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NorVergence Maelstrom Rolls On

Floating Forum Clause Invalidated As Unreasonable

By John C. Kilgannon

A recent decision from the Ohio Supreme Court may have an impact on the marketability of commercial lease agreements. In *Preferred Capital, Inc. v. Power Engineering Group, Inc.*, 112 Ohio St. 3d 429, 860 N.E.2d 741 (2007), the court held that an open-ended forum selection clause, often referred to as a "floating forum clause," was not enforceable. The *Preferred Capital* court found that a floating forum clause in a lease agreement, which provided that any lawsuit arising from the lease would be venued in the state of the lessor's *or its assignee's* principal place of business, was unreasonable and contrary to public policy. While one might conclude that the subject forum clause is innocuous, the court took issue with the fact that the designated forum could be transferred to another jurisdiction if the lease agreement were assigned. In other words, if the lease were assigned to an assignee with a principal place of business that differed from that of the lessor, the appropriate forum would change. Another significant consideration for the court was the disparity of information between the parties. At the time

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The Subprime Lending Crisis: What Does It Mean to the Leasing Industry?

By Patrick W. Begos

The news is full of stories about the substantial, long-term effects of the subprime mortgage crisis on the mortgage-lending industry. But little has been written about how it will affect other market segments like the leasing industry. There will certainly be spillover, although it won't be as dramatic. This article explores what the leasing industry should be looking for, and doing, in response to this crisis.

The Roots of Today's Subprime Crisis

It wasn't so long ago that home buyers needed 20% down for a mortgage. At best, it was 10%. Mortgages were pretty straightforward. In fact, the most exotic loans available to ordinary people were for adjustable rate mortgages. In those days, lenders were mainly brick-and-mortar banks that would probably expect to hold mortgages in their own portfolio for the long term. Today, those days appear positively quaint.

The last decade has witnessed huge changes in the mortgage industry. There are several developments that have played a major role in getting us where we are today. One could debate which development, if any, was the primary mover that led to today's state of affairs. But one thing is clear: If we follow the money, we'll get some important clues.

Let's start with collateralized mortgage obligations — CMOs — which is packaging and selling loans as an investment vehicle. CMOs are hardly new, but they became a lot more popular in the last decade or so. The growth in the CMO market led to a surge in demand for mortgages as investment vehicles. As banks found it easier to sell their mortgages, they naturally began to loosen their credit policies. This, combined with historically low interest rates, led to mass refinancings, and even serial refinancings. No longer was a mortgage a one-time affair, religiously paid off until the mortgage-burning party. Instead, people began to refinance regularly.

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As the mortgage market expanded, nontraditional lenders began to pop up all over. The Internet made it easy. You hardly needed an office — just a web site. Automated loan underwriting software eliminated the need for a trained underwriting staff. Lenders competed to see who could approve a loan the fastest. No more did borrowers have to wait days or weeks to qualify. They had their answer in minutes. Lenders didn't even need much capital. All they had to do was find a borrower, issue a commitment, and then shop for an investor to fund the loan before it closed. The "just-in-time" inventory concept moved into the mortgage industry.

But with all these lenders and all these investors chasing borrowers, the existing pool of homeowners just wasn't big enough. Lenders started looking for ways to give more money to more people. This is where new lending programs came into play. Lenders asked themselves why they had to limit themselves to borrowers who could put 10% down. Loans were made for 95%, then 100% — sometimes even more. But that wasn't enough. Because increasing the loan amount made the monthly payments unaffordable, lenders started the popularization of interest-only loans, reverse-amortization loans, and the like. Bad credit? "No problem," said the lenders. "We'll just add some points and increase the interest rate to cover the extra risk, and make the loan."

Because lenders were making so much money selling loans, and because there were so many lenders seeking borrowers, the business became all about origination. It became a matter of qualifying someone for a loan, any loan, by any means possible. Lenders didn't worry about what would happen when the adjustable rate reset in a couple of years, because someone else would own the loan by then. Besides, with all the refinancing, the chances that a loan made today would still exist in a few years were pretty slim. As long as rates stayed low, and housing prices increased, refinancing was inevitable. So a borrower could stay on an introductory, interest-only or reverse-amortization rate forever, lenders reasoned.

That brings us to housing prices. The increased supply of mortgage loans, and the decrease in their initial cost, caused more people to buy houses for the first time. This decade saw record home ownership rates. As demand for houses increased, prices increased. Speculators came hard and heavy, fueled by cheap credit. People flipped their houses like playing cards. This meant more mortgage origination, more refinances, and more money.

Investors liked the "exotic" — *i.e.*, risky — loans because the returns were higher. This, naturally, incentivized lenders to concentrate on those risky or subprime markets.

Oh, and let's not forget the fraud. It's only natural that the competition's making of legitimate, albeit risky, loans led originators to take shortcuts. One could write a book on the schemes invented by lenders, borrowers, and intermediaries, and still scratch only the surface.

Everything fed off everything else, leading us right to where we are today. Default rates are at historic levels. Entire neighborhoods are being threatened with foreclosures.

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Enforcement of State Security Breach Notification Laws

Part Three of a Three-Part Series

By Melissa J. Krasnow

The first two installments of this series addressed security procedures and practices, document destruction, and security breach notification. The series concludes with a discussion of the varying enforcement policies at the state level.

Thirty-four states have enacted security breach notification laws: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Kansas, Louisiana, Maine, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Vermont, Washington, and Wisconsin. Additionally, Michigan has passed such a law with an effective date of July 2, 2007. These laws cover the notification that a company must make in the event of a breach of security of its system with respect to computerized personal information.

How are these laws enforced in the event of a violation? They vary in terms of enforcement and penalties, as more particularly described below. This article provides an overview of the enforcement of the above state laws and describes examples of penalties.

Enforcement By State Attorney General Or State Regulator

State Attorney General Enforcement

A number of laws provide for enforcement by the state attorney general. Some laws provide that the attorney general may bring an action for injunctive relief. Other laws provide that the attorney general may bring an action in law or equity to address violations and for other relief to ensure compliance or to recover direct economic damages resulting from a violation, or both. Certain of these laws specify civil penalty amounts. For example, the Texas attorney general may bring suit to recover a civil penalty of between $2000 to $50,000 for each violation of the law, may bring an action for injunctive relief, and is entitled to recover reasonable expenses in obtaining injunctive relief, civil penalties, or both. The court also may grant other equitable relief. The New York attorney general may bring an action for injunctive relief, and the court may award damages for actual costs or losses, including consequential financial losses, incurred by a person entitled to notice under the law where notification was not provided. The court also may impose a civil penalty of up to $150,000 for a knowing or reckless violation.

State Regulator Enforcement

Some laws provide for enforcement by the attorney general or a state regulator. By way of example, the Hawaii law provides for enforcement by the attorney general or the Hawaii Office of Consumer Protection. The Maine law provides for enforcement by the attorney general or the Maine Department of Professional and Financial Regulation, where applicable.

Private Right of Action

Some laws provide for a private right of action. For instance, the California and Washington laws provide that a customer injured by a violation may bring a civil action to recover damages. Other laws define the amount of damages. For example, under the Louisiana law, a civil action may be brought to recover actual damages resulting from the failure to timely disclose to a person a breach of the security system resulting in the disclosure of the person's personal information. A person injured by a violation of the New Hampshire law may bring an action for damages and for equitable relief, including an injunction. If the court finds for the plaintiff, recovery is the amount of actual damages, and if the court finds that the act or practice was a willful or knowing violation, between two to three times the amount of actual damages is awarded. In addition, a prevailing plaintiff is awarded the costs of the suit and reasonable attorneys' fees.

Examples of Penalties

Administrative Fines

The Florida law provides for administrative fines. A person required to make a security breach notification who fails to do so within 45 days following the determination of a breach or receipt of notice from law enforcement is liable for an administrative fine in the amount of $1000 for each day the breach goes undisclosed for up to 30 days and, thereafter, $50,000 for each 30-day period for up to 180 days. If no notification is made within the 180-day period, the person is subject to an administrative fine of up to $500,000. These fines apply per breach and not per individual affected by the breach. The Florida Department of Legal Affairs may bring proceedings to assess and collect these fines.

Criminal Penalties

The Minnesota law provides for criminal penalties.

Corporate Dissolution Or Revocation of Authority

The Vermont law provides for the authority of the attorney general, a state's attorney, or a court to dissolve a domestic corporation or revoke the certificate of authority of a foreign corporation for a violation of the Vermont law.

Violation of State Unfair Practice Law

Finally, it is important to note that some state laws provide that a violation of the state law constitutes a violation of that state's unfair practice or similar law (*e.g.,* Connecticut and Illinois).

Conclusion

Given how state laws vary in terms of enforcement and penalties, it is imperative to refer to the state laws that are applicable to a particular situation for guidance. Congress is considering federal security breach notification legislation. But the different state security breach notification laws will continue to apply until a federal law is enacted that pre-empts these laws.

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Lending Crisis

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Mortgage lenders are failing left and right.

There's no question that these two factors will play a significant role in ensuring that governments, at all levels, will be doing *something* about the mortgage crisis. With the media keeping the issue on the front page, it will be impossible to avoid investigation, regulation, and legislation.

How Does This Affect Me?

In several respects, the leasing industry is far different than the mortgage industry. For one thing, nothing that is leased carries the emotional weight of a home. For another, the leasing industry's primary customers are businesses, rather than consumers. But that doesn't mean the leasing industry will be immune from the effects of the subprime fiasco. The mortgage crisis will certainly have ripple effects on this industry. It also should be a cause for introspection on whether it would be beneficial to implement changes in leasing practices.

Where's the Money?

Ultimately, it's all about the money. The carnage in the CMO industry may cause capital to run from debt. Stung by the vagaries of buying pools of secured obligations, investors might be less willing to invest in lease obligations. A smaller, more-skeptical market will mean a higher cost of capital, fewer leases, and less profit.

On the other hand, capital could run from CMOs right into lease pools. When the stock market declined earlier in the decade, investors began to buy commercial real estate in a big way. Buildings began selling at multiples that were impossible to justify — unless, of course, you were betting on someone buying you out in a couple of years. The same might happen with leases because investors have to put their cash somewhere.

Give Me My Money

The flip side of raising capital is, of course, collecting the money you are owed. It's no secret that this industry is heavily dependent on the financial situation of its customers. Those in the heavy-equipment leasing business have to anticipate the effects of a stagnating or deflating housing market. For example, Lennar Corp., a major home builder, recently withdrew its 2007 earnings goal, after its profits fell more than 73% in the three months ending February.

A bad market will mean less construction, which will mean less demand for equipment. It will likely mean increased defaults on existing leases, as companies that were too thinly capitalized find themselves unable to meet their obligations. Defaults will lead to repossessions. So leasing companies will have used equipment on their hands that they need to dispose of exactly at the time when demand for the equipment will be dropping.

[B]orrowers, courts, and juries may become more willing to fault predatory lenders or take notice of lender liability lurking in the depths of a defaulted loan or lease.

Underwriting

On a longer term, I firmly believe that we are experiencing a sea change — a tipping point, to use the popular phrase — in the public's perception of borrowing. It used to be that pre-qualifying for a mortgage was the *sine qua non* of having good credit. If a bank was willing to qualify you for a loan, you knew you were in sound financial health. You could finance your house, your car, or your boat knowing that you could afford it.

That particular notion may be fading away. Lenders may no longer be seen as gatekeepers, ensuring that only the worthy are allowed through the gates to the Land of Credit. Instead, they will increasingly be viewed as enablers, pushing debt on unsuspecting or addicted marks. You can see this happening already in the credit card industry.

Credit of any kind may become a controlled substance. Certainly, there will be increased regulation of all aspects of the credit industry. Underwriting standards will be tightened. Required disclosures will increase. Government will act in various and sundry ways to put checkpoints on the path to borrowing or leasing.

Moreover, borrowers, courts, and juries may become more willing to fault predatory lenders or take notice of lender liability lurking in the depths of a defaulted loan or lease. To be sure, predatory lending and lender liability are not new. But a larger segment of the public is going to see a default as the result of a greedy or unscrupulous lender rather than a foolish borrower.

Leasing companies need to start preparing for this new reality today. Underwriting needs to be tightened. If you don't have guidelines, you need to adopt them. If you have them, you need to make sure they are followed. If you gather information about the borrower, you should incorporate it into your underwriting decision. If you rely on information, you should take reasonable steps to ensure that it is accurate. What you need to prepare for is the worst-case scenario. How will your underwriting decisions appear to the outside when a business accuses you of predatory leasing practices? Will you be able to demonstrate that you had a reasonable basis to believe that the lessee could perform its obligations, or will it appear that the lease was signed with a blind eye to a likely future default?

The goal of 21st century underwriting cannot be "How do I protect myself against risk of default?" It will have to be "How can I minimize and balance the risks of this transaction

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for all parties?" There is no question that borrowers in the mortgage industry are going to be pursuing lenders for transactions that were arguably unsound or predatory. Institutionalizing sound, justifiable underwriting practices will help guard against similar claims in the leasing industry.

Workouts

The due diligence and care required in sound underwriting does not end when the lease is made. If and when a lessee falls behind, how will you respond? Your lease will provide all manner of remedies that you can exercise, but should you jump right to the most draconian? Of course, few lessors will repossess equipment when a lessee who is honest and straightforward experiences a short-term cash-flow crunch, but you need to institutionalize a workout process. You can be damned if you do and damned if you don't. Propose a reduction in monthly payments and an extension of the lease term, and you can be criticized (and sued) for allowing the customer to dig a deeper hole than he or she already was in. Pull the plug, and you can be criticized (and sued) for killing off a business that could have recovered.

In today's climate, any aggressive action by lenders or lessors is at risk of being second-guessed. You can't eliminate this risk, but you can act to ensure that, when the second-guessing happens, the path you took will be seen as a reasoned and reasonable one, taken after considering most, if not all, of the potential ramifications.

One effective way of minimizing the risks of a workout is to enter into a formal standstill or "pre-workout" agreement. In exchange for some concessions (either temporary or permanent) on your part, you may ask the lessee to agree to certain terms. These might include an express representation that you are not waiving rights by making workout proposals; the lessee's acknowledgment that your lease agreements are valid contracts and that you can exercise your rights under them; or a waiver of any claim that you are liable for any action you take in a future workout that was authorized by your lease documents.

You can also outsource the workouts. Sell the defaulted obligations to another entity that will do the heavy lifting and bear any liability for alleged overreaching. Lenders don't typically want to be in the collection business anyway. It's much more profitable to initiate the transactions than it is to collect. There is little question that the market for troubled credit will be booming in the near-term. Of course, everyone will be looking for bargains, but what else is new?

CONCLUSION

Though it is easy to dismiss the subprime lending crisis as a far-off storm that won't affect the equipment leasing world, it would be a mistake to do so. There are lessons to be learned from the tumult happening at that end of the credit market. As always, the people who learn the most, and the quickest, from the problems of others will outstrip their competition.

NorVergence

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the lease agreements were executed, the lessor was aware that the leases would be assigned to a company that was based in a foreign jurisdiction. The court's refusal to enforce the forum clause was based, in large part, on the lessor's failure to disclose that information at the time the parties entered into the lease.

The *Preferred Capital* decision should be required reading for leasing company executives and managers that do business in Ohio or with Ohio-based companies. However, the potential significance of this opinion extends beyond Ohio's borders. While *Preferred Capital* is not binding on courts in the other 49 states, the key question for those in the leasing industry is whether this opinion represents the first step toward increased judicial oversight and restriction of floating forum selection clauses.

CASE HISTORY

The facts of *Preferred Capital* are as follows. NorVergence, Inc. ("NorVergence"), a New Jersey corporation, entered into separate lease agreements (the "Lease Agreements") for telecommunications equipment with 12 out-of-state commercial entities (the "Lessees"). Significantly, the Lease Agreements contained a floating forum clause that provided as follows:

> This agreement shall be governed by … the laws of the State in which Rentor's principal offices are located or, if this Lease is assigned by the Rentor, the State in which the assignee's principal offices are located … and all legal actions relating to this Lease shall be venued exclusively in the state or federal court located within that State.

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Prior to the execution of the Lease Agreements, NorVergence entered into an assignment agreement with Preferred Capital, Inc. ("Preferred Capital"), pursuant to which NorVergence agreed to assign its interests in various equipment leases to Preferred Capital. At the time that the Lease Agreements were executed, Preferred Capital's principal offices were located in Ohio; NorVergence's principal place of business was in New Jersey.

One day after the Lease Agreements were signed, NorVergence assigned its interests in the Lessees' lease payments to Preferred Capital. Subsequent to that assignment, the Lessees refused to make payments on the grounds that NorVergence had breached certain representations in the Lease Agreements. This action, in turn, compelled Preferred Capital to sue each of the Lessees in Ohio, where its principal place of business was located. Thereafter, the Lessees moved to dismiss the cases asserting that the Ohio trial court did not have personal jurisdiction over them. The trial court granted the motions to dismiss. On appeal, the Ohio Court of Appeals consolidated each of the cases and reversed the trial court. The Court of Appeals reasoned that the floating forum selection clauses were valid and enforceable and provided the trial court with personal jurisdiction over the Lessees.

THE OHIO SUPREME COURT'S DECISION

On appeal of the appellate court's decision, the central question before the Ohio Supreme Court was whether the floating forum clauses were enforceable. The court commenced its analysis by recognizing the baseline presumption that parties to a contract may freely consent to the jurisdiction of a particular forum. Additionally, the court observed that in light of the realities of modern commercial transactions, a forum selection clause in the commercial contract should be enforced unless there is "a strong showing that it should be set aside."

The court then reviewed the standard that it had established in an earlier decision, *Kennecorp Mtge. Brokers, Inc. v. Country Club Convalescent Hosp., Inc.*, 66 Ohio St. 3d 173, 610 N.E.2d 987 (1993), which adopted a three-part test to determine the validity of a forum selection clause. Although the forum selection clause in *Kennecorp* designated a *specific* forum, the *Preferred Capital* court found that the following test should be employed to determine whether floating forum clauses are enforceable:

1) Are the parties to the contract commercial entities?

2) Is there evidence of fraud or overreaching?

3) Would enforcement of the clause be unreasonable and unjust?

With respect to the first prong of this test — whether the parties to the Lease Agreement were commercial entities — the court rejected the Lessees' argument that they were small, unsophisticated enterprises and therefore should not be considered commercial entities. The court observed that the contracts were between two commercial entities and documented a commercial transaction. Thus, despite the relative disparity in the size and sophistication of the parties, the court concluded that the first prong was satisfied. Similarly, the court found that the second prong was met because there was no evidence of fraud or overreaching because the forum selection clause was clearly and legibly printed on the second page of the Lease Agreements.

The final issue under the *Kennecorp* test was whether the enforcement of the floating forum clause would be unjust and unreasonable. The court answered this question in the affirmative and held that the forum selection clauses were not enforceable. Two primary explanations were offered in support of this holding. First, at the time the Lease Agreements were executed, there was no definitive indication as to where any suit arising out of the contract would be litigated. At that time, the appropriate forum would have been the location of NorVergence's principal place of business, to wit, New Jersey. However, one day after the agreements were executed, the assignment of the Lease Agreements to Preferred Capital effectively transferred the designated forum to Ohio. The court observed that nothing prevented Preferred Capital from assigning its interests under the contract, thereby creating yet another forum. It was abundantly clear from the opinion that the court was troubled by the fluidity of the designated forum. The court highlighted the distinction between a clause that waived personal jurisdiction to a specific forum, which was the situation in *Kennecorp,* and a floating forum clause that subjected the Lessees to the jurisdiction of any court in the nation.

The second basis of this holding was the disparity of the information between the parties. Norvergence and Preferred Capital had superior information in that they knew that the Leases were going to be assigned. Thus, the court held that when one party to a contract containing a floating forum selection clause possessed undisclosed information of its intent to assign its interest to a company in a foreign jurisdiction, the clause is unreasonable and cannot be enforced absent a clear showing that the second party knowingly consented to waive objections to the jurisdiction of any forum.

CONCLUSION

Because this decision is not binding on courts outside of Ohio, its impact on the leasing industry is limited. Clearly, *Preferred Capital* could have a significant affect on leasing companies that may find themselves litigating a lease agreement in Ohio state courts. Those companies would be well advised to closely examine the forum selection clauses in their lease agreements to determine whether they would be upheld under the new framework established by the Ohio Supreme Court. While

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Preferred Capital left open the possibility that floating forum clauses would be enforceable under certain circumstances, there is no question that the court does not favor such clauses. A concern arises as to whether an Ohio trial court or appellate court would view the *Preferred Capital* court's concerns regarding floating forum clauses as a blanket prohibition against such clauses. To pass muster under the *Preferred Capital* framework, leasing companies that do business in Ohio would be well advised to ensure that their lease agreements expressly state that: 1) the lease may be freely assigned; and 2) that the lessee has consented to resolve any dispute arising out of the agreement in *any* forum. In other words, the lessor should obtain the lessee's express blanket waiver of any objections to personal jurisdiction and venue to any forum. In addition, to the extent the information is available at the time of execution, the lease should provide full disclosure of the lessor's intent to assign the lease to a company based in a foreign jurisdiction as well as the timing of such assignment.

It remains to be seen whether the *Preferred Capital* decision represents a harbinger of similar restrictive opinions from other jurisdictions. Significantly, the dissenting opinion highlights several considerations that may significantly detract from *Preferred Capital's* value as persuasive authority. First, the dissent highlights several inconsistencies in the majority's reasoning that contradict some of the well-settled tenets of contract interpretation. Second, the dissent cites a decision that was authored by one of the most revered judges from the U.S. Circuit Court of Appeals that upheld an identical floating forum clause. The dissent criticized the majority's holding because it ignored a fundamental principle of contract law: Contracts should be interpreted as written. The Lease Agreements at issue in *Preferred Capital* expressly stated that: 1) they were freely assignable; and 2) the designated forum would be the principal place of business of the lessee or its assignee. Thus, the dissent reasoned, at the time the Lease Agreements were executed, the Lessees were fully aware that the agreements could be assigned and that the assignment could change the designated forum. Additionally, the parties to the Lease Agreements were commercial entities negotiating a commercial contract. Absent any evidence of fraud or overreaching, the dissent concluded that these factors were a sufficient basis to enforce the floating forum clauses as written.

The dissent criticized the majority's holding because it ignored a fundamental principle of contract law: Contracts should be interpreted as written.

The failure to identify any sound public policy that compelled the court to refuse to enforce the agreements as written was also problematic to the dissent. The fact that the Lessees did not know exactly where any disputes arising out of the Lease Agreements would be litigated was not a sufficient reason to void the floating forum clause. Rather, in the dissent's view, the parties expressly agreed to an open-ended arrangement, and it was the court's role to enforce this agreement.

Significantly, the dissent highlighted an opinion from the U.S. Court of Appeals for the Seventh Circuit, *IFC Credit Corp. v. Aliano Bros Gen. Constrs. Inc.,* 437 F.3d 606 (7th Cir. 2006) (Posner, J.), which involved the same floating forum selection clause, and the same lessor, Norvergence, that was considered in *Preferred Capital.* In *IFC,* the Seventh Circuit concluded that regardless of whether federal or Illinois state law controlled, the floating forum clause was enforceable. The *IFC* court reasoned that forum selection clauses should be treated like any other contractual provision and should be enforced unless they are subject to "any sorts of infirmity, such as fraud or mistake, that justify a court's refusing to enforce a contract." Judge Richard A. Posner, who authored the *IFC* opinion, observed further that the forum selection clause at issue was not confusing and clearly stated that the venue of any suit would be governed by the principal place of business of the lessor or its assignee. The centerpiece of the *IFC* decision was the well-recognized principle that parties to a contract may freely waive objections to personal jurisdiction and venue by agreeing to an open forum selection clause.

Critics of the *Preferred Capital* holding will argue that it impermissibly interferes with the parties' freedom of contract — the principle that individuals should be free to bargain over the terms of their own contracts. However, the potential economic impact of this decision may be of even greater significance. If courts in other jurisdictions adopt *Preferred Capital*'s approach to floating forum clauses, it would have a direct and significant affect on the marketability of leases. In essence, if such clauses are not enforced, parties to a lease would be precluded from negotiating and assigning the anticipated costs and risks of litigating in a foreign jurisdiction. In other words, if an assignee is required to bring suit to enforce a lease in a foreign jurisdiction (*i.e.,* the principal place of business of the lessor), the attendant incremental costs of litigating in an inconvenient forum would presumably be factored into the amount that the assignee would be willing to pay to acquire the lease. It is likely that this price adjustment would be passed along to the lessee in the form of higher lease payments.

IN THE MARKETPLACE

Telerent Leasing Corporation of Freehold, NJ, a wholly owned subsidiary of ITOCHU International Inc., announced the formation of its **TLC HealthCare Finance** division to provide equipment acquisition financing services to the health care marketplace. The new division will complement Telerent's existing financing and health care businesses, which maintain a strong presence with hospitals through TeleHealth Services, the largest provider of television systems to U.S. hospitals, and through its Vendor Capital Group, which provides capital equipment financing for U.S. hotels and franchise restaurants. Leading TLC HealthCare Finance's operations will be **Kevin G. Ward**, previously with Copelco Capital, another ITOCHU International subsidiary prior to its sale to Citigroup in 2000.

Associations Seek Role in Accounting Standard Reinterpretation

In a recent development in the ongoing reinterpretation of the accounting standard for commercial leases by the **International Accounting Standards Board** ("IASB") and the **Financial Accounting Standards Board** ("FASB"), **The Equipment Leasing and Finance Association** ("ELFA") has announced that six equipment finance representative associations from around the world have signed a joint communication seeking to have them play an instrumental and constructive role in the process. The joint communication by the **ELFA**, the **UK Finance and Leasing Association**, **Leaseurope**, the **British Vehicle Rental and Leasing Association**, the **Australian Finance Conference,** and the **Canadian Finance & Leasing Association** set forth 11 key principles that should be addressed as the IASB and FASB proceed with deliberations toward a single, efficient global leasing standard.

The 11 basic principles that the groups believe the new leasing standard must meet are as follows:

1) It must provide information about future lease obligations and rights to use assets that are both meaningful and useful to the users of accounts, such as information about future committed cash flows and the flexibility and conditionality of those cash flows.

2) The recognition that there are real economic differences between leases and loans, and other financial instruments. As a result, the new standard should distinguish leases from debt, other types of obligation, and other types of executory commitments.

3) The recognition that the rights and obligations of the lessee and lessor vary not only from contract to contract, but also by jurisdiction, and in some cases between the private and public sectors. Therefore, an appropriate international standard must be sufficiently robust and flexible to accommodate a variety of different legal frameworks.

4) The recognition that the range of assets and contractual arrangements between lessee and lessor and the flexibility for the lessee to cancel, extend, or modify these arrangements vary enormously. Consequently, accounting principles must treat the different legal effects appropriately.

5) There must be clear and unambiguous definitions of leased assets and obligations, and the basis of their measurement.

6) Both lessor and lessee accounting must be covered comprehensively. Lessor accounting raises complex issues that should be fully and properly debated and not simply considered the mirror image of the lessee's accounting.

7) Lessor accounting should take into account the economic consequences of material tax benefits and the time value of money in the measurement of leased assets and the recognition of income.

8) The introduction of simplicity into lessee accounting, whether tax based or not, so that otherwise sound economic transactions are not avoided because of cost benefit considerations. There must be a clear way to account for immaterial leases, which would presumably be similar to the current operating lease method. Here, a more robust disclosure may be useful, including explaining leasing policies for classes of assets, disclosing expected actions at lease expiry, disclosing calculations that the analysts need like the present value of lease payments using the unique incremental borrowing rate for each lease, disclosing the weighted average incremental borrowing rate of leases combined and the expected future rent expense to be paid for immaterial leases of core equipment.

9) With respect to small and medium enterprises ("SMEs"), the new standard should have a modular structure, with varying degrees of information and complexity required, in relation to the kind of lease transaction and lessee. Large and small-ticket transactions should be treated appropriately, but not necessarily identically.

10) Leased and owned assets should be clearly distinguished in the balance sheet of the lessee.

11) The profit and loss implications of a changed treatment of lease payments should be carefully considered. When the annual payments associated with an operating lease with no purchase option correspond to the cost of using the leased asset, any capitalization of the lease should not alter the P&L result.

To see the joint communication and other related accounting documents, please visit, *www.elfaonline.org/accounting/#FAS13*.

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