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Judgment Creditors Come One, Come All to NY

By Jennifer F. Beltrami

Recent case law has made New York an extremely beneficial place for a creditor seeking to enforce a judgment against a debtor's foreign assets. If a foreign bank has a branch in New York (which almost all do), then a New York judgment can be enforced against the bank's foreign assets, wherever located.

This recent expansion of New York law offers a special opportunity for judgment creditors around the country, because New York law provides a simple procedure for converting any state or federal judgment to a New York judgment.

NY Enforcement Mechanisms

Under New York law, any federal or state judgment in the country can be rendered a New York judgment by a simple filing procedure, after which the judgment is treated for all purposes, including enforcement, as if it were originally a New York judgment. Once converted, the judgment may be enforced against a judgment debtor's property, wherever located, as long as the debtor or "garnishee" (*i.e.*, a person or entity in possession of assets of the judgment debtor or owing a debt to the judgment debtor) has a branch or office in New York or is otherwise subject to New York jurisdiction.

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LILOs and SILOs: The Final Chapter?

By Philip H. Spector

In what may be the final chapter in the years of litigation over tax-exempt entity leasing transactions, the Circuit Court of Appeals affirmed the Federal Claims Court's decision disallowing Wells Fargo's deductions from SILO transactions. *Wells Fargo & Company v. United States*, Fed. Cir. 2010-5108 (April 15, 2011). For your recollection, in a sale-in, lease-out ("SILO") transaction the tax-exempt entity sells an asset it owns to the taxpayer. The taxpayer leases the asset back to the tax-exempt entity for a term less than the asset's remaining useful life. The lease is a net lease, meaning that the tax-exempt entity is responsible for all expenses normally associated with ownership of the asset. (In lieu of a sale, the tax-exempt entity may retain legal title to the asset and sell the property (for tax purposes) via a head lease for a term extending beyond the remaining useful life of the asset.)

The taxpayer funds the asset purchase price in part with its own funds and in part with a nonrecourse loan. The lessee places 95% of the proceeds in two cash collateral accounts, one for the taxpayer's equity portion and one for the debt portion. Each account generates investment income and sufficient cash to fund the lessee's rent payment obligations, which fund the lessor's debt service on the debt. The payment obligations are economically "defeased" — dedicated funds are set aside for the purpose of paying the obligations.

At the end of the lease term, the lessee has the option to purchase the asset for a fixed price. The purchase option price is fixed at the beginning of the transaction, and is set at an appraiser's estimate of the expected fair market value of the property at the time the option is exercisable. If the lessee exercises its option to repurchase the asset, the funds in the collateral account are sufficient to fund the purchase.

If the tax-exempt lessee chooses not to exercise its purchase option, the taxpayer can elect either the "return option," under which the taxpayer takes possession and control of the asset immediately, or the "service contract option." Under the service contract option, the tax-exempt entity is required to arrange for the continued

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Judgment Creditors

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The asset itself may be in a foreign jurisdiction.

Further, New York law makes such enforcement extremely easy by requiring only a New York attorney to sign and serve an *ex parte* restraining notice or execution on the New York branch or office.

New York law also allows, with a few exceptions, execution upon any intangible interest which could be assigned or transferred, whether it constitutes a future or present interest or whether it is vested or not. Thus, for example, if a judgment debtor possesses rights under a contract, but the contract obligor's performance is not yet due, the judgment creditor may step into the judgment debtor's shoes and receive the benefit of the obligor's future performance. Interestingly, under New York law, a typical non-assignment clause in a contract does not present an obstacle to such enforcement.

Should the judgment debtor and/or garnishee fail to transfer the assets sought in satisfaction of the judgment, the judgment creditor may bring what is known as a "turnover" proceeding in New York courts and obtain an order commanding the debtor or garnishee to turn the assets over to the judgment creditor. Full civil and criminal contempt sanctions are available for violation of a turnover order.

NY Enforcement Law Expands

The most powerful aspect of the recent expansion in this area of New York law is the decision by the New York Court of Appeals (the state's highest court) that, as long as a court has jurisdiction over a garnishee, the judgment creditor may reach the judgment debtor's assets in the hands of that garnishee, regardless of where the assets are located. The judgment debtor need not have any contact with New York; the court need not have jurisdiction over the judgment debtor; and the assets need not be in New York. A branch office or other indicia of doing business in New York is sufficient.

The expansion began with *Koehler v. Bank of Bermuda Ltd.*, 12 N.Y.3d 533 (2009), in which the New York Court of Appeals answered a certified question from the U.S. Court of Appeals for the Second Circuit: Can a court order a bank over which it has jurisdiction to turn over property of a judgment debtor (there, stock certificates) located outside New York? The New York Court of Appeals said yes. Koehler had registered a Maryland federal judgment in New York to reach stock certificates that the judgment debtor had pledged to garnishee Bank of Bermuda as collateral for a loan. Relying on its jurisdiction over the bank, which had a presence in New York, the court ordered the bank to turn over the stock certificates, even though they were held on deposit, not in New York, but in Bermuda.

State and federal courts in New York are following *Koehler*. Most recently, the U.S. District Court for the Southern District of New York relied on *Koehler* in directing a German Bank with a branch in New York to turn over funds of the judgment debtor located in Germany. *JW Oilfield Equip., LLC v. Commerzbank AG*, 2011 WL 507266 (S.D.N.Y. Jan. 14, 2011).

In *Koehler*, the assets sought were tangible stock certificates. In *Commerzbank*, the assets were funds. Intangible interests of a judgment

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Lease Accounting Project Update

By Bill Bosco

Subsequent to publication of last month's lease accounting update article, the FASB/IASB Boards conducted a meeting on May 19, 2011 at which they unexpectedly reversed some of their tentative decisions favorable to the industry. Although these tentative decisions were based on a high volume of common criticisms contained in comment letters (780+) and numerous outreach meetings, the Boards re-deliberated the issues and reversed course on some.

It appears that the project outcome is unsettled now. The Boards seemed to be listening to feedback, but now appear to be thinking that many of their decisions made in the Exposure Draft ("ED") will stand. This is surprising to me, as the feedback from users of financials (equity and debt analysts, lenders, and investors) on the information they find useful in financial statements regarding leases is being ignored.

The Boards changed their decisions on the following issues.

Re-exposure

I thought it was likely for a re-exposure to occur with a short comment period (60-90 days vs. the standard 120 days), but in light of the change in direction back to the decisions in the ED a re-exposure is less likely.

Effective Date

Tentatively decided on 2015, and I think that will hold.

Lessee Transition Method

To lessen the negative P&L impact of using a prospective method in transition, they are considering the full retrospective method. This will smooth the current P&L, but will result in a large hit to retained earnings. It will also be burdensome to go back to the inception of each lease.

Rates for Lessee and Lessor Accounting

Lessees use their incremental borrowing rate, unless the implicit rate in the lease is known, to capitalize the lease and impute interest expense in the P&L. Lessors use the implicit rate in the lease to calculate the receivable and residual assets and to accrue revenue.

The Boards made an important change in previous tentative decisions. They decided that the lessee must use the new, current incremental borrowing rate to adjust for changes in estimates of the lease term. This reintroduces a high level of complexity and volatility in reported results. The Boards did say they would re-look at the issue of the lessee discount rate in future meetings. Other changes to estimated payments would not require a change in the discount rate.

Lessee P&L Pattern

It appeared that the Boards would allow former operating leases (now called "other than finance" leases) classified using IAS 17-like criteria to have straight-line P&L cost pattern labeled as rent expense, but they reversed that tentative decision unexpectedly. The lessee cost pattern will be front ended. It will be comprised of amortizing the right-of-use asset (PV of the rents) and imputed interest at the incremental borrowing rate on the capitalized lease obligation (PV of the rents). This is an extremely unpopular decision. It will have unintended consequences regarding contracts and regulations that allow cost reimbursement for rent. The reason the Boards reversed their view is they could not justify using other than straight-line to amortize the right-of-use asset.

Lease Term

The lease term is tentatively defined as the contractual term plus renewals where the lessee has a "clear economic incentive" to exercise the options. This is essentially the current GAAP definition. It is hoped that they will decide that a renewal or extension is a new lease to avoid complex adjustments, but that remains to be seen.

Variable Payments

Variable lease payments will be included in the lease payments to be capitalized by the lessee and to be included in the lessor's lease receivable, but the specific variable payments will be limited vs. what was proposed in the ED.

The specific modification here is that all variable lease payments that depend on an index (*e.g.*, CPI) or a rate (*e.g.*, LIBOR-based floating rate leases) must be estimated and booked using the spot rate. They have not fully worked out how changes in the index or rate will be accounted for. This still means some complexity for floating rate equipment leases, like fleet leases, although they allow use of the spot rate rather than forward rate to calculate the future payments. It also means it is likely the complexity of capitalizing and adjusting real estate leases with CPI variable rent clauses will still be extremely burdensome.

Pre-commencement Payment/ Interim Rents

Interim rents are recognized as a rent prepayment, and at the date of the commencement the prepayments will be included in the cash flow discounting to determine the value of the right-of-use asset and capitalized lease obligation. Interim rents are now officially part of the capitalized lease amount, and as a result, lessees will be more aware of the cost of the lease.

Lease Incentives

Cash payments received from the lessor are included as a cash inflow in the cash flow discounting to determine the value of the right-of-use asset and capitalized lease obligation.

Bundled Lease Payments

Payments must be bifurcated by lessees and lessors. Bifurcate using observable stand-alone prices if known for all elements, consistent

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Accounting Update

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with the revenue recognition project; if only one element is observable, assume the cost of the other is the residual cost. Where no observable market prices are available, lessees capitalize the whole payment as a lease. Unless the Boards are more lenient in allowing estimates when market rates are not available to the lessee (they are considering it), this will mean that lessors will be forced to disclose the breakdown of elements in a full-service lease, as lessees will not accept capitalizing the full-bundled payments.

Conclusion

It initially appeared that the industry (both lessees and lessors) would fare very well in the re-deliberations, but that is now not so. It appeared the rules would be simpler and closer to current GAAP on the lessee side, but the Boards reintroduced accelerated P&L costs, will likely not call the expense rent, and added back complexity in deciding to change the incremental borrowing rate if the lease term assumptions change. There still are major concerns with lessor issues, although progress seems to be more in line with the industry views. It looked like the comment letter process would influence the FASB and IASB. Unfortunately, that does not seem to be the case with the Leases project. I urge you all to stay current on the project as it progresses. You should all comment when and if the re-exposed ED comes out later this year. You may wish to provide unsolicited comments now on the process and new decisions. Please do comment before it is too late!

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LILOs and SILOS

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operation of the asset under a third-party service contract and satisfy other conditions. Under either option, the lessee receives the balance of the funds in the two accounts.

SILOs offer three tax benefits to the taxpayer. First, as owner of the asset for tax purposes, the taxpayer may take depreciation deductions on the asset, although, because the lessee is tax-exempt, the deductions are straight-line under the "Pickle rule." Second, the taxpayer may take deductions for interest on the non-recourse loan. Third, the taxpayer may deduct certain transaction costs associated with the transaction. If the lessee exercises its purchase option, or if the asset is ultimately sold to a third party, these tax benefits are offset at the end of the lease by taxes owed on the taxpayer's gain from the sale of the asset.

A Long-Running Battle

SILOs evolved in response to a long-running battle among Congress, the IRS, and enterprising taxpayers regarding the boundaries of permissible leasing of tax-exempt property to generate tax benefits. In 1981, Congress enacted "safe-harbor leasing rules" that allowed taxpayers to lease property from tax-exempt entities. The safe-harbor rules, however, were quickly repealed the following year. In 1984, Congress enacted the so-called "Pickle rule," which provides that property leased from a tax-exempt entity would be depreciated at a slower rate than other property in order to limit the tax benefits generated by such transactions. Taxpayers then began to employ creative strategies to avoid the Pickle rule and receive greater tax benefits from the property of tax-exempt entities. The Federal Transit Administration at various times promoted SILOs (and their predecessor, LILOs) as a means of providing cash infusions for financially troubled public transit agencies. In 2004, Congress put an end to the tax benefits generated from SILO transactions by amending the Internal Revenue Code (*see* § 470).

From 1997 to 2003, Wells Fargo entered into several SILO transactions with tax-exempt entities. For tax year 2002, Wells Fargo claimed $115 million in deductions based on 26 SILO transactions. When the IRS denied the deductions, Wells Fargo paid the disputed amount and filed a refund suit in the Court of Federal Claims. Before trial, the parties agreed to let the court's disposition of five representative SILO transactions guide the resolution of the entire claim. Four of these representative transactions involved leases of passenger trains to domestic transit agencies, and one transaction was a QTE transaction involving cellular telecommunications equipment owned by Belgacom.

The Court of Federal Claims' Decision

Following a four-week bench trial addressing the five representative SILO transactions, the Court of Federal Claims denied Wells Fargo's claim in its entirety. *See Wells Fargo Company v. United States*, 91 Fed. Cl. 35 (Fed. Cl. 2010) and my analysis of that decision, "Taxpayer Suffers SILO (Pre-Tax) Loss in *Wells Fargo*," *LJN's Equipment Leasing Newsletter*, March 2010. In so ruling, the court found that transactions had to be disregarded for tax purposes under both the "substance-over-form" doctrine and the "economic substance" doctrine. The trial court found that the transactions in substance never transferred the benefits and burdens of ownership to the taxpayer because as a factual matter the lessees were virtually certain to exercise their purchase options. The trial court also found that the transactions lacked economic substance because the taxpayer failed to demonstrate that it had a reasonable expectation of pre-tax profit.

On Appeal

On appeal, Wells Fargo argued that the trial court: 1) employed an inappropriate mathematical test to determine that the lessees were

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Equipment Lenders Beware

Out-of-Court Foreclosure May Not Insulate Assets from Successor Liability Claims Asserted By the Borrower's Creditors

By Lawrence S. Goldberg and David M. Hillman

Equipment lenders often consider an out-of-court foreclosure as a fast and efficient way to recover collateral from a defaulting borrower. The Second Circuit Court of Appeals has thrown a monkey wrench into the attractiveness of the foreclosure option, especially for those equipment lenders who foreclose on collateral with the goal of preserving value by operating the business until a strategic buyer can be located. The Second Circuit Court of Appeals held that a secured creditor who purchases a debtor's assets in an out-of-court foreclosure sale under the Uniform Commercial Code ("UCC") and continues to operate the debtor's business may be liable for the debtor's debts. *Call Center Technologies, Inc. v. Grand Adventures Tour & Travel Publishing Corporation, Interline Travel & Tour, Inc.*, Docket No. 09-1224 (2d Cir. Mar. 11, 2011) ("*Interline*"). The Second Circuit reversed the lower court's grant of summary judgment in favor of the foreclosing lender because the issue of successor liability is fact-specific and the lower court erred by granting judgment as a matter of law. *Id*. at 1. A foreclosure conducted in accordance with the UCC will not automatically insulate the purchaser, as a matter of law, from a state law successor liability claim, even though under § 9-617 of the UCC a sale of collateral after default discharges the security interest of the foreclosing creditor and "any subordinate security interest or other subordinate lien." UCC § 9-617(a)(3). This decision means that a potential asset purchaser in an out-of-court foreclosure sale (whether it be the secured creditor through a credit bid or other independent party) must consider whether an unsecured creditor may seek to collect unpaid liabilities of the debtor from the purchaser, on the grounds that "the purchaser is a 'mere continuation' of the seller."

Successor Liability Doctrine Generally

The general rule is that a purchaser of assets does not assume the seller's liabilities. *Interline* at 7. Courts have established exceptions to this general rule. Generally, "a corporation which purchases all the assets of another company does not become liable for the debts and liabilities of its predecessor unless (1) the purchase agreement expressly or impliedly so provides; (2) there was a merger or consolidation of the two firms; (3) the purchaser is a 'mere continuation' of the seller; or (4) the transaction was entered into fraudulently for the purpose of escaping liability." *Interline* at 7. The court in *Interline*, applying Connecticut law, determined that the third exception — the "mere continuation" prong — was in question. Under Connecticut law, courts consider two theories to determine whether a purchaser is a "mere continuation" of the seller: "continuity of ownership" and "continuity of enterprise."

- Under the "continuity of ownership" theory, courts evaluate whether there is an identity "of stock, stockholders and directors between" the buyer and seller. *See Chamlink Corp. v. Meritt Extruder Corp.*, 899 A.2d 90 (Conn. App. Ct. 2006).
- Under the "continuity of enterprise" theory, courts evaluate whether the "'successor maintains the same business, with the same employees doing the same jobs, under the same supervisors, working conditions, and production processes, and produces the same products for the same customers.'" *Interline* at 9 (citing *Kendall v. Amster*, 948 F.2d 1041, 1051 (Conn. App. Ct. 2008)).

UCC § 9-617

The purchaser of assets in a UCC foreclosure sale "takes all of the debtor's 'rights' in the collateral, and the sale discharges the security interest under which the sale is made and any subordinate liens." Clark on UCC ¶ 4.09[c], citing § 9-617 of the UCC. The UCC § 9-617(a) provides that "[a] secured party's disposition of collateral after default … discharges any subordinate security interest or other subordinate lien other than liens created under any law of this state that are not to be discharged." Public policy supports this result: "[b]y providing the transferee with immunity from the foregoing title claims, it is hoped that the disposition will attract additional prospective transferees and result in higher prices. In this manner the statute benefits not only the transferee but also the foreclosing creditor and the debtor." Timothy Zinnecker, "The Default Provisions of Revised Article 9 of the Uniform Commercial Code: Part II," 54 Bus. Law. 1737, 1750 (1999).

Interline Facts

In June 1998, Call Center Technologies, Inc., an unsecured creditor ("Call Center"), sold a refurbished telecommunications system to Grand Adventures Tour & Travel Publishing Corporation, the debtor ("GATT"), for $130,090. Two consultants of GATT — Duane Boyd and Lawrence Fleischman — also made loans to GATT, and GATT granted a security interest in its assets to the consultants to secure the loans.

Aside from a $35,000 deposit on the telecommunications system from Call Center, GATT made no

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payments to Call Center. In April 2001, GATT had financial difficulties, which escalated after the September 2001 terrorist attacks. Boyd and Fleischman resigned as consultants, notified GATT of defaults on their loans, and assigned the loans and security interests to Interline Travel & Tour, Inc., a corporation they formed ("Newco"). After sending notices to GATT's secured creditors and GATT of a public foreclosure sale and publishing notice in a local newspaper, Newco held the public foreclosure sale on Oct. 30, 2001. Newco purchased the assets in the foreclosure sale.

Call Center sued GATT for balances owed and added Newco as a defendant. Call Center alleged that Newco was a successor in interest to GATT and asserted a successor liability claim against Newco. Newco moved for summary judgment to dismiss the successor liability claim. The district court granted Newco's motion, and Call Center appealed.

The Second Circuit vacated the grant of summary judgment and the holding by the district court that Newco was not a mere continuation of GATT, because in the Second Circuit's view the issue of whether a "continuity of enterprise" existed between GATT and Newco involved disputed issues of fact that could not be resolved by summary judgment. The Second Circuit proceeded to compare the management, employees, physical location, assets, liabilities and services provided by Newco with those of GATT. Although there were significant differences, in the view of the Second Circuit sufficient commonality existed to warrant further examination by the lower court of all the facts. For example, although the management of Newco consisted of Boyd and Fleischman, who were merely consultants at one time to GATT, the court noted that they "were not strangers to GATT." *Interline* at 9. Of Newco's employees, 31 of 51 were former GATT employees. The Second Circuit remanded the case back to the district court for a trial on the merits.

Analysis

Mere Continuation Theory

The Second Circuit in *Interline* did not expressly hold that a foreclosing lender is liable under Connecticut law as a successor under the "continuity of enterprise" theory. The court was clearly disturbed that the trial court resolved the matter without a trial and on a summary basis. It is worth noting that the Second Circuit (in a footnote) indicated that the "facts of [*Interline*] bear a strong resemblance to those in *Chamlink*, where the Appellate Court of Connecticut upheld a finding of non-liability." *Interline* at 12 n.3 The court distinguished *Chamlink* on procedural grounds because that case "involved review of the factual findings following trial." *Id.*

Foreclosure Does Not Bar Successor Liability Claims

The Second Circuit in *Interline* did not directly address whether a foreclosure sale conducted in accordance with the UCC should pre-empt any successor liability claims. Other courts, however, have addressed this issue. In *Ed Peters Jewelry Co., Inc. v. C & J Jewelry Co., Inc.*, 124 F.3d 252 (1st Cir. 1997), the court held that "an intervening foreclosure sale affords an acquiring corporation *no automatic exemption from successor liability*." *Id.* at 267 (emphasis added). The court explained that a foreclosure process, by its very nature, could not pre-empt a successor liability inquiry because "[w]hereas liens relate to assets (viz., collateral), the indebtedness underlying the lien appertains to a person or legal entity (viz., the debtor)." *Id.* The successor liability doctrine is founded on equity, and UCC § 1-103 provides that unless expressly pre-empted, general principles of equity shall supplement the provisions of the UCC. *Id.* at 268.

New York Cases

Few New York cases have dealt with this subject, though federal courts have considered what they think New York law would be. In one case, a federal district court held that it was "not persuaded that … the loan, security and statutory foreclosure process under the New York Uniform Commercial Code automatically preclude[d] the imposition of successor liability on Defendants." *Perceptron, Inc. v. Silicon Video, Inc. and Panavision Imaging, Inc.*, 2010 WL 3463098 at 6 (N.D.N.Y. Aug. 27, 2010); *see also Miller v. Forge Mench Partnership Ltd.*, 2005 WL 267551 at 12, 55 UCC Rep. Serv.2d 1022, 1027 (S.D.N.Y. Feb. 2, 2005)).

Practical Implications and Suggestions

The Second Circuit's decision in *Interline* and the other similar cases hold that a purchaser in a foreclosure sale may get more than what it bargained for. Even if the sale satisfies all UCC requirements and cuts off all subordinate liens, unpaid unsecured creditors may sue the purchaser and assert that the purchaser is liable for obligations owed by the debtor based on a successor liability theory. To the extent that the threshold for granting a motion by the purchaser for summary judgment is high, the purchaser faces the prospect of becoming embroiled in litigation. This decreases the attractiveness of an out-of-court foreclosure sale when the secured creditor seeks to sell the debtor's business as a going concern, and increases the attractiveness of a bankruptcy sale. The Bankruptcy Code generally permits a bankruptcy court to authorize a sale of assets free and clear of successor liability claims. *See* 11 U.S.C. § 363(f). *See, e.g. In re Chrysler LLC*, 576 F.3d 108, 119 (2d Cir. 2009), *vacated as moot sub nom. Ind. State Police Pension Trust v. Chrysler LLC*, 129 S. Ct. 2275 (2009), *appeal dismissed as moot*, *In re Chrysler LLC*, 592 F.3d 370 (2d Cir. 2010) (holding that § 363(f) of the Bankruptcy Code permitted the bankruptcy court to authorize the sale of assets free and clear of successor liability claims); *In re Motors Liquidation Co.*, 428 B.R. 43 (S.D.N.Y. 2010) (same). This is clearly not a result that furthers the goals of the foreclosure provisions of Article 9 of the UCC: attracting prospective purchasers and obtaining a

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higher purchase price in foreclosure sales.

A foreclosing secured creditor should take steps to avoid a finding that the acquisition vehicle is a "mere continuation" of the debtor. Assuming the secured creditor wishes to sell the debtor as a going concern, any acquirer (other than a strategic buyer already in the business) will probably retain the same employees, operate the same business, and provide goods and services to the same customers. Thus, the buyer should change the composition of the board and members of senior management, and to the extent possible contribute some additional assets to the acquisition vehicle and the target market of the business. The case also provides another reason for a lender to avoid participation in a debtor's business (in addition to the ordinary lender liability concerns); the *Interline* court focused on this in finding that "Boyd and Fleischman were not strangers to GATT." *Id.* at 9. In short, buyer beware.

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LILOs and SILOS

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economically compelled to exercise their purchase options; and 2) in applying economic substance principles, used the wrong test to measure pretax profit and misapplied the "nontax business purpose" test. The first argument is directed to the "substance-over-form" doctrine. The remaining arguments relate to the "economic substance" doctrine. The Circuit Court affirmed the trial court's decision on "substance-over-form" and never reached the economic substance issues.

Seeking to undermine the trial court's finding that the lessees were highly likely to exercise the purchase options, Wells Fargo challenged the testimony of the government's expert on financial economics. When the lessees make the decision whether to exercise their purchase options, they will compare the economic costs and benefits and burdens of exercising the option with the economic costs and benefits of the alternative options. Prior to closing the transactions at issue, Wells Fargo's appraisers analyzed the expected benefits to the lessee from the purchase option and the service contract option. The appraisers concluded that the respective benefits and costs of the two options would be such that the lessees would not be under any economic compulsion to exercise the purchase option. The government's expert conducted the same analysis but came to the opposite conclusion.

The crux of the disagreement between the government's expert and the appraisers is the discount rate that the tax-exempt entity would apply in calculating the net present value of its alternatives at the decision point. The appraisers selected the weighted average cost of capital ("WACC") prevailing in the industry sector in which the lessee operated (*e.g.*, the rail industry) as the discount rate that the entity would use to compare net present values of the purchase and service contract options. The government used a discount rate equal to the rate at which the tax-exempt entity could borrow funds (a lower rate than the WACC). Wells Fargo's expert, however, testified that the use of the debt rate as the discount rate "violate[d] a fundamental tenet of finance."

The Circuit Court held that the question of likelihood of exercise did not turn exclusively on resolution of the discount rate issue. Other witness testimony demonstrated that the options were virtually certain to be exercised. An urban public transportation expert testified that the transit agencies were "very likely" to exercise their purchase options due to the uncertainty and potential difficulties of complying with the service contract option requirements within a short time frame. The witness testimony regarding the four transit agency SILOs was supported by documentary evidence. Prior to the closing of the transactions, Wells Fargo did obtain written expert opinions as to the feasibility of the service contract option to the effect that the requirements were not so onerous as to cause the lessee to be practically compelled to exercise the purchase option. However, it does not appear that convincing evidence was provided at trial.

In light of the extensive witness testimony and documentation relied on by the trial court, even in the absence of the government's economic analysis of the transactions, the Circuit Court found that the trial court had compelling evidence of the very high likelihood that the lessees would exercise their purchase options. The trial court did not clearly err in concluding that the lessees were virtually certain to repurchase the assets and that in substance the taxpayer never acquired ownership of the assets.

PRIOR TO *WELLS FARGO*

Prior to the decision in *Wells Fargo*, a number of courts disallowed deductions claimed in LILO and SILO transactions between taxpayers and tax-exempt entities. *BB&T Corp. v. United States*, 523 F.3d 461 (4th Cir. 2008), *rehearing denied* (4th Cir. June 27, 2008); *AWG Leasing Trust*, 592 F. Supp. 2d 953 (N.D. Ohio 2008); *Altria Group, Inc. v. United States*, 694 F. Supp. 2d 259 (S.D.N.Y. 2010).

The sole exception is *Consolidated Edison Co. v. United States*, 90 Fed. Cl. 228 (2009), a case still awaiting final judgment. In *Consolidated Edison*, the Court of Federal Claims allowed deductions in a LILO transaction after finding that it was uncertain whether the tax-exempt entity would exercise its option to repurchase the leased assets. Whether that finding was supported by the evidence and whether the *Consolidated Edison* court applied the correct legal standard on the issue of probability are not questions addressed by the *Wells Fargo* case. Clearly, the finders of fact in that case and in *Wells Fargo* reached different conclusions regarding the likelihood of the tax-exempt lessee exercising its purchase option.

None of these cases resolve the "economic substance" issues raised

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IN THE MARKETPLACE

Fifth Third Bank of Cincinnati has changed the name of its equipment finance subsidiary from The Fifth Third Leasing Company to **Fifth Third Equipment Finance Company**. According to the company, the change reflects the sector's evolution to offering multiple types of commercial equipment finance products.

Navitas Lease Corp. of Ponte Vedra Beach, FL, has announced that **Dwight Galloway** has joined Navitas as the senior vice-president broker division. He will provide small-ticket funding to brokers and lessors by establishing **RLC Funding** in Columbia, SC, and will operate as a separate division for Navitas. RLC Funding will include Galloway's former managers and key team members, all well known to brokers nationwide from their many years with Republic Leasing and Netbank Business Finance.

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LILOs and SILOS

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by the taxpayer on appeal in *Wells Fargo*, but never addressed by the Circuit Court. The trial court held — somewhat gratuitously in light of its finding as to tax ownership — that the taxpayer also failed to demonstrate that the transactions were reasonably expected to generate pre-tax profit. The issue again turned on discount rate — whether the pre-tax profit must be measured on a present value basis, and if so, what discount rate is applicable. Until this decision, no case had required that cash flows be discounted for purposes of demonstrating expected pre-tax profit. The issue has been rendered somewhat moot by the enactment of § 7701(o) — the so-called statutory codification of the economic substance doctrine. For transactions entered into after March 30, 2010, taxpayers cannot rely on pre-tax profit to demonstrate economic substance unless the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected. To date, the Treasury Department has not issued and does not intend to issue guidance as to the application of these present value principles.

Tune in Next Time

The final chapter in the SILO saga? Possibly, but not likely. Although no appeal has been filed in the *Consolidated Edison* case, the taxpayer has filed a notice of appeal in the *Altria Group* case, to the Second Circuit. Finally, a case involving SILOs done by Union Bank of California was set to go to trial when the trial judge stayed the action pending the outcome of the *Wells Fargo* appeal. *UnionBanCal Corporation & Subsidiaries v. United States* (Fed Ct Cl., No.06-587C), June 9, 2010. In granting the government the stay, the court stated: "The Federal Circuit's decision [in *Wells Fargo*] will most likely help clarify and simplify evidence to be presented at trial and will conserve judicial resources." Did it? Tune in next time.

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Judgment Creditors

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debtor may be reached as well, wherever located, as long as the court has jurisdiction over the judgment debtor or garnishee. *Hotel 71 Mezz Lender LLC v. Falor*, 14 N.Y.3d 303 (2010) (allowing creditor to reach intangible interests of the debtor in various out-of-state companies). However, special rules apply with respect to certificated securities, uncertificated securities and security entitlements (as those terms are defined in the Uniform Commercial Code), which may be reached by garnishment, attachment or other legal process only as provided in the Uniform Commercial Code.

Some Distinctions

Two further caveats. First, the recent expansion in New York judgment enforcement described above applies to post-judgment enforcement efforts; the law with respect to pre-judgment attachment is more restrictive and generally requires the assets to be in New York. Second, efforts to enforce judgments against foreign states (including foreign sovereign banks) are distinguishable from enforcement against corporations or individuals. Enforcement of judgments against foreign sovereigns and their national banks are subject to the additional requirements of the Foreign Sovereign Immunities Act, including the requirement that the assets against which the judgment is sought to be enforced must be used for a commercial activity in the United States.

In short, creditors seeking enforcement of judgments against debtors who may be subject to New York jurisdiction or who may have an account with a foreign bank or brokerage with a branch in New York would be well advised to file the judgment in New York to take advantage of the state's liberal judgment enforcement rules.

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