COME HELL OR HIGH WATER OR ARTICLE 2A: HOW LEGISLATURES AND PRACTITIONERS CAN COPE WITH SEVERAL DRAFTING ANOMALIES IN ARTICLE 2A OF THE UNIFORM COMMERCIAL CODE*

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Codification of a given legal area which has evolved principally through the common law and analogies from other legal areas is usually a productive endeavor. The extensive reliance of the bar and bench upon codifications such as the various restatements of the laws of torts and contracts bear ample testimony to the time saving and predictive value normally associated with such an endeavor. However, the value of a codification is only as great as the accuracy of the premises and/or assumptions upon which it is founded. If the draftsmen fail to understand the circumstances of the actors who are most affected by their efforts, the result will range from wasted time to rank injustice. Unfortunately, this appears to be the case with one of the more recent projects of the National Conference of Commissioners on Uniform State Laws and the American Law Institute, the development of Article 2A of the Uniform Commercial Code

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("U.C.C."), an effort to codify the law of personal property leasing.[1] In view of the lack of opportunity for the courts to clarify certain anomalies in the statute, certain amendments therein are proposed with respect to larger commercial leases, along with suggested mechanisms for best dealing with the current statute.[2]

ARTICLE 2A BACKGROUND

While few would argue that the law of leasing has evolved in a patchwork fashion, which makes it difficult to find the law amid the debris of the Uniform Personal Property Leasing Act, common law, Article 2 of the U.C.C. (governing personal property sales), Article 9 of the U.C.C. (governing secured transactions) and various consumer protection statutes,[3] it is the author's thesis that certain key provisions of Article 2A have caused additional confusion and uncertainty for commercial parties acting pursuant to this statute, some form of which is now the law in virtually every state. It is recommended that the statute be modified in certain respects in the case of substantial leases to larger commercial enterprises having annual revenues in excess of some threshold.

Article 2A was developed in order to govern a world where the parties were relatively unsophisticated, of disparate bargaining power and rarely represented by counsel. The analog for the draftsmen was Article 2.[4]

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1. Uniform Commercial Code-Leases (hereinafter, "Article 2A"). The statute was originally promulgated in 1987 but major amendments were promulgated in 1990. This article refers to the more recent version. However, it must be emphasized that, although a version of Article 2A has been adopted in virtually all states, there are some significant differences among the different versions. Among other things, the California version is notably different than those in effect elsewhere and the 1990 amendments have been adopted in most but not all states.

2. Although dollar thresholds are proposed, *infra*, there is nothing magical about the specific figures. The effort is only to formulate an administrable standard for application of the proposed new rule.

3. A leading leasing attorney when writing in a leasing industry publication stated:

> UCC Article 2A was developed in the early 1980's as part of an effort to create a uniform personal property leasing act and overcome the absence of any coherent body of law for 'true' equipment leases. Until UCC 2A, lease transactions were interpreted by referring to a hodge-podge of judicial and other rulings in the fields of tax, bailments, secured transactions and landlord-tenant law. There was little uniformity in this area and little predictability if a lease was the subject of a law suit.

Whelan, *The Realities of Article 2A*, LEASING AND FINANCIAL SERVICES MONITOR, October 1992.

4. Official Commentary to § 2A-101 of Article 2A. "A review of the literature with respect to the sale of goods reveals that Article 2 is predicated upon certain assumptions: Parties to the sales transaction frequently are without counsel, the agreement of the parties often is oral or evidenced by scant writings . . . . Parties to a secured transaction regularly are represented by counsel; the agreement of the parties frequently is reduced

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COMMERCIAL LEASING REALITY

While this may accurately describe the environment in which many consumer leases are created[5] (as opposed to negotiated), it is seemingly antithetical to the circumstances surrounding a great deal of the commercial leasing which today fuels the capital goods segment of our economy.[6] While some leases are to small businesses and in small denominations for items such as automobiles and copy machines, it is both the author's observation and the demonstrable fact that a far greater volume of capital asset leases involve lessees and lessors which by any standard constitute substantial businesses as well as items of equipment costing in the six, seven and eight figures.[7] This is hardly the stuff of a crying need for legal oversight. Whatever may be the case in the consumer or small business arena in terms of lack of sophistication or imbalance of bargaining power, this is certainly not true of these large ticket commercial leases. In any event, a Federal Consumer Leasing Act, and its implementing regulation, Regulation M, already exist to address the special circumstances present in such an area principally by providing for various disclosures of the terms of the transaction to prospective consumer lessees.[8]

In the case of the larger commercial leases with which this article is concerned, lessor and lessee are typically substantial business entities having ready access to retained and/or employed lawyers, fre-

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to a writing, extensive in scope . . . the lease is closer in spirit and form to the sale of goods than to the creation of a security interest."

5. The term "created" is used advisedly to refer to many consumer and very small business leases where the final document truly is a contract of adhesion, involving the completion of blanks in a lessor's printed form. The "rent to own" programs of many consumer lessors in which consumers paid many times the retail sale price of items over several years and forfeited all of their prior payments if any payment was missed are indicative of the need for some government involvement in this market segment. "Certainly the fastest growing area of regulation of consumer leases is in the area of rent to own transactions." Wong, EQUIPMENT LEASING § 27[10] (1996).

6. The former chairman of the American Bar Association's leasing subcommittee, has estimated that leasing represents 30 percent of capital expenditures. "Considering that leasing represents 30 percent of capital acquisitions, it is surprising that there wasn't a Uniform Commercial Code article on leasing before." Zall, quoting Robert Strauss, Esq., *The Implications of UCC Article 2A*, EQUIPMENT LEASING TODAY, October 1993, at 27, 30.

7. The Equipment Leasing Association in its most recent *Annual Survey* of the industry for 1996 indicated that 52 percent of its 140 lessor respondents reported an average transaction size in excess of $100,000 and 29 percent of such respondents reported an average transaction size in excess of $250,000. The same source also estimated total 1995 leasing volume at approximately $161 billion or 29 percent of total business investment in equipment. Since another source places 1995 *new equipment* leasing activity at approximately the same level, Whelan, Strauss & Flick, *Leases*, 51 BUS. L. 1381 (August 1996) (referring to a U.S. Commerce Department survey), and since there is an active leasing market for used equipment, this figure probably understates the ultimate significance of leasing.

8. 15 U.S.C. § 1667-1667(e) (1982); 12 C.F.R. § 213 (1986).

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quent involvement in significant financial transactions and enough at stake in the case of any particular lease to have an incentive to carefully scrutinize any particular lease documentation package for objectionable provisions. Furthermore, the development of master lease[9] structures expressly contemplates frequent dealings between a lessor and lessee such that the lessor has an economic incentive to avoid overreaching its lessees. In short, the parties can "fend for themselves" by negotiating appropriate contractual language tailored to protect the legitimate interest of each.[10]

THE STATUTORY CONSEQUENCE

Given the premises upon which the draftsmen began their work, it should not be surprising that what emerged is a somewhat paternalistic statute which is intended to protect lessees against the depredations of all-powerful, overreaching lessors. Nowhere is this more evident than in several fundamental provisions of Article 2A which on their face are intended to permit lessees to cancel nominally binding leases. The language of §§ 2A-401, 2A-402 and 2A-517[11]

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9. A master lease is a set of contractual provisions which are negotiated at the outset of the relationship between lessor and lessee, committed to writing at that point and then incorporated by reference into the documentation for actual equipment transactions, which are normally called "supplements," "schedules" or "equipment schedules." The latter would include only the transaction specific items such as equipment description, rental amount, lease terms and any options of either party which are negotiated, such as renewal or purchase options or lessor rights of first refusal on future transactions. By negotiating and documenting the general legal parameters at the inception of the relationship, the parties avoid the need to customize documentation for each individual transaction.

10. The securities law area provides a useful analogy. In particular, the safe harbor promulgated by the SEC with respect to private placements expressly exempts from the prescribed disclosure requirements sales and/or resales to certain "accredited investors" and "qualified institutional buyers" who satisfy certain criteria relating to income, net worth, revenue, assets or business activity. *See* Securities Act Rules 501(a), 505 and 506, 17 C.F.R. §§ 230.501, 505, 506; Sec. Act. Rel. 6389, March 8, 1982) [1981-82 TransferBinder] Fed. Sec. L. Rep. (CCH) ¶ 83,106, defining "Accredited Investor" and specifying its use for private placement safe harbor purposes and Sec. Act Rel. No. 33-6862, 54 Fed. Reg. 30,076 (April 30, 1990), promulgating Rule 144A permitting unregistered resales of certain privately placed securities to "qualified institutional buyers." In each case, the SEC's objective was to avoid formalistic disclosure requirements in the case of sales to sophisticated buyers who can fend for themselves.

11. Section 2A-401. Insecurity; adequate assurance of performance.

> (1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.
> (2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable the insecure party may suspend any performance for which he or she has not already received the agreed return.
> (3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not

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permits lessees to retract their acceptance of leased items, effectively cancelling their lease, in the event of certain lessor misstatements enumerated in the statutes. While this may seem to be a reasonable approach, grounded upon considerations of fundamental

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provided to the insecure party within a reasonable time, not to exceed 30 days after receipt of a demand by the other party.
(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.
(5) Acceptance of any nonconforming delivery or payment does not prejudice aggrieved party's right to demand adequate assurance of future performance.

Section 2A-402. Anticipatory repudiation. If either party repudiates a lease contract with respect to a performance not yet due under the lease contract, the loss of which performance will substantially impair the value of the lease contract to the other, the aggrieved party may:

(a) for a commercially reasonable time, await retraction of repudiation and performance by the repudiating party;
(b) make demand pursuant to Section 2A-401 and await assurance of future performance adequate under the circumstances of the particular case; or
(c) resort to any right or remedy upon default under the lease contract or this Article, even though the aggrieved party has notified the repudiating party that the aggrieved party would await the repudiating party's performance and assurance and has urged retraction. In addition, whether or not the aggrieved party is pursuing one of the foregoing remedies, the aggrieved party may suspend performance or, if the aggrieved party is the lessor, proceed in accordance with the provisions of this Article on the lessor's right to identify goods to the lease contract notwithstanding default or to salvage unfinished goods.

Section 2A-517. Revocation of acceptance of goods.

(1) A lessee may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the lessee if the lessee has accepted it:
(a) except in the case of a finance lease, on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or
(b) without discovery of the nonconformity if the lessee's acceptance was reasonably induced either by the lessor's assurances or, except in the case of a finance lease, by the difficulty of discovery before acceptance.
(2) Except in the case of a finance lease that is not a consumer lease, a lessee may revoke acceptance of a lot or commercial unit if the lessor defaults under the lease contract and the default substantially impairs the value of the lot or commercial unit to the lessee.
(3) If the lease agreement so provides, the lessee may revoke acceptance of a lot or commercial unit because of other defaults by the lessor.
(4) Revocation of acceptance must occur within a reasonable time after the lessee discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by the nonconformity. Revocation is not effective until the lessee notifies the lessor.
(5) A lessee who so revokes has the same rights and duties with regard to the goods involved as if the lessee had rejected them.

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fairness, both substantive comparison to other areas of the law and a technical analysis of its implications in the leasing area suggest that it is unwarranted in the context of a sophisticated lessor and lessee.

While the inducement or performance of a contract in a manner which is tainted with misrepresentation always gives rise to a remedy of some sort, the Article 2A formulation goes well beyond the norm in terms of the recognition of lessee rights. In other areas of the law, the aggrieved party can always at least sue for money damages and can often seek a judicial decree providing for recission or modification of the offending contract. Of course, in the latter instance, the court must be convinced that such a remedy is warranted, based upon the seriousness of the misrepresentation and the conduct of the aggrieved party.[12] There is also little or no precedent for authorizing, let alone requiring, the court to disregard language in the contract which affirmatively states that the sole remedy of the aggrieved party is an action for money damages. Even where courts are inclined to intervene with a remedy other than a damage award, such action is rarely if ever undertaken in the context of relatively equal bargaining power.

TRANSACTIONAL COMPLICATIONS; CONTEMPORARY LEASING STRUCTURE AND PRACTICE

The structures and practices that have developed in the third party commercial leasing industry make this anomaly a significant impediment to the orderly functioning of the market. The *sine qua non* of this market is known as the "hell or high water" lease. The essence of this structure is a provision requiring that the lessee, once it accepts[13] the leased item, to pay its rent in all events (*i.e.*, come hell or high water) without regard for the proper function of the item or the conduct of the lessor with respect to the subject or any other transaction. An example of such a provision is set forth below:

> This Lease provides for a net lease, and the Rent due hereunder from Lessee to Lessor shall be absolute and unconditional, and shall not be subject to any abatement, recoupment, defense, claim, counterclaim, reduction, set-off or any other adjustment of any kind for any reason whatsoever.

This sort of provision, while it may seem harsh, in practice makes good sense for the interest of all concerned. The lessor is expending the cash needed to purchase the equipment from its vendor (or foregoing the cash proceeds which would be realized from a sale of used

12. *See, e.g.*, DAWSON & HARVEY, CASES ON CONTRACTS 773 (3d ed. 1977).

13. Acceptance is objectively determined in the industry by the lessee's execution and delivery to the lessor of a Certificate of Acceptance.

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equipment out of its inventory) but is also assuming the credit risk associated with the lessee's ability to make the contracted payments as well as (in most cases) the residual risk associated with the equipment value at lease expiration.[14] In return, the lessor needs at least the assurance of a legal entitlement to the contracted rent in order to permit both the financing activity described *infra* and any semblance of rational planning or forecasting of capital requirements, both of which ultimately impact the availability of capital for future transactions.

If the lessor cannot count on the enforceability of the lease in accordance with its terms, the process is converted into a sort of lottery where the lessor's ability to recoup the contracted payments (let alone a profit) depends solely upon the lessee's subjective satisfaction with the leased items and the retrospective assessment of a court as to the validity of the lessee's concerns. Even with the hell or high water formulation, the lessee is not deprived of a remedy for lessor fraud, misrepresentation, breach of the lease or a statute or any other claim. The lessee always has the ability to bring an action for money damages including, without limitation, recovery of rent for a lease which was procured by fraud or misrepresentation. The lessee, however, may not unilaterally invoke such rights.

14. In some cases, the lessor is not assuming such residual risk since the rental payments are sufficient to cover the full cost of the equipment. The accounting standards, such as Financial Accounting Standards Board Statement No. 13, *Accounting for Leases*, make much of the distinction between an "operating lease," in which the lessor does retain such risk on account of the relatively low percentage of equipment cost which is recovered from its initial lease and a "finance lease" [which is *not* equivalent to a finance lease as defined in Article 2A] in which the initial lease payments allow the lessor to recoup most or all of the equipment cost. *See* FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*, (December 1988). For the purpose of this analysis, there is no reason to distinguish the two types of leases. Note, however, that the nominal characterization as a lease does not trigger the application of Article 2A in cases where the transaction is in fact a disguised sale or security agreement and not a lease at all. "It is important to recognize that Article 2A is intended to apply solely to "true leases," not to leases intended as security or disguised security agreements." Munzer, *Update on UCC Article 2A*, LEASING AND FINANCIAL SERVICES MONITOR, (July/August 1991). "In an attempt to clarify the confusion over the distinction between a 'true lease' and a 'lease intended as security' the drafters of Article 2A amended the definition of a security interest . . . [to do] away with the "intent of the parties" as a factor to be used in determining whether a transaction constitutes a lease or a secured transaction and focus primarily on whether or not the lessor retains a meaningful residual value in the leased property." Flick, *Leases of Personal Property*, 45 BUS. L. 2331, 2332-33 (1990). The courts have devoted a great deal of time to grappling with this issue. *See, e.g.*, Strauss & Flick, *Leases*, 46 BUS. L. 1509, 1513 (1991).

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LEASE FINANCING

The financing practices of the third-party[15] leasing industry make even more compelling the need for an irrevocable lessee commitment. Lessors, like all other businesses, need to minimize the amount of capital which they have tied up in their businesses at any given time, whether to minimize their operating costs or simply to remain in existence. The leasing industry for many years has done this in collaboration with the lending community, through so-called "nonrecourse discounting" of leases. This involves the lessor turning over the lease instrument to a lender in return for an advance of funds equal to the present value (determined using the negotiated interest rate) of the rental payments which are then directed to the lender in writing by the lessor. The lender agrees, in cases where it is comfortable with the creditworthiness of the lessee, that its sole source of payment shall be the payments by the lessee and the value of the leased equipment; the lessor does not incur liability for a lessee default. This structure allows the lessor to recoup the funds which it invests in each lease on a lump sum basis instead of over the two to five year life of the lease and then reinvest such funds in new transactions which will then give rise to further nonrecourse discounting. Of course, the ability to "recycle" the lessor's capital serves to hold down the lessee's rental rates and thereby facilitates the acquisition of capital goods, which is generally deemed to be beneficial to the economy. The Court of Appeals for the Tenth Circuit has explicitly recognized the significance of the foregoing arrangement:

> . . .there are significant policy reasons for upholding hell or high water clauses where, as in the equipment leasing industry, the enforceability of the provision aids the parties in obtaining financing which would not otherwise be available.[16]

However, the foregoing structure functions only if the lender is comfortable with the lessee's obligation to pay. For a lender to advance funds against a lease on a nonrecourse basis, it must be certain that if it is correct in its assessment of the lessee's ability to pay, it will receive its agreed upon return. Lenders universally require that lessees directly pay their rent to the lender and acknowledge in writing

15. This analysis is applicable primarily to lessors which are not affiliated with an equipment manufacturer or other large entity. The latter (of which IBM Credit Corporation is an example), by virtue of their corporate affiliations, often finance at the entity level instead of at the transactional level. Also, securitization of lease receivables, while certainly not the industry standard, makes less compelling the need for hell or high water documentation in any particular case. Of course, even in a securitized lease portfolio, the vast majority of the individual items must be indisputably enforceable.

16. Colorado Interstate Corp. v. CIT Group/Equip. Fin., Inc. 993 F.2d 743, 749 (10th Cir. 1993) (citing § 2A-407, discussed *infra* at note 23).

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their agreement to do so. To the extent that the law introduces an element of uncertainty as to the enforceability of the lease, the lender becomes unable to commit its funds to the transaction since doing so would effectively involve mere speculation as to the construction of the lease. Better to simply refrain from financing leases but deploy the capital which would have been used for such purpose to other areas where there is no documentation risk.

Perhaps the impediments to financing are less inadvertent than one might think. The 1990 version of § 2A-303 validates certain contractual limitations on lessor assignments of rights (such as the right to receive payment) in the event that such assignments constitute "an actual delegation of a material performance of the lessor." The same section potentially permits cancellation of a lease, with respect to which an unauthorized transfer is made.[17] While this standard at first blush seems reasonable, a moment's reflection indicates that like the rest of the provisions discussed herein, it is at best unnecessary and at worst counterproductive. Putting aside the use of the assignment or financing process in the consumer context to evade warranties, which practices have been the subject of consumer legislation governing the uses and abuses of the so-called "holder in due course" doctrine,[18] it is hard to imagine how a lessor assignment can ever add to the lessee's burdens.

The lessee will send its check (or electronic funds transfer) to one place or the other. There is no reason to believe that it will make any difference to the lessee whether funds go to the original lessor or someone else—at least as long as the documentation contains adequate assurances that the assignment will not result in multiple liability.[19] The author's observation has been that lessee counsel is fully capable of negotiating the inclusion of language intended to

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17. Under Article 2A § 2A-303(5)(b)(ii), liability to the lessor may result from a transfer if it "materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party. . . ." Ominously for lessors, this section goes on to permit a court to "grant other appropriate relief, including cancellation of the lease contract or an injunction against the transfer." The provision is so difficult to understand that a well known leasing treatise, WONG, EQUIPMENT LEASING (1996 Section 3.08), includes a 16 box flow chart in an effort to explain it.

18. Federal Trade Commission Holder-in-Due-Course Regulations, 16 C.F.R. §§ 433.1, 433.2, 433.3 (1975).

19. It is important to distinguish between a mere financing, *i.e.*, assigning the right to receive payment of the rent—from a sale of the underlying equipment. The latter may in fact have adverse consequences such as multiple liability for the lessee in the event of a lessor bankruptcy or even at the end of the lease term if the original lessor has delegated its obligations to its purchaser and the purchaser refuses to honor end of lease renewal or purchase options. *See, e.g., In re* CIS Corp. (No. 89-10073 S.D. N.Y. 1989) (multibillion dollar lessor bankruptcy case which spawned a multiplicity of actions and proceedings, involving numerous parties and issues including, among other things, the implications of a lessor equity sale and the imposition of multiple liability upon a lessee). It may be useful to amend § 2A-303 in order to give legal effect to this distinction.

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prevent multiple liability. Again, this is yet another trap for the unwary lessor which in practice has resulted in the inclusion in lease documentation of lessee acknowledgments that the assignment does not add to the lessee's burdens. While lenders have apparently been less concerned about this disclaimer than about those pertaining to rights to revoke acceptance, this language could lead to a reduction in availability of financing while furnishing no benefit to lessees.

Whatever the evils of lease assignments in the consumer context, one wonders why the subject had to be addressed in the large-ticket commercial transaction context. It should be noted that very few large ticket lease transactions are undertaken by small lessors for the simple reason that they do not possess the capital required to originally purchase equipment and hold a lease before it can be financed. Thus, there is relatively little risk of a lessor pocketing financing proceeds and disappearing, leaving a lessee "holding the bag" in the event of lessor breaches of warranties.

The author and those similarly situated have directly observed the aforementioned reactions from the lending community since the enactment of Article 2A. Lenders and their counsel have simply refused to lend against leases of any significant size to which the Article 2A rights to revoke acceptance apply. The lending community has insisted upon a stop-gap type of remedy involving inclusion of waivers of any Article 2A rights of revocation in leases which are on their faces hell or high water.[20] This effort creates ample confusion in cases where lessor and lessee are negotiating a new master lease since Article 2A is not a typical subject for lessee counsel study before such negotiation; a great deal of educational work is required to explain what the statute is, let alone why a portion of it should be waived. The process is even more unwieldy in cases where a master lease was negotiated long ago. The parties justifiably pursued such effort in order to avoid separate negotiations in the case of each individual transaction. However, the required waivers must be included in the documents pertaining to individual transactions, requiring not only the same educational effort noted above

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20. Such language appears as follows in one lessor's documentation:

> Lessee hereby waives any right it may have under Section 2A-517 of the Uniform Commercial Code or otherwise to revoke this acceptance for any reason whatsoever including but not limited to (i) any assumption by Lessee that a nonconformity would be cured, (ii) any inducement of acceptance by the Lessor's assurances or any difficulty to discover a nonconformity before acceptance, or (iii) any Lessor default under the Lease. Lessee further hereby waives its rights under Section 2A-401 and 2A-402 of the Uniform Commercial Code to suspend performance of any of its obligations under the Lease with respect to the Equipment hereby accepted.

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but also an explanation as to why the originally agreed-upon documentation will no longer suffice.[21]

PRACTICAL EFFECT OF ARTICLE 2A: ATTEMPTING TO PREVENT THE PROBLEM

To the extent that such requests for waiver are successful, they consume significant time and convert the referenced provisions of Article 2A into nothing more than a trap for the unwary, which furnishes protection only to lessees "fortunate" enough to deal with an unsophisticated or sloppy lessor. To the extent that they are unsuccessful, they prevent the lessor from financing the pertinent leases and leave the lessor unable to redeploy such capital for another transaction, perhaps making it impossible for another lessee to obtain needed equipment.

The drafters of Article 2A apparently foresaw at least some of the problems which are currently associated with permitting revocation of acceptance. They took an exception to such rights in the case of leases which are deemed to be "finance leases" within the meaning of § 2A-103(g), which is a lengthy and confusing definition reproduced in the footnote.[22] To the same effect is the language of § 2A-

21. All of the major lessors' standard documentation contains language indicating that each Supplement and the corresponding Master Lease which is incorporated by reference constitutes a separately enforceable lease. Thus, the mere fact that a Master Lease was entered into prior to the effective date of Article 2A in the pertinent state would not immunize a Supplement entered into after such effective date from the application of Article 2A since such Supplement is a stand-alone contract. The practitioner commentary accompanying Article 2A recommends inclusion of waiver language in Supplement documentation. "The delivery and acceptance certificate should contain a reaffirmation by the lessee of the finance lease criteria." Wong, *It's Time to Update Your Equipment Lease*, JOURNAL OF EQUIPMENT FINANCING 5 (1989).

22. Note the references in § 2A-517 to transactions not involving a finance lease. "Finance lease" is defined in Section 2A-103(g) of the U.C.C. as follows: a lease with respect to which:

> (i) the lessor does not select, manufacture or supply the goods;
> (ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and
> (iii) one of the following occurs:
>> (A) the lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract;
>> (B) the lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;
>> (C) the lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications of remedies, or liquidated damages, including those of a third party, such as the manufacturer of the goods, provided to the lessor by the person supplying the goods in connection with or as part of the

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407.[23] However, it too, is triggered only by the presence of a finance lease. While it appears that the purpose of this exception for finance leases was to avoid subjecting lessors who do not manufacture the leased equipment to the risks identified above, this effort has not been successful. The case law under the definition is quite

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contract by which the lessor acquired the goods or the right to possession and use of the goods; or

(D) if the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this Article to the promises and warranties, including those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to use and possession of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies.

23. Section 2A-407 of Article 2A. Irrevocable promises; finance leases.

> (1) In the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods. [Such promise]
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> . . .
>
> (b) is not subject to cancellation, termination, modification, repudiation, excuse or substitution without the consent of the party to whom the promise runs.
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> . . .
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> (3) This Section does not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods.

Interestingly, one commentator, then chairman of the ABA's Uniform Commercial Code Committee's Leasing Subcommittee, writing at about the time of widespread enactment of Article 2A, strongly disagreed with the wisdom of including this provision: "One editorial comment: to date the commentators have not focused on the unfairness of U.C.C. section 2A-407. . . .This is merely a codification of standard commercial leasing practice—the same result that lessors currently achieve through contractual language . . . . Section 2A-407 thus is a trap for the unwary, and an unnecessary one at that." Strauss & Flick, *Leases*, 46 BUS. L. 1509, 1510 (August 1991).

In the opinion of the author, the position expressed about § 2A-407 indicates a misunderstanding of the intention of the draftsmen. It appears that the drafters realized that hell or high water leases served a critical purpose in commercial transactions and were expected by lessees in large transactions and endeavored to provide for the attainment of such purpose by avoiding a trap for the unwary *lessor*. The language of subsection (3), while cryptic, appears to be a saving clause of sorts which is seemingly intended to validate hell or high water leases. Whatever might have been the intention of the draftsmen, it is suggested that an explicit declaration of the rights of the lessor in this regard is preferable for all concerned. At this time, with the virtually nonexistent judicial gloss on the term "finance lease," and the demands of the lending community discussed *supra* at text accompanying notes 15 and 16, it appears that the efforts of the draftsmen did not succeed.

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sparse.[24] When coupled with the complexity of the definition, the result is sufficient uncertainty as to the significance of this exception that the lending community is placing very little value upon the exception. Rather, the cited waivers are still the order of the day. One alternative which has been pursued by the author, with some success, but which still causes some confusion, is relying only upon an acknowledgment by the lessee in the documentation that the lease constitutes a finance lease within the meaning of the cited provision.

PROPOSED LEGISLATIVE ALTERNATIVE

The current situation is simply untenable in the context of large transactions involving commercial parties. If such parties believe it necessary for a lessee to have a "second look" at leased equipment after first accepting it, they may expressly negotiate same. Perhaps, some lessors would be willing to allow such a right in return for a higher rental rate which would compensate them for difficulty involved with the financing transaction. There is no reason for parties who are fully capable of taking care of themselves and having ample motivation to do so to have the benefit of a legal thumb on the scales.

Accordingly, it is suggested that a new § 2A-407(4) be added reading substantially as follows:

> (a) In the case of leases providing for gross rentals in excess of $200,000 to lessees regularly engaged in a trade or business and which the lessor reasonably believes have received during their last full fiscal year gross revenue in excess of $500,000, any provision of such leases which provides for the irrevocability or noncancellability of the lessee's obligations shall be given effect in accordance with its terms. The foregoing is intended to apply notwithstanding any other provision of this Section 2A-407 or of Sections 2A-401, 402 or 517 hereof.
>
> (b) When determining the lessee's gross revenue, the lessor may conclusively rely upon any financial information (whether or not audited or in accordance with generally accepted accounting principles) furnished by the lessee directly to the lessor or filed with any governmental body or furnished to shareholders of the lessee.

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24. Siemens Credit v. Newlands, 905 F. Supp. 757 (N.D. Ca. 1994) is the only reported case of which the author is aware which construed (or more accurately, applied) the term "finance lease." The court's analysis was quite conclusive and gave little indication of its thought process. Other than references to the statute and corresponding official commentary, the court did not cite any authority in connection with its application of the finance lease definition. However, this case is seemingly the best authority which is currently available. "*Newlands*, which is a very favorable decision for equipment lessors, is one of the few reported decisions under Article 2A." *Court Upholds Finance Lessor Protection Under Article 2A*, EQUIPMENT LEASING TODAY, EQUIPMENT LEASING ASSOCIATION, March 1996, at 39.

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(c) Nothing contained in this Section 2A-407 is intended to reduce, negate or modify the right of any party to a lease to maintain an action for money damages for breach of such lease or fraud or misrepresentation in its inducement or to negate or limit the effect of any provision of such lease which expressly permits its cancellation.

(d) This Section 2A-407(4) shall be effective upon its date of enactment and shall be applicable to all leases in effect upon such date, irrespective of whether such leases were entered into between 19__ (insert date of enactment of Article 2A in particular state) and the date of enactment of this Section.

In view of the confusing effect of existing § 2A-407(3),[25] the proposed new language could also be substituted for it.

It is hoped that a provision such as the foregoing will be of assistance to both the lessor and lessee communities by permitting the enforcement of contracts in accordance with their terms, without forcing unwanted tradeoffs in situations where the contractual language accurately represents the intentions of the parties. In so doing, both parties should profit by expediting the consummation of transactions and avoiding lessor risk which necessarily translates into higher rates and/or reduced availability of lease financing.

HOW THE BAR CAN COPE (OR WHAT TO DO UNTIL THE LEGISLATURE GETS THERE)

In the meantime, practitioners representing the leasing industry should take care to provide for some sort of waiver of rights of revocation in each material[26] lease which is consummated. While the marketplace is currently not always kind to "full boat" waivers of all Article 2A rights, the author has observed a better reception to a simple acknowledgment that the particular lease constitutes a finance lease within the meaning of § 2A-103(g). Such an acknowledgment appears to have been deemed significant by the *Newlands* court and usually does not prompt the kind of scrutiny and skepticism that a request for waiver of statutory or other rights does. It may well be far more palatable to the nonlegal personnel involved with a given transaction to pursue the finance lease acknowledgment than the waiver.

For their part, counsel for lessees should understand the legitimacy of lessors' requests for relief from the more onerous provisions of Article 2A and be prepared to explain to non-legal personnel on their side that the Article 2A language ultimately does no more than reiterate the hell or high water characterization of the lease, *i.e.*,

25. *See supra* note 23.

26. Materiality should be evaluated based upon individual circumstances of each lessor *i.e.*, how large a transaction can it afford to carry in its own portfolio if a lender balks at financing it because of documentation concerns?

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what is always bargained for and deemed innocuous by a large ticket commercial lessor and lessee. Thus, the lessor is not trying to take away rights for which the lessee negotiated. Lessee counsel can better serve the interests of their clients by focusing on matters of operational significance to their clients such as upgrade and/or end of term renewal and purchase options. Furthermore, lessee counsel can also assist their clients by advising them to consider the economic viability of their lessors when awarding transactions so that a damage remedy is meaningful, but ultimately so that problematic situations which might otherwise call for the invocation of a statutory right to cancel are avoided.

Finally, counsel for lenders should recognize that as a technical matter their clients are just as well off with a "short form" finance lease acknowledgment than with the full waivers, requests for which merely serve to slow down the document negotiation process.

Of course, all concerned with large ticket commercial leases would ultimately be best served by pursuing a statutory amendment which would focus the legislative intervention where it would do the most good and removing it from areas where it serves no useful purpose.

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