

# Common Pitfalls of the Broker-Lender Relationship and Possible Documentary Solutions

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Given the vast number of equipment lease transactions occurring daily and the speed in which many are approved by funding sources, disputes commonly arise between funding sources and lease brokers. When these disputes are litigated, the result is costly and time consuming for both parties. However, many disputes may be avoided altogether through proper documentation and by taking simple, inexpensive precautions. This article discusses the potential problems that may arise between brokers and funding sources, and the precautions brokers and funding sources should take in crafting their documentation to avoid costly conflicts. Since a broker typically warrants that a lease is valid and enforceable, the burden initially falls on the successful broker to take extra care to ensure that the documentation is correct; however, the funding source that fails to follow simple precautionary procedures will often be left holding the bag if the broker is unable financially to honor its warranty obligations.

### **Potential Problem #1:**

**Incorrect or sloppy lease documentation – correct legal names, multiple leases, Certificates of Incumbency, Delivery and Acceptance Receipts, and UCC-1s.**

**Solution:** Brokers must ensure that all lease documentation is complete and accurate so as to avoid breaches of any representations or warranties made by them to the funding source in the broker agreement. The lease should properly identify the correct lessee by **legal** name and should be signed by a person with authority to bind the lessee. The broker can verify the legal name online through the Secretary of State for the particular state where the lessee is incorporated or maintains its principal office. The broker should also obtain a corporate secretary's certificate from the lessee to ensure that the signatory on the lease is indeed authorized to sign the lease, **even if** the funding source does not require it. Furthermore, if one version of the lease is superseded by a subsequent version (*i.e.*, the first funding source rejects the deal after assuring the broker that credit approval would be a breeze), the broker should send a letter to the lessee, documenting this fact to avoid future confusion over which version of the lease is in effect.

For \$1.00 purchase option leases or loans, unique issues arise relating to equipment delivery. Under the Uniform Commercial Code, the time period for filing a UCC-1 financing statement is triggered by physical delivery of the equipment to the lessee. The UCC-1 must be filed within 20 days of delivery of the collateral. See UCC §9-324(a). After the equipment is delivered, the broker should ensure that the delivery

and acceptance certificate from the lessee states that the equipment was delivered to the lessee; the lessee had a reasonable opportunity to inspect the equipment; the lessee **irrevocably** accepts the equipment; and that the equipment conforms with the lessee's needs or the lessee will accept the equipment despite its non-conformity. The delivery and acceptance certificate should also list the correct model and serial number of the equipment so as to avoid any confusion with identical equipment (and to reduce the opportunity for fraud). The funding source should perform a telephone confirmation to ensure that the equipment was in fact delivered and accepted **before** funding, thus reducing the potential for vendor or broker fraud. Where the vendor delivered the equipment before the lease is signed, the safest way to preserve a security interest in the equipment is to have the vendor timely file a UCC-1 against the collateral, **provided**, however, that its invoice either reserves title in the vendor or grants the vendor a security interest. (This means the broker needs to obtain a copy of the vendor invoice before moving forward.) In this circumstance, the vendor should assign the UCC-1 to the broker, which in turn should assign it to the funding source. The vendor should not terminate its UCC-1, unless the funding source is able to file its UCC-1 within 20 days of the equipment's delivery.

Similarly, funding sources should verify that all lease documentation is correct and complete before funding a transaction, especially the timing of the UCC-1 filings with respect to \$1.00 purchase option leases (and other disguised sales and loans). Funders can obtain an additional layer of protection by ensuring that the broker warrants: the total payments due under the lease, and the amount of the total payments unconditionally due; the lease is not subject to any side agreements not reflected in the

written lease; the lessee's signature on the lease and all related documents is genuine; the equipment is accurately described and has been received and ***irrevocably*** accepted by the lessee; the equipment is free and clear of all liens; and the broker timely filed a first lien security interest in the equipment, and will take all action reasonably requested by the funder to evidence and/or perfect the funder's rights to the equipment.

**Potential Problem #2:**

**The broker changes standard terms in the lease. As a result, the representations and warranties contained in the broker agreement differ from those in the lease agreement. Thus, the broker has made representations to the funding source that the lessee has not made to the broker, and the broker may be in default of the broker agreement.**

**Solution:** Disputes arise when the broker tweaks lease terms without making corresponding changes to the broker agreement. For example, end of term purchase options needed to be drafted with care to reflect the parties' intentions, either to make the purchase mandatory or truly optional. The simplest way to avoid the stress and expense of a later lawsuit by the funding source is to seek legal counsel before making these types of changes. A broker should have an attorney review the revised lease and the broker agreement to make sure that representations and warranties are consistent. Though brokers may be tempted to avoid the expense altogether, hiring an attorney to

review these documents will save fees in the long run, reducing the broker's exposure of breaching the broker agreement's representations and warranties and risking a lawsuit by the lender. Simple breach of contract litigation can run into the ten of thousands of dollars in fees, while having an attorney review a simple lease will cost but a small percentage of the broker's fee on the deal.

**Potential Problem #3:**

**The funding source discovers that the broker has engaged in questionable behavior and wants recourse.**

**Solution:** The broker agreement must include certain representations and warranties by the broker to ensure that the funding source has recourse against the broker for questionable behavior like splitting a lease, pocketing a commission from the lessee, keeping lease payments, and taking cash from the vendor or lessee. The broker agreement should contain the following representations and warranties: the broker has not made a split lease request between various funding sources without full disclosure in advance, and thus any application submitted is for the full amount the lessee applied for to the broker; if the deal is being re-brokered by the broker, the broker will notify the funder; no part of the money required to commence the lease has been loaned or advanced by broker or vendor; the broker has not entered into any reciprocal agreements with the lessee or the employee of the lessee; and the broker will turn over any lease payments received from the lessee to the funder.

**Potential Problem #4:**

**The broker attempts to enter into transactions on the funding source's behalf.**

**Solution:** All documentation between the parties should make clear that the broker is a separate legal entity from lender. The broker agreement should also provide that the broker is an independent contractor, cannot bind the funding source in any transaction, and that no agency is created by virtue of broker's actions in bringing the deal to the lender. The lease itself should include a clause disclaiming the vendor as an agent of the lessor.

**Potential Problem #5:**

**The broker, unhappy with a commission, complains to the funding source six weeks after a commission is paid out.**

**Solution:** The broker agreement should specify a time (for example, 30 days after receiving a commission) in which the broker must provide written notice of a fee dispute. If no written complaint is made with the funding source, all commissions should be deemed correct. The broker agreement should also provide that the funder is not liable for any expenses incurred by the broker.

### **Potential Problem #6:**

**The lender sues the broker for breach of the broker agreement. Where the suit can be filed, what law applies, and the remedies are unclear.**

**Solution:** Sometimes litigation is inevitable. However, there are ways for lenders and brokers to reduce their costs. First, the broker agreement should specify where any lawsuit concerning a dispute between the parties must be filed through a forum selection clause. Arbitration clauses are not recommended, because the cost of the arbitrator's services usually far exceeds the cost of going to court. Second, the agreement should address which state's laws govern the interpretation of the agreement. Third, the agreement should specify whether or not a jury trial is waived. Jury trials are expensive and burdensome, and, given the complex and sometimes confusing financial structure of equipment leasing, often are better left for judges. Thus, the parties may wish to waive their right to jury trial altogether. Fourth, the agreement should specify which party pays the other party's legal fees if there is a dispute. The parties may decide that the fairest option is that the winning party may collect its attorney's fees from the losing party. Fifth, the broker agreement must clearly specify the remedies for breach of the agreement. Lenders will want the following provisions: (1) if the broker breaches any representation or warranty, the broker must repurchase the lease for all outstanding payments, any assumed residual, unamortized expenses, and applicable taxes; and (2) the lender may terminate the agreement if the broker breaches agreement. Finally, the broker agreement should contain provisions which state that the agreement contains the entire understanding between the parties and

supersedes all negotiations; the agreement cannot be altered unless in writing and signed by both parties; and that any waiver of a provision must be in writing. These latter provisions all reduce litigation costs by limiting the type of evidence that may be introduced to show that the agreement between the parties differs from the terms of the written broker agreement.

Though disputes between lenders and brokers are occasionally inevitable, with the proper documentation, litigation cost and exposure can be greatly reduced.

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