Leases

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Case Law Developments

This survey covers several 2018 cases involving parties to equipment financing transactions or with third parties, disputing aspects of the transaction or the related equipment. The courts in these cases considered many of the fundamental issues in establishing and enforcing the respective rights, obligations, interests, and remedies associated with equipment financing agreements. The issues covered in the following cases include whether a transaction documented as a lease creates a true "lease" or a security interest, a lessor's damages remedies, the rights of assignees of interests under a lease, issues surrounding certainty of payment such as hell-or-high-water clauses, end-of-lease-term issues, vicarious liability of a lessor, and issues relating to forum selection clauses.

True Leases

The characterization of a purported lease as creating either a true "lease" or a security interest is likely to have a significant impact on the respective rights, remedies, and responsibilities of the purported lessor and lessee. This issue is commonly litigated in bankruptcy matters, enforcement cases, and priority disputes. As demonstrated in the cases summarized below, the characterization of the underlying agreement may have significant implications on the purported lessor's recovery of its investment by payment of the periodic or accelerated amounts and/or recovery of the related equipment.

In the first case we discuss, the court determined that the rental contract at issue created neither a true lease under U.C.C. Article 2A[1] nor a U.C.C. Article 9 security interest but, under non-U.C.C. law, should nonetheless be treated like a lease

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1. U.C.C. § 2A-103(1)(j) (2011).

for the purposes of Chapter 13 of the Bankruptcy Code.[2] In *In re Johnson*,[3] RentalAccess, LLC, a rental company and Chapter 13 creditor ("RentalAccess"), moved for relief from the automatic stay relating to the debtor's confirmed Chapter 13 plan (the "Plan") on the basis that the contract between RentalAccess and the debtor regarding a portable storage shed was a lease, and not a security interest, as it was categorized in the Plan. RentalAccess argued that because the Plan did not provide for the assumption of the lease, it is presumed that the lease is rejected and therefore not subject to the stay.[4] The court proceeded to analyze the characterization issue under Tennessee state law[5] rather than Georgia state law due to the contract's Tennessee choice-of-law provision.

Typically, when determining whether a rental agreement or lease creates a true lease or a security interest in the context of a bankruptcy case, the court will rely on the characterization tests and other provisions of U.C.C. section 1-203 and the related interpretative cases.[6] Acknowledging that although Tennessee has adopted the Uniform Commercial Code[7] (the "Tenn. U.C.C."), the court instead relied on the Tennessee Rental-Purchase Agreement Act[8] (the "Act") to determine that the contract at issue was a rental-purchase agreement,[9] and as such, it could not be characterized as creating a security interest, irrespective of the Tenn. U.C.C. characterization test.[10] From this, the court concluded that the contract was a lease under applicable Tennessee law, and therefore deemed rejected and removed from the bankruptcy estate, and granted RentalAccess relief from the stay to recover the leased storage shed.[11] This case should serve as a reminder

2. *See generally* U.C.C. § 1-203 (2011) (providing a standard for differentiating between true leases and disguised sales); U.C.C. § 9-109(a)(1) (2013) (stating that Article 9 applies to "any transaction, regardless of its form, that creates a security interest in personal property").

3. RentalAccess, L.L.C. v. Johnson (*In re* Johnson), 587 B.R. 195 (Bankr. M.D. Ga. 2018).

4. *Id.* at 198. In granting the motion, the court indicated that RentalAccess had not received notice of plan confirmation and therefore was able to proceed with the motion. *Id*. at 197–98.

5. As we previously noted in our 2018 survey, state law may expressly provide the lease characterization of certain types of agreements, such as a rental-purchase agreement. *See, e.g.*, Edward K. Gross et al., *Leases*, 73 Bus. Law. 1155, 1155–57 (2018) (citing *In re* Jack, 579 B.R. 627 (Bankr. M.D. Fla. 2017) (examining a rental-purchase agreement characterization under Florida law. The court held that because the relevant state law "expressly stated that a rental-purchase agreement (as defined [by state law]) is deemed to be a lease and not a security agreement," the agreement between these parties was a true lease.)).

6. *In re Johnson*, 587 B.R. at 199–200.

7. Tenn. Code Ann. § 47-1-203 (West 2019).

8. *Id*. §§ 47-18-601 to -614.

9. The court concluded that the contract fit each of the essential elements under the Act because it was (1) for the use of personal property (i.e., a storage shed), (2) by a natural person primarily for personal, family, or household purposes (i.e., the debtor is a natural person and the property was used to store personal household items), (3) for an initial period of four months or less (regardless of any obligation beyond the initial period) (i.e., the initial period of the agreement was for one month), (4) that is automatically renewable with each payment (the agreement provided that the debtor may automatically renew the agreement monthly by payment in advance), and (5) that permits the consumer to become the owner of the property (i.e., the agreement provided: "If [debtor] renews this agreement forty-eight (48) consecutive months, on time for a total cost of $4,600.32 . . . and otherwise complies with this agreement, then [she] will acquire ownership of the rented property."). *In re Johnson*, 587 B.R. at 197.

10. *Id*. at 200.

11. *See id.* at 200–01.

that when determining lease characterization, U.C.C. section 1-203 may or may not be dispositive.[12]

In re Clinton Nurseries, Inc.[13] involved a Chapter 11 bankruptcy ruling regarding a motion by a creditor ("Varilease") under Bankruptcy Code section 365(d)(5)[14] seeking to compel performance by the debtor (a horticultural nursery) under a purported lease of equipment. Having noted that "[i]t is well established that Section 365(d)(5) only applies to what has been characterized as a 'true lease,'"[15] the court set out to determine whether the master lease and related schedules between Varilease and the debtor constituted a true lease or a security interest under applicable state law.[16] If these lease documents created a true lease, the debtors would have been required to pay Varilease both accrued and accruing administrative rent pursuant to section 365(d)(5), and if they created a security interest, Varilease would likely recover very little of its investment in this transaction.[17]

The equipment to be leased under Schedule No. 1 to the master lease included irrigation equipment and the materials, rental, freight, and other costs and fees relating to the construction of a holding pond. The court noted that "approximately forty percent of the amount loaned pursuant to Schedule No. 1 was loaned to finance" the installation of the holding pond.[18] The balance of the equipment purportedly leased pursuant to Schedule No. 1 and all of the equipment purportedly leased pursuant to Schedule No. 2 consisted of "the installation of a computer software system," a very large portion of which consisted of "services provided rather than hardware or software installed."[19]

Interestingly, the court's characterization analysis focused first on the non-bright-line test in U.C.C. section 1-203(a), providing that whether a transaction in the form of a lease creates a lease or a security interest is to be determined by the facts of each case.[20] In that regard, the court noted that "[c]ourts have held that the practical inability of the lessee to return the leased goods due to the cost and difficulty of removal is evidence that a security interest was created.[21] The

12. *See id.* at 200. The court did note, however, that even if it interpreted the contract under Georgia law, it would have come to the same conclusion. *See id.* Applying Georgia's version of U.C.C. section 1-203, the court concluded that the contract created a lease because its term was not greater than the remaining economic life of the storage shed, the debtor was not obligated to renew, and the debtor was permitted to discontinue the lease at any time without being in breach. *Id.* The court considered whether Georgia's Lease-Purchase Agreement Act applied to the contract, but as there was no security interest exemption under that law, the U.C.C. section 1-203 characterization test should be applied if this matter was to have been determined by Georgia law. *Id.* at 200–01.

13. No. 17-31897 (JJT), 2018 WL 2293554 (Bankr. D. Conn. May 17, 2018).

14. 11 U.S.C. § 365(d)(5) (2018).

15. *In re Clinton Nurseries, Inc.*, 2018 WL 2293554, at *3.

16. *Id.* at *4 (citing Fangio v. Vehifax Corp. (*In re* Ajax Integrated, LLC), 554 B.R. 568, 577–78 (N.D.N.Y. 2016)).

17. *Id.*

18. *Id.* at *2.

19. *Id.*

20. *Id.* at *4 (quoting WorldCom, Inc. v. GE Global Asset Mgmt. Servs. (*In re* Worldcom, Inc.), 339 B.R. 56, 64 (Bankr. S.D.N.Y. 2006)).

21. *Id.* (quoting *In re Worldcom, Inc.*, 339 B.R. at 74).

court further noted that the parties must have been "fully aware" when entering into the lease documents to finance the installation of the holding pond that "the expectation that the goods [would] be returned to [Varilease] with some expected residual interest of value at the end of the lease term is simply not sensible or logically supportable,"[22] and the court held the lease documents created a security interest.[23]

However, the court must have concluded that the lease documents might still constitute a true lease with respect to the rest of the property financed by Varilease because it went on to analyze the transaction under the U.C.C. Bright-Line test.[24] The court enumerated each of the considerations under that test and applied them to the transactions documented by the lease documents,[25] and it ultimately determined that they created security interests with respect to all of the financed property because the debtor could purchase all of it for one dollar at the expiration of the term of each schedule.[26] Given the certainty that the so-called "buck out" purchase options would fail the Bright-Line test, it is curious that the court chose to first apply the practical inability test.[27]

In another Chapter 11 bankruptcy decision, *In re Lasting Impressions Landscape Contractors, Inc.*,[28] the debtor, Lasting Impressions Landscape Contractors, Inc. ("Lasting Impressions"), leased seven trucks from Ford Motor Credit Company, LLC ("Ford") subject to a master lease and several related supplements. Similar to the previous case, Ford sought to exercise its remedies under section 365(d)(5), which remedies would only be available to Ford if the lease documents created a true lease. Lasting Impressions sought to deny Ford's right to exercise such remedies by arguing that the lease documents created a secured transaction. Although the debtor in this case did not contend that the transactions constituted *per se* security interests under U.C.C. section 1-203(b) (i.e., the Bright-Line test), the court noted that "this does not end the inquiry."[29]

Similar to the *Varilease* case, the court focused on the post-lease expectations of the parties when they entered into the various supplements: "The central feature of a true lease is the reservation of an economically meaningful interest to

22. *Id.*

23. *Id.* at *6.

24. "U.C.C. section 1-203(b) provides that a security interest is created if (1) the original term of the lease is equal to or greater than the remaining economic life of the goods; (2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods; (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration; or (4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration [(the 'Bright-Line Test')]." *Id.* at *5 (quoting U.C.C. § 1–203(b)).

25. *Id.* at *5.

26. Varilease argued that the dollar purchase option was irrelevant, essentially because it never came into being due to the debtors' default under the master lease, but the court dismissed this argument by noting that cases in its circuit supported the conclusion that the date of the transaction, rather than a future date, is the appropriate time to determine the parties' rights. *Id.* at *6.

27. *Id.* at *4.

28. 579 B.R. 43 (Bankr. D. Md. 2017).

29. *Id.* at 51.

the lessor at the end of the lease term."[30] If the lessor has "a meaningful reversionary interest—either an up-side or a down-side risk—the parties have signed a lease, not a security interest," and if not, the lessor transferred title to the lessee (in substance, irrespective of the form) and the transactions create security interests, not leases.[31] In its analysis as to whether the lessor retained a meaningful reversionary interest, the court noted that U.C.C. section 1-203 failed to provide any guidance regarding the lease, and then undertook to sort through each of the various approaches used by other courts that had also considered characterization on the same basis.[32]

The court summarized the end-of-term lease obligations of Lasting Impressions upon lease expiration or early termination as having to either (i) retain the vehicles by paying the "assumed residual" of each, equal to 10 percent of the capitalized cost; or (ii) sell the vehicles, remit the applicable assumed residual amounts to Ford, and in such case, Lasting Impressions would (as applicable) retain the surplus amount over the assumed residual or pay any deficiency to Ford.[33] In either case, Ford would receive an amount equal to the assumed residual amount for each vehicle at lease expiry. After scrutinizing the implications of allocation to Lasting Impressions of the upside potential or downside risk using various related characterization tests,[34] the court concluded that under any and all of these tests, "Ford did not reserve a meaningful reversionary interest"[35] and, therefore, the parties had entered in a security arrangement, not a lease.[36]

The most interesting aspect of this case, other than the thoughtful trek through the various reversionary interest tests, was the court's failure to discuss whether this transaction constituted a statutory Terminal Rent Adjustment Clause ("TRAC" lease) under applicable federal income tax law or any correlative

30. *Id.* (quoting *In re* Grubbs Constr. Co., 319 B.R. 698, 715 (Bankr. M.D. Fla. 2005)).

31. *Id.* (quoting James White, Robert S. Summers & Robert A. Hillman, Uniform Commercial Code § 30:14 (6th ed. 2017)).

32. *See id.* at 52–55.

33. *Id.* at 46–47, 56.

34. *See id.* at 52–55. These included the Bright-Line test; the "Economics-of-the-Transaction" test, under which the court looks to "(1) whether the lease contains a purchase option price that is nominal; and (2) whether the lessee develops equity in the property, such that the only economically reasonable option for the lessee is to purchase the goods," Sunshine Heifers, LLC v. Citizens First Bank, (*In re* Purdy), 763 F.3d 513, 519 (6th Cir. 2014); the "All Facts and Circumstances" test, under which the court looks to six enumerated economic factors of the agreement to determine whether the lessor retained a meaningful reversionary interest, *In re* Gateway Ethanol, L.L.C., 415 B.R. 486, 504 (Bankr. D. Kan. 2009); and the "Economic Realities" or "Sensible Person" test, which provides "if only a fool would fail to exercise the purchase option, the option is generally considered nominal and the transaction characterized as a disguised security agreement," *In re* Triplex Marine Maint., Inc., 258 B.R. 659, 672 (Bankr. E.D. Tex. 2000).

35. *Id.* at 55.

36. *Id.* The court further noted that the terms of the underlying agreement presented a situation where "the only sensible course for [Lasting Impressions] at the end of the lease term is to exercise the option and become the owner of the goods," and thus Ford effectively transferred title to Lasting Impressions upon expiry, creating a security arrangement. *Id.* at 56 (quoting *In re Triplex Marine Maint., Inc.*, 258 B.R. at 672).

Maryland statutory commercial law.[37] The end-of-term provisions resemble what lessors and lessees typically include in over-the-road vehicle lease financings, which by the TRAC statute may allow the lessor to be treated as the owner for federal income tax purposes even though these provisions appear to allocate all upside benefit and downside risk to the lessee.[38] This is meaningful for commercial law purposes, because Maryland (like most states) adopted a correlative commercial statute that might be relied upon by lessors to argue that the mere inclusion of end-of-term provisions such as these might not be fatal to the true lease treatment of the related transaction.[39]

In re Pioneer Health Services, Inc.[40] is yet another Chapter 11 bankruptcy decision in which the court had to determine the characterization of certain financing documents in connection with an administrative expense claim made by a financing party pursuant to section 365(d)(5). As noted above, any such claim would only be available if the documents created a true lease. In this case, First Guaranty Bank ("First Guaranty") was the assignee of certain conditional sale agreements (the "CSAs") pursuant to which Med One Capital Funding, LLC ("Med One") financed a purchase by Pioneer Health Services ("Pioneer") of a payment system licensed by McKesson Technologies, Inc. ("McKesson").

First Guaranty's argument that the CSAs created a true lease were based, primarily, on certain provisions that apply if the financed property includes software; specifically, an agreement by Pioneer that "Med One is leasing (and not financing) the Software to [Pioneer],"[41] and that Med One could terminate the license and disable the software if Pioneer failed to make payments.[42] However, the court weighed more heavily the CSA provisions stating that the sale of the system was "non-cancellable," title to whatever was being financed would transfer to Pioneer upon completion of the payment plan, and until then Med One would retain title for "legal and security purposes."[43] Accordingly, the court relied on the tests in U.C.C. section 1-203(b)[44] and determined that no further analysis was required and concluded that the CSAs created security interests rather than a lease.[45]

It is noteworthy that the security interest characterization focused on the "Bright-Line" tests in U.C.C. section 1-203(b),[46] and not whether the financed software constituted "goods" as defined in U.C.C. section 9-102(44).[47] As de-

37. *See* 26 U.S.C. § 7701(h)(3)(A) (2018) [hereinafter TRAC Statute]; MD. CODE ANN., TRANSP. § 13-211 (West 2019).

38. *See In re Lasting Impressions*, 579 B.R. at 56.

39. *Id.*

40. 739 F. App'x 240 (5th Cir. 2018).

41. *Id.* at 244.

42. *Id.*

43. *Id.*

44. *See* UTAH CODE ANN. § 70A-1a-203(2)(b) (West 2019) (codifying the provisions of U.C.C. 1-203(b)).

45. *In re Pioneer Health Serv., Inc.*, 739 F. App'x at 244.

46. *Id.*

47. U.C.C. 9-102 (44) (2013) ("'Goods' means all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a

scribed in the opinion, the financed software does not appear to constitute "goods," and as defined in U.C.C. section 2A-103(j), a "lease" is a transfer of possession and use of goods for a term in return for consideration.[48]

Lessor's Damages

Among the critical default remedies for the lessor is the right to demand that the lessee pay damages in a stipulated amount sufficient to compensate the lessor for the loss of its bargain as anticipated at the time of the lease's inception.[49] However, courts may exercise discretion in awarding lessors such liquidated damages in light of erroneous damages calculations, the reasonableness of the amount sought, or public policy concerns.

This first case is of particular interest because the court relied on the commercial law of Louisiana, the only state in which U.C.C. Article 2A has not been adopted.[50] In *Bank of the West v. Prince*,[51] the United States District Court for the Western District of Louisiana was asked to determine the amount of the damages payable with respect to a defaulted lease, and it relied on the Louisiana Lease of Movables Act (the "Act") for that determination. Gladiator Energy Services, LLC (the "Lessee") leased various items of "moveable equipment" from Summit Funding Group, Inc. (the "Lessor") pursuant to a master lease and various equipment schedules (the "Leases"), and the defendant ("Prince") guaranteed the Lessee's obligations under the Leases. Bank of the West (the "Bank") purchased the Lessor's right to receive the payments under the Leases pursuant to a non-recourse loan/discounting arrangement with the Lessor.

After the Lessee defaulted, the Bank sought to recover the "negotiated damages (liquidated damages equal to the present value of the remaining payments due under the Lease, discounted at a rate of 2% per annum), plus interest, costs, and attorneys' fees" from Prince. Prince did not dispute that the Bank was entitled to past-due monthly rent payments from the time of the default until the Bank had recovered the equipment, but argued that the Bank could not also recover accelerated rent after having recovered the leased equipment.

Prince cited the Act, which states that in the event of default by a lessee, a lessor may (1) recover accelerated rent after recovering the leased equipment or

conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes.").

48. U.C.C. § 2A-103(j) (2011). Interestingly, First Guaranty endeavored to avoid the application of the U.C.C. to determine characterization, and it argued that other Utah law should be applied because the U.C.C. applied to goods, and software did not constitute goods. The court chose not to resolve that issue because it determined that it was unresolved under Utah law as to whether the U.C.C. applies to software, and First Guaranty had failed to argue why the outcome would be different if other Utah law was applied. *In re Pioneer Health Servs., Inc.*, 739 F. App'x at 243 n.1.

49. *See* U.C.C. §§ 2A-504, 2A-523(1)(f) (2011) (permitting lessor to "exercise any other rights or pursue any other remedies provided in the lease contract").

50. *What Is Uniform Commercial Code?*, La. Secretary St., https://www.sos.la.gov/BusinessServices/UniformCommercialCode/WhatIsUniformCommercialCode/Pages/default.aspx (last visited Feb. 13, 2019).

51. No. 16-1098, 2018 WL 3868796 (W.D. La. Aug. 14, 2018).

(2) "cancel the lease, recover possession of the leased property and recover such additional amounts and liquidated damages as may be contractually provided under the lease agreement" but not both.[52] With respect to liquidated damages, the Act provides that a lessor can recover "amounts then due and owing under the lease as well as liquidated damages,"[53] to the extent that a court finds the amount of liquidated damages "reasonable."[54]

The court's analysis centered around the reasonableness of the liquidated damages sought and the amount, if any, to award.[55] The Bank argued that the court should focus on the amount of the actual damages and lost profit when determining whether the liquidated damages provision in the Lease was reasonable.[56] Prince argued that "the Bank may not recover what is essentially the full amount of future rent under the Lease, disguised as liquidated damages," because it had already elected to recover the equipment, and to allow the Bank to also recover the liquidated damages would be against Louisiana public policy—requiring lessors to choose between these mutually exclusive optional remedies provided for by the Act.[57] The court agreed with Prince, and refused to enforce the liquidated damages remedy as written,[58] but did award the Bank an amount equal to the past-due rent stipulated by both parties, together with what were deemed "reasonable damages."[59] These reasonable damages were calculated by the court as an amount equal to the Bank's initial investment (i.e., the non-recourse loan amount, characterized by the court as the accelerated rent payments, purchased by the Bank at a discounted rate), *less* both the payments previously made and the proceeds of the sale of equipment, which net amount the court believed was "sufficient to make the Bank whole and is reasonable."[60]

This case is interesting for various reasons, including among others: the court focused on the Bank's damages (not the collaterally assigned lessor's damages), the absence of any discussion regarding the characterization of the Leases, and any impact on the applicability of the Act and what might have been a very different outcome if analyzed under the non-mutually exclusive liquidated damages and other remedy provisions of U.C.C. Article 2A.[61] Unlike the Act, U.C.C. section 2A-504 provides non-specific guidance as to how damages may be effectively liquidated in a lease agreement (i.e., the amount or formula must be "reasonable in light of the then anticipated harm caused by the default or other act or omission").[62] In that regard, whether applying U.C.C. section 2A-504 or the Act, lessors should not be entitled to a windfall that would result from demanding the

52. La. Stat. Ann. § 9:3318(A) (West 2018).
53. *Id.* § 9:3325(A).
54. *Id.* § 9:3325(B).
55. *Bank of the West*, 2018 WL 3868796, at *2.
56. *Id.* at *3.
57. *Id.*
58. *Id.* at *4.
59. *Id.*
60. *Id.*
61. *See generally* U.C.C. §§ 2A-504, 2A-523 (2011).
62. *Id.* § 2A-504(1).

future rent and recovering the leased asset.[63] Liquidated damages claims have been enforced in cases where the lessor has also recovered the equipment,[64] and in a number of those cases the formula used when calculating those damages included accelerated rent amounts discounted at a reasonable discount rate, less a mitigation amount consistent with the lessor's having recovered the equipment and its disposition value.[65]

Rights of Assignees

In re Woodbridge Group of Companies, L.L.C.[66] involved promissory notes issued by a mortgage investment fund to various lenders; both the notes and the loan agreement prohibited assignment of the note without the borrower's consent. After the borrower filed for bankruptcy, the lenders under three notes sold the notes to a venture fund, which filed a proof of claim in the bankruptcy proceedings. The debtor objected, citing the anti-assignment clause, and the court agreed, noting that when a contract merely limits a party's right to assign, an assignment is valid and enforceable, but generates a breach of contract action.[67] However, where the express language of the note limited the power to assign, such as in the case before the court, the purported assignment was void.[68] The court rejected the argument that U.C.C. section 9-408 overrides any such restrictive contractual provisions, noting that while section 9-406 of the U.C.C. applies to assignability of promissory notes, section 9-408 applies only to grants of security interests and hence is not applicable to assignment of a note.[69] This decision is noteworthy for its applicability to syndication or securitization of equipment loans or leveraged lease loans which are evidenced by a promissory note.

63. *See* Quality Equip. Leasing, L.L.C. v. Ala. Logistics, L.L.C., No. 2:17-CV-00127-AKK, 2017 WL 4304626 (N.D. Ala. Sept. 28, 2017) (holding the lessor was entitled to recover actual damages of the rent payments from the period between the default through termination of the leases, under four defaulted lease agreements for trucks and trailers, but was not entitled to recover liquidated damages of accelerated rent payments to the termination date, as they amounted to double recovery of the same injury and would have resulted in a windfall for the lessor); *see also* Edward K. Gross et al., *Leases*, 73 Bus. Law. 1155, 1157–59 (2018) (discussing same).

64. *See* Xerox Corp. v. AC Square, Inc., No. 15-cv-04816-DMR, 2016 WL 5898652, at *8 (N.D. Cal. Sept. 1, 2016) (holding plaintiff lessor was entitled both acceleration-type damages, and the right to recover equipment, without requiring any mitigation credit).

65. *See In re* Snelson, 305 B.R. 255, 264–65 (Bankr. N.D. Tex. 2003) (noting a liquidated damages clause was reasonable, despite allowing repossession of the equipment, as the clause required a present value discount of future rent and a credit of proceeds from the disposition).

66. 590 B.R. 99, 102 (Bankr. D. Del. 2018).

67. *Id.* at 104–05.

68. *Id.* The Loan Agreement contained the following language in section 4(d):

> This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns, provided, however, that Lender shall not assign, voluntarily, by operation of law or otherwise, any of its rights hereunder without the prior written consent of Woodbridge and any such attempted assignment without such consent shall be null and void . . . .

Id. at 102.

69. *See id.* at 108.

NY Capital Asset Corp. v. F & B Fuel Oil Co.[70] involved a sale of accounts, in which the predecessor of NY Capital Asset Corp. paid a lump sum to acquire a specified percentage of the seller's future sales of inventory, until a specified purchase amount had been received by the purchaser. Rejecting the seller's claim that the transaction was in substance a loan and hence usurious, the court upheld the contract as a "sale and purchase of accounts receivables as a matter of law."[71] The court cited three elements: 1) the contingent payout of receivables to the purchaser was dependent on the merchant's product sales volume;[72] 2) there was no finite term within which the purchaser was entitled to receive the purchase amount";[73] and 3) the purchaser had no recourse against the seller (or its guarantor) if the seller were to enter bankruptcy proceedings.[74] The court concluded that risk of loss fell on the purchaser and hence that the agreement was a contract of sale and not a loan. This decision provides useful structuring guidance for lessors and lenders entering into syndications, portfolio sales, or sales of leases and loans as the first step in a securitization.

In *United Capital Funding Corp. v. Ericsson Inc.*,[75] the assignee of accounts receivable sought payment from the account debtor, claiming that the account debtor should not have paid another creditor pursuant to a garnishment judgment. The court agreed with the assignee and held that because the account debtor was notified of the assignment and was clearly instructed to direct all payments to the assignee, the notice of assignment was effective and hence the account debtor could discharge the debt only by paying the assignee.[76] The court explained that an account debtor who receives an effective notice of assignment before entry of a garnishment judgment must apprise the court, which issued the garnishment order, of the notice of assignment or else it cannot later seek immunity by arguing that it paid the garnishor instead.[77]

In *Liberty Bell Bank v. Rogers*,[78] Liberty Bell Bank ("Liberty Bank") extended over 100 separate loans to Rogers and his companies ("LGR Entities") to finance the purchase of equipment intended for lease. Each loan was secured by assignment to Liberty Bank of equipment leases to various customers of the LGR Entities, as well as by a security interest in the leased equipment. The LGR Entities were to collect the lease payments under each equipment lease and remit those to Liberty Bank as payment on the loans. Unbeknownst to Liberty Bank, multiple

70. 58 Misc. 3d 1229(A), 98 N.Y.S.3d 501 (N.Y. Sup. Ct. 2018).

71. *See* slip op. at 7.

72. *Id.* at 6.

73. *Id.* at 6–7. The agreement specified that: "Seller is selling a portion of a future revenue stream to [purchaser] at a discount, not borrowing money from [purchaser]. There is no interest rate or payment schedule and no time period during which the Purchased Amount must be collected by [purchaser]." *Id.* at 2 (citing Agreement ¶ 2.2).

74. *Id.* at 7.

75. United Capital Funding Corp. v. Ericsson Inc., 728 F. App'x 682 (9th Cir. 2018).

76. *Id.* at 685.

77. *Id.* Revised Code of Washington § 6.27.300 provides immunity to a garnishee, when in satisfaction of a writ of garnishment, the garnishee pays the garnishor instead of other creditors. WASH. REV. CODE § 6.27.300 (2018).

78. 726 F. App'x 147 (3d Cir. 2018).

leases that were assigned to it as collateral did not exist, because either the customer had cancelled the lease or the equipment was never purchased. In other instances, the LGR Entities pledged the same leases to two other banks to secure other loans. One of the banks, Branch Banking & Trust Company ("BB&T"), intervened in the action brought by Liberty Bank. The court held that Rogers and LGR Entities engaged in racketeering activity within the meaning of the Racketeer Influenced and Corrupt Organizations Act,[79] when they failed to purchase equipment that was to secure loans, and double-pledged leases for equipment as collateral to multiple banks.[80] The court granted Liberty Bank's motion for summary judgment and awarded more than $10 million in damages.[81]

In a later decision,[82] the district court awarded Liberty Bank $64,063.89 from the proceeds of four copiers under one of the leases, while BB&T received $49,596.84 from the proceeds of the other copiers under the same lease.[83] Liberty Bank argued such distribution constituted a windfall to BB&T, but the court disagreed and explained that BB&T's blanket security interest entitled it to apply the sale proceeds toward other LGR loans owed to it.[84] The court explained that Liberty Bank had a priority security interest solely in the proceeds of the four copiers it identified in its filed financing statement, while BB&T had a first lien and security interest in the proceeds attributable to other equipment not listed in Liberty Bank's financing statement, as collateral for all other loans made by it to the LGR Entities.[85] Because BB&T had entered—almost three years prior to Liberty Bank's loan—into a loan and a security agreement that granted it "a first lien and security interest in . . . all leases now existing or hereafter arising," such priority allowed BB&T to apply the proceeds of its security interest to other loans it had extended to LGR Entities.[86] The decision is silent as to whether Liberty Bank took possession of the "original" counterpart of the leases which it financed, but underscores that a search of the U.C.C. records would have revealed BB&T's earlier blanket lien.

Hell-or-High-Water Clauses

In *Hitachi Data Systems Credit Corp. v. Precision Discovery, Inc.*,[87] the lessor of data storage equipment sued the lessee for failure to make its rent payment. The lessee counterclaimed that the lessor leveraged a personal relationship with the

79. *See* 18 U.S.C. §§ 1962, 1964(c)–(d) (2018).
80. *Liberty Bell Bank*, 726 F. App'x at 155.
81. *Id.* at 155.
82. Liberty Bell Bank v. Rogers, 1:13-cv-7148 (NLH/KMW), 2018 WL 4110923, at *1 (D.N.J. Aug. 29, 2018).
83. *See* Liberty Bell Bank v. Rogers, No. 1:13-cv-7148 (NLH/KMW), 2018 WL 4110923, at *1 (D.N.J. Aug. 29, 2018). BB&T loaned $18,000 against that lease, and Liberty Bank loaned $570,258.15 against that lease and other leases, but BB&T had made other loans to the LGR Entities, collateralized by its blanket lien at the time of this lawsuit. *Id.*
84. *Id.* at *2.
85. *Id.* at *1.
86. *Id.*
87. 331 F. Supp. 3d 130 (S.D.N.Y. 2018).

lessee's president to fraudulently induce him to enter into the lease schedule on behalf of the lessee and alleged the lessor knew the equipment was unsuitable for the lessee's use.[88] The court explained that under New York Law, if a party to a contract agrees that it is not relying on any promises of the other party, it cannot later complain that it entered into the contract based on any such alleged misrepresentation.[89] Accordingly, the court held that because the master lease (which was incorporated into the disputed equipment schedule) disclaimed any representation by the lessor regarding suitability of the leased equipment, the lessee could not establish it reasonably relied on any such alleged misrepresentation.[90] Although the lessor also pointed to the hell-or-high-water clause in the lease, the court did not decide the case on that ground. Nevertheless, lessors would be wise to include both a hell-or-high-water clause and a disclaimer of warranties, to enhance the likelihood of prevailing in a dispute against a defaulting lessee.

End-of-Term Issues

In *Onset Financial, Inc. v. Victor Valley Hospital Acquisition, Inc.*,[91] the court analyzed whether the end-of-term options set forth in the master lease at issue or instead those options outlined in the proposals sent by lessor Onset Financial, Inc. ("Onset") should govern.[92] Lessee, Victor Valley Hospital Acquisition, Inc. ("Victor Valley"), argued for equitable relief based on unilateral mistake. The court noted that "[w]hen one party's mistake of fact is coupled with knowledge of the mistake by the other party or a mistake is produced by. . . inequitable conduct by the nonerring party, the mistake provides a basis for reformation or rescission."[93] The court further noted that under a theory of unilateral mistake, "the mistake must have occurred notwithstanding the exercise of ordinary diligence by the party making the mistake."[94] Applying these principles, the court found the end-of-term provisions in the proposal were not entirely inconsistent with those contained in the master lease.[95] The court noted that even if such terms had been found to be inconsistent, proposals by their very nature are only proposals.[96] The court found that "[i]t would seem farfetched to categorize having more complete terms in the final documentation as inequitable conduct."[97]

88. *See* U.C.C. § 2A-213 (2011) ("Except in a finance lease, if the lessor at the time the lease contract is made has reason to know of any particular purpose for which the goods are required and that the lessee is relying on the lessor's skill or judgment to select or furnish suitable goods, there is in the lease contract an implied warranty that the goods will be fit for that purpose."). The lessee may have attempted to utilize this provision because the lessor was an affiliate of the manufacturer.

89. *Hitachi Data Sys. Credit Corp.*, 331 F. Supp. 3d at 149.

90. *Id.*

91. No. 2:17CV01133-DAK-BCW, 2018 WL 1662611 (D. Utah Apr. 4, 2018).

92. *Id.* at *1.

93. *Id.* at *2 (quoting Guardian State Bank v. Stangl, 778 P.2d 1, 5 (Utah 1989)).

94. *Id.* (quoting John Call Eng'g, Inc. v. Manti City Corp., 743 P.2d 1205, 1209 (Utah 1987)).

95. *Id.* at *3.

96. *Id.*

97. *Id.*

The court also noted that "Onset was under no duty to ensure [lessee] understood every provision."[98] The court therefore held Victor Valley's counterclaim for equitable rescission or reformation failed as a matter of law.[99]

One other noteworthy aspect to the case is that Victor Valley alleged the automatic renewal provisions resulted in usurious interest rates under California law. California courts "have uniformly enforced contracts allowing interest rates above the limit under California law where there is shown a substantial relationship between the contract and the state which is referenced in the choice-of-law provision."[100] The court found that Utah had a substantial relationship with the contract given that Onset is a Utah corporation, with its principal place of business in Utah and the contract was signed in Utah.[101] Therefore, Utah law governed and accordingly California's usury law was not applicable.[102]

Vicarious Liability

In *Scott v. A Betterway Rent-A-Car, Inc.*,[103] Plaintiff Crystal Scott ("Plaintiff") brought suit against defendant A Betterway Rent-A-Car, Inc. ("Betterway"), which was the owner of the rented motor vehicle at issue, and co-defendant Kirk Anglin ("Anglin"), who was the lessee/driver of such vehicle, for injuries Plaintiff sustained when defendant Anglin collided with Plaintiff. Plaintiff had not alleged any negligence or criminal wrongdoing on the part of defendant Betterway. Defendant Betterway argued that Florida's vicarious liability law was preempted by the Graves Amendment[104] (which shields lessors covered by the statute from liability based solely on the ownership of the applicable motor vehicle[105]) and therefore Defendant Betterway could not be held vicariously liable simply because it owned one of the vehicles involved in the accident. In analyzing whether defendant Betterway was negligent, and therefore outside the protections of the Graves Amendment,[106] the court considered whether defendant Betterway had any duty to perform a pre-rental investigation of defendant Anglin's ability to drive.[107] The court found that vehicle owners do not have such a duty but instead have the duty to only rent vehicles to those drivers

98. *Id.*
99. *Id.*
100. *Id.* at *4 (quoting Palm Ridge, L.L.C. v. Ahlers, No. EDCV 08-00652-SGL (OPx), 2008 WL 11339594, at *2 (C.D. Cal. June 23, 2008)).
101. *Id.*
102. *Id.*
103. No: 5:17-cv-240-Oc-41PRL, 2018 WL 1558268 (M.D. Fla. Mar. 27, 2018).
104. *See* 49 U.S.C. § 30106(a) (2018) ("An owner of a motor vehicle that rents or leases the vehicle to a person (or an affiliate of the owner) shall not be liable under the law of any State or political subdivision thereof, by reason of being the owner of the vehicle (or an affiliate of the owner), for harm to persons or property that results or arises out of the use, operation, or possession of the vehicle during the period of the rental or lease, if—(1) the owner (or an affiliate of the owner) is engaged in the trade or business of renting or leasing motor vehicles; and (2) there is no negligence or criminal wrongdoing on the part of the owner (or an affiliate of the owner).").
105. *Id.*
106. *See id.* § 30106(a)(2).
107. *Scott*, 2018 WL 1558268, at *2.

who are licensed to operate vehicles and accordingly to inspect the driver's license and verify the signature on same.[108]

In *Parker v. Miller*,[109] plaintiff Shanice Parker ("Plaintiff") alleged that defendant Dakotaland Transportation, Inc. ("Dakotaland"), which was the lessee of the vehicle at issue, defendant Fowlds Brothers Trucking, Inc. ("Fowlds"), which was the owner of the vehicle at issue, and Eric Miller ("Miller"), who was the driver of the vehicle at issue and also the employee of defendant Dakotaland, were all liable for the injuries Plaintiff sustained as a result of an accident between the vehicle defendant Miller was driving and the police patrol car in which Plaintiff was sitting at the time of the accident. Plaintiff and defendants Dakotaland and Fowlds provided arguments and responses, respectively, regarding the applicability of the Graves Amendment. The court initially noted that Plaintiff had not alleged any claims against defendant Fowlds based on such defendant's ownership of the vehicle at issue.[110] Plaintiff's claims against defendant Fowlds were instead based on Plaintiff's allegations that defendant Miller was jointly employed by both defendant Dakotaland and defendant Fowlds. The court held that Ohio does not impose the type of vicarious liability on motor vehicle lessors that the Graves Amendment was designed to prohibit (i.e., liability based solely on the ownership of the applicable vehicle).[111] Instead, Ohio law imposes liability on an owner when the driver is an *employee or agent* of the owner who is acting within the scope of his employment or agency.[112] The court therefore held that the Graves Amendment was not applicable[113] and, accordingly, denied defendant Fowlds' motion for summary judgment.[114]

In *Newton v. Caterpillar Financial Services Corp.*,[115] plaintiff Anthony Newton ("Newton") brought a suit against defendant Caterpillar Financial Services Corporation ("Caterpillar"), which was the owner of the multi-terrain loader vehicle at issue, and defendant Charles Cram ("Cram"), who was the lessee of the loader, alleging, among other things, that Caterpillar as owner was vicariously liable for injuries sustained by Newton as a result of the alleged negligence of defendant Cram. Newton relied on Florida law that imposes vicarious liability on owners of motor vehicles for the negligence of individuals to whom a dangerous instrumentality is voluntarily entrusted by the owner. The court noted that "[c]ommon knowledge and plain language demonstrate that loaders, like farm tractors and forklifts, are motor vehicles for the purpose of [Florida's] dangerous instrumentality doctrine."[116] The court further noted that "the dangerous instrumentality doctrine is not limited to motor vehicles being operated on a public highway

108. *Id.*
109. Parker v. Miller, No. 2:16-cv-1143, 2018 WL 898981 (S.D. Ohio Feb. 15, 2018).
110. *Id.* at *3.
111. *Id.* at *4.
112. *Id.*
113. *Id.* at *5–6.
114. *Id.*
115. 253 So. 3d 1054 (Fla. 2018).
116. *Id.* at 1057.

and may apply to a motor vehicle on private property."[117] The court held that "a loader is a dangerous instrumentality as a matter of law."[118] The court therefore remanded the case to the trial court for an order granting summary judgment in favor of plaintiff Newton pursuant to Florida's dangerous instrumentality doctrine.[119]

It is noteworthy that neither the defendant nor the court (including the dissenting opinion) discussed the applicability (or inapplicability) of the Graves Amendment. As noted above, the court found that the loader at issue was a motor vehicle for the purpose of Florida's dangerous instrumentality doctrine.[120] The Graves Amendment defines a "motor vehicle" as "a vehicle driven or drawn by mechanical power and manufactured primarily for use on public streets, roads, and highways, but does not include a vehicle operated only on a rail line."[121] It may be that the defendant and/or the court concluded that while a loader was a motor vehicle for purposes of the Florida dangerous instrumentality doctrine, it was not a motor vehicle for purposes of the defendant availing itself of the protections of the Graves Amendment. This may actually be the correct result given that the Graves Amendment appears to more narrowly define the term "motor vehicle" and ties such definition to vehicles operated primarily on roads.[122] However, given that the same term "motor vehicle" is used in both the Florida doctrine and the Graves Amendment, it is unclear from the reported facts and decision why this was not raised by the defense or discussed by the court.

Forum Selection Clauses

In *Signature Financial, LLC v. Neighbors Global Holdings, LLC*,[123] plaintiff Signature Financial, LLC ("Signature"), as assignee of the originating lessor, brought a collection suit against the co-lessees under certain equipment leases in New York state court alleging non-payment. The co-lessees removed to federal court and moved to dismiss for lack of personal jurisdiction.

Paragraph 25 of each of the leases at issue provided for jurisdiction in "THE STATE OF LESSOR's, OR ITS ASSIGNEE's, PRINCIPAL PLACE OF BUSINESS[.]"[124] The issue before the court was whether this provision was enforceable under New York law. The court noted that "New York courts have specifically found that forum selection clauses can be relied upon to establish personal jurisdiction over out-of-state defendants who otherwise would not be liable to suit in New York."[125] The defendants argued that the foregoing clause was unenforceable because it lacked specificity and predictability.

117. *Id.* (quoting Rippy v. Shepard, 80 So. 3d 305, 307 (Fla. 2012)).
118. *Id.*
119. *Id.*
120. *Id.*
121. 49 U.S.C. § 30102(a)(7) (2018).
122. *Id.*
123. 281 F. Supp. 3d 438 (S.D.N.Y. 2017).
124. *Id.* at 442.
125. *Id.* at 446.

The court contrasted the above provision, which it called a "mandatory consent to jurisdiction" clause,[126] with "full forum selection" clauses and pointed out that the difference is that the type of clause at issue here "does not specify one forum where all suits must be brought, but rather requires one or both parties to abandon jurisdictional defenses when sued by the other party in certain forums."[127] The court elaborated that this type of clause "does not establish one possible forum for the resolution of [all] disputes arising under the contract—[instead,] it guarantees to one party the right to bring cases in the forum of its choice."[128]

The court held that this type of "'floating' mandatory consent to jurisdiction clause" was not so unclear or non-specific as to render the clause unenforceable.[129] The court elaborated that,

> [f]loating mandatory consent to jurisdiction clauses are enforced in New York because they facilitate the loan assignment market by allowing lenders to assign loans to other lenders and still sue borrowers for non-payment of rent in their home jurisdictions. The purpose of the clauses is not to surprise or inconvenience defendants, but to lower the cost of servicing lease portfolios.[130]

Last, the court explicitly acknowledged that the use of mandatory consent to jurisdiction clauses are capable of being abused in certain circumstances, in which case, the New York courts would decline to enforce them.[131] By way of example, the court noted that New York courts have previously dismissed cases arising out of a nationwide fraud perpetrated by a defunct company called NorVergence.[132] The court pointed out that in such cases, the defendants were unsophisticated, "small, out-of-state, local businesses" for which litigating in New York would be unfair.[133] In the case at hand, the court observed that the defendants were a nationwide conglomerate and were capable of defending the suit in New York.[134] The court also commented that the defendants' executives likely knew that the leases would be assigned to other lenders outside the state and that the defendants "were assuming the risk of litigating in a less convenient forum."[135] The court therefore denied the defendants' motion to dismiss Signature's complaint.[136]

In *EverBank Commercial Finance, Inc. v. Neighbors Global Holdings, LLC*,[137] plaintiff EverBank Commercial Finance, Inc. ("EverBank") filed a collection

126. *Id.* at 447.
127. *Id.*
128. *Id.*
129. *Id.* at 448.
130. *Id.*
131. *Id.* at 449.
132. *Id.*
133. *Id.*
134. *Id.* at 449–50.
135. *Id.* (quoting IFC Credit Corp. v. Rieker Shoe Corp., 881 N.E.2d 382, 391 (Ill. App. Ct. 2007)).
136. *Id.* at 450.
137. Everbank Commercial Fin., Inc. v. Neighbors Glob. Holdings, LLC, No. 2:17-3356 (WJM), 2017 WL 5598216 (D.N.J. Nov. 21, 2017).

suit against defendant Neighbors Global Holdings, LLC ("Neighbors") under a certain equipment lease that was assigned to EverBank. Defendant Neighbors removed the case and filed a motion to dismiss for lack of personal jurisdiction. The lease at issue contained a forum selection clause that permitted EverBank, as assignee, "to file suit in any court in the Lessor's or any assignee's principal place of business."[138]

The court found that forum selection clauses are presumptively enforceable unless the objecting party demonstrates that enforcing such clauses would be unreasonable under the facts and circumstances.[139] The court noted that "[t]o find a forum selection clause 'unreasonable,' the defendant must make a 'strong showing' . . . (1) that it is the result of fraud or overreaching, (2) that enforcement would violate a strong public policy of the forum, or (3) that enforcement would in the particular circumstances of the case result in litigation in a jurisdiction so seriously inconvenient as to be unreasonable."[140]

Under the facts at hand, the court found that the defendant failed to make the required strong showing that enforcement of the forum selection clause would be unreasonable.[141] First, the defendant did not show how enforcing the clause would be counter to any strong New Jersey public policy.[142] Second, there was no evidence submitted to indicate that litigating in New Jersey would deprive the defendant of its day in court.[143] Third, there was no evidence showing that plaintiff obtained the agreement for the forum selection clause by fraud or any overreaching conduct.[144] The court therefore found the forum selection clause to be valid.[145]

Finally, the court noted that when the defendant signed the lease at issue, which contained the above forum selection clause, it had "waived the right to challenge the preselected forum as inconvenient or less convenient for themselves or their witnesses, or for their pursuit of litigation."[146]

138. *Id.* at *2.
139. *Id.* (quoting Foster v. Chesapeake Ins. Co., 933 F.2d 1207, 1219 (3d Cir. 1991)).
140. *Id.* (internal citation omitted) (first quoting M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 15 (1972), then quoting Coastal Steel Corp. v. Tilghman Wheelabrator Ltd., 709 F.2d 190, 202 (3d Cir. 1983), *overruled on other grounds by* Lauro Lines v. Chasser, 490 U.S. 495 (1989)).
141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.*
146. *Id.* at *3 (quoting Atl. Marine Constr. Co. v. U.S. Dist. Court, 571 U.S. 49, 64 (2013)).