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Attorneys at Law**



Let the Big Dogs Handle Your Collections ...

LEASING & FINANCE UPDATE

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Inside this issue:

How To Detect Leasing Fraud	1
New Lease Accounting Rule Could Hit Profits	2
When A Good Lease Goes Bad	3

IN THE KNOW: HOW TO DETECT LEASING

In this age of information and technology, you might expect to learn a new, high-tech formula for detecting fraud. In fact, the same automation that creates a streamlined and efficient process can be one of the contributing factors to leasing fraud. The best ways to detect fraud still involve the simple, back to basics methods that have been proven effective and relied upon for years.

In equipment leasing, most fraud occurs when new leases are being originated. Leasing fraud typically involves a fake supplier, a fake asset, or a fake customer. Leasing fraud can range from identity theft of an existing business, to the non-existence of actual leasing equipment, to a lease applicant misrepresenting its financial strength. Small equipment customers can easily disappear.

Most equipment lessors utilize an automated underwriting process when originating a new lease and can-

not effectively compete in the industry by utilizing a manual review process on all lease applications. Do some homework - such as checking references and verifying bank accounts. Contacting the Secretary of State will tell you if the company is indeed an LLC. Judgment or litigation searches are also helpful.

In order to detect and minimize leasing fraud, equipment lessors should establish and enforce a policy of conducting manual reviews on a certain percentage of their lease applications. The percentage of lease applications which are manually reviewed should directly correlate with the needs of the particular leasing company and the company's past experience with fraud. When some companies detect patterns of fraud in a geographic area, they will add an extra step. In response to increased concerns in the Chicago area, our firm, serving as National counsel, began to personally verify information.



At a minimum, a fraud screen should include an examination of the following for an entity seeking credit:

- The consistency and validity of phone and address information
- Recent history and frequency of the entity's credit seeking activity

Similar checks should be done of the equipment supplier on the lease transaction. The fraud screen should be periodically reviewed and revised to incorporate the most current techniques being used to defraud leasing companies.

(Continued on Page 4) ...



TOLL FREE: 1-877-809-4345
TEL: 856-779-0300
FAX: 856-779-3362
E-MAIL: rsaldutti@saldutticollect.com
WEB: www.saldutticollect.com

Main Office:
800 N. Kings Highway, Suite 300
Cherry Hill, NJ 08034
NJ State Capitol Office / Lawrenceville
PA Offices / Philadelphia & West Chester

LEASE RULE WOULD HIT PROFITS

Retailers, banks and airlines, which often use long-term leases to add to their locations or aircraft fleets, are pushing back against a proposed accounting rule that would act as a drag on their profits. U.S. and international accounting-standards setters appear ready to reconsider the proposed rule, which has emerged as the most controversial piece of their effort to overhaul accounting rules for leases. The outcome could influence the length of commercial leases, how fast some companies grow and how much exposure they might have to the real-estate market.



The proposed rule, part of a long-term project by the U.S. Financial Accounting Standards Board and its overseas counterpart, the International Accounting Standards Board (IASB), would make balance sheets more accurately reflect a company's assets and liabilities. The overhaul aims to address complaints that current accounting rules let companies leave investors in the dark about the size of their lease obligations. Many companies keep most of these obligations off their balance sheets, disclosing only a few details in financial footnotes.

Most American companies are resigned to the centerpiece of the overhaul: treating leases - or the right to use a piece of property or equipment - as a new kind of asset. This new asset would be offset on a company's balance sheet by a corresponding liability, the obligation to pay rent. The change would add a total of \$1.7 trillion in current liabilities to corporate balance sheets world-wide, ac-

ording to analyst estimates.

However, companies are at odds with the standards setters over how lease expenses should be recorded on their books. As the proposal stands, companies would have to use a method called front-loading, which effectively concentrates the cost of a lease into its early years. Currently, they can spread the average rental cost under a lease evenly over its lifetime, often as long as 20 or 25 years.

Leases generally are more valuable to retailers in later years, after a location has built a following and is generating more cash. If forced to adopt front-loading, retailers argue, they would have to book higher costs for a new store before its sales have had a chance to take off. If a retailer was expanding, signing new leases faster than its old ones expired, front-loading could take a heavy toll on profits. Similarly,

front-loading could weigh down profits for years at banks that have lots of retail branches.

Based on companies' current disclosures about leases, Bill Bosco, a member of the IASB's working group on lease accounting, estimates that big retailers that use long-term leases would book higher lease expenses for eight to 15 years under the new proposal than they would using the current straight-line method.

Companies could potentially shorten the length of their leases in order to keep the overall cost down, and so minimize the expenses they record, said Bret Hardy of commercial-real-estate firm Colliers International. But, if companies were to shorten leases, that would require more-frequent renewals, leaving them more exposed to swings in the real-estate market, according to Credit Suisse accounting analyst David Zion.

Source: Wall Street Journal

"Credit is a system whereby a person who can not pay gets another person who can not pay to guarantee that he can pay."

~ Charles Dickens (1812-1870), British Novelist

WHEN A GOOD LEASE GOES BAD - TIMELINE

When a lease defaults, it is important to expedite the following steps:

A. Immediately reviewing your documentation:

1. Verify that your file is complete (check for guarantees).
2. Verify that you are in the lien position that you expect and that you have properly perfected the lien under the UCC or that you have the Certificate of Title on titled collateral. (You do not want to repossess collateral only to realize later that you can't sell it or all of the proceeds should go to another creditor).
3. If your files are incomplete, **you need to strategize.**
4. Check your options in the default section of the lease. Know your options for collection and how to calculate the damages on default.
5. What does the lease say about notices? Make sure that you comply.
6. If there are guarantors - have the guarantors pledged collateral? The financial strength of the guarantor and value of any guarantor collateral may be the most important factors in deciding how to proceed.
7. Check status of Lessee (Google, company web site, Secretary of State, Better Business Bureau, etc.)
8. Call - is their phone number still working?

B. Confirm that there is an actual default:

1. Is there a dispute about application of payments or any other aspect of the lessee's performance? You may choose not to call a default that is not a clear violation of the contract to avoid possible lessee claims. You may also decide to file suit for possession of the collateral rather than using self-help repossession which could subject you to a claim for conversion of the property.
2. Check for non-monetary lessee defaults such as insurance lapse or unauthorized use or relocation of the collateral.

C. Next you need to check the collateral:

1. Is the collateral insured? Does the lessee have liability coverage if the collateral is in use? Do you have correct insurance information?
2. What are the costs of repossessing and remarketing the collateral? What is the secondary market for this equipment?
3. The answer to these and other collateral-related questions

may determine whether you repossess the collateral or try to work out the default with the lessee.

D. Is this a non-consumer lease?

Check to be sure: is proper language in the lease? Do you know how the lessee is using the equipment?

E. Is it a true lease or lease-purchase?

F. Check on the lessee's financial health - QUICKLY

G. Broker/Assignor Liability.

Review the broker agreement or assignment agreement to determine if the transaction was on a recourse basis or if the broker/assignor has breached any representation or condition that would enable you to require the broker/assignor to repurchase the lease.

Repossession

1. Self-help repossession: Under Article 2- §2A-525 and Article 9 §9-609 a creditor may take possession of collateral. However you cannot do so if in repossessing the collateral you "**breach the peace.**"
2. Repossession sale. The sale can be a public or private sale. You must provide notice to the lessee and any other lienholders. Review your contract and the UCC for details. Be mindful that some contracts purport to give lessors/lenders greater rights than allowed under the UCC or other applicable law. Check jurisdictional issues and state laws.

When to involve your lawyer

1. You can't repossess the collateral without "breaching the peace" - If you cannot repossess the collateral or cannot do so without breaching the peace, you will need to file suit for possession of the collateral. Under certain circumstances you will also have the remedy of court assisted repossession of the collateral before a judgment is entered.
2. Bankruptcy - Stop all normal collection action against party filing bankruptcy and participate in the bankruptcy case. Consider having your lawyer file, as appropriate, one or more of the following: Proof of Claim, Objection to Confirmation, Motion to Assume or Reject Lease and Motion for Relief from

(Continued on Page 4) ...

LEASING FRAUD (con't)

Over the past decade, Saldutti, LLC has been on the cutting edge of credit and collections for the equipment leasing industry. In our years of practice, we have compiled the following list of red flags.

Always be on the lookout for:

- Vendor and lessee are from different geographic areas (particularly if the vendor is in Nevada)
- Rush need for approval, especially without asking rate
- Multiple trade references that seem too-good-to-be-true
- Trade references that are vaguely similar (check wording and phrases)
- Excellent financials or tax returns provided on a small deal without being requested
- Appearance of financial strength but needs smallest possible advance
- PG in difference geographic area than lessee company
- Two "front names" (Tony Williams, John Roberts) for PG

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800 N. Kings Highway
Suite 300
Cherry Hill, NJ 08034
Phone: 877-809-4345
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BAD LEASE TIMELINE (con't)

Automatic Stay. However, unless the debt is a consumer debt and the lessee is in chapter 13, you may still pursue collection from guarantors or co-debtors.

3. When you are ready to file suit against lessees and guarantors:

Should you file suit?

- Is the lessee business still open? If it is a business entity and is closed with no assets, suit may not be productive. Is there a "new" company?
- Are there guarantors that may have assets or income?
- Do you anticipate a counterclaim? Does it have merit?
- Are there potential claims concerning insolvency, fraud, etc.?

Preparing for Litigation:

- Compile all transaction documents, correspondence, notes and other records related to the transaction.
- Take precautions to insure that electronic records related to the transaction will not be deleted.

When to file:

Once you have decided that you cannot collect the debt without filing suit, the sooner you file suit, the better. If you delay, you will need to be aware of the statute of limitations for the state where you file suit. Generally speaking, the older the delinquency, the more difficult it is to collect.

Where to file:

- Review the lease to determine if there is a forum selection clause. Is the forum provision mandatory for the lessor or do you have discretion.
- If you have a forum clause that allows you to sue in your home state you should consider whether you want to do so and then domesticate the judgment in the lessee's state or do you just want to file the suit in the lessee's home state? The lessee is less likely to file an Answer or Counterclaim in your home state.
- If you do not have a forum selection clause, discuss venue issues.

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New Jersey and Pennsylvania Collections