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Lease Voided Due To Vendor's Default

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On Oct. 31, 2007, a trial-level court in New York issued a decision finding that an equipment lease "fail[ed] for lack of consideration" when the bankrupt vendor did not deliver the leased equipment, even though the lessee had signed a lease amendment stating (as quoted by the court) that:

[i]n consideration of Lessor's agreement to advance funds as requested above, Lessee agrees to immediately commence payments under the Lease, even though all of the Equipment may not yet be installed. Lessee agrees that, in order to induce Lessor to make payment as described above, the Lease will be in full force and effect immediately upon execution of this Amendment, as will Lessee's duty to make all payments and to fulfill all other obligations pursuant to the Lease. Should any item of Equipment not be delivered, Lessee alone shall be responsible and shall have recourse only to the appropriate Vendor. ... Nondelivery of any item of Equipment shall not relieve Lessee of the obligation of payment in full under the Lease.

Although this decision will likely be appealed and may be reversed, it still provides a cautionary tale of which lessors should be aware, so as to reduce the likelihood of suffering a loss due to a vendor's default.

While on its face this decision seems to run afoul of the basic leasing tenet that a finance lessor is only responsible

for providing money to a deal and any issues regarding the equipment are between the lessee and the vendor, the facts set forth in the decision in *CN Funding LLC v. The Ensig Group Ltd. et al.* allowed the court to hold that the lessor did not qualify as a finance lessor insulated from the vendor's obligations.

In a typical finance lease transaction, the lessee enters into an agreement with a vendor to acquire specified equipment for an agreed-upon price. The finance lessor then pays the purchase price directly to the vendor, acquires title to the equipment (which is usually shipped directly from the vendor to the lessee), and leases the equipment to the lessee. Notwithstanding the sale of the equipment from the vendor to the lessor, the lessee obtains the right to enforce all representations and warranties relating to the delivery and quality of the equipment. Thus, in a typical finance lease transaction, the lessee has standing to seek recourse directly from the vendor in the event of non-delivery of the equipment or other equipment-related issues.

The problem in *CN Funding* seems to flow from the court not being provided with any documentation between any party and the vendor that would provide the lessee with a basis for seeking redress from the vendor. Since the lessee was not informed of any promises and warranties made by the vendor, and there was no evidence that the lessor had received any promises or warranties from the vendor, the court found that the lessor did not qualify as a finance lessor under UCC Article 2-A.

It appears that the lessor in *CN Funding* had been making progress payments to the vendor and withheld the final \$14,000 at the lessee's request.

However, because the court was not presented with any agreement between either the lessor or the lessee and the vendor, and the lease was silent as to the lessor's rights and obligations with respect to the amounts and timing of advance payments, the court did not view the advance payments as consideration sufficient to support the lease.

CN Funding appears to be a case where a judge looked for and found a way to help a small business owner whom she perceived as having been wronged. According to the decision, the lessor knew of the vendor's bankruptcy at the time of the lease, but the lessee did not. While the judge did not rely on this fact to support her decision, it very well may have influenced the outcome. Had the lessor crossed its "t's" and dotted its "i's," perhaps the result would have been different.

If a lessor wants the protections of UCC Article 2-A, it should insist on a written agreement between the vendor and the lessee, and scrupulously follow the requirements found in Article 2-A to qualify as a finance lessor. Even if the *CN Funding* decision gets reversed on appeal, there are many judges who always seem to favor "the little guy" and will look for any opportunity to rule in their favor. Try not to provide them with the opening.



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