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CO-LESSEES

Many people in the industry have heard that co-lessees do not provide the same protection as a guaranteed lease but do not necessarily know why. Usually, the co-lessee issue is raised when the better credit does not want to (or can't) sign a guaranty. In such cases, a proposal is made for "joint and several obligations". However, this co-lessee resolution should be considered carefully as it raises a variety of risks, most of them resulting from the judicial system's lack of familiarity with this issue.

Courts know what to do with guaranties. However, this author knows of no litigated cases involving co-lessees in which the lessor sought to compel one lessee to cover another's obligations or joint obligations. As such, it is much more difficult to determine how a court would rule if one lessee defaults or goes into bankruptcy. Similarly, there is little (if any) precedent for how a court might rule if the lessees (in a true lease) or actual owner/borrowers (in a lease-purchase) squabble over the use and possession of the equipment or their respective obligations to pay taxes, remove liens, maintain, pay for return or pay rent.

Co-borrowers are not uncommon but a lease is a significantly different situation since a lease includes the right to use and possess equipment as well as the obligation to pay for it, while a loan document only covers repayment of a debt. Quite simply, co-borrowers cannot generally involve the lender in a dispute regarding the collateral in the same way that co-lessee's may be able to do so. Clearly, a lease-purchase is less of a problem than a true lease, but judges have a penchant for ignoring the substance of a lease-purchase transaction when it suits them.



If a guaranty cannot be used, a lease-sublease structure may provide an appropriate work-around. In that case, the original lessee will become the "sublessor" and the documents should make clear that the original lessee/sublessor remains legally obligated for performance but has no rights to use the equipment, all of which rights are passed to the sublessee. The sublease can then be assigned as collateral to the original lessor. Of course, there are intricacies here and such documents must be drafted carefully to make sure the sublessee's rights are fully subject and subordinate to the original lessor's rights. In addition, this structure implicates a variety of UCC and other documentation issues.

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