

CURRENT ISSUES AND DEFENSES IN LEGAL ENFORCEMENT

By: Anthony L. Lamm, Esq.
Lamm, Rubenstone, Totaro & David, LLC
Bensalem, Pennsylvania

I. ENFORCEABILITY OF OPEN-ENDED OR “FLOATING” FORUM-SELECTION CLAUSES

A. Example of Open-Ended or “Floating” Forum-Selection Clause

The following is an example of a typical open-ended or “floating” forum-selection clause:

This agreement shall be governed by, construed and enforced in accordance with the laws of the State in which the Rentor’s principal offices are located or, if the Lease is assigned by Rentor, the State in which the assignee’s principal offices are located, without regard to such State’s choice of law considerations and all legal actions related to this lease shall be venued exclusively in a state or federal court located within that State, such court to be chosen at Rentor or Rentor’s assignee’s sole option.

B. Favorability of Open-Ended Clauses to Financing Entities

1. Delay identification of the forum for enforceability until a final determination of the financing entity to which the paper is sold or assigned is made.
2. Enhancement of value of the paper due to free transferability.
3. Inducement for financing entities to finance transactions in distant locations.

C. Defenses to Enforcement of Open-Ended Clauses

1. Absence of an identifiable forum at the time of execution of the lease renders the clause unconscionable and unenforceable.
2. Enforcement of open-ended clauses violates public policy of “notice” in certain states.
3. Incorporation of clause into agreement is a product of fraud or undue influence.

But see IFC Credit Corp. v. Aliano Bros. General Contractors, Inc., 2005 WL 643288 (N.D.Ill. 2005) (refusing to enforce the above forum-selection clause); Copelco Capital, Inc. v. Shapiro, 331 N.J. Super. 1, 750 A.2d 773 (N.J. Super. Ct. App. Div. 2000) (refusing to enforce an open-ended forum-selection clause).

F. Considerations by the Courts in Applying Bremen Reasonableness Standard

1. Whether the incorporation of the open-ended forum-selection clause into the agreement was the product of fraud, undue influence or overreaching;
2. Whether the party contesting the open-ended clause can show the forum is gravely difficult and inconvenient for that party so as to deprive the party of its day in court; and/or
3. Whether the enforcement of the open-ended clause is contrary to the public policy in the forum state (i.e. public policy of notice).

G. Future Considerations for Financing Entities

1. Recognize open-ended forum-selection clauses may be challenged.
2. Make sure the open-ended clauses are clear and in conspicuous print.
3. Consider telephone verifications to inform the lessee of the location of the financing entity and afford the lessee the opportunity to voice whether there is any reason why the financing entity should not fund the transaction (i.e. objection to distant forum).

For additional information see Attachment A, reprinted with permission: Stephen Levin, Esq. and Jonathan K. Moore, Esq., "*Floating*" *Forum Selection Clauses: The M/S Bremen Afloat in the Wake of NorVergence*, LJN's Equipment Leasing Newsletter (May, 2005).

D. Value and Consideration

Under Section 3-303 of the UCC, an instrument is issued or transferred for value if:

- (1) the instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;
- (2) the transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;
- (3) the instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;
- (4) the instrument is issued or transferred in exchange for a negotiable instrument; or
- (5) the instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

Under the UCC, "consideration" means any consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. If an instrument is issued for value as stated in subsection (a), the instrument is also issued for consideration.

E. Defenses Raised to Enforcement

1. That the lessor is not a holder in due course because the subject lease is not a "negotiable instrument" under Article 3 of the UCC.
2. That the equipment lessor is not a holder in due course because the lessor took the subject lease with notice that the lessee had certain defenses to the enforcement of its obligations under the lease.
3. That the equipment lessor is not a holder in due course because the lessor took the subject lease with notice that there existed certain uncured defaults.
4. That the subject lease contains certain conditional provisions that make the lease fall outside the ambit of the definition of "negotiable instrument."

F. Enforcement: Responding to Lessee's Holder in Due Course Defenses

1. The "good faith" standard is based on willful dishonesty or actual knowledge.
2. There is no affirmative duty of inquiry on one taking a negotiable instrument.
3. There is no constructive notice unless circumstances are so strong that if ignored constitute bad faith.

III. PRIVATE LABEL AGREEMENTS – NOTICE OF ASSIGNMENT

A. What is a Private Label Agreement?

An agreement between a funding source and lease originator and/or equipment vendor that sets forth the rights and obligations of the parties surrounding leasing transactions in which the lease originator is identified as lessor. For example, ABC Leasing Company offers leasing to Quality Widgets under the name Quality Widgets Leasing.

In most instances, the lease is assigned to the funding source. The question arises as to what Notice of Assignment must be provided to the end user and the timing of such Notice in order for the funding source, as assignee, to enforce the provision in most standard leases providing that the account debtor may not assert against the assignee any claim or defense that the account debtor may have against the assignor.

B. Applicable Provisions of Article 9 of the UCC

§ 9-403. Agreement Not to Assert Defenses Against Assignee.

(a) In this section, "value" has the meaning provided in Section 3-303(a).

(b) Except as otherwise provided in this section, an agreement between an account debtor and an assignor not to assert against an assignee any claim or defense that the account debtor may have against the assignor is enforceable by an assignee that takes an assignment: (1) for value; (2) in good faith; (3) without notice of a claim of a property or possessory right to the property assigned; and (4) without notice of a defense or claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument under Section 3-305(a).

(c) Subsection (b) does not apply to defenses of a type that may be asserted against a holder in due course of a negotiable instrument under Section 3-305(b).

(d) In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the rights of an assignee are subject to claims or defenses that the account debtor could assert against the original obligee, and the record does not include such a statement: (1) the record has the same effect as if the record included such a statement; and (2) the account debtor may assert against an assignee those claims and defenses that would have been available if the record included such a statement.

(e) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(f) Except as otherwise provided in subsection (d), this section does not displace law other than this article which gives effect to an agreement by an account debtor not to assert a claim or defense against an assignee.

§ 9-404. Rights Acquired by Assignee; Claims and Defenses Against Assignee.

(a) Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (b) through (e), the rights of an assignee are subject to: (1) all terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and (2) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

(b) Subject to subsection (c) and except as otherwise provided in subsection (d), the claim of an account debtor against an assignor may be asserted against an assignee under subsection (a) only to reduce the amount the account debtor owes.

(c) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the account debtor's recovery against an assignee with respect to claims and defenses against the assignor may not exceed amounts paid by the account debtor under the record, and the record does not include such a statement, the extent to which a claim of an account debtor against the assignor may be asserted against an assignee is determined as if the record included such a statement.

(e) This section does not apply to an assignment of a health-care-insurance receivable.

4. Lease agreements that make reference to other documents; e.g., a master lease agreement do not rely upon the terms of the documents so referenced in order to receive payment upon the subject lease.

At this time, the full impact and outcome of the holder in due course issues raised by equipment lessees has yet to be determined.

II. DEFENSES RAISED THAT RELATE AND ATTEMPT TO DIFFERENTIATE LESSORS FROM HOLDERS IN DUE COURSE

A. How Defenses Reference and Relate to Holders in Due Course

Article 2A of the Uniform Commercial Code (“UCC”) applies to any transaction, regardless of form, that creates a lease. However, if the requisites of Article 2A of the UCC are not met. Article 9 of the UCC then usually governs the transaction. Recently, in response to actions involving complex lease agreements, lessees have sought to attack complex lease agreements by raising defenses related to finding that the lessors qualify as holders in due course under Article 3.

B. An Overview of Negotiable Instruments

Negotiable instruments are principally governed by state statutory law. Every state has adopted Article 3 of the UCC, with some modifications, as the law governing negotiable instruments. The UCC defines a negotiable instrument as an unconditioned writing that promises or orders the payment of a fixed amount of money. Drafts and notes are the two categories of instruments. A draft is an instrument that orders a payment to be made (ex. a check). A note is an instrument that promises that a payment will be made (ex. a certificate of deposit – CD). Drafts and notes are commonly used in business transactions to finance the movement of goods and to secure and distribute loans. To be considered negotiable, an instrument must meet the requirements stated in Article 3. Negotiable instruments do not include money, payment orders (governed by Article 4A - fund transfers) or to securities (governed by Article 8 - investment securities).

The rule of derivative title, which is applicable in most areas of the law, does not allow a property owner to transfer rights in a piece of property greater than his own. If an instrument is negotiable this rule is suspended. A good faith purchaser, who does not have any knowledge of a defect in the title or claims against it, takes title to the instrument free of any defects or claims. In relation to the suspension of the rule of derivative title, Article 3 provides for warranties to protect the parties in transactions involving negotiable instruments.

C. Holders in Due Course

Under Section 3-302 of the UCC, "holder in due course" means the holder of an instrument if: (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a). *Emphasis added.*

D. Enforcement of Forum-Selection Clauses Historically

Prior to the Supreme Court's decision in Bremen v. Zapata, forum-selections clauses were not favored by American Courts as "contrary to public policy" or effectively "ousting the jurisdiction" of the court. M/S Breman v. Zapata Off-Shore Co., 92 S. Ct. 1907, 1913, 407 U.S. 1, 9 (1972).

In Bremen, the Supreme Court developed a "reasonableness standard" in holding that a forum clause should control absent a strong showing that it should be set aside, and unless a party opposing such a clause "could clearly show that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching" Bremen, 92 S. Ct. at 1916, 407 U.S. at 15.

Inconvenience is not a basis for striking the provision unless the party raising inconvenience can demonstrate that "trial in the contractual forum will be so gravely difficult and inconvenient that he will for all practical purposes be deprived of his day in Court." Bremen, 92 S. Ct. at 1917, 407 U.S. at 17-18.

Clauses are generally enforced as to persons who were not a party to the original agreement containing the clause that confers jurisdiction upon them, absent the clauses being the product of fraud or overreaching. See e.g. Stephens v. Entre Computer Centers, Inc., 696 F.Supp. 636 (N.D. Ga. 1988); Adelson v. World Transportation, Inc., 631 F.Supp. 504, 508 (S.D.Fla.1986); Friedman v. World Transportation, Inc., 636 F.Supp. 685, 690-91 (N.D.Ill. 1986); Dukane Fabrics International, Inc. v. M.V. Hreljin, 600 F.Supp. 202, 203 (S.D.N.Y. 1985); Clinton v. Janger, 583 F.Supp. 284, 290 (N.D.Ill. 1984).

E. Recent Decisions with Regard to Enforcement of Open-Ended Forum Selection Clauses

The trend amongst the majority of the courts considering this issue is to enforce forum-selection clauses that are open-ended with respect to the forum, absent fraud. See e.g. Lyon Financial Services, Inc. v. Hall & Son Builders, Inc., 2005 WL 503371 (D.Minn.) (finding the open-ended forum-selection clause above enforceable); Commerce Commercial Leasing, LLC v. Jay's Fabric Center, 2004 WL 2457737 (E.D.Pa. 2004) (finding the open-ended forum-selection clause above enforceable); GreatAmerica Leasing Corp. v. Telular Corp., Civ. A. No. 98-127, 1999 WL 33656867, at *4 (N.D.Iowa Apr.20, 1999) (finding forum-selection clause to be enforceable but granting motion to transfer); Danka Funding, LLC v. Page, Scrantom, Sprouse, Tucker & Ford, P.C., 21 F.Supp.2d 465 (D.N.J.1998) (enforcing forum-selection clause contained in lease conferring jurisdiction over lessee in any jurisdiction where lessor or its assignee maintains their principal corporate offices); A.I. Credit Corp. v. Dijounas, Civ. A. No. 91- 6234, 1992 WL 131783, at *1 (S.D.N.Y. 1992) (enforcing open-ended forum-selection clause which allows suit in partnership's place of business or transferee's principal place of business despite that there was no certain geographic jurisdiction named).