

TRUE LEASE AGREEMENTS AND RESIDUAL VALUES

Equipment leasing has become an increasingly important part of business financing arrangements in this country. In particular, since the most recent recession has begun, banks have had to constrict their lending capabilities in many fashions. The equipment finance industry has, in part, worked to provide an additional form of financing for acquisition of equipment and other business property.

An equipment lease differs from a traditional financing arrangement with a bank. In a true lease, the crucial difference is that the leasing company maintains titled interest in the property. An additional difference, that is really part of the definition of a true lease, is that the equipment leasing company maintains a meaningful interest in the residual value of the equipment. (A very brief description of the "residual value" would be the value that the equipment would bring to the lessor upon a sale of the equipment at the end of the lease term.) A lease transaction was analyzed by courts referring to the residual value under the common law for years.

In recent years, however, the Uniform Commercial Code has been amended to include a specific chapter dealing with equipment leases. As a result of the amendment of the Uniform Commercial Code in this fashion, prolonged discussions and analysis of residual values need no longer occur. Rather, the statutory definition of a true lease is easier to follow, and does not require a detailed analysis of the residual.

There is a time, however, when the residual value does become of importance: at that time when a lessee defaults under a lease and enforcement efforts are pursued by the lessor. At such a time, if the equipment is not recovered, or it is recovered in a damaged condition, it can be important to be able to prove the existence of a booked residual value for purposes of obtaining additional damages in the judgment obtained by the leasing company. To assist the leasing company in obtaining this benefit, however, the lease should refer to the fact that the equipment must be returned in a good condition, reasonable wear and tear excepted, and if not so returned, that the leasing company is entitled to collect additional damages. The amount of the damages may be subject to dispute based on the condition of the equipment. The fact that they should be made available to the leasing company, however, should not be in dispute if the documentation is drafted appropriately.

Our firm has represented leasing companies for the entire 20 years of its existence and, prior to that time, Robert Storm represented leasing companies for an additional 8 years. Should you have questions on leasing documentation or enforcement of leasing documentation, do not hesitate to contact either Robert Storm or Jennifer Hayden, as we will be happy to provide assistance and use our knowledge to represent you in these matters.