Leases

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Case Law Developments

This survey covers several 2019 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, vicarious liability of a lessor, issues relating to forum selection clauses, the rights of assignees of interests under a lease, and issues surrounding certainty of payment, such as hell-or-high-water clauses.

True Leasing Cases

The characterization of a purported lease as creating either a true "lease" or a security interest is commonly litigated in bankruptcy matters, enforcement cases, and priority disputes. As demonstrated in the cases summarized below, the characterization of the underlying agreements may have significant implications to the purported lessor's recovery of its investment by payment of the periodic or accelerated amounts or recovery of the related equipment.

The bankruptcy court in *In re Green Parts International, Inc.*[1] was asked to consider whether an "Equipment Lease Contract" (the "Lease") between Green Parts International, Inc., the lessee/debtor ("Green Parts"), and Conserv Equipment Leasing, LLC, the lessor ("Conserv"), created a true lease or a security interest in connection with Conserv's motion for relief from the automatic stay under sections

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1. Conserv Equip. Leasing, LLC v. Green Parts Int'l, Inc. (*In re* Green Parts Int'l, Inc.), No. 19-53617-PMB, 2019 WL 3713691 (Bankr. N.D. Ga. Aug. 6, 2019).

362(d)(1) and (d)(2) of the Bankruptcy Code (the "362 Motion") so that it could exercise its repossession and other default remedies under the Lease. Green Parts argued that the Lease was a "disguised security agreement" under Tennessee's version of U.C.C. section 1-203.[2] As Conserv failed to perfect its security interest in the equipment, Green Parts asserted it held only an unsecured claim which may be avoided pursuant to Green Parts' "strong arm" powers under section 544(a) of the Bankruptcy Code and, accordingly, the 362 Motion should be denied.[3]

Green Parts asserted that the Lease failed both the "bright-line" and "economic realities" tests,[4] because it had a bargain purchase option. Although the only purchase option expressly provided in the Lease was an option to purchase the equipment at lease expiration for fair market value ("FMV"), Green Parts relied on a letter from Conserv stating that the equipment could be purchased at the end of the lease for $3,250.[5] Green Parts argued that the letter modified the purchase option in the Lease and, in any event, was evidence of what the parties assumed would be the FMV at lease expiration. In either context, Green Parts asserted that $3,250 was nominal relative to the original purchase price of the equipment ($65,000) and the aggregate rentals payable before Green Parts could exercise the option ($82,868.50).[6]

However, the court rightly held the letter to be inadmissible because (i) the Lease contained a provision that its express terms, including an FMV purchase option,[7] could only be altered by mutual written agreement, and (ii) the parol evidence rule prohibits the use of pre-contract negotiations within the scope of the contract.[8] The court addressed Green Parts' nominal consideration argument by noting that "use of [the term 'FMV'] results in an inference that the consideration to be paid for an associated purchase by a lessee is not nominal, though this inference may be rebutted."[9] Also, Green Parts failed to support its nominal consideration argument by presenting any evidence that the useful life of the equipment would not extend beyond the Lease term.[10] Because Green Parts did not present any admissible evidence that the Lease failed either the bright-line test or the economic realities test, the court held that the Lease was a true lease and granted Conserv's 362 Motion so that Conserv could exercise its rights against the leased equipment.[11]

2. TENN. CODE ANN. § 47-1-203 (Supp. 2018); *see also* U.C.C. § 1-203 (2011).

3. *In re Green Parts Int'l, Inc.*, 2019 WL 3713691, at *2–3.

4. *See* TENN. CODE ANN. § 47-1-203(b)–(e) (Supp. 2018) (codifying what are known as the "bright line" and "economic realities" tests); *see also* U.C.C. § 1-203(b)–(e) (2011) (same).

5. *In re Green Parts Int'l, Inc.*, 2019 WL 3713691, at *1.

6. *Id.* at *2.

7. *Id.* at *1 & n.3 (defining "Fair Market Value" as "an amount [Conserv] reasonably estimate[s] to be the price a willing buyer . . . would pay for such Equipment in an arm's-length transaction to a willing seller").

8. *Id.* at *4. The letter's inadmissibility was further supported by the Lease's merger clause, which precluded any modification by terms not expressly included in the Lease. *Id.*

9. *Id.* at *5 (citing Jahn v. M.W. Kelloff Co. (*In re* Celeryvale Transp., Inc.), 822 F.2d 16, 18 (6th Cir. 1987)).

10. *Id.*

11. *Id.*

In re McQuaig,[12] which was another bankruptcy court decision involving the lease characterization issue, resolved an objection by Cardinal Group, LLC, a rental company ("Cardinal"), to the confirmation of a Chapter 13 bankruptcy plan by Beth A. McQuaig (the "Debtor"). Cardinal and the Debtor were parties to a "lease-purchase agreement" (the "Agreement") relating to a portable lofted barn. Cardinal objected to the Debtor's Chapter 13 plan because it treated the Agreement as creating a security interest, when it should have been treated as a lease, requiring her to assume or reject the lease under section 365 of the Bankruptcy Code as a condition to the confirmation of her Chapter 13 plan.

The court performed its analysis under the bright-line test codified in the U.C.C. as adopted in the state of Kentucky.[13] The Debtor argued that the Agreement created a security interest because it was a non-cancellable lease for a term approximating the useful life of the equipment, and provided for ownership to transfer to the Debtor at expiration of that term, and therefore failed the bright-line test under U.C.C. section 1-203(b). The central fact at issue was whether the Debtor was required to lease the equipment for forty-eight consecutive months and become the owner upon expiration of that forty-eight month term or, instead, could decide on a month-to-month basis whether to continue to lease the equipment or to return it to Cardinal.[14] The Debtor's argument was based on the form, not the substance, of the Agreement because it was headed "48 Month Lease Agreement" (although subtitled "(Month to Month)"), and also included a reference to "48 Month Purchase Agreement & Disclosure Statement."[15] Despite any confusion resulting from the headings, the court concluded that the month-to-month nature of the term was unambiguous under the Agreement because it expressly defined the word "Term" as a period of one month, and permitted the Debtor to either renew "for consecutive Terms of one month," or terminate the Agreement by returning the equipment upon the expiration of "any Term."[16]

Because the Debtor could terminate the Agreement and return the property after any month without penalty, she would have to renew and comply with the Agreement dozens of times before paying rents in an aggregate amount equal to the total cost of the equipment.[17] Accordingly, the court held that

12. Cardinal Grp., LLC v. McQuaig (*In re* McQuaig), No. 18-20259, 2019 WL 1470891 (Bankr. S.D. Ga. Mar. 28, 2019).

13. *See* Ky. Rev. Stat. Ann. § 355.1-203(2) (LexisNexis 2019) (stating that, if a debtor has no early termination right and any of "(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 additional consideration upon compliance with the lease agreement; or (d) The lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement," then, under the U.C.C., the lease would instead be characterized as a security agreement); *see also* U.C.C. § 1-203(b)(1)–(4) (2011) (virtually same).

14. *In re McQuaig*, 2019 WL 1470891, at *3.

15. *Id.* at *1, *4 (quoting the Agreement).

16. *Id.* at *4 (quoting the Agreement).

17. *Id.* at *5.

the Agreement was a true lease under U.C.C. section 1-203 and had to be assumed or rejected by the Debtor.[18]

Although the essential commercial terms in these two cases were clearly consistent with true lease characterization facts,[19] a sophisticated debtor's counsel in a bankruptcy case is likely to identify any perceived vulnerabilities in a lessor's claim, including as to characterization, if they can be leveraged to reduce or avoid the claim. The lessors in these cases ultimately prevailed because the pertinent provisions of the underlying lease documents (i.e., the integration clause in *Green Parts* and the monthly termination option in *McQuaig*) sufficiently addressed the basis for the debtor's challenges in each case. Because true lease characterization is so often critical to a lessor's rights and remedies in a lessee's bankruptcy case, lessees are likely to challenge that characterization, so the obvious take-away from the above cases is that carefully drafted lease documents both as to the pertinent economic terms and the boilerplate should promote favorable results for lessors.

Lessor's Damages

Lessors recognize that there are a number of meaningful risks associated with investing in large, expensive leased assets, especially those in specialty asset classes, such as helicopters. Certain of those risks are less susceptible to the lessor's control, including a significant deterioration of either the lessee's creditworthiness during the lease term, or market conditions associated with the leased asset upon lease expiry. Although there are some risks that lessors may limit or mitigate by prudent documentation and enforcement practices, recovery may still be thwarted by court decisions that sometimes seem more result-oriented than judicious.

In *Huntington National Bank v. Bristow U.S. LLC*,[20] the court found the lease documents and lessor's enforcement actions to be insufficient to support the lessor's motion for summary judgment for holdover rent and other damages claims related to the lessee's alleged failure to comply with certain of the return requirements in a lease. After the return of a leased helicopter, Huntington National Bank ("HNB"), the lessor (by assignment from the original lessor), and Bristow U.S. LLC ("Bristow"), the lessee, filed summary judgment claims against each other.[21] HNB claimed that Bristow had not complied with the lease's Return Addendum requirement to enroll the helicopter's engines in an engine maintenance program.[22] The Return Addendum required Bristow to:

18. *Id.*

19. In *In re Green Parts International*, the lessee had an option at lease expiration to purchase equipment having a meaningful residual value for a price equal to its then fair market value; and in *In re McQuaig*, the lease term was cancellable by lessee at any time during the term. *See id.* at *1; Conserv. Equip. Leasing, LLC v. Green Parts Int'l, Inc. (*In re* Green Parts Int'l, Inc.), No. 19–53617-PM13, 2019 WL 3713691, at *4–5 (Bankr. N.D. Ga. Aug. 6, 2019).

20. Huntington Nat'l Bank v. Bristow U.S. LLC, No. 17 Civ. 8595 (ER), 2019 WL 1004218 (S.D.N.Y. Mar. 1, 2019).

21. *Id.* at *1.

22. *Id.* at *2.

> (1) *assign* its rights under its current "Engine Maintenance Program" with General Electric Company ("GE") to HNB; (2) "*arrange*," at no cost to HNB, for the Engines' "eligibility" in a comparable Engine Maintenance Program between HNB and GE; or (3) *pay* HNB an amount equal to the current estimated cost of causing the Engines' full enrollment in an Engine Management Program.[23]

The lease also required Bristow to return the helicopter to HNB "at a location specified by Lessor within the continental U.S." in the condition required by the lease.[24]

In August 2016, well before the January 5, 2017, lease expiration date, Bristow informed HNB that it would not be purchasing the helicopter and would return it at expiration.[25] HNB did not respond until January 26, 2017, after the scheduled expiration date, then noting that there were issues to be addressed prior to the helicopter's return.[26] On February 16, 2017, HNB notified Bristow that "it had contacted GE to discuss the Engines' enrollment in a new GE maintenance and service contract" but that the GE agreement offered was "not responsive to the requirements of HNB or the return conditions of the Lease."[27] On March 9, 2017, HNB informed Bristow that the redelivery location was the RSG facility at Meacham International Airport in Fort Worth, Texas, and "that it was prepared to send a pilot to Bristow's facility in Angleton, Texas, on March 13, 2017, to conduct an end-of-lease evaluation flight."[28] Bristow sent HNB a letter agreement to extend the helicopter's coverage under its own GE Engine Maintenance Program for an additional sixty days which Bristow believed would allow HNB to complete its own arrangements with GE.[29] On March 13, 2017, HNB did not send a pilot to Angleton and did not specify another return date or location, but instead later proposed a new arrangement by which Bristow would continue to maintain the helicopter while HNB attempted to remarket it.[30] This was not acceptable to Bristow, and after more letters, Bristow returned the helicopter to HNB on August 4, 2017.[31]

Bristow asserted counterclaims against HNB for breach of contract, breach of the implied covenant of good faith and fair dealing, unjust enrichment, and declaratory judgment.[32] Bristow supported its claims by arguing that HNB sought to delay the return of the helicopter with the hope that the market conditions for that helicopter type might ultimately improve.

The court denied both parties' respective motions for summary judgment, citing that there were material issues of fact concerning both parties'

23. *Id.* (footnote omitted) (quoting the Lease).
24. *Id.* (quoting the Lease).
25. *Id.* at *2, *3.
26. *Id.* at *4.
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.* at *5.
31. *Id.*
32. *Id.*

performance.[33] The court noted that the pertinent terms of the Return Addendum were not sufficiently clear as to how the lessee was to fulfill its obligations,[34] including the meaning of the obligation to "arrange to have the Engines eligible" for enrollment in an engine maintenance program[35] and whether compliance was required prior to redelivery.[36] Additionally, it was not clear that HNB had "fully performed its obligation under the Lease to designate a time and place for return."[37]

The circumstances of this case might not be all that uncommon. The return requirements associated with transportation assets are often so technical in their nature that lessors may rely on asset managers and other technical experts to draft or contribute to the language of the contract. In that case, although certain requirements may be addressed with technical precision, the effectiveness of those provisions might be undermined by lack of drafting clarity or failure to provide for adequate remedies for noncompliance. If lessor's counsel manages the drafting process, he or she may defer to the technical advisors, and be disinclined to edit or meaningfully revise these specialized provisions. Other drafting inadequacies may also occur when a lessor has a less sophisticated understanding of the asset or the lessee's intended use, and merely repeats the return provisions from another lease involving an asset that is not sufficiently similar to the leased asset.

Perhaps the most noteworthy equipment leasing case decided in 2019 was *In re Republic Airways Holdings Inc*.[38] because it relates to a published decision by the U.S. Bankruptcy Court for the Southern District New York interpreting the commercial laws of the State of New York with respect to issues that are common to true leases of any asset type. In that case, Republic Airlines ("Republic")[39] entered into seven aircraft sale-leaseback transactions with Wells Fargo Bank Northwest, N.A., as owner trustee (the "Lessor").[40] Republic filed Chapter 11 many years later and rejected the leases, Lessor filed proofs of claim aggregating over $55 million relating to the leases and guarantees for alleged damages arising from Republic having rejected the leases, and Republic filed objections to Lessor's claims, arguing that the actual lease-rejection losses were "readily calculable" and aggregated only $5.7 million.[41]

Each lease's liquidated damage formula included a negotiated stipulated loss value ("SLV") for each aircraft, correlating to each month of the lease term and set out in schedules to each of the leases.[42] Upon expiration of the term, "the SLV equal[ed] the residual value that Lessor needs to realize from the

33. *Id*. at *9–10.
34. *Id*. at *10.
35. *Id*.
36. *See id*. at *7–10.
37. *Id*. at *9.
38. *In re* Repub. Airways Holdings, Inc., 598 B.R. 118 (Bankr. S.D.N.Y. 2019).
39. The original leases were entered into by Chautauqua Airlines, Inc. *Id*. at 121–22. Republic guaranteed Chautauqua's obligations under the leases pursuant to a guarantee. *Id*. at 122–23.
40. *Id*. at 121.
41. *Id*. at 127.
42. *Id*. at 125 (noting that "the SLVs adjust on a month-to-month basis such that, after accounting for monthly payments of basic rent and tax benefits, they are always equal to the amount that provides the Lessor with a four percent return on the Aircraft purchase").

Aircraft for its four percent return."[43] The aircraft's actual value at the time of Republic's lease rejection was significantly less than the parties had anticipated at lease formation and as reflected in the leases' SLV liquidated damages formulas. The actual value at lease rejection was relevant to the ultimate liquidated damages amount, because the net sales proceeds were to be applied as a credit against Republic's obligation to pay the SLV-based portion of the liquidated damages amount.

The court found that "the liquidated damages provisions in these leases are unenforceable because they violate [the requirements of] Article 2A [of the U.C.C.] that they be reasonable in light of the then-anticipated harm from default."[44] According to the court, the large disparity between the remaining rent amount and the corresponding SLV amount in the liquidated damages formulas evidenced the failure to satisfy the "reasonableness" requirement of U.C.C. section 2A-504.[45] Republic argued, and the court agreed, that the SLV-based liquidated damages formulas inequitably allocated to Republic the risk that the market value of the leased aircraft, and consequently the actual net sale proceeds to be applied as a credit, might significantly decline during the terms of the leases.[46]

The court noted that, although SLV-based acceleration formulas may be enforceable for insurance purposes and as value protection under an early termination or other similar option, they are not necessarily enforceable in the context of liquidated damages because of the statutory reasonableness requirement.[47] The court's holding was surprising because it relied on pre-U.C.C. Article 2A case law regarding liquidated damages, and ignored the official comments to U.C.C. section 2A-504, which specifically recognize the common industry practice of relying on SLV-based liquidated damages formulas to calculate acceleration damages in lease transactions.[48] Further, the court deemed the allocation of value-decline risk to be sufficiently unreasonable to be against public policy, even though it was in the context of a contractual promise by a sophisticated lessee, represented by experienced counsel, to pay the negotiated damages amount as one of many economic terms, and was supported by an appraisal provided at

43. *Id.* The court found it significant that "the liquidated damages clauses and the Schedule SLVs in the Amended Leases are identical to those in the Original Leases—notwithstanding the previous rent payments made and the reduction in the residual value of the Aircraft between the Original Leases and the Amended Leases." *Id.*

44. *Id.* at 121. References in the opinion to the U.C.C. referred to a version of the Code as then adopted in the State of New York. The court relied on the New York U.C.C. and other commercial laws of the State of New York when considering the pertinent enforcement issues, consistent with the stipulation by the parties included in the boilerplate of the related leases. *Id.* at 129–50 (citing N.Y. U.C.C. LAW §§ 2-A-103, 2-A-407, 2-A-504 (Consol. 2016)).

45. *Id.* at 121; *see also* N.Y. U.C.C. LAW § 2-A-504 (Consol. 2016) ("Damages . . . may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in the light of the then anticipated harm caused by the default . . . .").

46. *In re Republic*, 598 B.R. at 136–37.

47. *Id.* at 138.

48. *Id.* at 129–31; U.C.C. § 2-A-504 cmt. (2011); *see also* N.Y. U.C.C. LAW § 2-A-504 cmt. (Consol. 2016).

lease inception relied upon by both Republic and the Lessor.[49] As noted later in this survey,[50] the court also refused to enforce the guarantor's obligation to pay the claimed liquidated damages amounts, based on the court's public policy determination, despite the guarantor's contractual promise to unconditionally guaranty Republic's payment of all amounts payable under the Leases, irrespective of any such defense.[51]

The *Republic* case could encourage debtors in bankruptcy and defaulting lessees outside of bankruptcy to challenge SLV liquidated damages provisions where there is a large disparity between the anticipated residual value at lease formation and the actual sale or rental proceeds after a lessee's default.

Lessors need not abandon their reliance on these formulas because, as noted above, they are consistent with U.C.C. section 2A-504.[52] However, lessors should focus on those aspects of any formula that could be scrutinized if challenged in an enforcement or bankruptcy case. The formula should reflect the economics that have been mutually agreed upon by the parties. Fundamentally, the damages amount should be consistent with the lessor achieving the benefit of its negotiated bargain throughout the lease term to no lesser extent than would have been the case if the lease was not earlier canceled. The formula should not be constructed in a manner such that, at lease commencement, the lessor would likely receive an amount that would constitute a windfall.

If an SLV-based formula is included, the SLV amount should take into account the lessor's economic expectations, which are likely to include the lessor's recovering the purchase price it advanced, its anticipated yield on that investment, any loss of assumed tax benefits, and some prepayment charge. If the formula includes the accelerated remaining rent, it should be discounted to present value as of the date of determination using a reasonable discount rate. If the formula also includes the anticipated residual value of the equipment at lease expiration, that component should also be discounted at a reasonable discount date.[53] Most importantly, the lessor should not be entitled both to demand the formula amount and also to recover possession of the equipment without a mitigation credit to be applied against the lessee's damages obligation. It would be advisable if the calculation of the mitigation amount is aligned with the calculation of the damages amount.

49. *In re Republic*, 598 B.R. at 132, 138–40.

50. *See infra* notes 117–27 and accompanying text.

51. *In re Republic*, 598 B.R. at 143–48.

52. For a more detailed analysis of this case, its implications and related practice tips, see Arlene N. Gelman & Edward K. Gross, *A Valentine's Day Massacre of Liquidated Damages: In re* Republic Airways Holdings Inc., J. EQUIP. LEASE FIN., Spring 2019, at 1.

53. U.C.C. § 2A-103(1)(u) (2011) (defining "present value" as "the amount as of a date certain of one or more sums payable in the future, discounted to the date certain[, where t]he discount is determined by the interest rate specified by the parties if the rate was not manifestly unreasonable at the time the transaction was entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into").

Accordingly, if the formula includes the present value of the accelerated remaining rent, the mitigation amount should also be comprised of the present value of the remaining rent under an actual or prospective re-lease of the equipment having similar terms to the canceled lease during a coterminous period.[54] If the formula includes the anticipated lease expiry residual value, the mitigation amount should include the sales proceeds or a market sales value of the equipment. If actually sold, the sales proceeds applied should be net of the disposition costs, sales, and other related reductions from the amounts received by the lessor in connection with the sale. If the equipment is not actually sold, the market value should take into account the actual condition of the equipment; the likely disposition costs, taxes, and other charges; and the date on which the equipment might be available for a sale.

In addition to a carefully drafted liquidated damages formula, any lease form should include an acknowledgment or other assurance by the lessee supporting the enforceability of that formula. It might also be useful for a lease form to include an acknowledgment by the lessee that the lessor may avail itself of alternative acceleration remedies, either detailed in the lease or otherwise available to the lessor under U.C.C. Article 2A, in the event that a court is unwilling to enforce the liquidated damages formula agreed to by the parties and set forth in the lease.

Vicarious Liability

Escobar v. Nevada Helicopter Leasing, LLC[55] involved the widow of a deceased helicopter pilot who sued the owner/lessor of the helicopter, Nevada Helicopter Leasing, LLC, relating to the helicopter crash that caused her husband's death. At issue was whether a federal limit[56] on liability for an aircraft's lessor, owner, or secured party preempted a state vicarious liability law. The lower court had held that "[plaintiff's] state claims were preempted by 49 U.S.C. § 44112, which at the time limited the liability of an aircraft's lessors, owners, and secured parties unless the aircraft was 'in the *actual possession or control* of the lessor, owner, or secured party.'"[57] The lower court concluded that "[defendant lessor] did not have 'actual possession or control' at the time of the crash."[58] The Ninth Circuit reversed "because a genuine dispute exists as to whether [defendant lessor] had

54. By "coterminous," we mean a term commencing on the date the equipment was released or available for release under a prospective re-lease, and expiring on the scheduled expiration date of the canceled lease.

55. 756 F. App'x 724 (9th Cir. 2019).

56. *See* 49 U.S.C. § 44112(b) (2018) ("A lessor, owner, or secured party is liable for personal injury, death, or property loss or damage only when a civil aircraft, aircraft engine, or propeller is in the actual possession or operational control of the lessor, owner, or secured party, and the personal injury, death, or property loss or damage occurs because of—(1) the aircraft, engine, or propeller; or (2) the flight of, or an object falling from, the aircraft, engine, or propeller.").

57. *Escobar*, 756 F. App'x at 725 (emphasis added by appellate court) (quoting 49 U.S.C. § 44112(b) (2012), *amended by* FAA Reauthorization Act of 2018, Pub. L. No. 115-254, § 514, 132 Stat. 3186, 3358).

58. *Id.*

'actual possession or control' of the aircraft."[59] In a significant footnote, the Ninth Circuit referenced a "statutory amendment [that] substituted the language 'actual possession or *operational* control,' for 'actual possession or control.'"[60] The court indicated that, "[u]pon remand, the district court should consider whether this amendment alters or merely clarifies the exception to liability and whether it has any effect on this case."[61]

O'Donnell v. Diaz[62] involved a plaintiff who was a passenger injured in a car accident who brought a state vicarious liability claim against the company that rented a car to the driver of the other vehicle. The court analyzed "whether 'negligent entrustment' remains a viable cause of action [in Texas] in light of the Graves Amendment."[63] The Graves Amendment[64] "preempt[s] state law in the area of vicarious liability for owners engaged in the business of renting or leasing motor vehicles."[65] The court noted that:

> Under Texas law, the elements of a negligent entrustment claim are: "(1) entrustment of a vehicle by the owner; (2) to an unlicensed, incompetent, or reckless driver; (3) that the owner knew or should have known to be unlicensed, incompetent, or reckless; (4) that the driver was negligent on the occasion in question; and (5) that the driver's negligence proximately caused the accident."[66]

The court recognized negligent entrustment as one of the exceptions for negligence permitted under the Graves Amendment.[67] However, the court nonetheless found that there was "a lack of evidence supporting [p]laintiff's negligent entrustment claim."[68]

Collins v. Auto Partners V, LLC[69] involved a plaintiff who was badly injured in an accident involving a car driven by an automobile dealership employee who brought his personal car to such dealership for service and was provided a loaner car. Plaintiff brought suit against the dealership alleging vicarious liability under Florida law,[70] and also against the driver of such loaner car. The court analyzed

59. *Id.*

60. *Id.* at 725 n.1 (emphasis added by appellate court) (quoting, in the first instance, 49 U.S.C. § 44112(b)).

61. *Id.*

62. No. 3:17-cv-1922-S, 2019 WL 1115715 (N.D. Tex. Mar. 11, 2019).

63. *Id.* at *2.

64. *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).").

65. *O'Donnell*, 2019 WL 1115715, at *2 (quoting Cates v. Hertz Corp., 347 F. App'x 2, 6 (5th Cir. 2009) (per curiam)).

66. *Id.* (quoting Williams v. Parker, 472 S.W.3d 467, 472 (Tex. App. 2015)).

67. *Id.*

68. *Id.* at *3.

69. 276 So. 3d 817 (Fla. Dist. Ct. App. 2019).

70. *See* FLA. STAT. § 324.021(9)(b)(2) (2019) ("The lessor, under an agreement to rent or lease a motor vehicle for a period of less than 1 year, shall be deemed the owner of the motor vehicle for the

whether a loaner car fits within the protections of the Graves Amendment. As a preliminary matter, the court held that "the Graves Amendment simply does not require a written rental agreement."[71] The court found that an automobile dealership employee who

> had taken his [personal] car in for service and was provided a short-term rental vehicle while his was being serviced . . . was not acting within the course and scope of his employment, and he was treated like any other customer who received the use of a rental car while the customer's vehicle was in the repair shop.[72]

The court concluded that a loaner car does fit within the protections of the Graves Amendment. The court held that the trial court was correct to enter summary judgment in favor of defendant auto dealership based on the Graves Amendment protections, which preempted Florida's vicarious liability law regarding dangerous instrumentalities.[73]

Favorite v. Sakovski[74] involved a suit by the wife of a truck driver killed when another truck driver, who had leased his truck from a rental company, crashed into plaintiff's husband's truck. This court also analyzed whether "negligent entrustment" was a form of negligence permitted under the Graves Amendment. The court held that "the Graves Amendment only applies if 'there is no negligence . . . on the part of the owner,'"[75] which would include negligent entrustment. The court noted that, "[t]o state a negligent entrustment claim, a plaintiff must allege that the defendant 'gave another express or implied permission to use or possess a dangerous article or instrumentality which [defendant] knew, or should have known, would likely be used in a manner involving an unreasonable risk of harm to others.'"[76] The court denied defendant lessor's motion to dismiss plaintiff's negligent entrustment claim because there were enough facts alleged in the complaint to constitute negligent entrustment.

Keiper v. Victor Valley Transit Authority[77] involved an accident between a tractor-trailer and a bus. The court analyzed whether the Graves Amendment applied to a claim under California's vicarious liability law,[78] which imposes

purpose of determining liability for the operation of the vehicle or the acts of the operator in connection therewith only up to $100,000 per person and up to $300,000 per incident for bodily injury and up to $50,000 for property damage. If the lessee or the operator of the motor vehicle is uninsured or has any insurance with limits less than $500,000 combined property damage and bodily injury liability, the lessor shall be liable for up to an additional $500,000 in economic damages only arising out of the use of the motor vehicle. The additional specified liability of the lessor for economic damages shall be reduced by amounts actually recovered from the lessee, from the operator, and from any insurance or self-insurance covering the lessee or operator. Nothing in this subparagraph shall be construed to affect the liability of the lessor for its own negligence.").

71. *Collins*, 276 So. 3d at 822.

72. *Id.*

73. *Id.*

74. No. 19 C 1597, 2019 WL 3857877 (N.D. Ill. Aug. 16, 2019).

75. *Id.* at *2 (quoting 49 U.S.C. § 30106(a)(2)).

76. *Id.* (quoting Evans v. Shannon, 776 N.E.2d 1184, 1190 (Ill. 2002)).

77. No. EDCV 15-703 JGB (SPx), 2019 WL 6703395 (C.D. Cal. July 30, 2019).

78. *See* CAL. VEH. CODE § 17150 (Deering 2019) ("Every owner of a motor vehicle is liable and responsible for death or injury to person or property resulting from a negligent or wrongful act or

"vicarious liab[ility] for injury to a person and property resulting from the negligence of someone who uses the vehicle with the owner's permission."[79] The plaintiff bus passengers argued that the defendant tractor-trailer lessors were independently negligent, and therefore not exempt under the Graves Amendment because they were "motor carriers" that were subject to the Federal Motor Carrier Safety Regulations[80] and negligently failed to have reflective tape on the vehicles at issue as required by such regulations. The court held that the plaintiffs had not provided any evidence that the defendants were "motor carriers" under such federal law and thus the regulations requiring that motor carriers arrange to have reflective tape on the trailer and tractor were not applicable.[81]

Forum Selection Clauses

Handoush v. Lease Finance Group, LLC[82] involved a California lessee, Zeaad Handoush, who entered into an equipment lease agreement with lessor, Lease Finance Group, LLC. The lease was governed by New York law and included a New York jurisdiction clause and a jury waiver. The court analyzed the enforceability of a jury waiver clause for a California lessee. Lessee, doing business in California, argued that "the forum selection clause impact[ed] his substantive rights under California law because it include[ed] a predispute waiver of the right to a jury trial and such a right is unwaivable, even voluntarily, under California law."[83] The court held that, "because the right to a jury trial in California is a fundamental right that may only be waived as prescribed by the [California] Legislature, courts cannot enforce predispute agreements to waive a jury trial."[84] The court concluded that lessee was therefore entitled to a jury trial in California.

One practical takeaway from the decision is for practitioners to consider deleting jury trial waiver clauses in template lease forms used in California while retaining the forum selection clause for a state other than California. It appears that, absent the jury waiver clause, this court might have enforced the forum selection clause.

Hewlett-Packard Financial Services Co. v. New Testament Baptist Church[85] involved a lease which contained a "permissive" (rather than mandatory) forum selection clause, which stated that "Lessor and Lessee consent to the jurisdiction of any

omission in the operation of the motor vehicle, in the business of the owner or otherwise, by any person using or operating the same with the permission, express or implied, of the owner.").

79. *Keiper*, 2019 WL 6703395, at *5.

80. *See* 49 C.F.R. § 393.11(a)(1) (2019) ("Table 1 specifies the requirements for lamps, reflective devices and associated equipment by the type of commercial motor vehicle. The diagrams in this section illustrate the position of the lamps, reflective devices and associated equipment specified in Table 1. All commercial motor vehicles manufactured on or after December 25, 1968, must, at a minimum, meet the applicable requirements of 49 CFR 571.108 (FMVSS No. 108) in effect at the time of manufacture of the vehicle. Commercial motor vehicles manufactured before December 25, 1968, must, at a minimum, meet the requirements of subpart B of part 393 in effect at the time of manufacture.").

81. *Keiper*, 2019 WL 6703395, at *5 (citing 49 C.F.R. § 390.5 (defining "motor carrier")).

82. 254 Cal. Rptr. 3d 461 (Ct. App. 2019).

83. *Id.* at 464.

84. *Id.* at 466 (citing Grafton Partners L.P. v. Super. Ct., 116 P.3d 479 (Cal. 2005)).

85. No. 2:18-CV-10230-MCA-SCM, 2019 WL 3800234 (D.N.J. Aug. 13, 2019).

local, state or Federal court located within the State of New Jersey and waive any objection relating to improper venue or forum non-conveniens to the conduct of any proceeding in any such court."[86] The court analyzed the implications of using a "permissive" forum selection clause. Lessor, Hewlett-Packard Financial Services Company, initially filed its collection action against lessee, New Testament Baptist Church, in Florida before voluntarily filing a dismissal without prejudice. Lessor then re-filed its action in New Jersey. Lessee filed a motion to transfer the case to the Southern District of Florida on the basis that lessor waived its right to invoke the forum selection clause (pointing to New Jersey) when it filed its original action in Florida.[87] The court held that the "forum selection clause is permissive rather than mandatory . . . [because] it permits litigation to occur in a particular forum but does not foreclose the possibility of the litigation occurring elsewhere."[88] The court held that such a clause "simply provides New Jersey as a place for filing and waives objection to that venue; it does not limit New Jersey to be the only forum."[89] The court held that "[t]he forum selection clause does not include language regarding waiver of the clause if there is a previous filing."[90] The court concluded that lessee "fail[ed] to provide any case law to provide the [c]ourt with a basis to find that [lessor] may now not [re-]file in any court in New Jersey."[91] The key takeaway is that the court found that lessor had not waived its ability to bring its suit in New Jersey simply by originally filing in Florida.

Brilliant DPI, Inc. v. Konica Minolta Business Solutions, U.S.A., Inc.[92] involved a lessee, Brilliant DPI, Inc., which brought a declaratory action in Wisconsin against lessor, Konica Minolta Business Solutions, U.S.A., Inc., several affiliates of lessor, and CIT Technology Financing Services, Inc., as assignee, alleging, among other things, fraud and misrepresentation by lessor. The assignee moved to transfer the case to New Jersey, its principal place of business. This is another case where the court analyzed the implications of a "permissive" forum selection clause. The lease provided that:

> If the [l]essor or its [a]ssignee shall bring any judicial proceeding in relation to any matter arising under the [Lease], the [lessee] irrevocably agrees that any such matter may be adjudged or determined in any court or courts in the state of the [lessor] or its [a]ssignee's principal place of business . . . .[93]

The court held that the "lease agreement . . . does not specify a forum where all suits *must* be brought. Instead, it requires [lessee] to abandon jurisdictional defenses when sued by [assignee] 'in any court or courts of the [l]essor or its [a]ssignee's principal place of business [(New Jersey)].'"[94] The court held that

86. *Id.* at *2 (quoting the Master Lease).
87. *Id.* at *1.
88. *Id.* at *3.
89. *Id.*
90. *Id.*
91. *Id.*
92. No. 18-CV-799, 2019 WL 1376017 (E.D. Wis. Mar. 26, 2019).
93. *Id.* at *2 (quoting the Lease).
94. *Id.* at *3 (quoting the Lease).

"the language is permissive and does not empower [assignee] to oust jurisdiction in favor of New Jersey when, as here, [lessee] [brought] suit in another state."[95] The court denied assignee's motion to transfer the case to New Jersey.

Ortho-Clinical Diagnostics, Inc. v. Mazuma Capital Corp.[96] involved a lessee, Ortho-Clinical Diagnostics, Inc., that brought suit against lessor, Mazuma Capital Corp., in lessee's home state of New York, seeking, among other things, a declaratory judgment that the lease provision calling for automatic renewal was unenforceable because lessor failed to provide lessee with the New York required notices reminding lessee to give written notice to prevent the leases from automatically renewing. The court analyzed whether a lease with a mandatory Utah forum selection clause and a Utah governing law clause would contravene a strong public policy of New York with regard to a New York lessee. The leases at issue provided that:

> THE PARTIES AGREE TO SUBMIT TO THE EXCLUSIVE JURISDICTION OF THE STATE OF UTAH. ANY SUIT OR OTHER PROCEEDING BROUGHT BY EITHER PARTY TO ENFORCE OR CONSTRUE THIS LEASE . . . OR TO DETERMINE MATTERS RELATING TO THE PROPERTY OR THE REPLATIONSHIP BETWEEN THE PARTIES HERETO SHALL BE BROUGHT ONLY IN THE STATE OR FEDERAL COURTS IN THE STATE OF UTAH . . . .[97]

The court noted that where

> the party opposing the enforcement of the forum-selection clause argues that its enforcement would "contravene a strong policy" of the forum in which the suit was brought, it must show that the available remedies under the law of the forum named in the forum-selection clause are "insufficient" to deter the opposing party's alleged wrongful conduct.[98]

The court held that lessee had not demonstrated that the remedies under Utah law, the forum named in the forum selection clause, were insufficient. The court therefore held that "[lessee] ha[d] not rebutted the presumption that the [Utah] forum-selection clause is enforceable."[99] The court therefore held that the New York notice requirements were not applicable and, in light of the forum selection clause (pointing to Utah), the court granted lessor's motion to dismiss lessee's case.[100]

Rights of Assignees

In *In re Steele*,[101] Swift Financial Corporation ("Swift") entered into a Future Receivables Sale Agreement (the "Agreement") and advanced $250,000 to RSI,

95. *Id.*
96. No. 18-CV-6416 CJS, 2019 WL 1082987 (W.D.N.Y. Mar. 7, 2019) (citing N.Y. Gen. Oblig. Law § 5-901).
97. *Id.* at *1 (quoting the Lease).
98. *Id.* at *5 (quoting Roby v. Corp. of Lloyd's, 996 F.2d 1353, 1363, 1365 (2d Cir. 1993)).
99. *Id.* at *7.
100. *Id.*
101. Swift Fin. Corp. v. Steele (*In re* Steele), No. 17-03844-5-JNC, 2019 WL 3756368 (Bankr. E.D.N.C. Aug. 8, 2019).

Inc. (the "Seller") to purchase 12 percent of the Seller's future receivables, to be collected until Swift had received a sum certain from daily ACH debits against the Seller's bank account. When the Seller filed its petition for relief under the Bankruptcy Code and challenged the Agreement as a disguised loan, the court concluded that the Agreement constituted a sale, emphasizing the plain terms of the Agreement, such as the title "PURCHASE SUMMARY," language describing the transaction as "a sale and not a loan" with "no defined repayment term," and use of the words "purchaser" and "sold" throughout the Agreement.[102] The court noted that no collateral was posted, other than the sold assets.[103] Further, the Seller's obligations under the Agreement were "contingent on its continued business operations and consequential generation of cash or account receipts," whereas payment obligations under a loan are absolute.[104] The decision highlights for practitioners the substantive elements of a "true sale" of leases and rentals.

Funding Metrics, LLC v. NRO Boston, LLC[105] reached a different result. Funding Metrics, LLC ("Funding Metrics") entered into a Merchant Agreement (the "Agreement") and advanced $200,000 to NRO Boston, LLC ("NRO") to purchase a percentage of NRO's future receivables, to be collected until Funding Metrics had received a sum certain from daily ACH debits against NRO's bank account. NRO defaulted and claimed that the Agreement was criminally usurious and void as the implicit interest rate was in excess of the legal rate.[106] The court concluded that the Agreement constituted a loan with an illegal interest rate, noting that (1) the receivables purchase price was repayable not later than a date certain, (2) NRO's "obligation to repay the purchased amounts from independent funds" if the receivables payments were insufficient to repay the purchase price, and (3) NRO's absolute liability for repayment of the purchase price under all circumstances including an event of default.[107] This analysis confirms that the mere labeling of a document as a sale will not protect it from being deemed a loan.[108]

In *In re Polk*,[109] the court found several elements of a sale and a loan, when it analyzed a Revenue Based Factoring Agreement to determine whether the defendant was guilty of embezzlement. Although the indefinite term and cash flow reconciliation provisions suggested a sale, bankruptcy of the seller constituted an event of default, entitling the purported buyer to accelerate the remaining amounts payable under the agreement, to enforce its security interest in the receivables, and to enforce the debtor's personal guaranty of those amounts. Because the contract was governed by New York law, and because a federal court in New York interpreting New York law already concluded that materially

102. *Id.* at *4–5.
103. *Id.* at *5.
104. *Id.* at *4.
105. No. 64204/2016, 2019 N.Y. Misc. LEXIS 4878 (Super. Ct. Aug. 28, 2019).
106. *Id.* at *1–2.
107. *Id.* at *3.
108. *Id.* at *11.
109. No. 18-30913-JPS, 2020 WL 762215 (Bankr. M.D. Ga. Feb. 13, 2020).

similar contracts constituted actual sales, not leases, the bankruptcy court followed that lead and reached the same conclusion.[110] Nonetheless, practitioners should be aware that requiring payment to the purported buyer by a date certain may undermine a "true sale" opinion.

In re I80 Equipment, LLC[111] illustrated a related issue: perfection of the sale of chattel paper leases. The secured party filed a financing statement against the Debtor which covered "[a]ll Collateral described in First Amended and Restated Security Agreement dated March 9, 2015 between Debtor and Secured Party."[112] After the Debtor defaulted on the loan, the appellate court concluded that incorporation by reference to the security agreement sufficiently described the collateral as being objectively determinable under sections 9-502 and 9-108 of the U.C.C.[113] The security agreement included a detailed list of the collateral and hence the financing statement was able to "notif[y] subsequent creditors that a lien may exist and that further inquiry [was] necessary to disclose the complete state of affairs."[114] Although this decision provides comfort that incorporation by reference is adequate, many practitioners, in preparing financing statements to perfect sales of chattel paper leases, nonetheless have been describing the sold assets in the financing statement itself.[115]

Hell-or-High-Water Clauses

In *In re Republic Airways Holdings Inc.*,[116] the U.S. Bankruptcy Court for the Southern District of New York ruled that use of a SLV table (typically used to establish the lessor's damages if the equipment is destroyed) to establish liquidated damages following an event of default "violate[d] public policy and constitute[d] unenforceable penalties" under U.C.C. Article 2A.[117] The court further ruled that the "absolute and unconditional" guarantee of the lessee's parent company also was unenforceable because, "as a matter of public policy, parties may not waive defenses to liquidated damages clauses."[118]

110. *Id.* at *10–11 (citing Colonial Funding Network, Inc. v. Epazz, Inc., 252 F. Supp. 3d 274 (S.D.N.Y. 2017)).

111. First Midwest Bank v. Reinbold (*In re* I80 Equip., LLC), 938 F.3d 866 (7th Cir. 2019).

112. *Id.* at 869 (quoting the financing statement).

113. *Id.* at 870–73.

114. *Id.* at 874 (quoting Grabowski v. Deere & Co. (*In re* Grabowski), 277 B.R. 388, 391 (Bankr. S.D. Ill. 2002)).

115. *Cf. In re* Fin. Oversight & Mgmt. Bd. for P.R., 914 F.3d 694, 711 (1st Cir. 2019) ("Here, as said, the 2008 Financing Statements do not describe even the type(s) of collateral; instead, they describe the collateral only by reference to an extrinsic document located outside the UCC filing office, and that document's location is not listed in the financing statement. This at best gives an interested party notice about an interest in *some* undescribed collateral, but does not adequately specify *what* collateral is encumbered.").

116. 598 B.R. 118 (Bankr. S.D.N.Y. 2019).

117. *Id.* at 150; *see supra* notes 39–55 and accompanying text.

118. *In re Republic*, 598 B.R. at 126, 147; *see id.* at 143–48. The lessor apparently attempted to recover $50 million in guarantee claims even though the remaining unpaid rent amounted to only $7 million. *Id.* at 148 n.26 (citing *In re* Republic Airways Holdings, Inc., 582 B.R. 278, 283 n.2 (S.D.N.Y. 2018)).

This decision arguably was flawed in both respects but was especially noteworthy regarding the guarantee. The court ignored New York and Second Circuit case law that upheld waiver-of-defenses provisions in a guaranty,[119] and preferred to focus on decisions that carved out an exception to an absolute and unconditional guarantee, where the underlying contract was illegal, invalid, or induced by "fraudulent acts, misrepresentations, or misconduct."[120] Nothing in the court's ruling announced that the lease itself was illegal, invalid, or fraudulently induced. Nevertheless, the decision has sparked an ongoing discussion that there may be a zone of egregious conduct that would provide a guarantor with a defense to its otherwise unconditional obligations.[121]

Xerox Corp. v. Bus-Let, Inc.[122] upheld the obligations of the lessee, notwithstanding its allegations that Xerox failed to provide services under separate equipment maintenance agreements. The court noted that the lessee's claim "that Xerox failed to maintain the leased equipment is immaterial: because there is a 'hell or high water' clause in the lease agreement, Xerox's performance is irrelevant to [its] entitlement" to summary judgment.[123] The lease agreements also stipulated that, if Xerox were to default on its obligations under the maintenance agreements, the lessee's sole remedy would be to demand that Xerox replace the nonperforming equipment. This decision underscores the wisdom of using a separate agreement to document any maintenance services and including the stipulation that any failure will not excuse the lessee's obligations under the equipment lease.

GreatAmerica Financial Services Corp. v. Monge & Associates, P.C.[124] also upheld the hell-or-high-water clause against attack by the defaulting lessee that the assignee should not be permitted to invoke the clause because of its "close connection" with the equipment vendor.[125] In affirming summary judgment for the assignee, the court upheld the hell-or-high-water clause, even if the assignee was not a holder in due course, and found no evidence that the assignee had knowledge of any wrongdoing by the original lessor.[126] The lessee's defense was based upon a typical vendor agreement between the equipment vendor and the assignee, thereby emphasizing that these arrangements—intended to provide the framework for a "flow program" of financing by the assignee—must be drafted so that the financing party cannot have so much knowledge of the vendor's business that it can be inferred that the financier should have known about any fraudulent activities by the vendor.

119. *Id.* at 145–46 (collecting cases).

120. *Id.* at 146 (quoting Miller v. Ahrens, 163 F. 870, 875 (C.C. N.D. W. Va. 1908)).

121. Stephen L. Sepinuck, *Guaranties of Unenforceable Obligations*, TRANSACTIONAL LAW., Dec. 2019, at 5.

122. No. 18-CV-6725-FPG, 2019 WL 2514855 (W.D.N.Y. June 18, 2019).

123. *Id.* at *4.

124. No. 18-1233, 2019 WL 3720469 (Iowa Ct. App. Aug. 7, 2019).

125. *Id.* at *3; *cf.* C&J Vantage Leasing Co. v. Outlook Farm Golf Club, LLC, 784 N.W.2d 753, 761 (Iowa 2010) ("In the context of finance leases, application of the close-connection doctrine would sever finance lessor status for a lessor who is closely connected with the equipment vendor. Therefore, the lessor would lose the ability to enforce a valid hell-or-high-water clause and would possibly be subject to the implied warranties of the vendor.").

126. *GreatAm. Fin. Servs.*, 2019 WL 3720469, at *5.