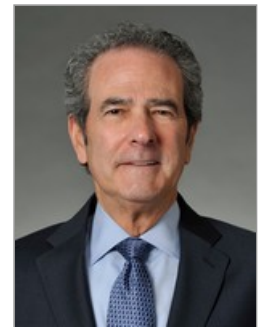


The Whys And Hows Of Motor Vehicle Titling Trusts: Part 2

By **Alan Mogol**

Law360, New York (August 25, 2017, 10:12 AM EDT) -- When certificate of title motor vehicles are acquired and titled in the name of an equipment finance company, a subsequent syndication of that lease financing, which would include a transfer of legal title to the motor vehicle, can involve a significant administrative burden and expense. A titling trust can avoid having to transfer legal title, which permits the equipment finance company to avoid the administrative burden and not only the filing fee but also the excise, sales or transfer taxes imposed by some states.



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The first part of this article examined how to create such a trust, the roles of the servicer and custodian and the creation of sub-trusts. This installment will examine how the beneficial ownership interest in a sub-trust may be used for warehouse financing, permanent financing and syndication, and the importance of compliance with securities laws in syndication arrangements

Encumbering the Beneficial Ownership Interest in a Sub-Trust

Warehouse Line of Credit

It is possible to use the beneficial ownership interest in a sub-trust as collateral for a loan. This could be a loan made either to the equipment finance company (perhaps under a warehouse line of credit or a permanent loan), or to an investor after the conveyance to it of the beneficial ownership interest in a sub-trust.

If the equipment finance company uses a warehouse line of credit with respect to transactions to be placed in the titling trust program, a separate sub-trust will be created for use with respect to each warehouse lender making an advance under a warehouse line of credit for the equipment finance company. The equipment finance company will direct the trustee to allocate the equipment and related leases being financed under the warehouse line of credit from the general trust assets to the sub-trust created with respect to the applicable warehouse lender.

The equipment finance company will be the owner/holder of the beneficial interest in the sub-trust and will grant a security interest to the warehouse lender with respect to its beneficial ownership interest in the applicable sub-trust, which security interest will be perfected by the filing of a UCC financing statement. It is not necessary for the lien of the warehouse lender to be noted on the certificate of title with respect to a motor vehicle.

The lien of the warehouse lender attaches to the beneficial ownership interest in the sub-trust, which permits the warehouse lender to foreclose on that beneficial ownership interest and step into the shoes of the holder of the sub-trust, controlling all of the assets contained in the sub-trust (including the equipment and the related leases).

As additional equipment and related leases are allocated to that particular sub-trust, the equipment finance company's beneficial ownership interest in that equipment and related leases automatically is subjected to the existing security interest in favor of the applicable warehouse lender. No UCC

financing statement amendments are required to be filed.

Similarly, as the warehouse line of credit is paid off with respect to specific lease transactions, the applicable equipment and related leases are reallocated out of that sub-trust and the equipment finance company's beneficial ownership interest in that equipment and related leases no longer is subject to the security interest held by that warehouse lender. No UCC statements of partial release or partial termination are required to be filed.

For the protection of the warehouse lender, the trust agreement will require the equipment finance company to allocate equipment and related leases to the sub-trust created with respect to the applicable warehouse lender; and will restrict the ability of the equipment finance company to instruct the trustee to reallocate equipment and related leases from the sub-trust created for the warehouse lender without the confirmation of that warehouse lender.

When the warehouse loan is paid with respect to certain equipment and related leases, the warehouse lender will confirm (a) payment of the warehouse loan to that extent, and (b) authorization for the trustee to reallocate that equipment and related leases.

Permanent Financing

If the equipment finance company wishes to arrange for permanent financing with respect to certain equipment and related leases, a separate sub-trust will be created for use with respect to each permanent lender making a loan to the equipment finance company.

As was the case with respect to a warehouse line of credit structure, with respect to permanent financing again the equipment finance company will direct the trustee to allocate the equipment and related leases being financed under the permanent loan from the general trust assets to the sub-trust created with respect to the applicable permanent lender.

The equipment finance company will be the owner/holder of the beneficial interest in the sub-trust and will grant a security interest to the permanent lender with respect to its beneficial ownership interest in the applicable sub-trust, which security interest will be perfected by the filing of a UCC financing statement. It is not necessary for the lien of the permanent lender to be noted on the certificate of title with respect to a motor vehicle.

The lien of the permanent lender attaches to the beneficial ownership interest in the sub-trust, which permits the permanent lender to foreclose on that beneficial ownership interest and step into the shoes of the holder of the sub-trust, controlling all of the assets contained in the sub-trust (including the equipment and the related leases).

As additional equipment and related leases are allocated to that particular sub-trust, the equipment finance company's beneficial ownership interest in that equipment and related leases automatically is subjected to the existing security interest in favor of the applicable permanent lender. No UCC financing statement amendments are required to be filed.

Similarly, as equipment and related leases are reallocated out of that sub-trust, the equipment finance company's beneficial ownership interest in that equipment and related leases no longer is subject to the security interest held by that permanent lender. No UCC statements of partial release or partial termination are required to be filed.

For the protection of the permanent lender, the trust agreement will restrict the ability of the equipment finance company to instruct the trustee to reallocate equipment and related leases from the sub-trust created for the permanent lender without the confirmation of that permanent lender. When the permanent loan is paid with respect to certain equipment and related leases, the permanent lender will confirm (a) payment of the permanent loan to that extent, and (b) authorize the trustee to reallocate that equipment and related leases.

The beneficial ownership interest in the sub-trust created with respect to the permanent lender shall be retained by the equipment finance company (or may, with the consent of the permanent lender, be conveyed to an Investor subject to the lien of the permanent lender). The trust agreement will require the equipment finance company to allocate equipment and related leases to the sub-trust

created with respect to the applicable permanent lender; and will restrict the ability of the equipment finance company to instruct the trustee to reallocate equipment and related leases from the sub-trust created for the permanent lender without the confirmation of that permanent lender.

When the permanent loan is paid with respect to certain equipment and related leases, the permanent lender will confirm (a) payment of the permanent loan to that extent, and (b) authorization for the trustee to reallocate that equipment and related leases.

Syndication

If the equipment finance company wishes to syndicate its interest with respect to certain equipment and related leases, a separate sub-trust will be created for use with respect to each Investor receiving an assignment of the equipment finance company's beneficial ownership interest in certain equipment and related leases.

The equipment finance company will direct the trustee to allocate the equipment and related leases being syndicated from the general trust assets to the sub-trust created with respect to the applicable investor. The investor will be the owner/holder of the beneficial interest in the sub-trust.

If the equipment and related leases to be syndicated to an Investor were financed either through a warehouse loan or a permanent loan, when the warehouse loan or permanent loan is paid with respect to that equipment and related leases, the equipment finance company will direct the trustee to reallocate that equipment and related leases from the sub-trust created for the warehouse lender or permanent lender (as applicable), to a sub-trust created with respect to the applicable investor.

The portfolio interest certificate issued by the trust with respect to the sub-trust will indicate that the Investor is the owner/holder of the beneficial interest in the sub-trust evidenced by the portfolio interest certificate.

After the transfer of beneficial ownership interest has occurred, the investor is entitled to the tax benefits accruing with respect to all equipment allocated to its sub-trust and all rent and other payments made under the related leases.

The investor will have the right to remove and replace the servicer under the servicing agreement solely with respect to the sub-trust then held by that investor. The investor may also elect to withdraw the assets from the titling trust program. Under the terms of the trust agreement, the investor has the right to instruct the trust to distribute the equipment and related leases to the investor or its nominee, free of the trust, and to cause any certificate of title motor vehicles to be retitled in the name of the investor or its nominee (at the expense of the investor).

Special Provisions to be Addressed in the Assignment Agreement

As part of the syndication process, it is important to remember that the assignment agreement entered into between the equipment finance company and the investor must be tailored to reflect the involvement of the titling trust program and should include the following special provisions:

- representations with respect to the trust, including: the creation and continued existence in good standing of the trust; and the creation of the sub-trust and the allocation to that sub-trust of the equipment and related leases;
- conditions precedent including: issuance of the allocation notice; and issuance of the portfolio interest certificate and delivery to the investor; and
- confirmation that the asset being assigned is the beneficial ownership interest in the sub-trust, and not the actual underlying equipment and related leases.

In addition, the standard securities law disclaimer and confirmation provisions should be included.

Securities Laws Compliance

That is important because it is unclear whether the conveyance of the beneficial ownership interest in

a sub-trust would be construed as the sale of a security for purposes of the Securities Act of 1933, as amended, and applicable state securities laws. The analysis should be the same as that which is applicable with respect to the syndication of a lease financing by the assignment of all or an interest in a master lease agreement or an equipment schedule or the transfer of a participation interest.

Accordingly, it would be appropriate for the equipment finance company to include in the conveyance instruments appropriate statements, disclaimers and representations by the parties confirming that:

- the conveyance of the beneficial interest in the sub-trust may involve the sale of a security and may be subject to restrictions on transferability and resale, except as permitted under applicable federal and state securities laws;
- the beneficial interest in the sub-trust is being offered and sold without registration under federal and state securities laws, in reliance on an exemption from the registration requirements of those laws; and
- the recipient: (1) is acquiring the beneficial interest in the sub-trust solely for its own account, for investment and not with a view to resale, (2) has such knowledge and experience in business and financial matters as is necessary to evaluate the merits and risks of an investment in the beneficial interest, (3) has had access to all financial and other information that it deems necessary to evaluate the merits and risks of an investment in the beneficial interest and (4) is experienced in making investments in transactions similar to the beneficial interest and is financially able to undertake the risks involved in such an investment.

Summary Benefits of the Titling Trust Program

Minimize Administrative Burden and Expense

The benefits of a titling trust program are various. First, the purpose of the use of the titling trust is to avoid the significant administrative burden and expense typically associated with a syndication of the financing of certificate of title motor vehicles.

By using the titling trust structure, the trust is designated as the registered owner on the certificate of title. The initial beneficial owner of the trust assets is the equipment finance company. The equipment finance company may transfer the beneficial ownership interest of the individual sub-trusts without having to retitle the motor vehicles, since the conveyance is only with respect to the beneficial ownership interest in certain trust assets, and not the legal title ownership of the assets themselves.

This should avoid the imposition of any sales or excise tax which would otherwise be incurred in connection with the conveyance of title to tangible personal property, since the conveyance is with respect to intangible property only; i.e., the beneficial ownership interest in certain sub-trusts.

Dealing with Investors

Second, the equipment finance company would continue to deal with its Investors as it has in the past, using the same sale/assignment documents with only slight modification to reflect the involvement of the titling trust program. Each investor will have the right to terminate its sub-trust and cause the equipment and related leases comprising a portion of the assets of its sub-trust to be transferred and/or retitled, at its own expense.

Fiduciary Duty of Trustee

Third, the trustee and custodian typically are independent financial institutions which owe a fiduciary obligation to the beneficiaries of the master trust and the various sub-trusts. The rights and limitations on the ability of the trustee and custodian to take actions with respect to the trust assets will be clearly delineated in the trust agreement.

PC, has more than 40 years' experience in the negotiation and documentation of equipment finance transactions. He has assisted more than a dozen national equipment financing companies in developing standard lease and syndication documentation, including the implementation of titling trusts.

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