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## CERTIFICATES OF ACCEPTANCE, PURCHASE MONEY SECURITY INTERESTS AND PARTIAL DELIVERIES: OH MY!

Many of you have probably been warned against the common practice of having the Lessee sign a Certificate of Acceptance in advance of equipment installation and inspection. If the equipment malfunctions and the lessee defaults, the lessee might be able to show that it signed the Certificate of Acceptance before actual inspection and reopen the issue of whether the lease terms (ahem . . . which include your hell and high water clause) actually kicked in. *See Colonial Pacific Leasing Corp. v. J.W.C.J.R Corporation* 977 P.2d 541 (Utah Court of Appeals, 1999). As such, many in the industry feel that it is a prudent business practice with respect to certain sized leases to have the lessee inspect the equipment prior to its signing of the Certificate of Acceptance.

However, when this practice is used for transactions involving partial deliveries, lease documentation must be carefully drafted to avoid some highly technical cracks that may otherwise appear in your pmsi armor. This article provides an outline some of the risks associated with partial deliveries as well as some advice as to how to protect against such risks.

### OVERVIEW OF PURCHASE MONEY SECURITY INTERESTS

A purchase money security interest (sometimes called a *õpmsiõ*) allows a lender to obtain a super priority security interest that trumps any other security interests. A lender's security interest has priority over all others, as long as: (1) money is being loaned to finance the lessee's *acquisition* of equipment (i.e. the equipment is new to the lessee) and (2) the security interest is *õperfectedõ* within twenty days from the date the lessee first receives possession of the equipment,

A security interest is generally perfected upon the *later of*: (a) attachment and (b) the filing of a financing statement. For purposes of this article, the reader only needs to know that attachment requires the lessee/borrower to specifically grant a security interest to the lessor/lender.

### **PROBLEMS WITH PARTIAL PARTIAL DELIVERIES**

When leased equipment is delivered in distinct lots over time, courts can hold that the lessee has received possession of some or all of the equipment prior to the last delivery. This holding can negatively impact a lessor's pmsi under leases which state that the lease term commences, and the provisions of the lease "kick in", when the Certificate of Acceptance is executed.

If the lessor follows sound advice and does not have the lessee sign a Certificate of Acceptance until after the last delivery, the provisions of the lease and the lessee's grant of a security interest may not become binding until that point. If a court holds that the lessee received possession of some or all of the equipment more than 20 days prior to that time, the lessor could arguably lose pmsi status with respect to all such equipment. Carefully drafted lease documents can avoid this problem by containing language similar to the following: "Notwithstanding anything to the contrary herein, including the date upon which the Lease Term commences, any security interest granted by Lessee to Lessor hereunder shall become effective between the parties with respect to any item of Equipment as soon as Lessee receives possession thereof."

Additional issues arise if a deal involves partial delivery *and* pre-funding. Many leasing companies have reported increasing pressure from vendors to pre-fund transactions. Lessors willing to pre-



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fund have handled some of their concerns by way of a progress payment agreement (a "PPA") or similar document which requires the lessee to pay principal and interest under what is more-or-less a promissory note. If the lessee does not accept the total delivery under the lease, the "note" contained in the PPA becomes immediately due and payable. Of course, there is no guarantee that the lessee will accept the equipment and the lessor is essentially making an unsecured loan. As such, many PPA's do not contain any language that grants the lessor a security interest. Ironically, if the lessee later accepts the equipment (thereby triggering the lease/security agreement), the lessor may find itself without a proper pmsi.

As before, partial deliveries may lead some courts to decide that the lessee has received possession of some or all of the equipment on a date (the "Triggering Date") that is 20 or more days prior to the execution of the Certificate of Acceptance, in which case the lessor may have lost its pmsi with respect to such equipment. Lessors who have language in their *lease* similar to that recommended earlier in this article should be protected *so long* as the lessee has signed *the lease* within 20 days of the Triggering Date. However, many lessors that rely on a PPA don't have a lease executed until a large portion of the equipment is delivered to the lessee. As such, lessors should put language *in their PPA* whereby the lessee grants the lessor a security interest in any item or items of equipment as soon as the lessee receives possession thereof. In addition, lessors should file a UCC as soon as the PPA is executed and file a second UCC which amends the first filing and better describes the collateral once the Acceptance Certificate is signed.

Marks & Weinberg, PC is law firm with significant experience in dealing with virtually every type of equipment and facility lease financing. The lawyers of the firm have participated in leasing financings for more than a billion dollars of equipment and are recognized throughout the industry. If you would like more cases or articles on leasing, or have any questions or comments about this Article or other leasing issues, please visit [www.lease lawyer.com](http://www.lease lawyer.com) or contact Barry Marks at 205-251-8303 or Ken Weinberg at 205.251.8307.

