lenders providing credit to high risk borrowers.

About Our Firm

Marks & Associates is a law firm that focuses exclusively on equipment leasing and finance. The lawyers of our firm have significant experience in dealing with virtually every type of equipment and facility financing, have participated in equipment financings worth billions of dollars, and are recognized throughout the industry. We invite you to read more about us and to use the wealth of materials provided in our Cases and Articles section of the website, which has hundreds of cases and articles about equipment leasing and finance and is updated regularly.

Our lawyers include present or past members of the Equipment Leasing Association's Legal Committee (now ELFA), the Board of Editors of LJN's Equipment Leasing Newsletter, and the Journal of Equipment Lease Financing. They also include two former in-house bank lawyers,, the first lawyer to be certified as a Certified Lease Professional (CLP), the 1999 winner of the Bill Granieri award for leasing education, a member of the Best Lawyers of America®, members of the Best Lawyers in Alabama®, and a contributing draftsman on Alabama's Uniform Commercial Code Article 2A Enactment. Our firm has an AV Peer Review "Preeminent" Rating, the highest possible rating in both legal ability and ethical standards by LexisNexis/Martindale-Hubbell.

We are longstanding members of the Equipment Leasing Association and The National Association of Equipment Leasing Brokers and have participated in conferences and seminars conducted by all the major leasing and finance associations. Our lawyers routinely publish articles in a variety of equipment leasing and financing journals. They have also published chapters in leading treatises in the industry and have co-authored multiple books. Their publications appear in the following:

- ABA's Business Law Today
- ABF Journal
- The Journal of Equipment Lease Financing
- Equipment Leasing Today
- The Monitor
- LJN's Equipment Leasing Newsletter (formerly Leaders)
- Matthew Bender's Equipment Leasing
- Practicing Law Institute's Equipment Leasing - Leveraged Leasing
- Power Tools for Leasing
- Power Tools for Small Ticket Leasing
- Technology Leasing
- Secured Transactions, Article 9 of the Uniform Commercial Code

In addition, we have contributed information to the Commercial Finance Guide, the ELFA Executive Guide to Lease Documentation, and the "Getting It Right" Video Series.

Formed in 2006, Marks & Associates, P.C. takes pride in our reputation for prompt, cost-effective service, consistent quality and unparalleled knowledge in our industry.

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Be Safe!

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