

BUSINESS LEASING AND FINANCE NEWS (BLFN)

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About BLFN: [David G. Mayer](#), a Business Group partner at Patton Boggs LLP, founded this monthly e-newsletter in January 2002. BLFN's mission is to provide leasing and financing strategies for your success.

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FOUNDER'S NOTE:

By [David G. Mayer](#)

Wind Energy Momentum

Investment in equipment and renewable energy projects has continued to recover and grow since the 2008-2009 economic crisis. In project development and finance of wind energy, about 30 (or so) lenders have slowly come off the bench and gotten back into the lending game. They intend to lend money in a few selected and selective deals.

But who gets their money? U.S. banks have limited capital available as a result of the 2008-2009 economic crisis. They have little choice to focus on serving their existing customers or other potential customers that have a strong credit profile, acceptable cash flow and net worth, and other strong fundamentals, such highly competent and well-known management. They resist start-up projects and usually refuse to consider untested turbines or unknown manufacturers as these machines need to produce reams of generation data to win support of the project lending community.

Lenders deal in "clubs" – a circle of trust of known and responsible lenders that can collectively fund the transactions. They typically demand, that private equity or other investors, including the project sponsors, have a sufficient tax appetite (a/k/a "tax equity") for investment tax credits or tax grants under the [American Recovery and Reinvestment Act of 2009](#) (ARRA) to kick in approximately 50 percent of the equity. Unfortunately, tax equity continues to be in short supply, even if lenders agree to advance more than 50 percent of the project cost. While tax grants last or lenders have confidence in a wind project, they may advance up to 80 percent of construction cost of the cost to build a wind farm. Lessors have not stepped into the ring to fight for their share of wind deals, and the wind energy industry has yet to accept leasing as a viable type of wind energy project financing.

Whether in wind energy or equipment finance, the new reality has set in for many financiers. They must produce deal flow this year, even if fewer deals than they did before the economic crisis in 2008 and 2009. Their task is a difficult one, but, undaunted and driven, they still continue to push ahead to find good projects. Their clear direction is one of growth even as the stock market and other economic indicators remain in flux. Lenders have even begun to compete on price again, which seems at odds with the lessons supposedly learned during 2008 and 2009 of creating price margins for losses.

As wind energy grows, the American Wind Energy Association (AWEA) promotes the passage of a national "renewable energy standard (RES)." In theory, a RES, if enacted, would propel the development

of wind energy and other renewables, to power up more homes and businesses. State incentives give wind energy a boost it needs to become a more prominent source of power in the U.S. Perhaps renewable energy will lead a sustainable upward trend in the energy segment of our economy. With a supportive electorate, it will be interesting to see whether our political leaders recognize this trend will help the industry keep up the momentum.

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About Patton Boggs LLP; PB Capital Resource Center; Publications, Speech and Radio Interviews

BLFN AT A GLANCE

The [lead article](#) explains how small commercial wind projects can make money. The [second article](#) explores the concept of the master limited partnership and key aspects of how investors use them. The [third article](#) discusses a case that has sent environmental shock waves out for all lessors – by a court decision that imposed Superfund Liability on a lessor where least expected. Finally, the [fourth article](#), BLFN’s Finance 101, asks: What is a “Deceptive Trade Practice?”

Read each of the articles for news and research links and the current insights into each topic. Feel free to contact me by telephone at (214) 758-1545 or e-mail at dmayer@pattonboggs.com to discuss BLFN’s topics or other issues affecting your business. If you see the name of another author or editor at the end of an article, you should (if you prefer) pick up the telephone or e-mail that person directly.

1. Despite Economic Challenges, Small Commercial Scale Wind Projects Charge Ahead

Can developers profitably design, construct and operate a wind project with a capacity of 20 megawatts (MW)? Developers believe they can build such a project (New Project) and plan to do so, with careful attention at the outset of development to the economic, siting, regulatory, tax and design issues unique to a project of this size. A developer’s success will depend on maximizing cost savings and minimizing risks or disadvantages of the New Project relative to other sizes or categories of wind projects.

**Terms to Know:* “A MW is one million watts and a kilowatt (kW) is one thousand watts. Watts (W) are the yardstick for measuring power. A one hundred watt light bulb, for example, is rated to consume one hundred watts of power when turned on. If such a light bulb were on for four hours it would consume a total of 400 watt-hours (Wh) of energy. Watts, therefore, measure instantaneous power while watt-hours measure the total amount of energy consumed over a period of time.” See [What is a Megawatt?](#) - By Bob Bellemare, President and CEO, [UtiliPoint International Inc.](#) online (June 24, 2003).

How to Categorize 20 MW Wind Projects

A New Project is not small wind. However, it is on the smaller end of the spectrum of commercial scale or utility scale projects, even though it may be scalable to a much larger project. A New Project also possesses characteristics of distributed generation. These terms and others used in the wind power markets, though often indistinct, fundamentally divide projects into two groups – projects that use the power generated from wind power generation and all others that sell the power to third parties.

Commercial scale wind projects sell their power under a power purchase agreement (PPA) to utilities and/or businesses with significant energy demands. The utility purchaser [transmits](#) electrical power (over interconnected lines to a distribution point) or [distributes](#) the power to its customers, while business

purchasers may consume the power in their operations and potentially sell their excess power, if any, to a local utility.

**Terms to Know:* A [small wind](#) project refers to [wind power](#) generation designed for and used by homeowners, ranchers and small businesses. See [The U.S. Small Wind Guide](#). A [community wind](#) project is owned by a variety of individuals including local small business owners, farmers, local organizations (such as schools and universities), Native American Tribes, rural electric cooperatives, municipal utilities and religious institutions. These projects can range from a single turbine to a community-owned commercial-scale wind farm. A [commercial-scale](#) wind energy project refers to wind power generation where the electricity is sold rather than used on-site. This category can include large arrays of 100 or more turbines. A [distributed wind](#) power project (DW) refers to small-scale power generation technology that provides electric power at a site closer to customers than the central station generation. The term is commonly used to indicate non-utility sources of electricity, including facilities for self-generation. The DW market is primarily rural homeowners, farms, small businesses and schools.

Essential Characteristics of New Projects

Developers may characterize New Projects as a hybrid of a commercial-scale wind power project and DW. For a New Project to be viable and profitable, developers usually look for sites with close proximity to their customers. A New Project must overcome several [hurdles](#) generally associated with DW, primarily diseconomies of scale in system costs, interconnection and construction costs. A developer of New Project usually:

- **Builds** the New Project in rural areas with a good wind resource, near an interconnection point and electrical power load (demand) area;
- **Enjoys** community support but is not owned by members of the community in which it is built;
- **Requires** government tax incentives, including for example, sales tax exemptions, property tax abatements, grants and guarantees from the Department of Energy (DOE) and development grants to achieve positive earnings of a New Project;
- **Obtains** financing from sophisticated project lenders rather than local banks (however, local banks accustomed to the complexity and volume of documentation associated with wind power projects may be willing to finance New Projects); and
- **Negotiates** electric power purchase rates under the PPA which are sufficient to overcome any diseconomies of scale associated with the New Project.

These criteria understandably restrict developers to certain types of sites for New Projects.

**Tip:* Regardless of the site chosen, New Projects, like almost every other wind energy project, should adhere to lender financing standards from inception of development to avoid expensive delays caused by, among many other factors, insufficient wind data, poorly drafted real estate leases and easements, and unacceptable pricing and/or terms in PPAs.

What Economics Lenders Will Need To Finance a New Project

In today's market, lenders require economically strong and legally sound projects. Project documents must be assignable as collateral to the lender, including the PPA, the balance of plant (construction) contracts (BOP), the interconnection agreement and operations and maintenance agreement (O & M). These standards remain consistent for most wind projects with few, if any, exceptions for New Projects.

**Warning:* Due to the relatively small size of a New Project, project lenders may refuse to participate because their earnings probably do not justify their efforts associated with the project's due diligence, credit approval and loan documentation. Do not be surprised if lenders of "international standing" known as wind project lenders will not consider financing a New Project. Their "sweet-spot" cannot be generalized, but often starts with a single project of at least 50MW, with expansion to more than twice the size (100MW).

When analyzing the economics of a New Project, a developer should work with market-based terms acceptable to project lenders, including the following five criteria:

1. PPA: PPA pricing from a utility with an investment grade credit rating that virtually assures that the debt will be paid when due, with little curtailment and contingent liability for the developer. Such contingent liabilities to avoid include guaranteeing energy deliveries to the PPA purchaser or making corresponding cash payments in lieu of deliveries, regardless of wind conditions.
2. Subsidies: Sufficient [DOE loan guarantees](#), plus sponsor equity, plus a 30 percent cash grant (Cash Grant or [1603 Program](#)) in lieu of the investment tax credit (ITC) under [American Recovery and Reinvestment Act of 2009](#) (ARRA), assuming a ratio of 80 percent debt to 20 percent equity during construction period and approximately 50 percent debt and 50 percent equity for long-term debt with a tenor of 15 – 20 years.
3. Coverage Ratios: Debt coverage ratios of 1:45 to 1:00 at “P50” and 1:00 to 1:00 at “P97-99.”

**Term to Know:* The “P” factor in P50 or P97-99 refers to the probability - based energy production level for a wind farm. For example, “P99 energy” is the term used for the annual amount of energy predicted to be available at a point of delivery with a probability of 99 percent or greater.

4. Interest Rate: Spread over the lender’s cost of funds index of 300 basis points or more.
5. Reserves: Construction reserves of at least 9-12 months, and adequate debt service, O&M reserves, and other reserves during the long-term debt period.

**Tip:* Even if you are a sophisticated developer, you should either employ and/or engage experienced pricing analysts and project consultants at the outset of a New Project to determine the economic viability of a New Project and continually reassess the economics of the New Project as the development progresses.

For more factors considered by lenders to project finance wind energy projects, see [Top 12 Requirements to Finance Wind Energy Projects](#), [Business Leasing and Finance News](#) (Nov. – Dec. 2009).

10 Ways to Save Cost in Developing and Financing New Projects

A New Project by its nature and size enjoys some cost or design benefits, but otherwise requires developers to endure the same process as large projects from inception to commencement of deliveries.

1. PPA: As in all projects, the quality of the PPA and its cash flows determine the amount of debt a lender will advance (“right-size”) to a developer and the potential profit for the developer. A New Project may be able to find an off-taker that is willing to pay a higher price for power because the higher cost is largely immaterial and satisfies state renewable energy requirements. However, utilities are often reluctant to purchase such output unless the project is bid into a request for proposal regime sanctioned by the pertinent State utility commission. In any case, the cost of negotiation and documentation in a New Project will likely be comparable to larger projects. Especially in documentation, projects of a similar type create legal issues and structures that must be properly documented by knowledgeable counsel.
2. Land Rights: Land lease and easements costs may be less than those of a large project simply because of the reduced acreage needed to erect the turbines and optimize the use of the wind resource. However, a developer must still take the same steps in a New Project as a large project to acquire and negotiate the land rights.
3. Efficient Design: Creating an efficient design, and doing so once, may provide cost savings for a New Project, especially if no design changes are required by a lender’s independent engineer.

**Tip:* As a developer, you should employ or engage appropriate engineers from the start of development to gain the benefit of their experience in designing the same size of project. The engineer should have a view toward efficiently completing a design that supports your pro forma assumptions and achieves the cash flow from which to pay your lenders.

4. Tax Benefits and Government Programs: For New Projects, DOE grants or loan guarantees, coupled with Cash Grants, provide the single greatest investment benefit. They are essential to make the economics work – both as to cash flow and profitability.

5. Met Towers: Because of the smaller land area needed in most cases for a New Project, a developer may have to erect only one met tower (or at least fewer met towers) to obtain the resource data needed to prepare pro formas and right-size the debt financing. This situation may reduce development cost compared to large sites that require multiple met towers.
6. Studies/Permitting/Regulatory Scrutiny: Depending on the location of the New Project, the smaller size of the New Project site, relative to a large project site, may reduce the cost of transmission studies, transmission upgrades and environmental studies. This reduced regulatory work may occur in part because the power produced and the land area used may not trigger as many system upgrades or regulatory reviews.

The Federal Energy Regulatory Commission (FERC) may not regulate projects of 20 MWs or less as strictly as larger projects. The owners of such facilities, if the facilities are “qualifying small power production facilities,” will not be required to obtain specific authorization to sell power from FERC (wind facilities more than 20 MWs do need such authorization, regardless of whether the facilities are [qualifying facilities](#) (QFs)).

***Term to Know:** According to FERC and AWEA, a “[small power production facility](#)” is a generating facility of 80 MW or less whose primary energy source is renewable (hydro, wind or solar), biomass, waste or geothermal resources. There are some limited exceptions to the 80 MW size limit that apply to certain facilities certified prior to 1995 and designated under section 3(17)(E) of the Federal Power Act ([FPA](#)) ([16 U.S.C. Section 796\(17\)\(E\)](#)), which have no size limitation. In order to be considered a qualifying small power production facility, a facility must meet all of the requirements of 18 C.F.R. Sections [292.203\(a\)](#), [292.203\(c\)](#) and [292.204](#) for size and fuel use, and be certified as a QF pursuant to 18 C.F.R. Section [292.207](#).

While owners of QFs are technically “public utilities” under the FPA, they are exempt from much FPA regulation and are exempted from much State regulation governing electric utilities.

7. Interconnect Upgrades: With lower total costs of connecting to transmission, a New Project developer may reduce his/her costs to interconnect or may have the opportunity to obtain reimbursement from the off-taker for all or a substantial portion of the cost. In addition, FERC’s standardized interconnection rules for small projects (20 MWs or less) streamline some of the study request processes. However, in areas where a “cluster” approach has been approved for queuing purposes (such as the [Southwest Power Pool](#)), there may be only one set of interconnection rules governing projects of all sizes.
8. Operation and Maintenance Costs: O&M costs, which today usually range from \$40,000 to \$90,000 per turbine per year, may tilt toward the higher end with New Projects because they have fewer turbines and towers to service and spread costs among, which affects the vendor’s cash flow and total work at the site. However, a developer can reduce costs by efficiently scheduling repairs, resourcing parts prospectively at favorable costs, keeping parts available so there is no lag time when parts need to be replaced and putting the affected turbine back in service as promptly as feasible. See *Lowering Wind Costs In Order To Be Competitive*, By David Koyle, [North American Wind Power](#), Vol 7, Number 4 at 187 (May 2010).
9. Transaction Costs. If a developer wishes to gain the most benefit from its design and implementation of the New Project, it may attempt to replicate a project design and development effort in the same geographical area as another New Project. This approach may allow the developer to drive ease transaction costs and fix fees for various professional services in subsequent New Projects. Lenders negotiated fixed fees more frequently, and, by doing so, seem to be setting a trend in the wind energy market today.

***Tip:** No two sites are the same, and each requires separate evaluation and documentation. To the extent a developer can build “cookie cutter” projects, the developer should be able to reduce transaction costs.

10. Use Creative Financing: Developers can resort to project financing from sources other than the typical project lender. For example, non-U.S. turbine manufacturers may provide initial equity for a project to have the opportunity to sell their turbines on the site of the New Project. U.S. manufacturers, in the current market, may consider long-term vendor financing of the turbines to

“win” an order of turbines while supplies last. Utilities might like to have the option to buy a New Project, and may negotiate terms in their PPA that enable them to do so. In exchange, these utilities may provide some early stage financing. Many ideas for financing can exist, and the size of New Projects is conducive to experimenting with new financing ideas.

Not All Costs Are Less

Costs of construction, which have fallen somewhat from \$600,000 per turbine to about \$400,000 per turbine by some estimates, tend to be more expensive for New Projects. New Projects do not have much, if any, benefit from economies of scale like large projects. They have too few turbines to reduce average construction costs per turbine. For example, the same crane must be delivered to a site to install 100 turbines as 20 turbines, increasing the cost per turbine for installation. Further, projects rarely cost less to develop than planned. As such, the pro forma for a New Project must have some reserves for unexpected cost overruns and contingencies attributable to, among other factors, the construction of the towers.

In the current market environment, the Cash Grant and DOE project guarantees and grants can make or break the economics of New Project. If these programs expire, New Projects will have to find other ways to charge ahead in the increasingly diverse and competitive wind energy market.

Thanks to (i) [Robert Gay](#), PhD, CEO of Monarch Wind Power, a developer of a 20MW wind project, for commenting on and editing this article, (ii) [Amy Koch](#), a Partner at Patton Boggs LLP (PB) in the Washington, D.C., for providing the FERC aspects of this article, and (iii) [Joel Bannister](#), an Associate at Patton Boggs LLP in its Dallas office, for editing this article.

2. Amid Tax Complexity, Master Limited Partnerships Attract Investors to Potential Cash Flow

If you flip through the names of publicly traded companies, you might notice that most of the names of the companies on the list end with one of the following: Corporation, Corp., Incorporated, Inc., or Company. Why? Most publicly traded companies are organized as corporations. However, nestled among the names of all these publicly traded corporations will be a name of a company that ends with: Partners, Limited Partnership (or, LP), Limited Liability Company (or, LLC). Why are some publicly-traded companies organized as limited partnerships or limited liability companies?

***Terms to Know:** A “[partnership](#)” is a business enterprise in which two or more individuals or entities (referred to as general partners) co-own the assets and co-obligate themselves for the obligations of the business enterprise. They operate and manage the enterprise for their mutual benefit. However, a “limited partnership” has one or more limited partners in addition to having at least one general partner who manages the partnership. Limited partners are not actively involved in the management of the business. Their liability for the debts of the limited partnership is limited to the amount of capital the limited partner invests in the limited partnership. A publicly-traded limited partnership is generally referred to as a “[master limited partnership](#)” (MLP).

Pivotal Role of Taxes

Taxes play a pivotal role in the structure of entities. For example, the federal government taxes corporate profits of C corporations not once, but twice. First, the federal government taxes the profits of the corporation at the corporate level. Second, stockholders pay tax on dividends, even though the corporation cannot deduct the dividends paid to its stockholders. In contrast, partners in a partnership pay income taxes on their shares of the profits of the partnership. Partnerships do not pay federal income tax.

***Technical Point:** MLPs lead to more complex tax reporting. Investors receive Form K-1 rather than Form 1099. Items on the Form K-1 must be reported on various lines of the investors’ tax returns. Investors receive their Form K-1 much later than the January 31 deadline for filing Form 1099. As an investor, you will find it more difficult to track tax basis in an MLP than in a corporation because shares of income and loss, distributions and contributions, all affect basis.

[Section 7704](#) of the [Internal Revenue Code](#) (IRC), states that “publicly traded partnerships” (which are partnerships or limited liability companies whose interests are traded on an established securities market

or secondary market) will be treated as corporations under the tax code (see IRC Sections 7704(a) and 7704(b)). This rule does not apply to a publicly traded partnership if 90 percent or more of its gross income for a given year consists of “qualifying income.” See IRC Section 7704(c).

Qualifying income generally includes:

- interest,
- dividends,
- real property rents,
- gain from the sale or other disposition of real property,
- income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil or products thereof),
- income and gains from marketing of any mineral or natural resource (including fertilizer, geothermal energy and timber), industrial source carbon dioxide, or the transportation or storage of certain bio-diesel fuels and alcohol fuels
- any gain from the sale or disposition of a capital asset held for the production of income of the above, and
- in the case of certain partnerships, income and gains from commodities or futures, forwards and options with respect to commodities.

***Warning:** The IRC includes some qualifications and carve-outs to the above revenue categories, so a company’s revenue stream must be carefully scrutinized to insure all that revenues that appear to qualify actually do qualify.

Companies with revenues that can meet the 90 percent test set forth above can be organized as a partnership or a limited liability company, can be publicly traded and can still receive partnership tax treatment. Alternatively, if a company has a group of income-producing assets that would meet the 90 percent test, then those assets could be spun off into a separate entity as a partnership or a limited liability company and be publicly traded.

***Tip:** You should analyze any spin-off as it is likely to be taxable. For companies that have assets that would produce qualifying revenue and are hopeful that an IPO is in their future, the management of that company should analyze whether the company as a whole (or a spin-off of certain assets of the company) should do an MLP offering. Structuring a company for an IPO offering as an MLP requires careful legal and tax planning, so getting those teams in place early will lead to an easier path to success or a quicker answer that your company’s revenues will not qualify under Section 7704.

A Publicly Traded Partnership by Any Other Name

As of May 15, 2010, more than [90 publicly traded partnerships](#) (including limited liability companies) use this structure. Energy companies dominate the list.

Most master limited partnerships are organized as limited partnerships (as opposed to limited liability companies). As such, each MLP will have a general partner, and all of the investors in the MLP will be the limited partners of such MLP. However, most MLPs will refer to their publicly traded units as “common units” or “limited partnership units.” The general partner, usually, will be an affiliate of the company that has organized master limited partnership. See John C. Goodgame, Master Limited Partnership Governance, 60 Bus. Law 471, 472-3 and 473-74 (2004-2005).

Focus of MLP: Cash Out the Door

While not the case for all MLPs, most MLPs are focused on the distribution of cash to its investors. See id. at 475. When they are earning income, most MLPs make quarterly distributions to their investors to allow the investors to make their required federal tax payment attributable to their share of the MLP’s

income. See John C. Goodgame, *Master Limited Partnership Governance*, 60 Bus. Law 471, 475 (2004-2005).

High Splits – A General Partner Incentive

Many MLPs allow the general partner to earn what is known as “[high-splits](#)”, which creates an incentive for the general partner to increase the distribution per unit ratio as high as possible. How do high splits work?

MLPs allow for the general partner to “split” the quarterly distributions with the limited partners. See C.S. Ciccotello and C.J. Muscarellar, *Contracts between Managers and Investors: A Study of Master Limited Partnership Agreements*, Journal of Corporate Finance 7, at 8 (2001). The amount of the general partner’s split is calculated based on the distribution per unit ratio – with the general partner’s split increasing as the distribution per unit ratio gets higher. The partnership agreement will specify a floor amount that the general partner earns, such as two percent for \$X distributions/per unit. Then, the partnership agreement will allow for the general partner to earn a higher percentage of the distributions in specified ranges.

Worth the Risk?

Although a savvy investor may receive acceptable income and cash distributions, he or she should closely review the tax complexity and risk profile of each MLP. Tax and legal professions can help, but ultimately the investor must know his or her own limits when purchasing shares in an MLP.

Thanks to [Jason Schumacher](#) for contributing this article and to [Martin Gibson](#) and George Schutzer for commenting on it. Jason and Martin work together in the Patton Boggs Oil and Gas Practice in the Dallas Office, and [George Schutzer](#) is the Co-Chair of the Tax Practice.

3. BLFN Case & Comment: “United States v. Saporito” Dumps Superfund Liability on Lessors

Even if a lessor does not own or lease real estate underlying industrial equipment it leases to a lessee, the lessor may still be held liable for all cleanup costs under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 ([CERCLA](#), popularly known as [Superfund](#)), 42 U.S.C. [Section 9601](#) et seq. That liability potentially extends to an entire Superfund site, not just the place where the equipment releases [hazardous substances](#).

FACTS/BACKGROUND: In [United States v. Saporito, ---F.Supp.2d ---, 2010 WL 489703 \(N.D. Ill. 2010\)](#), the Crescent Plating Works had operated in northwest Chicago for several decades. Spills, poor maintenance, and the corrosive nature of many of the chemicals used in plating processes at the site resulted in [releases](#) of hazardous substances to the concrete flooring and through leaky pipes to the underlying and adjacent ground. The defendant loaned money to the operation and was operating it at the time Environmental Protection Agency (EPA) shut it down. He owned much of the plating equipment and leased it to Crescent Plating. With a \$1.5 million clean up bill for the Superfund site, the EPA settled with one party and sought to impose the entire remaining amount of liability on Mr. Saporito. It did so, in part, based on his status as an “[owner](#)” under CERCLA, but as also based on his status as lessor of the equipment situated on the land, rather than owner of the underlying land.

ISSUE: Is an equipment lessor jointly and severally liable for an entire Superfund site in connection with releases of hazardous substances from its leased equipment situated on the site?

OUTCOME/DECISION: Yes, unless the release is covered by a [federally permitted release exemption](#) such as a permit issued under the [Clean Water Act](#). The court held that the lessor, as the owner of leased production equipment, in this instance plating equipment, was the owner of a “facility” as defined in CERCLA. In effect, the court treated the lessor as if the lessor owned part of the land at the contaminated installation. *Saporito* at 15. Specifically, the court held that “in fact, the equipment owner is arguably more

culpable: a landowner might not inquire into how her land is being used, but an equipment owner is likely to know exactly what her equipment can do.” The statute expressly defines the term “[facility](#),” to include the term “[equipment](#).” CERCLA, Section 101(9)(A); 42 U.S.C. Section 9601.

LAW OF THE CASE: This decision revives an earlier line of cases from the 1990s, primarily involving the federal government’s war production efforts. Those cases assessed liability based on releases of hazardous substances from specific production equipment owned by the federal government and used in making munitions, pesticides and other war material. The court in *Saporito* adopted this line of reasoning at the federal government’s urging, based on the decision holding the United States liable in *Elf Atochem North America, Inc. v. United States*, 868 F.Supp. 707, 709 (E.D. Pa. 1994).

This case applies to any piece of leased industrial equipment generating hazardous substances released into the environment. This rationale includes not only stationary equipment, such as the plating machinery involved in this case, but mobile equipment such as shipping containers, railroad cars, vehicles and aircraft. The breadth of coverage stems from the statutory definition of “facility,” which expressly includes “motor vehicle, rolling stock, or aircraft,” as well as “storage container.” CERCLA, Section 101(9)(A).

***Comment:** The recession has reduced the ability of some manufacturers to pay for current proper environmental compliance and for Superfund cleanups to address past hazardous substance releases. In prior recessions, manufacturers either filed for bankruptcy and/or abandoned badly maintained facilities full of waste materials and in need of government cleanups. Government agencies conducting such cleanups may make increasing use of this revised liability rule in the search for financially solvent, legally responsible parties to bear such cleanup costs.

Perhaps more significantly, this decision highlights a significant and previously unappreciated risk arising in connection with true leases of industrial production equipment, such as that involved in this case. CERCLA provides a [secured creditor exemption](#) from liability. CERCLA, Section 101(20). However, the exemption did not extend to lessors under this case. Because of a muddled factual record, the *Saporito* court did not evaluate whether the lease constituted a disguised security agreement under the Uniform Commercial Code and related case law. If the factual record here had allowed such an analysis, the court might have concluded that the lease actually constituted a security agreement. As such, the lessor should have been entitled to the secured creditor exemption from liability under Superfund. See *Saporito* at 15. In future cases where Superfund claims are raised against lessors of such equipment, this defense would be worth asserting if the lease has been properly drawn to support those contentions, as explained below.

***Tips:** The ruling, which appears to be a “game changer,” creates strong incentives for lessors to:

1. **File** appropriate financing statements reflecting the type of transaction – a lease or loan or conditional sale, and document the transaction with *Saporito* clearly in focus;
2. **Avoid** ownership or leasehold interests in the subject property;
3. **Consider** using loan or conditional sale documents instead of leases;
4. **Refuse** to exercise any rights to control operations at the lessee’s property, particularly operations likely to generate hazardous substances which may be released to the environment;
5. **Check** the environmental records of their lessees for any exemptions, investigations, notices or other actions affecting the property on which the leased equipment will be situated. Thus, for a costly piece of equipment leased for years, a Phase I environmental assessment may be in order for the premises where the equipment will be installed;
6. **Inquire** into the lessee’s specific use of the equipment, including the disposal of any waste that the equipment is likely to create;
7. **Assure** that the lease clearly allocates the responsibility for proper equipment maintenance to the lessee;

8. **Include** a separate indemnity agreement (not just the one in the lease) with the lessee for any third-party claims arising from any environmental violations resulting from the lessee's use of the equipment or for any unpermitted releases of hazardous substances from the equipment; and
9. **Keep** meticulous records of the use, maintenance and waste disposal for government furnished equipment (GFE) and other equipment used in government contracting work. If a government later asserts superfund claims against the contractor, these records can be a basis for significant counterclaims or third-party claims against the United States.
10. **Draft** leases as financing leases (as distinguished from UCC Article 2A "finance leases"), and express clearly that the lease is intended as security.

Few equipment lessors will know that the *Saporito* decision has increased their financial exposure for environmental problems at the lessee's property. For past leases, there is little lessors can now do to protect themselves. For future leases, the *Saporito* court has placed a premium on careful due diligence and careful documentation of the lease, security interests, equipment maintenance and environmental compliance. Although the statutory language supports the court's *Saporito* decision, the result may raise the risks and expense of equipment leasing and potentially increase U.S. manufacturing costs by reducing financing and production flexibility.

Thanks to [Russ Randle](#) of Patton Boggs' [Environmental Law](#) Practice Group for contributing this article.

4. BLFN's Finance 101: What is a "Deceptive Trade Practice"?

When one party to a transaction unreasonably interferes with another's promotion and conduct of its business, the actions of the alleged wrongdoer may have perpetrated a deceptive trade practice or competed unfairly in a way that entitles the other party to start a legal action against the wrongdoer.

Concurrently, the alleged wrongdoer may have also violated the Uniform Trade Practice Act (Uniform Act) and/or other state law, federal law and even common law (case law arising from ordinary disputes in court) for deceptive trade practices. See Uniform Act in the [Cornell Legal Library](#) set forth as the Uniform Deceptive Trade Practices Act [1964 Act or 1966 Revision, [original text - 1966 Revision](#)].

The Uniform Act can be roughly subdivided into conduct involving either misleading trade identification or false or deceptive advertising. Focused on the sale of goods and services, the Uniform Act prohibits a wide range of conduct which creates a likelihood of confusion or of misunderstanding in a transaction.

In a leasing transaction, lessors may face problems in connection with in their purchase of goods to be leased or other conduct. To illustrate, suppose a lessee acquires and accepts goods subject to a lease, but later determines that the seller represented that goods or services met a particular standard, quality or grade, or that goods were of a particular style or model. If any related statement ultimately is incorrect, the seller may have violated the Uniform Act. The conduct may result in a fight over the errors in identifying or describing the leased property.

Uniform Act

According to the collection of uniform laws presented by the Uniform [Business and Financial Laws Locator](#) at the Cornell Law Library, the Uniform Act is in effect in the following states:

- [Colorado](#) (1966 Revision) - §§ 6-1-101 to 6-1-115
- [Delaware](#) (1964 Act) - Del. Code, Title 6, Subtitle II, Ch. 25, Subchapter 3, §§ 2531-2536
- [Georgia](#) (1966 Revision) - §§ 10-1-370 to 10-1-375
- [Hawaii](#) (1966 Revision) - §§481A-1 to 481A-5
- [Illinois](#) (1964 Act)
- [Maine](#) (1964 Act)

- [Minnesota](#) (1966 Revision) - §§ 325D.43 to 325D.48
- [Nebraska](#) (1966 Revision) - §§ 87-301 to 87-306
- [New Mexico](#) (1966 Revision) - N.M. Statutes, Chapter 57, Art. 12
- [Ohio](#) (1966 Revision) - Ohio Revised Code, Title 41, Ch. 4165
- [Oklahoma](#) (1964 Act) - 78 §§ 51 to 55
- [Oregon](#) (1966 Revision) - §§ 646.605 to 646.656

These laws generally do not preclude the application of other state laws to deceptive or unfair conduct. For example, [Section 325D.44\(3\) Subdiv. 2](#) of the Minnesota Statutes says simply: Subd. 3. “**Other law.** This section does not affect unfair, deceptive, or misleading trade practices otherwise actionable at common law or under other statutes of this state.”

Texas Deceptive Trade Practice Act

Other states have deceptive trade practices laws apart from the Model Act. For example, Texas has a statute called the [Texas Deceptive Trade Practices – Consumer Protection Act](#). The statute affects most leasing, lending and selling transactions. See Section 17.41 of the [Texas Business and Commerce Code](#) (DTPA).

The DPTA is designed to protect “Consumers” against, among other things, “false, misleading and deceptive business practices” (§17.44(a)) in connection with the “lease ... of any property, tangible or intangible, real, personal or mixed ... affecting the people of [Texas].”

**Warning:* A “Consumer” in Texas includes virtually any person or entity that does not have “assets of \$25 million or more, or that is not owned by a corporation or entity with assets of \$25 million or more.” Section 17.45(4) of the DPTA defines a Consumer as “an individual, partnership, corporation, this state, or a subdivision or agency of this state who seeks or acquires by purchase or lease, any goods or services, except that the term does not include a business consumer that has assets of \$25 million or more, or that is owned or controlled by a corporation or entity with assets of \$25 million or more.”

In other words, the DTPA applies to a broad range of individuals and businesses even in the context of leasing and lending transactions. It includes any individual purchasing anything, as well as the vast majority of businesses buying for a business purpose. To be a consumer under the DTPA, an entity must do more than merely seek or acquire goods or services. The goods or services must be sought or acquired by “purchase or lease.” See [The Texas Deceptive Trade Practices Act - Still Alive And Well](#), by Richard M. Alderman, [The Journal of Texas Consumer Law](#) (2005).

**Tip:* As a lessors or lenders in Texas, you should consult your counsel and consider including a protective lease provision that attempts to waive the impact of the DPTA in transactions governed by Texas law. Find the laws that affect you in each leasing or lending transaction and ask that your counsel advise you on how to structure your deals in compliance with such laws.

The DPTA and the Uniform Act provide protection for consumers against a wide variety of deceptive acts. A savvy lender or lessor will not make assumptions about the scope of these statutes unless, of course, they wish to deceive themselves about potential liability to their customers.

About Patton Boggs LLP

[Patton Boggs LLP](#) is a law firm of approximately 600 attorneys and other professionals located in [Washington DC](#), [Northern Virginia](#), [New Jersey](#), [New York](#), [Dallas](#), [Denver](#), [Anchorage](#) and internationally in [Abu Dhabi](#), United Arab Emirates and [Doha](#), Qatar.

Patton Boggs has major practice areas in business, intellectual property, public policy and litigation. These areas are composed of many practice groups designed specifically to meet client needs and the trends in developing legal markets. David G. Mayer often focuses on capital equipment and facility financing and

development in energy, transportation, infrastructure, aviation and technology transactions, workouts and litigation.

The firm provides a broad array of skills in domestic and international business transactions, including equipment finance and leasing, corporate finance, secured transactions, syndications, mezzanine finance, aviation and transactions law, federal leasing, project finance, real estate, health care, pharmaceuticals, technology transactions and public policy work.

The equipment finance practice at Patton Boggs regularly involves the buying, selling, financing and leasing of personal property of all kinds, including business aircraft, energy facilities, power plants (including wind farms and other renewable energy facilities) and technology and health care assets.

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Partial List of Publications and Radio Interviews

The following is a partial list of articles written or co-authored by [David G. Mayer](#) and a mention of radio show appearances by BLFN Founder David G. Mayer:

Prepackaged Bankruptcies: A Faster Way For To Emerge From a Bankruptcy Involving Leases? LNJ Leasing Newsletter (scheduled: Aug. 2010) by [Michael P. Richman](#), Chair of Patton Boggs’ [Bankruptcy and Restructuring](#) Group and [Mark Salzberg](#), a Partner in the same group, and [David G. Mayer](#), a Patton Boggs Partner in the Business Transactions Group.

[My Opinion: Where Financing Deals Will Emerge as the Economy Recovers](#), [World Leasing News](#) (May 4, 2010)

[Capital Thinking Internet Radio](#) (Patton Boggs podcast), with host [Kevin O’Neill](#): Interview of [Ed Bolen](#), president and CEO of the [National Business Aviation Association](#) and David G. Mayer, Patton Boggs partner, July 30, 2009, regarding the significant challenges and trends in business aviation today. To listen to the interview, click on [Bolen & Mayer Interview](#).

[Capital Thinking Internet Radio](#) (Patton Boggs Podcast), with host [Kevin O’Neill](#): Interview of David G. Mayer on March 12, 2009 regarding trends in financing and development of natural gas storage facilities. To listen to the interview, click on [Mayer Interview](#).

A Test of the Cape Town Convention: Useful Tool in Debtor Insolvencies and Defaults or a Trap for the Unwary, David G. Mayer and Frank Polk, [Corporate Rescue and Insolvency Magazine](#), Vol. 2.5 (Oct. 2009).

U.S. Court of Appeals Upholds Graves Amendment in Garcia v. Vanguard, by Connie Ariagno and David G. Mayer, with the assistance of Tyson Wanjura, *LNJ Leasing Newsletter* (Dec. 2008).

Unique Pad Gas Lease Supports Project Financing and Development of Gas Storage Facility in U.S., by David G. Mayer (with Fortis Capital Corp.), *Asset-Based Lending Review*, [Financier Worldwide](#) (Nov. 2006).

Thanks to BLFN's Team

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All the best,

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