Leases

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Case Law Developments

Our survey covers a number of cases decided in 2015 involving disputes between parties to equipment financing transactions or with third parties regarding the lease financing or related equipment. The courts in these surveyed cases considered many of the issues that are fundamental to establishing the respective rights, obligations, interests, and remedies associated with equipment financing. These issues include, among others, whether a transaction documented as a lease creates a true lease or a security interest, the rights of assignees of interests under a lease, certainty of payment issues such as waivers of defenses and "hell or high water" payment obligations, vicarious liability of a lessor, a lessor's damages remedies, and options reserved to lessees relating to the leased equipment.

True Lease

The characterization of a transaction as either a true lease or a secured transaction is likely to impact the putative lessor's rights and remedies with respect to the calculation of damages recoverable under the transaction documents as well as to the residual value of the subject equipment, especially if the lessee files for bankruptcy.[1]

In *Lyon Financial Services, Inc. v. Illinois Paper & Copier Co.*, the court considered whether a six-year lease of office equipment constituted a true lease or a secured loan "disguised as a lease."[2] First, the court considered a provision in

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1. "If one is a lessor as opposed to a secured seller, one has different rights on default, on lessee bankruptcy, in regard to federal, state and local taxes, and under state usury laws, and the difference even extends to the lessor's and lessee's balance sheet." 2 James J. White & Robert S. Summers, Uniform Commercial Code § 13-2 (5th ed. 2008).

2. No. 10 C 7064, 2016 WL 147654, at *11 (N.D. Ill. Jan. 13, 2016); *see also* Edward K. Gross et al., *Leases*, 70 Bus. Law. 1183, 1192–93 (2015) (discussing a previous ruling by the Minnesota Supreme Court involving the same case).

the lease agreement that set forth a narrow set of circumstances that would excuse performance on the part of the lessee.[3] The lessor and the seller of the lease to Lyon argued that the lease agreement did not create a security interest in the equipment because such provision gave the lessee an "out."[4] In rejecting this argument, the court reasoned that the lease provision "simply authorizes a remedy for [the lessee's] default"[5] that is "available only in extremely limited circumstances, where the [lessee] is essentially broke or where it would be otherwise legally impossible for it to make payments."[6] As such, the court rejected the argument that the provision allowed for early termination by the lessee[7] because the lessee could only suspend its obligations under the lease agreement "if there were no legally viable way for it to make payments" to the lessor.[8] Accordingly, although the lessee's failure to perform would constitute a default, if the circumstances surrounding such failure to perform met the requirements of the provision, such default would be excused.

Second, the court rejected the argument that the agreement constituted a lease intended for security, finding that either section 1-203(1) or (4) of the U.C.C. could apply under the circumstances, and concluded that a dispute of material fact existed regarding the economic value of the equipment at the end of the lease.[9] Although the court recognized the "troubling policy implications of allowing [the lessee] to enter into the Lease Agreement and then unilaterally declare it void,"[10] it held that disputes of fact precluded a summary judgment determination of whether the agreement was a true lease.[11]

In *In re Wells*,[12] the lessee sought to characterize a motor vehicle lease agreement as a secured debt in her Chapter 13 bankruptcy plan. Pursuant to the lease agreement, Shontail Wells leased a 2012 Dodge Avenger from American Car Center, LLC for a $1,200 down payment, bi-weekly payments of $198.08 for ninety-one months, and an option to purchase the leased vehicle at lease expiration for $3,444.05. The dispute before the court was whether the lease agree-

3. *Lyon*, 2016 WL 147654, at *3–5. The agreement provided that the lessee's performance may be excused under the following circumstances: (i) funds were not sufficiently appropriated to satisfy all obligations during a subsequent fiscal period, (ii) such non-appropriation did not result from any act or failure to act by the lessee, (iii) the lessee had exhausted all funds available for payment owing to the lessor, and (iv) no other legal procedure was available to lessee by which payment might be made to lessor. *Id.* at *3.

4. *Id.* at *12.

5. *Id.* As interpreted by the court, the provision set forth a remedy for default such that (i) in the event the lessee was in default because funds were not appropriated for a fiscal period; (ii) the lessee shall return the equipment to the lessor at the lessee's expense; and (iii) the lessor's remedies for such default shall be to "terminate the lease . . . retain the advance payments, if any; and/or sell, dispose of, hold, use or rent the equipment." *Id.*

6. *Id.*

7. *Id.* at *13.

8. *Id.*

9. *Id.* at *13–14.

10. *Id.* at *16.

11. *Id.* at *14.

12. No. 15-80056-CRJ-13 2015 WL 3862969 (Bankr. N.D. Ala. June 22, 2015).

ment for the automobile constituted a true lease or a security agreement under Tennessee law.

Tennessee Code section 47-1-203(b) governs when a lease will be deemed a security interest.[13] Amongst its provisions are the requirements that the lessee must not have the option to terminate the lease and (i) the original term of the lease must be equal to or greater than the remaining economic life of the goods, (ii) the lessee must be bound to renew the lease for the remaining economic life of the goods, or (iii) the lessee has the option to become the owner of the goods at the expiry of the lease for no additional consideration.[14] The lease at issue in *In re Wells* contained an early termination option. The lessor argued that the lease constituted a true lease because it did not bind the lessee to become the owner of the vehicle at the expiry of the lease and because of the early termination provision. The lessee contended, on the other hand, that this was not an effective early termination provision because the amount owed on early termination was uncertain, due to the unpaid biweekly payments.

The court ruled that it was not necessary to determine the certainty of the early termination amount because the lessee failed to demonstrate that the lease created a security interest under Tennessee Code section 47-1-203(b)(1)–(4).[15] First, the court noted, the original term of the lease agreement was less than the remaining economic life of the vehicle.[16] Also, though the lessee could purchase the vehicle at the end of the lease, the lease bound the lessee neither to do so nor to renew the lease for the economic life of the vehicle.[17] A vice president of the lessor testified at an oral hearing that the lessor requires a separate set of loan documents to exercise the purchase option; therefore, the lessor does not allow any of its lessees to retain a leased vehicle and simply make further lease payments at the expiry of the lease.

Further, the court found that the vehicle would continue to have value at the expiry of the lease.[18] The lessee contended that the payment of $3,444.05 constituted nominal additional consideration under Tennessee law because the amount represented 38.8 percent of the vehicle's value at buyout, when the vehicle would be six years old. Meanwhile, the lessor asserted that the purchase price amounted to 20 percent of the vehicle's original agreed-upon value.[19] The court found that the payment was not nominal in either case, and that the purchase price "indicate[d] that the vehicle [would] continue to have value at the end of the lease term."[20] Accordingly, the court agreed with the lessor and concluded that the lease agreement was a true lease and not a security interest.[21]

13. *Id.* at *1.
14. *Id.* (quoting TENN. CODE § 47-1-203(b)).
15. *Id.* at *2.
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*

In *GEO Finance, LLC v. University Square 2751, LLC*,[22] the court was asked to consider the characterization of a water supply agreement to determine if the transaction contemplated by that agreement constituted a true lease. This characterization was essential to the purported lessor's action to recover the related equipment and damages pursuant to that agreement. The facts considered by the court included, among other things, what might be considered a "bundled transaction," property that could constitute fixtures, and the respective rights and obligations of parties relating to an agreement to which neither was an original party.[23] As in many similar characterization cases, if the transaction documented by the subject agreement were a "lease," the lessor would have greater rights relating to the leased equipment, and if the agreement were not a "lease," the purported lessor's rights would be vulnerable to third-party claims.

The plaintiff in this case, GEO Finance, LLC ("GEO Finance"), claimed breach of contract, conversion, and unjust enrichment against the defendant, University Square 2751, LLC ("University Square"), relating to certain equipment (the "Equipment") installed at the premises then owned by University Square. The Equipment had been installed at the premises by GEO Finance's predecessor in interest, Hardin Geotechnologies, Inc. ("Hardin"), pursuant to a Geoexchange Water Supply Agreement (the "Agreement") entered into by Hardin with U-Square Associates, L.P. ("U-Square") in 2001. Pursuant to the Agreement, Hardin agreed to provide a geothermal water supply system (the "System") engineered to support the heating and cooling of the premises. To provide the System, Hardin agreed to install the Equipment and perform design services, maintenance, and other undertakings necessary to provide geoexchange water to sufficiently heat and cool the premises, and U-Square promised to make monthly usage and other payments to Hardin as consideration for the same.

The terms of the Agreement pertinent to the "lease" characterization included a purchase option under which U-Square had the option to purchase the System for a price of $296,075 at any time during the first eight years of the term of the Agreement, or for $281,000 at any time thereafter, by giving sixty days' prior written notice. The Agreement also contained an evergreen provision by which the Agreement would be renewed automatically at a fixed rental after the first ten-year term, for up to eight consecutive terms of five years each, unless U-Square notified Hardin in writing that it did *not* intend to renew. Additionally, either party could terminate in the event of a material breach by the other party following sixty days' written notice if the breach were not cured.

In 2007, U-Square sold the buildings to 2751 Jefferson Realty, LLC, and, on the same day, 2751 Jefferson Realty, LLC executed a mortgage on the properties in favor of JP Morgan Chase Bank, N.A. ("JP Morgan"). In 2010, Hardin assigned its rights and obligations as lessor under the Agreement to GEO Finance. After GEO Finance succeeded Hardin under the Agreement, it notified the management company employed by 2751 Jefferson Realty, LLC. GEO Finance sent in-

22. 105 F. Supp. 3d 753 (E.D. Mich. 2015).
23. *Id.* at 756–57.

voices to the management company every month and all were paid in due course.

However, JP Morgan foreclosed on its mortgage, and, in 2011, the buildings were conveyed by sheriff's deed to JP Morgan's holding company affiliate. In 2012, Sidhant Dhir bought the properties from JP Morgan's holding company affiliate and then assigned his interest in the properties to the defendant, University Square. In the purchase agreement, Dhir agreed as purchaser to "assume all Contracts at Closing," defined as "all service, maintenance, supply or other contracts relating to the operation of the Property, and all other such assignable contracts or agreements in effect as of the Effective Date."[24] As part of the due diligence, financial statements referencing both the System installed at the premises and the related payments under the Agreement were provided to Dhir and reviewed by his father.

The critical issue to be determined by the court, so as to determine the respective rights and interests of the parties, was whether the Agreement constituted a true lease of the Equipment pursuant to which GEO Finance would be deemed to have retained ownership of the Equipment. To make its determination, the court applied the analysis from the Sixth Circuit's recent decision in *In re Purdy*,[25] in which the court applied a two-step test in the form of a "bright-line test" followed by an "economics-of-the-transaction test."

The bright-line test determines whether a transaction documented as a lease is actually a security interest, "if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee" and one of four conditions is met.[26] The court in this case found that the Agreement by its plain language constituted a "lease" because it "transfer[red] the right to possession and use of goods for a term in return for consideration."[27]

The court rejected the defendant's argument that the Agreement was not a lease because it was "not terminable by the lessee," as the lessee could terminate the Agreement in several ways, such as giving written notice of its intent to terminate sixty days before the end of the original ten-year term or at any time

24. *Id.*

25. 763 F.3d 513 (6th Cir. 2014); *see also* Edward K. Gross et al., *Leases*, 70 Bus. Law. 1183, 1183–85 (2015) (summarizing *Purdy*).

26. *GEO Fin.*, 105 F. Supp. 3d at 762. These conditions include:

> (a) the original term of the lease is equal to or greater than the remaining economic life of the goods;
>
> (b) 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;
>
> (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal consideration upon compliance with the lease agreement; and
>
> (d) the lessee has the option to become the owner of the goods for no additional consideration or for nominal consideration upon compliance with the lease agreement.

Mich. Comp. Laws § 440.1203(2) (2013).

27. *GEO Fin.*, 105 F. Supp. 3d at 763 (citing Mich. Comp. Laws § 440.2803(1)(j)).

giving sixty days' notice to exercise the purchase option.[28] The court also rejected University Square's argument that because the lessee had the option to renew the term of the lease for up to fifty years, cumulatively, it exceeded or equaled the economic life of the System, because the minimum term of ten years did not extend past the economic life of the goods.[29] Under this test, the court found the Agreement was not a *per se* security agreement.[30]

Under its analysis of the economics-of-the-transaction test,[31] the court found that neither the original purchase option price of $296,075 nor the "discounted" price of $281,000 were nominal as defined under the U.C.C. because "neither amount demonstrably exceeded a reasonable estimation of the lessee's cost of performing under the lease."[32] Given that the discounted option price was 95 percent of the original purchase option price, and the Agreement did not provide for any further reductions, there was no evidence to suggest that the lessee developed any meaningful amount of "equity" in the System. Based on its analysis under these tests, the court found that the Agreement was a true lease.[33]

As to whether GEO Finance maintained its interest in the System despite the lack of a filed financing statement, the court turned to Article 2A of the U.C.C., under which a "lease contract is effective and enforceable according to its terms between the parties against purchasers of the goods and against creditors of the parties" and "the effectiveness or enforceability of the lease contract is not dependent upon the lease contract or any financing statement or the like being filed or recorded."[34] A lessor's interest in fixtures, "'whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if . . . the encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures.'"[35] However, the court did not perform an analysis of whether the System was a "fixture" rather than "equipment," as it found the question immaterial and GEO Finance's leasehold interest valid regardless of classification.[36]

GEO Finance prevailed with respect to its conversion and unjust enrichment claims, but not regarding its contract damages claim. The court ruled in favor of GEO Finance on its conversion claim, finding that it retained title to and had the right to recover the Equipment as owner and lessor under the Agreement, and the "undisputed facts" showed that University Square "appropriated, used and refused to surrender upon demand" the plaintiff's property.[37] However, the

28. *Id.* at 764–65.
29. *Id.*
30. *Id.*
31. Under the economics-of-the-transaction test, the "most weighty" factors are: (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. *Id.* at 764.
32. *Id.*
33. *Id.* at 765.
34. *Id.* (citing MICH. COMP. LAWS § 440.2901 cmt. 2).
35. *Id.* at 766 (quoting MICH. COMP. LAWS § 440.2909(5)).
36. *Id.*
37. *Id.* at 767.

court dismissed GEO Finance's breach of contract claim because it found that GEO Finance failed to present evidence that a valid contract existed between the parties.[38] Specifically, the court was not convinced that University Square either expressly assumed the Agreement or affirmed by its words or acts any responsibility under any contract that might have been implied in fact between GEO Finance and either JP Morgan's holding company or its management company.[39]

The court ruled in favor of GEO Finance on its unjust enrichment claim against University Square for the monthly metered usage fees required by the Agreement.[40] The court concluded that GEO Finance was entitled to judgment as a matter of law because it would be inequitable to allow University Square to retain the benefit of its wrongful appropriation and use of the System, particularly where University Square refused to honor repeated demands by GEO Finance despite having actual or inquiry notice of both GEO Finance's retention of its interest pursuant to the Agreement and its arrangement with JPMorgan.[41]

Rights of Assignees

In *In re Dryden Advisory Group, LLC*,[42] the court considered whether a factoring agreement functioned as a true sale of accounts receivable or, rather, constituted a secured financing agreement.

The court upheld the agreement at issue (described as a "purchase contract and security agreement," which purported to be "a true nonrecourse sale" of accounts).[43] The court concluded that the parties entered into a true sale arrangement because the receivables were not commingled with the seller's general operating funds but rather were to be held in trust and safekeeping as the property of the buyer and were to be immediately turned over to the buyer whenever payment on any account was received.[44] The court cited the buyer's ability to de-

38. *Id.* at 768.
39. *Id.*
40. *Id.*
41. *Id.*
42. 534 B.R. 612 (Bankr. M.D. Pa. 2015). Sales of receivables may be characterized as either a true sale or a financing agreement. In determining whether a factoring transaction is a true sale or a financing agreement, courts employ a totality of the circumstances analysis and consider the following factors:

> 1) whether the buyer has a right of recourse against the seller; 2) whether the seller continues to service the accounts and commingles receipts with its operating funds; 3) whether there was an independent investigation by the buyer of the account debtor; 4) whether the seller has a right to excess collections; 5) whether the seller retains an option to repurchase the accounts; 6) whether the buyer can unilaterally alter the pricing terms; 7) whether the seller has the absolute power to alter or compromise the terms of the underlying asset; and 8) the language of the agreement and the conduct of the parties.

Id. at 620.
43. *Id*. at 621–22. Under U.C.C. section 9-312, sales of accounts and chattel paper, including leases, must be perfected as if the transaction were the creation of a security interest. U.C.C. § 9-312 (2013).
44. *In re Dryden*, 534 B.R. at 622.

mand payment directly from account debtors, as well as the absence of recourse against the seller (except in very limited circumstances), as support for its finding that the transaction was a sale.[45]

In *In re Dryden*, the factoring agreement provided that the buyer accept the risk of nonpayment, and, although the agreement specified some events[46] that would afford the buyer recourse for nonpayment, the court concluded that "the presence of recourse in a sale agreement without more will not automatically convert a sale into a security interest"[47] and that "the legal rights and economic consequences of the agreement [must] bear a greater similarity to a financing transaction or to a sale."[48] As such, "if a seller conveys its entire interest in a receivable, the transfer is a true sale, even if the seller has a recourse obligation."[49] This conclusion runs contrary to the prevailing view that the extent of seller recourse is a significant element in any true sale analysis.[50]

Waiver of Defenses

In *Lease Finance Group LLC v. Traian Indries*, the lessor brought an action under the defendant's personal guarantee of an equipment lease.[51] The guarantor moved for summary judgment on the grounds that the lease agreement was unconscionable with respect to its forum selection clause, which provided that disputes between the parties were to be heard in a New York court.

The court held that requiring the California defendant to travel to New York to defend himself (as guarantor of the lessee) in an action to recover $2,600 was "so outrageous as to warrant holding [the lease] unenforceable on the ground of substantive unconscionability alone,"[52] as well as unjust and unreasonable where the lease agreement bore no substantial nexus with New York.[53]

The court rejected the reliance by the lessor (as assignee of the original lessor) upon the waiver of defenses clause in the lease, finding that because the evidence did not establish that the agreement was a secured transaction, the lessor could not rely on U.C.C. section 9-403.[54] This decision illustrates that notwithstanding

45. *Id.* The court emphasized that "[o]ne of the core attributes of owning a receivable is the risk that it will not be paid. If the buyer 'sells' the receivable, but retains the risk of non-payment, it is more likely that the transaction will be recharacterized as a loan." *Id.* at 623.

46. The agreement provided that the buyer may require the seller to repurchase accounts if there was an event of default, if any account was subject to a dispute, or if any account remained unpaid for ninety days. *Id.*

47. *Id.* (citing Major's Furniture Mart, Inc. v. Castle Credit Corp., 602 F. 2d 538, 544 (3d Cir. 1979)).

48. *Id.* (citing *Major's Furniture Mart*, 602 F. 2d at 544).

49. *Id.*

50. Stephen T. Whelan, Securitization: Equipment Leasing §§ 13:06[1]–13:06[6] (Mathew Bender & Co. eds., 2012).

51. CV-002826-14/NY, slip op. at 1, N.Y. City Ct. (Dec. 9, 2015).

52. *Id.* at 6 (quoting Gillman v. Chase Manhattan Bank, N.A., 73 N.Y.2d 1, 12 (1988)).

53. *Id.* The court found that the lease agreement bore no substantial nexus with New York because the defendant, a California resident and business owner, signed the agreement with the original lessor, a California corporation, in California. *Id.*

54. *Id.* at 3. The plaintiff argued that pursuant to U.C.C. section 9-403, as an assignee of the lease agreement, in good faith and without notice of defenses, it could enforce waivers of defenses. *Id.* at 6.

U.C.C. section § 2A-301's "freedom of contract," courts will scrutinize waiver of defenses clauses for substantive unconscionability, as well as whether unconscionability in an underlying contract could nullify enforceability of a supporting obligation.

"Hell or High Water" Clauses

In *In re Lehman Bros. Holdings Inc.*,[55] the court considered a "hell or high water" clause that barred Lehman from presenting the defenses of lack of consideration and lack of authority.[56] The court cited authority that "hell or high water" clauses are enforceable against "sophisticated parties"[57] and that such a clause constitutes a waiver of all challenged defenses (including lack of consideration and lack of authority).[58]

The court rejected Lehman's argument that "in order to bar a specific defense, a waiver must specifically disclaim that defense, unless the contract was the product of 'extended negotiation.'"[59] The court noted that "extended negotiation" is not dispositive of enforceability,[60] and declared that enforceability of a waiver turns on whether the parties are "sophisticated" and whether the contractual terms are clear and "unambiguous."[61] The court concluded that Lehman was a sophisticated party represented by counsel during negotiations, and that a waiver "of all defenses" is clear and unambiguous under New York law.[62]

In *AEL Financial, LLC v. Sheppard*, the lessor filed an action to recover for the lessee's failure to make payments under a lease agreement involving a chiropractic decompression table.[63] The lessee filed a third-party complaint against the supplier of the equipment, contending that the equipment was never delivered. The lessee argued that although he signed a certificate of acceptance evidencing receipt of the decompression table, he did so mistakenly and in anticipation of future delivery. He further argued that under his mistaken belief of future delivery, he made $30,000 worth of payments to the lessor under the lease, for which he argued that the supplier, the third-party defendant, should be liable.

An Illinois circuit court awarded summary judgment in favor of the lessor,[64] holding that (1) the lease was a "finance lease" under the U.C.C.,[65] (2) the lessee's execution of the certificate of acceptance constituted "acceptance" of the decompression table, regardless of whether the table had been delivered, (3) the lessee's acceptance of the table made his obligations under the lease "irrevocable

55. 541 B.R. 551 (S.D.N.Y. 2015).
56. *Id.* at 571.
57. *Id.* (citing Wells Fargo Bank, N.A. v. BrooksAmerica Mortg. Corp., 419 F. 3d 107, 110 (2d Cir. 2005)).
58. *Id.*; *see* Citibank, N.A. v. Plapinger, 485 N.E.2d 974, 976–77 (N.Y. 1985).
59. *In re Lehman Bros.*, 541 B.R. at 571–72.
60. *Id.* at 572.
61. *Id.* (citing *Wells Fargo Bank*, 419 F. 3d at 110).
62. *Id.* (citing *Plapinger*, 485 N.E.2d at 977).
63. AEL Fin., LLC v. Sheppard, No. 1-13-3867, slip op. at 1 (Ill. App. Ct. June 5, 2015).
64. *Id.* at 4.
65. *See* U.C.C. § 2A-103(1) (2011).

and independent,"[66] and (4) the lessee's failure to make required payments under the lease agreement constituted a default, entitling the lessor to recover damages.[67] The circuit court granted the supplier's motion for summary judgment under an Illinois law that provides that a defendant may bring a third-party action against a third-party defendant only if the latter's alleged liability is derivative of the defendant's liability to the plaintiff.[68]

The appellate court upheld the circuit court's award of summary judgment in favor of the supplier and third-party defendant, concluding that because the defendant's obligations under the lease were "irrevocable and independent" under U.C.C. section 2A-407(1), he was liable to the lessor without regard to whether the supplier delivered the decompression table.[69] The court required the lessee to bring a separate action against the supplier for nondelivery of the equipment.[70]

Vicarious Liability of Motor Vehicle Lessors

Since last year's leasing law survey, there have been no reported decisions successfully challenging the Graves Amendment.[71] Instead, plaintiffs continue to focus their efforts on the *direct* negligence of lessors, such as lack of maintenance or repair or negligent entrustment claims, rather than the *vicarious* liability of such lessors.[72] For example, in *Fisher v. National Progressive, Inc.*,[73] the plaintiff argued that the lessor negligently entrusted the subject vehicle to a lessee who caused the accident. The court rejected the defendant's claim that the plaintiff's negligent entrustment claims were barred by the Graves Amendment and instead analyzed whether the elements of negligent entrustment were met under Oklahoma law. The court held that "an individual may be held liable for negligent entrustment when that 'individual supplies a chattel for the use of another whom the supplier knows or should know is likely to use the chattel in a way

66. *See id.* § 2A-407.

67. *Sheppard*, slip op. at 7.

68. *Id.* at 4; *see also* 735 Ill. Comp. Stat. Ann. 5/2-406 (West 1982) (providing that "a defendant may by third-party complaint bring in as a defendant a person not a party to the action who is or may be liable to him or her for all or part of the plaintiff's claim against him or her"). The third-party defendant argued that its liability for not delivering the decompression table was not derivative of the defendant's liability to the plaintiff for its breach of the lease agreement. *Sheppard*, slip op. at 4.

69. *Sheppard*, slip op. at 8.

70. *Id.*

71. 49 U.S.C. § 30106(a) (2012) ("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).").

72. *See, e.g.*, Shew v. Hill, No. 4:13-CV-420-VEH, 2013 WL 5290005, at *3 (N.D. Ala. Sept. 18, 2013) (holding that, while the Graves Amendment preempts state vicarious liability laws respecting motor vehicle lessors, it contains a savings clause permitting direct negligence actions).

73. No. CIV-12-853-C, 2015 WL 105971 (W.D. Okla. Jan. 7, 2015).

dangerous and likely to cause harm to others.'"[74] The court ultimately concluded that the plaintiff had not, in fact, satisfied the requirements of negligent entrustment and thus granted summary judgment on this issue in favor of the defendant lessor.[75]

In several other recent cases, the respective courts specifically held that summary judgment was indeed appropriate in favor of motor vehicle lessors when the Graves Amendment was found to be applicable.[76] For example, in *Eisenberg v. Cope Bestway Express, Inc.*,[77] the court determined that the plaintiff had not even alleged negligence on the part of the defendant. The court held that

> [the defendant] established that the Graves Amendment applied to shield them from liability by demonstrating the absence of any material issues of fact with respect to whether they were commercial lessors of motor vehicles, that they had in fact leased the subject chassis to [their co-defendants] pursuant to a user equipment agreement at the time of the accident, that the chassis qualifies as a motor vehicle under the Graves Amendment, and that there are no allegations of direct negligence against them.[78]

The court held that the "[defendants] established their *prima facie entitlement to judgment as a matter of law* by demonstrating that they were not vicariously liable for the negligence of the driver in connection with the subject accident."[79]

Similarly, in *Gachlin v. Coastal International Trucks, LLC*,[80] the court held that

> it is apparent from the allegations in the complaint that the plaintiff seeks to hold [defendant lessor] vicariously liable for the alleged negligence of [the lessee's driver], who was operating the vehicle at the time of the accident. The plaintiff has not alleged any negligence or criminal wrongdoing by [defendant lessor]. Accordingly, the plaintiff's action against [defendant lessor] is precluded by the Graves Amendment, and [defendant lessor] is entitled to summary judgment.[81]

A somewhat atypical variation of a case involving damages for personal injury caused by a motor vehicle is illustrated in *Houston v. McNeilus Truck & Manufacturing, Inc.*[82] In this case, the Graves Amendment was not invoked; instead, the case addressed the issue of whether

74. *Id.* at *5 (citing Pierce v. Okla. Prop. & Cas. Ins. Co., 901 P.2d. 819, 823 (Okla. Super. Ct. 1995)).

75. *Id.*

76. *See* Gachlin v. Coastal Int'l Trucks, LLC, No. FSTCV146022985S, 2015 WL 1500547, at *3 (Conn. Super. Ct. Mar. 10, 2015) (setting forth the requirements of the Graves Amendment: "(1) the action must have commenced on or after August 10, 2005; (2) the owner of the vehicle must be engaged in the trade or business of renting or leasing motor vehicles; and (3) there is no negligence or criminal wrongdoing on the part of the vehicle owner." (citing Davis v. ELRAC, LLC, No. CV136037866S, 2014 WL 5394924 (Conn. Super. Ct. Sept. 26, 2014))).

77. 17 N.Y.S.3d 457 (App. Div. 2015).

78. *Id.* at 460.

79. *Id.* (emphasis added).

80. *Gachlin*, 2015 WL 1500547.

81. *Id.* at *3.

82. 999 N.Y.S. 2d 284 (App. Div. 2015).

> [the defendant lessor], "'*by its agents,* servants and/or employees,'" was negligent in, inter alia, failing to inspect the garbage truck for any defects before leasing it; failing to place a warning or notice of dangerous condition on the garbage truck; failing to inspect the garbage truck to determine if all mechanical equipment and devices were safe and functioning properly; and failing to inspect the garbage truck as to the proper method for using the cable winch.[83]

The court held that "as a general matter, a finance lessor . . . that never possesses a product due to its direct shipment to the lessee—and thus has no ability to inspect the product for defects—may not be held liable in negligence for failure to inspect or warn of a dangerous condition."[84]

It is noteworthy that although the majority of the appellate panel in this case affirmed the lower court's denial of the lessor's summary judgment motion due to the existence of factual issues regarding whether the lessee (an affiliate of the lessor) had actually been appointed as the lessor's agent to inspect the vehicle, a strongly worded dissenting opinion would have granted the lessor's summary judgment motion because "[the defendant lessor] submitted evidence establishing that [the defendant lessee] arranged to purchase the item, a garbage truck, directly from the manufacturer, and that [the defendant lessor] never possessed the vehicle."[85] The dissenting opinion also noted that the plaintiff did not, in fact, raise the agency argument in the "motion court."[86]

End-of-Lease Options

In *Mid-Missouri Spray Service, Inc. v. South Delta Aviation, Inc.*,[87] the court addressed a novel end-of-lease variation regarding the defendant lessor's alleged repudiation of the plaintiff lessee's purchase option under an aircraft (a crop duster) lease. The lessee brought suit claiming that the lessor failed to consummate the sale relating to the lessee's lease-end purchase option. The parties disputed whether the lessee had, in fact, given the required thirty-day prior written notice to the lessor. The lessor took the position that even if the lessee had given such notice, the lessee was not financially able to pay the purchase price and thus suffered no recoverable damages. Rather than addressing whether proper notice had been given by the lessee, the court found that it was clear from the evidence at hand that the lessee could not, in fact, have purchased the aircraft without a loan and that the loan proceeds were not available at the applicable time of purchase.[88] Notwithstanding that the Arkansas Supreme Court had not yet addressed the issue, the court cited the *Restatement (Second) of Contracts* and granted the lessor's summary judgment motion, finding that "[b]ecause there's insufficient evidence to create a jury question on whether [the lessee]

83. *Id.* at 285–86 (emphasis added).
84. *Id.* at 285.
85. *Id.* at 287 (Smith, J.P. & Lindley, J., dissenting).
86. *Id.*
87. No. 2:13-cv-150-DPM, 2015 WL 3828246 (E.D. Ark. June 19, 2015).
88. *Id.* at *3.

could have closed the deal in [the required applicable time frame], [the lessee] cannot recover for [the lessor's] (assumed) repudiation of the option to buy the airplane."[89]

Thomas Energy Corp. v. Caterpillar Financial Services Corp.[90] involves a case in which the plaintiff lessee, due to a business downturn, requested that the defendant lessor modify the underlying equipment leases to allow the lessee to miss payments and to return the equipment early. The lessee claimed that the lessor verbally agreed to allow the missed payments and early equipment return but then reneged on the deal. The trial court granted summary judgment in favor of the lessor. The court found that the lease "clearly set forth the procedure for the return of the equipment."[91] The court found that "[p]laintiff failed to establish that it had reached an agreement with [d]efendant to return the leased equipment . . . [and] that even if the parties had reached an oral agreement, the alleged agreement . . . was void because it was not reduced to writing as required by the terms of the lease agreements.[92] The appellate court concurred with the trial court's decision to grant a motion for directed verdict because there was no signed agreement amending the leases.[93] Thus, the court left the end-of-term lease provisions regarding return of the equipment as specified in the lease agreements.

In *Pacific Space Design Corp. v. PNC Equipment Finance, LLC*,[94] the court took a somewhat surprising view of a case involving an automatic renewal clause. In this case, the lessee entered into a sixty-month equipment lease with a lessor which gave the lessee three options at lease end: (i) to purchase the equipment with a fixed-price purchase option; (ii) to return the equipment and terminate the lease; or (iii) to do nothing, which would result in an automatic renewal for an additional twelve-month period and successive one-month terms thereafter. The lessee did nothing, and the lease automatically renewed according to its terms. Payments were made via automatic withdrawals from the lessee's bank. The lessee made thirty-four payments following the initial lease term, at which point the lessee brought suit to recover the alleged "overpayments." The court held that "the language of the Agreement pertaining to termination of the lease is unambiguous."[95] The court further held that

> pursuant to the plain terms of the agreement, the lease automatically renewed until [the lessee] took the necessary steps to terminate it . . . . [The lessee's] own failure to take the steps required under the Agreement to terminate the Agreement, even if due to neglect or inadvertence, does not equate to a breach of contract on the part of [the lessor].[96]

89. *Id.* at *3 (citing Restatement (Second) of Contracts § 254 (1) & cmt. a. (1981)).
90. No. E2014-00226-COA-R3-CV, 2014 WL 7366676 (Tenn. Ct. App. Dec. 26, 2014).
91. *Id.* at *7.
92. *Id.* at *8.
93. *Id.*
94. No. 1:13-cv-00460, 2014 WL 6603288 (S.D. Ohio Nov. 19, 2014).
95. *Id.* at *4.
96. *Id.*

The court also concluded that collecting the automatic renewal payments did not result in unjust enrichment, holding that "[the lessee] cannot assert a claim that [the lessor] was unjustly enriched by alleging that [the lessor] received payments in accordance with terms of an agreement for which both parties contracted and of which both parties had knowledge."[97] Finally, and also surprisingly, the court noted that whether the lease was a true lease under the U.C.C. or a conditional sales contract would not "alter the plain language of the contract."[98]

Remedies/Lessors' Damages

In *BA Jacobs Flight Services LLC v. Rutair Limited*,[99] a lessee failed to pay its rent payments in full and on time, and the lessor exercised its repossession remedy after deeming that the lessee's partial payments constituted an event of default under the applicable provisions of the lease. The facts of the case were undisputed, and the pertinent default trigger and remedy provisions were similar to those found in many modern lease forms. Nonetheless, the lessee challenged both the lessor's reliance on the default trigger and its manner of enforcement, based on literal interpretations of the pertinent lease provisions.[100] The court was, appropriately, unimpressed and unconvinced.

The dispute involved Rutair Limited, the lessee under an aircraft lease from BA Jacobs Flight Services LLC, the lessor. Pursuant to the lease, the lessee agreed to pay sixty consecutive monthly rental payments, each in the amount of $25,000, to the lessor. The first monthly rent payment was payable by the lessee to the lessor upon delivery of the aircraft, and the remaining fifty-nine rental payments were due on the first day of each succeeding month. Failure by the lessee to pay a rent payment on a due date entitled the lessor to demand that the lessee pay a late payment fee on the delinquent payment.

At the signing of the lease, the lessee was required to pay the lessor the first rental payment, a $75,000 security deposit, and the cost of any fees associated with the delivery of the aircraft. The lease was executed December 1, 2011, after which the lessee made several installment payments to cover the security deposit. The aircraft was delivered December 25, 2010. The additional monthly rental payments following delivery began January 1, 2011. The lessee made a payment of $35,000 on January 12, 2011, of which $27,684 went to the cost of delivery and the remaining $7,316 was applied to the January 1, 2011, rental payment. Thereafter, the lessee made the following payments to the lessor; $4,000 on January 21, 2011; $6,000 on January 25, 2011; $25,000 on February 10, 2011; $9,000 on February 27, 2011; and $11,000 on March 20, 2011. The lessor repossessed the aircraft on April 2, 2011, pursuant to a provision in the lease entitling the lessor to exercise its repossession remedy if the "[l]essee fails to make any payment of rent or other charges within 30 days after such

97. *Id.* at *6.
98. *Id.* at *5.
99. No. 12 C 2625, 2015 WL 360758 (N.D. Ill. Jan. 27, 2015).
100. *See id.*

amounts are due and payable."[101] The lessee argued that the lessor wrongfully repossessed the aircraft based on the lessee's interpretation of the pertinent default and remedy provisions of the lease.[102]

The lessee's first argument was that it was not in default under the lease because a nonpayment default would occur pursuant to the pertinent lease provision only if the lessee failed to "make *any* payment of rent" within the proscribed period, and that the lessee had actually made *some* payments of rent each month.[103] The lessee contended that the referenced default trigger was ambiguous because it was unclear whether it meant "a failure to make the entire payment within 30 days" or "failure to make some payment within 30 days," and offered parol evidence that the lessee's managing director believed that these partial payments would not constitute a lease default.[104]

The court was not persuaded by the lessee's ambiguity argument, and it found as a matter of law that Rutair breached the lease.[105] Not surprisingly, the court determined that the lessee's interpretation of the word "any' in the context of the whole lease was not a reasonable interpretation, when reading the nonpayment default trigger in the context of the rest of the lease and construing it as a whole.[106] As the court noted, this interpretation was not commercially reasonable because it would mean that the lessee "could pay $1.00 on the first of each month and never be in default,"[107] which would clearly conflict with the rent provision requiring sixty payments of $25,000 over the lease term.[108] "Construing the [l]ease as a whole," the court found the full rent payment of $25,000 was due on the first of each month, and the lessee's failure to make full rental payments on the first of each month was a breach under the lease.[109]

The lessee's other argument regarding the enforceability of the lessor's repossession remedy focused on the text of the repossession remedy provisions in the lease. The lease provided that the lessor had the right to repossess the aircraft without demand or notice if the lessee failed to "make *any* payment of rent" within thirty days after the due date for such rent payment, "or if Lessee [committed] an Event of Default" as defined in the lease.[110] Actions considered "Events of Default" would include failure to pay the full amount of the rent when due, as discussed above, but the lease also afforded the lessee an opportunity to cure an Event of Default by paying the subject overdue amount within fifteen days of receiving the lessor's default notice.[111]

101. *Id.* at *4–5.
102. *Id.* at *5.
103. *Id.* (emphasis added).
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.* at *6.
109. *Id.*
110. *Id.* (emphasis added).
111. *Id.*

The lessee argued that the repossession was wrongful because the lessor failed to provide notices to the lessee regarding the various nonpayment defaults, and as a result did not afford the lessee an opportunity to cure those defaults and avoid the repossession.[112] The court determined that the lessor's repossession remedy could be exercised, alternatively, so that it could either wait for the thirty-day nonpayment period to expire and repossess without notice or expedite the repossession process by giving the lessee prompt notice of its nonpayment default and waiting for the fifteen-day period to expire.[113] The lessor elected to rely on the thirty-day repossession trigger and had no obligation to the lessee or the guarantor to provide notice or afford either of them additional time to make the delinquent payments before the lessor could repossess the aircraft. Although the lessor did provide delinquency notices to the lessee, the notices were not made in furtherance of the fifteen-day repossession trigger, and the court found that the adequacy of the notices or the fact of their having been sent by the lessor did not limit the lessor's reliance on the thirty-day nonpayment repossession trigger.[114] Based on this determination, and having dismissed the lessee's other ambiguity argument, the court held that the lessor was entitled to summary judgment in favor of the lessee's liability under the lease.[115]

112. *Id.*
113. *Id.* at *7.
114. *Id.*
115. *Id.* at *7–8.