

The Intangible Side of Equipment Leasing: Third Party Claims Against Stored Data.

By Warren E. Agin, Esq.

You lean back in your chair, satisfied after a good day's work. Your company had financed the purchase of several high-end computers for one of those new .com Web site companies. Unfortunately, it defaulted on the leases. Fortunately, you recovered the computers just days before the company filed a Chapter 7 bankruptcy petition and had just sold the used machines at a good price. Pleased at a good result for what is usually a bad situation, you barely notice the telephone ringing. The lessee's Chapter 7 bankruptcy trustee is on the line. "Where are the computers" he asks, "I want them back." Apparently, the computers contained the lessee's Web site, which cost ten million dollars to develop and was generating \$100,000 a month in revenue from linking agreements. The trustee wants to operate the Web site during the Chapter 7 case while he looks for a buyer. He already has an offer worth \$250,000. He just has to be able to prove that the data is still available.

Today, companies rely more than ever on computers and computer equipment, and a significant amount of this computer equipment is leased. Unlike other types of equipment, however, a computer is used to store data and this data is becoming increasingly valuable. Of special concern are computers used to store and operate Web sites. These Web sites are becoming valuable assets in their own right. For example, Internet Financial Services in Minnesota, recognizing the asset value of Web sites, will finance Web site development taking a purchase money security interest (PMSI) in the Web site. The resulting problem is that leased computer equipment may contain data subject to third party claims, data that is not subject to the lease.

For example, a bankruptcy trustee may want to preserve and sell the Web site. She might want to operate the Web site during the bankruptcy case to generate cash flow. The equipment lessor might not have a lien against the data, either because the lease is a true lease, because the lessor failed to perfect under UCC Article 9, or because the security interest taken is too narrow. The bankruptcy trustee will then have the right to the data, can bring a turnover proceeding against the lessor under 11 U.S.C. §542(a), and obtain damages against the lessor if the lessor can not surrender the property. A company like Internet Financial Services may have a PMSI in the Web site, senior, pursuant to UCC §9-312(4), to any lien held by the lessor. A traditional lender may have a blanket lien that covers the Web site data. The lessor's interest in the data may be junior to the primary lender's previously perfected security interest. A lessor who repossesses and sells, or even worse erases, computer data in violation of a senior lender's rights risks a lawsuit. A third party might have rights against the Web site, such as when the lessee hosts a Web site for another company. All of these entities have an interest in making sure the data is preserved, even when the equipment lessor is entitled to repossess and sell the computer itself.

Even when the equipment lessor has the right to repossess and dispose of the data in addition to the computer, the lessor might be required to comply with Article 9 provisions governing asset disposition. The disposition method must be commercially reasonable, and arguably this means that an effort must be made to dispose of the data as well. Erasing the hard drives and reselling the computer could result in significant liability to the lessor. Since few Web sites have been sold through creditor sales, what constitutes a commercially reasonable manner is not easy to determine. The lessor also has to make some effort to maximize the sale price despite the unusual nature of the content.

The danger of ignoring the potential value of computer data is illustrated by the Supreme Court of Arkansas' decision in *Mercantile Bank v. B&H Associated, Inc.*, 330 Ark. 315, 954 S.W.2d 226

(Ark. 1997). Mercantile Bank took possession of an in-house computer software system owned by its borrower and used by banks to manage accounting functions. Mercantile sold the collateral to a third party for \$25,000. This third party already had licensed limited rights to develop and use the system. The court held that Mercantile's disposition of the software system was not commercially reasonable because Mercantile failed to obtain a fair market value of the system and made no effort to advertise the sale in trade magazines and newspapers. Therefore, Mercantile lost the right to seek a deficiency judgment against its borrower.

Equipment lessors dealing in computer equipment should remain aware of the issue of stored data, and the potential rights of third parties in that data. When repossessing equipment, the lessor should provide notice to entities known to have an interest in the data. The lessor should also make an effort to preserve the data during the disposition process. Then, if a third party or bankruptcy trustee later demands the lessor surrender the data, the lessor has the option of complying. The lessor can preserve the data by removing the computer's hard drives or copying the data before selling the computer. Finally, the lessor should be aware that the data contained in the computers has value, and when possible attempt to realize that value in satisfaction of the lease obligation.

Eventually, third-parties, such as Web site owners and key secured lenders, will focus on protecting their rights in data from equipment lessors. Today, lenders frequently require a borrower to obtain waiver and consent forms from its landlord. Soon, lenders will require that similar agreements be obtained from equipment lessors. Until then, the responsibility will be on equipment lessors to recognize and avoid the potential pitfalls when repossessing and disposing computer equipment.

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