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LEASE ASSIGNMENTS: Is the residual protected? (1993)

Equipment lease brokers have various ways of defining their relationships with their funding sources; some speak of an assignment of a rent stream, an assignment of the lease with the residual retained, an outright sale or other variations. In fact, there are two essential types of transaction where the broker signs as lessor and then assigns to a leasing company or lender.

Most transactions between broker and funding source are either (1) outright sales of the lease and underlying equipment, in which the funding source becomes the lessor for all purposes or (2) assignments of the rents only, in which the lessor grants a security interest in the equipment or assigns the rents for security purposes only, retaining the right to the residual value of the equipment at the end of the term.

Pitfalls for both parties may result from confusing the two types of transaction, usually by reason of the use of the word "assignment" for both.

In an outright assignment of the lease and sale of the leased equipment, the broker is generally released from all obligations (if the assignment is without recourse) once the transaction is consummated. In such cases, the funding source will need sufficient representations by the broker to indicate that the transaction it is purchasing has the requisite value. As the purchaser is usually looking to the residual value of the equipment, some determination as to this value must



be made. If it is contemplated that the broker will participate in a subsequent sale of the equipment, a separate re-marketing agreement is advisable.

Where the transaction contemplates merely a sale of the rent stream, with the lessor retaining the right to the residual value of the equipment, the assignment actually states specifically that the assignment is made for security purposes only and that the lessor retains title to the equipment, subject to a security interest in favor of the funding source. In these instances, it is crucial that the document indicate that, once all rents have been paid and the lease term has ended without default, the assignment will be null and void and the funding source will claim no further interest in the equipment. Absent such assurances, the interest of the funding source might constitute a cloud on the lessor/broker's title.

In either event, the funding source should always be assured of its right to take full title to (or exercise its rights pursuant to a security interest in) the equipment in the event of a lessee default or breach of broker representations. Any remarketing agreement or termination of the assignment at the end of the lease term should be subject to the funding source's right to sell the equipment to a third party, free of the broker's interest, following a lessee default.

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