LJN LAW JOURNAL NEWSLETTERS

LJN's
Equipment Leasing Newsletter ®

An ALM Publication

Volume 34, Number 12 • January 2016

What's New in The Law

By Robert W. Ihne

True Lease Versus Security Interest

In re Hunt, 2015 WL 6501074 (Bankr.D.Idaho Oct. 27, 2015)

Debtors in bankruptcy obtained financing from a friend to purchase a small plumbing business, including various property related thereto. When the debtors attempted to argue that the property was not property of the bankruptcy estate, but instead was being leased under a (true) finance lease under Idaho law, the court concluded that the agreement between the debtors and their friend was instead a disguised security interest — since the agreement indicated that the debtors would own the property at the end of the transaction (when they had completed all payments to their friend) for no additional consideration.

In the matter of Wells (*Wells v. American Financial, Inc.*), 2015 WL 3862969 (Bankr.N.D.Ala. June 22, 2015)

The debtor in this bankruptcy claimed that its 91-month automobile lease with the defendant finance company was not a true lease. The court agrees with the finance company, finding that the purchase option in the lease of $3,445.05, representing about 20% of the original purchase price of $16,300, was not nominal, citing a U.S. Court of Appeals for the Sixth

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New FASB/IASB Lease Accounting Rules to Be Issued Soon

Overview and Implications

By Bill Bosco

The International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) have completed decision-making meetings and the respective staffs are drafting the final rules, which will be signed and issued this month. The IASB and FASB will issue separate rules as they have chosen two different models for lessee accounting. They both have adopted the same lessor model with a few minor differences.

The transition year for public companies will be 2019 (fiscal years beginning after Dec. 15, 2018) with SEC-required comparative balance sheets for 2018 & 2019, and comparative P&L for 2017, 2018 and 2019. For U.S. private companies, the transition year will be 2020 (fiscal years beginning after Dec. 15, 2019) with two years' recommended comparative balance sheet and P&L, although not required.

FASB Version: Lessee Accounting

The FASB retained the current classification rules with minor changes. This is very good news — the 75% of useful life and 90% PV of asset cost/value bright lines will remain as guidance to determine lease classification. It will still be important that leases be classified as operating leases by lessees for reasons stated below.

The FASB capitalizes operating leases with terms greater 12 months with the liability not presented as debt, rather as an "operating" liability like accrued expenses (as an example) and P&L cost is the straight-line average rent expense (same as current GAAP). The capitalized operating lease asset (right of use or "ROU" asset) is also presented separately from finance lease assets. The impact of presenting the operating lease liability as an operating liability is that it will not cause debt limit covenant breaches and will not impact debt to equity ratios. The impact of

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maintaining the straight line rent expense is it closely matches the IRS tax treatment so there will not be any new deferred tax assets and it will not erode equity and earnings. The impact of reporting the capitalized operating lease assets separate from other assets is that allows tax compliance, regulatory capital calculations and lenders' analysis of collateral to be done as easily as is done under current GAAP.

Finance leases are treated the same as current GAAP for capital leases, as discussed below.

IASB Version: Lessee Accounting

There are no classification tests for lessees as they treat all leases as capital/finance leases.

All leases (except for short term — < 12 months and except for small value (< $5,000) items) are capitalized using the model for current capital leases — the liability is presented as debt, the asset is commingled with finance lease assets and the lease cost is front-ended, that is, the expense is a combination of straight-line depreciation of asset and imputed interest on the liability, each reported separately on the P&L statement. The impacts of the IASB one-lease model will be severe. Debt covenants will be broken, large deferred tax assets will be created, earnings and equity will be eroded, most financial ratios and measures will be worse, banks will have to raise more capital (to make up for the front ended lease costs, to apply to the operating lease ROU asset that is not separately reported and to cover the deferred tax asset created by the front-ended costs), and lessees will see the need to keep records under existing GAAP to provide information for reporting for tax, regulatory capital and lenders' needs.

FASB/IASB Comparison of Ratios/Measures Changes

Some financial ratios and measures will change for the worse and the results for U.S. companies vs IASB companies will be different as follows:

Key Ratios/ Measures	FASB Version	IASB Version
EBITDA	no change	better: rent replaced by amortization & interest
Gross Margin	no change	no change
Operating Efficiency Ratio	no change	better: rent replaced by amortization
Current Ratio	worse: asset not cur	worse: ROU asset not current
Quick Ratio	worse: add'l liab	worse: additional liability
Net Worth	no change	no change
Debt/Equity Ratio	no change	worse: additional debt + eroded equity
Return on Assets	worse: add'l asset	worse: additional asset + front ended costs
Return on Equity	no change	worse: less equity but front ended costs

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Equipment Leasing

Newsletter ®

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LJN's Equipment Leasing Newsletter® (ISSN 9733-4304) is published by Law Journal Newsletters, a division of ALM.

Telephone: (877) 256-2472
Editorial e-mail: jgromer@alm.com
Circulation e-mail: customercare@alm.com
Reprints: www.almreprints.com

POSTMASTER: Send address changes to:
ALM
120 Broadway, New York, NY 10271

Published Monthly by:
Law Journal Newsletters
1617 JFK Boulevard, Suite 1750, Philadelphia, Pa 19103
www.ljnonline.com

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Lessor Accounting

The IASB and FASB are substantially converged — keeping current GAAP with some exceptions:

1. The FASB drops leveraged lease accounting, grandfathering existing leases on the transition date. The implication here is that there is still a window to do leveraged leases and they will be grandfathered. They will be able to be traded after the transition date.
2. The FASB changes sales type lease accounting for those leases where third-party insurance/guarantees are needed to pass the 90% test — in that case the gross profit is amortized with lease revenue as opposed to allowing for up-front gross profit recognition as per current GAAP. To my knowledge, this will not impact many manufacturers and dealers. They still will be able to get more accelerated recognition than if they did not purchase third-party insurance as operating lease treatment forces a straight line recognition of gross profit on sale.
3. Both require guaranteed residuals to be considered in lease classification but they recorded as a residual (physical asset) rather than a lease payment (financial asset). The implication is that it will be difficult to securitize the guaranteed residual — it may end up being an on balance sheet financing.
4. We are not sure if ITC/tax grants will be expressly treated as revenue in a finance lease. The implication of not treating it as revenue is that the economic yield and reported revenue of a lease with ITC/tax grants will be distorted, appearing to be well below market and the benefit of the ITC/tax grant will be buried in tax expense. We have to wait to see the final words in the rules.

Other Items

Variable rents based on an index or rate are lease payments subject to capitalization at the spot rate — IASB requires rebooking when rents change — FASB requires rebooking only when another event causes the lease to be rebooked.

Residual guarantees in TRAC/Synthetic leases are capitalized at their expected value (what the lessee is likely to pay) — the amount is usually zero. This outcome should make TRAC-like structures with lessee residual guarantees more popular, as the capitalized amount is only the present value of the rents and the present value (likely zero) of the amount expected to be paid under the residual guarantee.

Sale leasebacks with fixed purchase options are not sales unless the lessee is acting as an agent, not a principal, or when the lessee does not control the asset at the time of the sale leaseback. The resulting accounting for a failed sale leaseback leaves the asset on the books of the lessee and the leaseback is accounted for as debt. The lessor also accounts for the transaction as a financing. This outcome will cause lessors that use sale leasebacks to fund their portfolio to take steps to insure they do get lease treatment. This outcome will also cause lessees and lessors to add steps to the process of leasing new assets where a sale leaseback is used to insure lease treatment.

Initial direct costs definition is changed to include only third-party costs. The implication is that more costs will be charged to current earnings than under current GAAP and there is a different treatment for loan vs lease IDC — many think this is not logical.

The lessee and lessor must bifurcate non-lease components of gross or bundled billed payments (leases with a service component). Gross billed leases are common in real estate and full-service truck and rail car leases. The lessee must use observable market pricing of one of the components to estimate the bifurcated amounts unless the lessor divulges the breakdown. The lessee capitalizes the present value of the lease component only, although the lessee can elect to capitalize the full payment. Lessees will demand a breakdown of the lease and service components because observable market evidence is generally not available. Lessors generally view the details of their pricing as proprietary and will not divulge the breakdown. The alternative of capitalizing the full payment is not acceptable to lessees, as it would cause the lessee to capitalize amounts significantly in excess of the cost of the asset.

CONCLUSION

The U.S. market should see little change in new business volumes, as the FASB chose an approach that allows the lessee financial statements to reflect the economic substance and legal and tax reality of operating and finance leases. The reasons for leasing still remain strong, especially because accounting is not the major reason that companies decide to lease.

A summary of the general reasons why customers lease and how those reasons fare under the FASB's version of the proposed new rules is contained in the chart on page 4.

What's New

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Circuit decision holding that a 10% purchase option was not nominal. In the course of so concluding, the court stated, "The Plaintiff, while arguing the payment option is nominal, asserts that the buyout amount represents 38.8% of the value of the vehicle at buyout. Whether the payment represents 20% or 38.8% of the vehicle's original value, the Court finds that the payment is not nominal using either calculation." It is difficult to be sure, but the court may be misunderstanding the plaintiff's point. If the plaintiff was claiming that the amount represented 38.8% of the vehicle's value at the end of the lease — as opposed to 38.8% of the vehicle's original value —

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Reason for Leasing	Details	Status After Proposed New Rules
Raise Capital	Additional capital source, 100% financing, fixed rate, level payments, longer payment terms, avoid impacting debt limit covenants, lease cost in operating budget	Still a major benefit versus buying financed by a bank loan/debt especially for small and medium sized entities and non-investment grade lessees with limited sources of capital
Low cost capital	Low payments/rate due to tax benefits, residual and lessor low cost of funds; implied equity vs. the capitalized lease amount is less than actual equity required when borrowing to buy	Still a benefit versus a bank loan and owning the asset
Tax benefits	Lessee can't use tax benefits and the lease vs. buy analysis shows lease option has lowest after tax present valued cost	Still a benefit
Manage assets/residual risk transfer	Lessee has flexibility to return asset	Still a benefit
Service	Outsource servicing of the leased assets.	Still a benefit
Convenience	Quick and easy financing process often available at point-of-sale	Still a benefit
Regulatory	Capital issues	Still a benefit as regulators should still treat ROU assets as "capital free" as they are an accounting contrivance and do not represent an asset in a bankruptcy liquidation
Accounting	Off balance sheet	Still a partial benefit if the present valued capitalized amount is less than the cost of the asset, should be true for high residual assets and the impact of tax benefits

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What's New

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there may have been a good reason to conclude that the lease was not a true lease inasmuch as that might have represented a bargain purchase option (if such a bargain was determinable as of the inception of the lease).

GEO Finance, LLC v. University Square 2751, LLC, 2015 WL 1637310 (U.S.Dist.Ct. E.D.Mich April 13, 2015)

Amid a rather complex set of facts was the central question of whether the agreement to finance a geothermal water supply system was a true lease or a security interest. The court correctly noted that the fact that the equipment consisted of fixtures does not itself answer the question, since the UCC permits fixtures to be the subject of a true lease as well as of a security interest. While analyzing the status of the transaction under UCC 1-203, the court focused especially on whether the agreement's purchase option was "nominal" (which would thereby convert the lease to a security interest) according to that Section's statement that "Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised." The court reasoned that the large purchase option amounts were likely substantially higher than lessee's cost of performing during the original term of the lease, and therefore had not been proven to

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Chapter 11 Plans of Reorganization and Equipment Lessors

Protecting Lessors' Rights

By Deirdre M. Richards

Filing Chapter 11 is a very expensive proposition these days. The filing fees, coupled with the astronomical attorneys' and special litigation counsels' fees, plus the accountants' fees, are just a few of the expenses for a debtor-in-possession ("DIP"). So what does this mean for us as equipment lessors? It means we must react accordingly and often very quickly to protect ourselves.

It means that many company DIPs set up their exit strategy before they file Chapter 11 to minimize the time that they are in a Chapter 11 bankruptcy proceeding and thereby minimize their costs for attorneys and other fees that the DIPs incur. That equates to us, as equipment lessors, having to play catch-up after being taken by surprise by a slew of so-called "First Day Motions" (such as Motions to Approve Cash Collateral or Debtor-in-Possession Financing, Motions to Pay Pre-Petition Wages, Motions to Pay Utilities, Motions to Pay Critical Vendors, Motions to Employ DIP Attorneys and others similar motions). You might even see a Motion to Sell Substantially All Assets of the DIP, or a Disclosure Statement and Plan of Reorganization filed just a few weeks after the Chapter 11 filing. Just as we are reading the court orders on the First Day Motions, we are inundated with additional pages of documents to read and analyze in order to protect our rights before it's too late.

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At this point the equipment lessor might have already decided to engage its own attorney to review the various DIP motions for their respective impact on the equipment lessor. It is generally best to know what relief the DIP seeks and determine its impact on the equipment lessor before there is a binding court order permitting the DIP to infringe on an equipment lessor's rights.

Two Critical Documents

There are two essential documents a lessor should examine once it has been learned that a bankruptcy petition has been filed. One is the Disclosure Statement, which is more detailed and describes the Plan, and the other is the debtor's Chapter 11 Plan. These are by no means the only documents that an equipment lessor should review, but these documents are extremely important. The culmination of a DIP's Chapter 11 case is to have the bankruptcy court conduct a confirmation hearing and confirm a DIP's Plan. However, the first step in that process is the court's approval of the DIP's Disclosure Statement.

The Disclosure Statement ("DS") is a document the DIP files as a requirement of Bankruptcy Code § 1125 that the DIP provide "adequate information" to its creditors. "'Adequate information' means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan … ." 11 U.S.C. § 1125. The DS is helpful in allowing an equipment lessor to review a Summary of the Plan and the Plan's treatment of the lessor as well as a general description of why the DIP filed bankruptcy and what it intends to do before it exits bankruptcy.

However, the reading does not stop there because the equipment lessor must read the Plan to make sure of its treatment. The Plan provides for the treatment of the DIP's creditors, including the equipment lessors. You want to read it with an eye toward how you will be treated as an equipment lessor. Plans may set forth a general treatment such as — all leases are rejected unless otherwise assumed. You may realize that the two documents are somewhat repetitive, but the DIP is required to file both documents and the DS is the more descriptive document. A Plan usually contains a phrase to the effect that if there are any inconsistencies between the DS and the Plan, the language of the Plan controls.

The DIP's Motion to Approve the Disclosure Statement

In addition to the DS and Plan, the lessor should also be prepared to read the Motion to Approve the DS. This motion generally summarizes the DS, and it attaches to it the DS and the Plan.

The Motions to Assume And the Motions to Reject Leases

Throughout a bankruptcy case, a DIP may file one or more Motions to Assume Executory Contracts and Unexpired Leases ("Motion to Assume") and it may file one or more Motions to Reject Executory Contracts and Unexpired Leases ("Motion to Reject"). The best way to think of these motions is that they are the DIP's mechanisms to rid itself of undesirable leases and keep the desirable leases. This decision is made based on the DIP's business judgment and any challenge to the decision to the DIP's decision to assume or reject will be confronted with challenging the DIP's business judgment. A court must approve the DIP's decision to Assume or Reject a lease. Generally, an equipment

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lessor will want to protect itself from an adverse decision and a lease cannot be both assumed and rejected.

Lease Acceptance or Rejection

DIPs use their business judgment when deciding whether to assume or reject a given lease. The emphasis of this article is not so much to understand why a DIP may assume or reject an Unexpired Lease or Executory Contract, but what an equipment lessor may and should do to protect its rights after the DIP decides to either assume or to reject a give lease.

The best place to start is Bankruptcy Code § 365. Section 365 provides, in relevant part:

> "(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.
>
> **
>
> (b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee — (A) cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property … ."

A Lessor's Objection To Lease Assumption

In a DIP's Motion to Assume, it will include a "Cure" amount. That is the amount of money that the DIP owes the equipment lessor for a prior default under the lease. If a lessor does not object to the cure provided by the DIP, the DIP's statement of the cure amount is controlling. Practically speaking, an equipment lessor whose lease is subject to a Motion to Assume, should file an Objection to the Assumption if the cure amount is incorrect. If not, the cure amount as stated by the Debtor will be the cure amount ordered by the court. Some DIPs just put a $0 cure, and leave it up to the lessor to object or get $0.00.

A Lessor's Objection To Lease Assignment

A DIP's Motion to Assume will generally provide that the lease is to be assigned to an assignee of the DIP's choice. For example, if your lease is to be assigned to the DIP's purchaser, you may want to file an additional objection if you are not confident that the purchaser has the financial wherewithal to provide you with adequate assurance of continued performance under the lease.

A Lessor's Filing of A Rejection Damages' Proof of Claim

As set forth herein, a DIP's decision to reject a lease subject to its own business judgment. Pursuant to the Bankruptcy Code, a rejection of a lease constitutes a "breach" of such lease. 11 U.S..C. § 365(g). I will therefore not address filing an Objection to the Debtor's Motion to Reject. If you decided to question the DIP's business judgment you will need a lawyer to go to court for you with experts to challenge the DIP.

This article addresses what you should practically do if the DIP files a Motion to Reject your lease and the court orders the lease rejected. The Order Rejecting the Lease will generally provide you with a deadline to file a Proof of Claim for Rejection Damages. A typical method for such a calculation would be to take the past due payments and the stream of all future payments (discounted to present value) and subtract any mitigation such as sale proceeds from the returned equipment or the present value of the rent stream from future leasing of the item. A lessor can add expenses of re-letting and attorney fees if or when the lease permits.

The DIP's Plan and the Treatment of Unexpired Leases and Executory Contracts

If your lease was not otherwise assumed in a Motion filed by the DIP to Assume Executory Contracts and Unexpired Leases, you will have to look at the Plan's Schedules or Exhibits because they usually have the treatment of each of the leases. If you believe there is a problem with the cure amount stated in the Plan for your Lease, you should Object to Confirmation and Cure.

A DIP's Plan may refer to a Plan Supplement or Exhibit containing specific treatment of the leases. The Plan may state that the Plan Supplement or Exhibit will not be filed until a week before the Confirmation Hearing and after the Objection Deadline to Confirmation. If this is the case, the DIP will generally provide a second Objection Deadline for Objections of Lessors to Cure. As set forth herein, cure is defined earlier in this article as the amount of money that the DIP agrees to pay the lessor to cure the DIP's prior default under the lease. Under this scenario, if a lessor does not object to the cure provided by the DIP before the objection deadline for the Plan Supplement or Exhibit, the DIP's statement of the cure amount is controlling.

Conclusion

A DIP that seeks to sell all of its assets often assumes and assigns some of its leases. In response, an equipment lessor must not just file a Proof of Claim, but also review the Motions to Assume or Reject as filed by the DIP, the DS, the Plan and any of its Plan Supplements regarding the treatment of the particular lessor. The Chapter 11 process occurs at a fast clip now, so the equipment lessor should monitor a lessee's bankruptcy case accordingly to protect its rights.

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be "nominal." The court missed the point of this Code provision, however, since the Code's (perhaps not very clearly stated) point is to compare the purchase option amount with the lessee's cost of performing its end-of-lease obligations. If such end-of-lease obligations are more expensive, then the lessee has a clear incentive to exercise the purchase option and become the owner of the equipment rather than expend a good deal of money to, for example, return the equipment (even if that option is for a substantial amount of money — not the usual understanding of the word "nominal"). The court concluded that the agreement was a true lease with the lessor retaining a meaningful residual interest in the equipment. The court failed to inquire, perhaps because the parties did not raise the issues, either: 1) whether the lessee may have been "economically compelled" to exercise the purchase option (for example, because the leased equipment was difficult or impossible to identify, disassemble and return); or 2) whether the lessor may have been responsible for removing and returning the equipment for a prohibitively expensive amount. In either of such cases, there would be a strong argument that the lease was in fact a security interest.

In re Gutierrez (*Gutierrez v. Popular Auto, Inc.*), 2014 WL 3888277 (Bankr.D.Puerto Rico Aug. 8, 2014)

The debtor/plaintiff in this bankruptcy proceeding had entered into a motor vehicle lease for 72 months with an option to purchase the vehicle for $0.00 plus a charge of $150.00. After the plaintiff argued that this lease was in fact a security interest, the vehicle lessor pointed to a provision in the lease stating that the lessee agreed the lease was a financial lease contract under Puerto Rico's Act to Regulate Personal Property Lease Contracts. Although the lessee attempted to argue that the later-enacted Puerto Rico Commercial Transactions Act (which adopted our UCC's previous definition of "security interest" in 1-201(37) that converted a lease with a nominal purchase option into a security interest) repealed conflicting provisions of the Act to Regulate Personal Property Lease Contracts, the court agreed with the lessor that the lease provision amounted to a waiver of the lessee's rights under the Commercial Transactions Act — and therefore concluded that the lease must be treated as a true lease. Whether or not this is an accurate statement of Puerto Rican law today, it is clearly a different outcome than would be the case under the UCC in effect in all 50 of the United States, under which the economics of an agreement calling itself a lease determines its legal status as opposed to what the parties may state in such agreement.

Liability of Motor Vehicle Lessors for Equipment-Related Injuries, Damages

Eisenberg v. Cope Bestway Express, Inc., 2015 WL 5708479 (N.Y.App.Div. Sept. 30, 2015); *Gachlin v. Coastal International Trucks, LLC*, 2015 WL 1500547 (Conn. Super. March 10, 2015) (unpublished opinion, check court rules before citing)

The two cases found that a grant of summary judgment with regard to personal injury damage claims is appropriate in favor of truck lessors where the Graves Amendment applies — *i.e.*, the action was commenced on or after Aug. 10, 2005; the truck or chassis qualifies as a motor vehicle under the Graves Amendment; the lessor/owner was engaged in the business of renting or leasing motor vehicles; and there are no allegations of negligence or criminal wrongdoing on the part of the lessor.

End-of-Term Issues

Mid-Missouri Spray Service, Inc. v. South Delta Aviation, Inc., 2015 WL 3828246 (U.S.Dist.Ct. E.D.Ark. June 19, 2015)

A lessee of an aircraft sued its lessor for damages, claiming that the latter had refused to consummate the sale of the aircraft to the lessee according to the terms of a purchase option given the lessee. The court granted the lessor's motion for summary judgment, concluding that, even if the lessee had given the lessor timely notice under the option agreement (a fact disputed by the lessor), the lessee did not have the ability at the time the lease expired to make the purchase option payment because it did not have the funds available or approval for a loan for which it had applied. This court based its conclusion on common law, citing the Restatement (Second) of Contracts, even though the Arkansas Supreme Court has not addressed the issue.

Indemnity Clauses

Barnette v. Paxton Van Lines of North Carolina, Inc., 772 S.E.2d 256 (N.C.Ct.App. June 2, 2015)

After the driver of a car was injured when her car was struck by a truck, she sued the truck driver, its employer and the lessor of the truck to the employer, alleging negligence in failing to inspect and maintain the braking system. The lessor, a truck dealer, had been granted a motion for partial summary judgment against the lessee/employer in the trial court based upon a provision in the rental agreement in which the lessee agreed to indemnify the lessor against all claims related to the use of the truck. This appellate court affirmed the trial court's ruling by citing a North Carolina Supreme Court case upholding the right of a party to contractually provide for indemnification against its own negligence, and further finding that such a right extends to negligent acts committed by the party to be indemnified prior to entry into the rental agreement containing the indemnification agreement. (It should be noted that the possibility of being indemnified for one's own negligent acts is not necessarily the case in all states.)

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Leasing and Finance Industry Economic Outlook

The Equipment Leasing & Finance Foundation's ("ELFA") 2016 Equipment Leasing & Finance U.S. Economic Outlook reports that investment in equipment and software is expected to grow by a modest 4.4% in 2016.

The moderate growth forecast by the report considered a variety of economic challenges such as weakness in the global economy (particularly China), low commodity prices, and a strong dollar diminishing businesses' incentive to invest. Tipping the balance on the growth side in the equipment finance sector, however, is the strengthening U.S. economy and elevated propensity to finance. The Foundation's report, which is focused on the $1.046 trillion equipment leasing and finance industry, highlights key trends in equipment investment and places them in the context of the broader U.S. economic climate. The report will be updated quarterly throughout 2016.

Key Takeaways

The study showed that domestic strength should offset global challenges, as U.S. GDP growth is expected to tick up to 2.8% in 2016 from 2.6% in 2015. Further, over the last 12 months, several key drivers of growth in recent years have faltered, while other sectors that have lagged began to pick up steam. The net result is that this fundamental shift will underpin U.S. economic expansion in 2016.

In addition, the U.S. credit system is healthy and financial stress is muted, limiting financial risks going into next year. Solid U.S. economic data are setting the stage for gradual Fed interest rate increases in 2016, which may alleviate spread compression for equipment lessors.

Equipment and software investment growth rebounded to a 7.4% pace in Q3 2015 from a 1.7% annual pace in Q2 2015, but investment is up only 2.5% year-on-year — the slowest annual growth rate in two years. Continued moderate growth in equipment and software investment is expected in Q4 2015 and into 2016.

Twelve Verticals

The Foundation-Keybridge U.S. Equipment & Software Investment Momentum Monitor (http://bit.ly/1GIPPTv), which is included in the report and tracks 12 equipment and software investment verticals. In 2016, as in 2015, negative global trends are expected to hurt certain equipment verticals, while signs of strength in the U.S. economy will fuel continued gains in others:

- Agriculture machinery investment growth will likely remain weak over the next three to six months.
- Construction machinery investment growth may slow somewhat, yet remain solid over the next three to six months.
- Materials handling equipment investment growth should remain weak over the next three to six months.
- All other industrial equipment investment growth is likely to slow over the next three to six months.
- Medical equipment investment growth is expected to stabilize over the next three to six months.
- Mining and oilfield machinery investment growth should remain strongly negative over the next three to six months.
- Aircraft investment growth may increase over the next three to six months.
- Ships and boats investment growth is poised to strengthen in the next three to six months.
- Railroad equipment investment growth is likely to remain negative over the next three to six months.
- Trucks investment growth should remain steady over the next three to six months.
- Computers investment growth rates appear set to increase moderately over the next three to six months.
- Software investment growth may strengthen over the next three to six months.

The Foundation produces the Equipment Leasing & Finance U.S. Economic Outlook report in partnership with economics and public policy consulting firm Keybridge Research. The annual economic forecast provides a three-to-six month outlook for industry investment with data, including a summary of investment trends in key equipment markets, credit market conditions, the U.S. macroeconomic outlook and key economic indicators. The report will be updated quarterly throughout 2016 and may be accessed at http://bit.ly/1O2GlVI.

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