Leases

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Case Law Developments

This survey covers several 2020 cases involving disputes among parties to equipment leases or other personal property financings, or involving third parties claiming to have related rights or interests. The courts in these cases considered many of the fundamental issues often raised by parties when litigating commercial enforcement or bankruptcy protections or rights associated with such leases and financings. The issues covered in cases summarized in this article include whether a transaction documented as a lease creates a true "lease" or a security interest, the enforceability of certain lessor remedies, vicarious liability, the enforceability and shortcomings of forum selection clauses, the enforceability of hell-or-high-water clauses, and the rights of assignees.

True Leases

When asked to determine whether a transaction that is documented as a lease creates, for commercial law purposes, a "true" lease or a security interest, courts often analyze the proper characterization of the transaction by applying the Uniform Commercial Code (the "U.C.C."), including its text, official commentary, and interpretive case law. Although a transaction may be documented as a lease, the economic and other terms of that purported lease, and the related practicalities associated with the rights and obligations provided for in those terms, will be considered when characterizing the transaction. The rights, obligations, and remedies of the parties will be governed by U.C.C. Article 2A if the transaction is deemed a true lease or by U.C.C. Article 9 if it is deemed to create a security interest. Although there could be similarities between the U.C.C.-based analysis and the analyses from non-commercial contexts, such as accounting or

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tax treatment,[1] the analysis in those other contexts is often set forth in related laws, regulations, or interpretations. However, if none is provided, courts will sometimes undertake the U.C.C.-based analysis to determine the proper characterization of the transaction.[2]

In *Huntington Technology Finance, Inc. v. Neff*,[3] the court applied the so-called "bright-line" test followed by a fact-specific inquiry into the nature of the transaction to determine the lease characterization.[4] The parties entered into a purported lease agreement pursuant to which the defendants "leased" an electronic billboard mounted on a bus terminal. At the end of the initial term, the defendants could either purchase the billboard for approximately $1.2 million or exercise a "Three Year Renewal with End-of-Term Ownership"[5] option. If the defendants elected the second option, they would continue to lease the billboard for three additional years and would purchase the billboard at the expiration of that renewal term for one dollar.

The defendants argued that the agreement in question was not in fact a true lease, but rather created a security interest in favor of the plaintiff. This distinction would have afforded the defendants certain defenses that they purportedly waived in the lease and in the guarantees, which waivers are permitted by U.C.C. Article 2A, but not under U.C.C. Article 9.[6] The court, however, rejected this argument, holding that the defendants failed to meet their burden to demonstrate that the transaction was other than what it purported to be on its face.[7]

The bright-line test[8] applied by the court to determine the lease characterization provides, in part, that a purported lease creates a security interest if the lease is not terminable by the lessee, *and* includes an option to become the owner of the goods subject to the lease for nominal additional consideration upon compliance with the lease.[9] Because the nominal purchase price option could not be exercised by the lessee at the expiration of the initial lease term, but rather

1. *See* Vital Pharm., Inc. v. Balboa Cap. Corp., 806 F. App'x 884, 887 (11th Cir. 2020) (citing CAL. COM. CODE § 10103(a)(7) cmt. g (West, Westlaw through ch. 17 of the 2021 Reg. Sess.)) (noting that the term "finance lease" in other contexts, such as tax or accounting, may include leases that are disguised secured transactions). The term "finance lease" is often used by non-lawyers to refer to a non-true lease, but in a commercial law context, it refers to a certain type of true lease governed by the applicable provisions of U.C.C. Article 2A.

2. *See* SAIF Corp. v. Ward (*In re* Comp. of Ward), 477 P.3d 429, 433 n.6, 436 (Or. Ct. App. 2020) (citing OR. REV. STAT. ANN. §§ 72A.1030(1), 656.027(15), 656.027(28) (West, Westlaw through the 2020 Reg. Sess.) (explaining, in a workers compensation case, use of the Oregon U.C.C. definition of "leasehold interest" to determine the parties' interest in a truck as an element of whether Ward was a "subject worker").

3. Huntington Tech. Fin., Inc. v. Neff, No. 18-CV-01708, 2020 WL 1430092 (D. Conn. Mar. 24, 2020).

4. *Id.* at *9–13.

5. *Id.* at *10.

6. *Id.* at *8.

7. *Id.* at *10.

8. The court applied the bright-line test under the former U.C.C. section 1-201(37), rather than the revised U.C.C. section 1-203, as the lease was entered into prior to December 2014. *Id.* at *10 n.9 (citing U.C.C. § 1-201(37) (AM. L. INST. & UNIF. L. COMM'N 1999); U.C.C. § 1-203 (AM. L. INST. & UNIF. L. COMM'N 2001)).

9. *Id.* at *10.

only after the exercise of an additional extension of the lease past its term, this was not a disguised security interest under the bright-line test.[10]

Having not satisfied the bright-line test, the court noted that the next step of analysis was to look to the facts of the case and the nature of the transaction. Despite the plaintiff's arguments to the contrary, simply failing the bright-line test did not necessarily require that the lease automatically be deemed a true lease.[11] The court noted that the fact-specific analysis hinges on the reversionary interest retained by the lessor in the transaction. If the lessor retains a meaningful reversionary interest, the transaction should be deemed a true lease, but otherwise the transaction may be deemed a disguised sale and security interest.[12]

Because the purchase price at the expiration of the base term was $1.2 million (which the court determined not to be nominal), and the lessee could only purchase the billboard for a nominal amount if it exercised the renewal option, the court held that the lessor retained a meaningful reversionary interest in the billboard and the transaction was a true lease.[13] This holding makes clear that the bright-line test is only the starting point of the "facts of each case" analysis to be applied when determining whether a transaction creates a lease or a security interest, and if not "knocked out" by that test, a court will consider all of the pertinent facts and circumstances, including the economic realities of the transaction.

In *In re Roberts*,[14] two neighboring farmers (who happened to share grandchildren) entered into an undocumented lease in 2016 for certain farming equipment. The farmers agreed to certain terms which included: (1) the lessee would pay the lessor a specific amount each year for five years, with certain credits earned by the lessee if he spread manure on the lessor's property; (2) if the lessee paid as agreed during the five-year term, he had the option to purchase the equipment at the end of the lease term for $1; and (3) the lessee had the option to terminate the lease and return the equipment at any time during the lease term, for any reason, without penalty. The lessee made a few payments during the first two years of the lease term, and accrued credits for spreading manure on the lessor's property, but failed to pay any sum or earn any further rent credits after 2017. After several attempts to address the amount due, the lessor met with the lessee in 2019 and offered to terminate the lease and take the equipment back with "no hard feelings,"[15] as per their original agreement. Unbeknownst to the lessor, the lessee had filed for bankruptcy in 2018 and had listed the lessor

10. *Id.*

11. *Id.* at *11. Note that, under both former U.C.C. section 1-201(37) (the test used by the court), and U.C.C. section 1-203 (the current version of the test), "[w]hether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case." U.C.C. § 1-201(37) (Am. L. Inst. & Unif. L. Comm'n 1999); U.C.C. § 1-203(a) (Am. L. Inst. & Unif. L. Comm'n 2001). Accordingly, if the transaction does not satisfy the "bright-line" test under paragraph (b) of section 1-203, and is not automatically deemed a security interest, then the court must consider the facts of the case under paragraph (a). *See Huntington Tech. Fin., Inc.*, 2020 WL 1430092, at *11 (interpreting predecessor).

12. *Huntington Tech. Fin. Inc.*, 2020 WL 1430092, at *11.

13. *Id.* at *12–13.

14. *In re* Roberts, 620 B.R. 336 (Bankr. D.N.M. 2020).

15. *Id.* at 339.

first as a secured creditor and then as an unsecured creditor, claiming the lease was a secured financing and not a true lease.

The court ultimately determined that the lease was a true lease because it was "terminable at will by [the lessee] at any time, without penalty."[16] The court noted the handshake agreement between the two grandfathers was a true lease under both the "bright-line" test[17] (because the lessee was able to terminate the lease at will without penalty) and the "economic realities" test[18] (because, if the equipment was returned to the lessor, it would have been of substantial value to him).[19] The fact that the lessor was willing to accept return of the equipment saved him from losing the equipment and/or recouping its cost—and likely made for happier family holidays.

In re Zetta Jet USA, Inc.[20] involved the commercial law characterization of a purported lease in the context of a U.S. Bankruptcy Court proceeding. The court did not apply the tests set forth in the U.C.C., because the leases included provisions that they were to be governed by English law. The lessee was Zetta Jet USA, Inc. ("Zetta USA"), a charter operator and U.S. affiliate of a Singapore company, primarily based in California.

In Zetta USA's chapter 7 bankruptcy case, the trustee asserted that certain aircraft leases were disguised secured transactions, rather than true leases, and consequently the bankruptcy estate of Zetta USA had commercial law ownership of the related aircraft pursuant to California law (i.e., the U.C.C.). Specifically, the trustee argued that U.C.C. section 1-203 should be applied by the court to determine the characterization of each of the leases, notwithstanding the express agreement by the parties that English law should govern matters relating to each lease. Although it is often the case that similar results are achieved when undertaking a commercial law analysis whether considering the applicable provisions of the U.C.C. or English common law, that is not the case with characterization of transactions documented as leases.[21] While English law strongly favors form and generally prohibits recharacterization, the U.C.C. approach adopted by California is to conduct a fact-specific inquiry into the economic realities of the transaction to determine whether a purported lease may actually be considered a security interest or installment contract.[22] The court ultimately decided to honor the parties' agreement to apply English law, and thus the lease was not recharacterized, despite facts that may have led to a different result under the

16. *Id.* at 342.

17. *See* N.M. STAT. ANN. § 55-1-203(b)–(e) (West, Westlaw through ch. 4 of the 1st Spec. Sess. of the 55th Leg.) (codifying what are known as the "bright-line" test and the "economic realities" test).

18. *Id.*

19. Both the lessor and the lessee testified that the equipment was worth about $100,000 as of the date of the court case. *In re Roberts*, 620 B.R. at 342.

20. REDACTED Memorandum of Decision, King v. Bombardier Aerospace Corp. (*In re* Zetta Jet USA, Inc.), No. 17-BK-21386 (Bankr. C.D. Cal. Oct. 15, 2020).

21. *Id.* at 19 (citing HFGL Ltd. v. Alex Lyon & Sons Sales Managers & Auctioneers, Inc., 700 F. Supp. 2d 681 (D.N.J. 2010)).

22. *Id.* (discussing the "American" approach under the U.C.C.).

U.C.C.[23] The important takeaway here is that, while U.S. parties often expect a court to look to the U.C.C. to determine the characterization of a lease, parties should not necessarily expect the same result if a non-U.S. governing law is chosen.

Lessor's Damages

Although parties at the inception of a transaction may bargain for certain remedies, if litigated, courts will determine whether those remedies may be enforced. In particular, courts have analyzed the enforceability of liquidated damages remedies in leases when challenged by a lessee based on statutory or common law defenses. Lessors may attempt to mitigate this risk by prudent drafting, but the enforceability of any remedy will be, if challenged, subject to a court's analysis of the applicable law and the relevant facts of each case.

Wells Fargo Trust Co., N.A. v. Synergy Group Corp.[24] related to two leases between Wells Fargo Trust Company, N.A. ("Wells Fargo"), as owner trustee, and Oceanair Linhas Aereas S.A. d/b/a Avianca Brazil ("Avianca"), pursuant to which Wells Fargo leased aircraft engines to Avianca, and Synergy Group Corp. ("Synergy") guaranteed Avianca's obligations. After Avianca defaulted under the leases, Wells Fargo brought an enforcement action against Synergy pursuant to the guaranties.[25] The parties stipulated that the guaranties were absolute and unconditional, the lease/guaranty obligations were outstanding, and Synergy had breached its guaranties, so the court only needed to rule on the validity and enforceability of the damages provisions and any amount of damages to be awarded to Wells Fargo.[26]

The lease and guaranty default remedy provisions included the lessor's right to demand damages in an amount equal to (A) the sum of (1) past due rent and use fees, (2) the present value of future rent for the remaining terms of the leases (the "future rent damages"), (3) compensation for failure to return the engines in accordance with the lease requirements (the "end of lease damages"), (4) any engine repair costs, and (5) any costs for repossessing the engines, *less* (B) a mitigation credit in the amount of any engine sale or lease proceeds if returned.[27] Synergy argued that the lease remedy provisions were "punitive, against public policy and therefore unenforceable."[28] The court's analysis focused on Article 2A, Section 504 of the New York U.C.C., including various cases interpreting that section.[29]

23. *Id.* at 20 (citing facts alleged by the trustee in the complaint and related filings).
24. Wells Fargo Tr. Co., v. Synergy Grp. Corp., 465 F. Supp. 3d 355 (S.D.N.Y. 2020).
25. *Id.* at 359–61.
26. *Id.* at 361.
27. *Id.* at 359–60.
28. *Id.* at 362.
29. *See id.* (citing N.Y. U.C.C. Law § 2-A-504(1) (West, Westlaw through L.2021, chs. 1–49, 55–58, 60–102) ("[D]amages payable by either party for default . . . may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default . . . ."); JMD Holding Corp. v. Cong. Fin. Corp., 828 N.E.2d 604, 609 (N.Y. 2005) ("Whether the early termination fee represents an enforceable liquidation of damages or an unenforceable penalty is a question of law, giving due consideration to the nature of the contract

Synergy argued that the future rent damages were unenforceable because they put Wells Fargo in a better position than if Avianca had fully performed under the leases, entitling Wells Fargo to receive both the future payments under the leases as well as any lease or other disposition proceeds attributable to any returned engines.[30] However, the court ruled that the "future payments ensure that [Wells Fargo] receives the benefit of its bargain, *i.e.* rent and use fees through the duration of the leases" and that they "put [Wells Fargo] in the position it would have been in had there been no breach,"[31] and noted Synergy's argument was hindered by the mitigation credit provision and the fact that the lease afforded Wells Fargo "sole discretion" as to whether it leased, sold, or held idle the returned engines.[32]

Synergy also argued that its express agreement to pay the end of lease damages should not be enforced because these damages improperly "transfer . . . the risk of idiosyncratic depreciation or damage to a particular engine to Avianca."[33] The court disagreed, citing the express risk allocation on which Wells Fargo had based its claim,[34] and emphasizing that "the parties are sophisticated commercial entities, capable of determining how to allocate their risks and adjust their pricing accordingly."[35]

Overall, the court attributed Synergy's various arguments to "a misunderstanding of N.Y. U.C.C. [Article 2A section] 504 and the principle against punitive damages,"[36] and held that Synergy should bear the responsibility for damages that were "direct analogues" to Synergy's promises.[37] Generally, a lessor is entitled to recover residual value damages suffered by reason of a lessee's breach under a lease, particularly if those damages would not, at the time of agreement, appear to provide the lessor with a windfall or be deemed punitive to the lessee.[38] On May 26, 2021, the Second Circuit upheld the United States District Court for the Southern District of New York's decision in *Synergy* by summary order granting Wells Fargo summary judgement and damages citing

and the circumstances . . . ."); CVS Pharm., Inc. v. Press Am., Inc., 377 F. Supp. 3d 359, 375 (S.D. N.Y. 2019) (determining whether damages provision constitutes an unenforceable penalty or an enforceable liquidation of damages is a "question of law"); Rubin v. Napoli Bern Ripka Shkolnik, LLP, 118 N.Y.S.3d 4, 6–7 (App. Div. 2020) (quoting Truck Rent-A-Ctr., Inc. v. Puritan Farms 2nd, Inc., 361 N.E.2d 1015, 1018 (N.Y. 1977)) ("A contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation.")).

30. *Id.* at 363.

31. *Id.* at 362–63.

32. *Id.* at 363.

33. *Id.*

34. *Id.*

35. *Id.* at 364.

36. *Id.*

37. *Id.* The court further noted a "corollary principle"—Synergy "cannot attempt to undo the promises it has already made in the guise of challenging purportedly punitive damages provisions." *Id.*

38. *See* U.C.C. § 2A-504 cmt. (Am. L. Inst. & Unif. L. Comm'n 1990) ("A liquidated damages formula that is common in leasing practice provides that the sum of lease payments past due, accelerated future lease payments, and the lessor's estimated residual interest, less the net proceeds of disposition (whether by sale or re-lease) of the leased goods is the lessor's damages.").

that the district court "correctly concluded that the provisions in the agreements between the parties providing that Wells Fargo was due payments for future rent, end of lease, and repair and maintenance were not unenforceable penalties."[39]

The *Synergy* decision is particularly noteworthy because it seemingly conflicts with the February 2019 decision in *In re Republic Airways Holdings, Inc.*,[40] which also emerged from the Southern District of New York, and which refused to enforce liquidated damages in a commercial aircraft lease between sophisticated parties.[41] *Synergy* and *Republic* share the fundamental consideration of whether such sophisticated parties should be held accountable for express contractual promises believed by the parties to be a reasonable allocation of risks at the time those promises were made. In *Republic*, the U.S. Bankruptcy Court for the Southern District of New York refused to enforce the expressly bargained for liquidated damages remedies in those leases on the basis that the remedies were punitive and against public policy[42]—conclusions that seem inconsistent with applicable law.[43]

Unlike the *Republic* court, the *Synergy* court upheld the lessor's liquidated damages claims by emphasizing notions of freedom of contract among sophisticated commercial parties and assessing the reasonableness of damages remedies in the context of what the parties contemplated when they executed the related lease documents, which determinants are both strongly supported by U.C.C. Article 2A and the precedent cited in the court's opinion.[44] The *Synergy* opinion should be useful as support in enforcement actions involving liquidated damages, as well as providing guidance when drafting remedy provisions of this type.[45]

In *Bank of the West v. Prince*,[46] the Fifth Circuit was tasked with a cross-appeal of the district court's damages award, which was previously summarized in our 2019 *Leases* survey.[47] To refresh the facts at issue, the lessee leased a trailer-mounted frac unit (the "Equipment") and Danny K. Prince and Steven Cloy Gantt (the

39. Wells Fargo Tr. Co. v. Synergy Grp. Corp., Summary Order, No. 20-2177, 2021 U.S. App. LEXIS 15668 (2d Cir. May 26, 2021).

40. *In re* Repub. Airways Holdings, Inc., 598 B.R. 118 (Bankr. S.D.N.Y. 2019).

41. *Id.* at 121.

42. *Id.* at 150; *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, 1 (critiquing the *Republic* decision).

43. Gelman & Gross, *supra* note 42, at 1 ("The authors of this article believe that the court's findings were based on misinterpretations or mischaracterizations of the applicable statutory and case law . . . .").

44. Wells Fargo Tr. Co., v. Synergy Grp. Corp., 465 F. Supp. 3d 355, 362–65 (S.D.N.Y. 2020) (citing N.Y. U.C.C. Law § 2-A-504 (West, Westlaw through L.2021, chs. 1–49, 55–58, 60–102)) (collecting cases); *see In re* Snelson, 305 B.R. 255, 264–65 (Bankr. N.D. Tex. 2003); PacifiCorp Cap., Inc. v. Tano, Inc., 877 F. Supp. 180, 183–84 (S.D.N.Y. 1995).

45. For example, rent acceleration liquidated damages should commence after recovery of the equipment, be present valued as of the date of the demand using a reasonable discount rate, and be reduced by a mitigation credit. *See* U.C.C. § 2A-504 cmt. (Am. L. Inst. & Unif. L. Comm'n 1990).

46. Bank of the W. v. Prince, 942 F.3d 697 (5th Cir. 2019).

47. Dominic A. Liberatore, Edward K. Gross & Stephen T. Whelan, *Leases*, 74 Bus. Law. 1225, 1231–32 (2019) (addressing Bank of the W. v. Prince, No. 16-1098, 2018 WL 3868796 (W.D. La. Aug. 14, 2018)).

"Guarantors") personally guaranteed the lessee's obligations.[48] The lease provided for several remedies upon lessee's event of default, including the lessor's rights to: (1) recover from lessee all accrued and unpaid amounts, (2) recover from lessee, as liquidated damages, the present value of all amounts to be paid by lessee under the lease, discounted at 2 percent per annum, (3) demand that lessee return the Equipment, and (4) recover from lessee all amounts incurred by the lessor in enforcing its rights and remedies, including repossession costs, reasonable attorneys' fees, and reasonable internal costs.[49] The lessor assigned its interest in the lease to Bank of the West (the "Bank").[50] The lessee subsequently defaulted on the lease by failing to make a monthly payment, and voluntarily surrendered the Equipment, which the Bank then sold at auction.[51] The Bank filed suit against the Guarantors to recover liquidated damages under the lease, plus costs and attorneys' fees.[52] The district court refused to enforce the liquidated damages remedy,[53] instead awarding the Bank both (1) an amount equal to the past-due rent stipulated by both parties, and (2) an amount deemed "reasonable damages,"[54] which was characterized by the district court as the net amount believed "sufficient to make the Bank whole."[55]

The Fifth Circuit agreed with the district court that the Louisiana Lease of Movables Act (the "LLMA")[56] applied to the lease, as a lease of movable property located in Louisiana,[57] but vacated the district court's alternative damages award and remanded for recalculation, holding that the lease provisions entitling the lessor to both repossess and recover the accelerated rental payments as liquidated damages violated the LLMA's prohibition against cumulative remedies.[58] The LLMA requires lessors to "choose between two exclusive sets of remedies: (1) cancelling the lease and collecting accelerated rental payments, or (2) repossessing the [Equipment] and collecting liquidated damages."[59] The court further held that the proper measure of liquidated damages under the lease was the loss of profits contemplated by the original lessor, rather than damages suffered by the Bank.[60]

Similar to the *Zetta USA* case discussed earlier in this article, the *Prince* case also underscores how the governing law determined to be applicable to the enforcement of a particular lease could materially impact lessors' rights and

48. *Prince*, 942 F.3d at 699.
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. Bank of the W. v. Prince, No. 16-1098, 2018 WL 3868796, at *4 (W.D. La. Aug. 14, 2018).
54. *Id.*
55. *Id.*
56. LA. STAT. ANN. §§ 9:3301–9:3342 (West, Westlaw through 2020 2d Extraordinary Sess.).
57. *See Prince*, 942 F.3d at 700 (citing LA. STAT. ANN. § 9:3303 (West, Westlaw through 2020 2d Extraordinary Sess.)).
58. *Id.* at 698, 700–04.
59. *Id.* at 701 (citing LA. STAT. ANN. § 9:3318(A) (West, Westlaw through 2020 2d Extraordinary Sess.)).
60. *Id.* at 704.

remedies, including the calculation or amount of damages in the event of a lessee's breach. The district court's original decision to award damages to the Bank in an amount it claimed to have suffered as a result of the lessee's default, rather than the damages that the original lessor might have claimed if it had not collaterally assigned its rights to the Bank,[61] was vacated for recalculation of losses equivalent to those "sustained by the [original] obligee and the profit of which he has been deprived."[62] Louisiana is the only state not to adopt U.C.C. Article 2A;[63] accordingly, the *Prince* decision hinged upon interpretation of the LLMA. Had the court relied upon U.C.C. Article 2A and related precedent, it is likely that the court would have upheld a liquidated damages provision that both accelerated rent due under the lease and permitted repossession of the Equipment, so long as the accelerated rent amount was discounted using a reasonable discount rate and the damage amount was reduced by a mitigation credit consistent with the lessor's having an opportunity to dispose of the returned equipment.[64]

In *Ultra Group of Companies, Inc. v S&A 1488 Management, Inc.*,[65] the plaintiff was unable to argue its appeal under a U.C.C. framework, because it did not raise this argument before the hearing officer of the Georgia Lottery Corporation. The plaintiff, the owner of coin-operated amusement machines, leased several machines to the defendant, the owner of a convenience store. When the defendant breached the lease, the plaintiff sued for liquidated damages.

One of the factors in the characterization test applied by the court required that "the stipulated sum must be a reasonable pre-estimate of the probable loss resulting from such a breach,"[66] which is similar to the requirement in U.C.C. Article 2A, Section 504 that liquidated damages must be in "an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission."[67] Similar to the *Prince* decision discussed above, the *Ultra Group* court rejected the liquidated damages clause because it entitled the lessor to the cumulative damages of "all future revenue and full possession of the property with the ability to re-rent or sell."[68] It is noteworthy that both of these cases were decided under a non-U.C.C. framework as Article 2A does not prohibit the enforcement of liquidated damages along with other remedies, such as repossession. Whether decided under a U.C.C. analysis or not, courts generally do not allow the lessor to be put in a "far

61. As noted in our 2019 analysis, this choice was unusual, and it appears the appellate court agreed. Liberatore, Gross & Whelan, *supra* note 46, at 1232.

62. *Prince*, 942 F.3d at 701 (quoting La. Civ. Code Ann. art. 1995 (West, Westlaw through 2020 2d Extraordinary Sess.)).

63. *See What Is Uniform Commercial Code?*, La. Sec'y State, https://www.sos.la.gov/BusinessServices/UniformCommercialCode/WhatIsUniformCommercialCode/Pages/default.aspx (last visited May 7, 2021).

64. *See supra* notes 24–38 and accompanying text.

65. Ultra Grp. of Cos. v. S&A 1488 Mgmt., Inc., 849 S.E.2d 531 (Ga. Ct. App. 2020).

66. *Id.* at 534 (quoting Nat'l Serv. Indus., Inc. v. Here to Serve Rests., Inc., 695 S.E.2d 669, 671 (Ga. Ct. App. 2010)).

67. U.C.C. § 2A-504(1) (Am. L. Inst. & Unif. L. Comm'n 1990).

68. *Ultra Grp. of Cos.*, 849 S.E.2d at 534.

better position than it would have been if the contract had never been breached."[69]

Vicarious Liability

Chang v. United States[70] involved a motor vehicle crash between plaintiff, Lloyd Chang ("Chang"), and Joel Baybick ("Baybick"), an employee of co-defendant the U.S. Government ("USA"). Chang alleged that Baybick was driving a vehicle owned by co-defendant Enterprise Leasing Company of Florida, Inc. ("Enterprise") and rented to the USA pursuant to a rental agreement ("Rental Agreement"), with Enterprise vicariously liable for the crash. Enterprise asserted that Chang's claim against Enterprise for vicarious liability was preempted by the Graves Amendment.[71] Chang raised a novel argument that the USA and Enterprise contracted themselves out of the protections of the Graves Amendment by including the following clause in the Rental Agreement: "Notwithstanding the provisions of any [Enterprise] rental vehicle agreement or contract executed by the [USA] employee when renting a vehicle under the terms of this Agreement, [Enterprise] will maintain in force, at its sole cost, insurance coverage or a duly qualified self-insurance program which will protect the [USA] and its employees against liability for personal injury, death, and property damage arising from the use of the vehicle."[72]

The court disagreed with Chang's assertion that the co-defendants contracted themselves out of the Graves Amendment protection and noted that the "[p]laintiff relies on language in a provision that provides insurance coverage and is silent as to liability."[73] The court further noted that the "[p]laintiff fails to cite law supporting his argument that this language creates an exception to the Graves Amendment."[74] The court found the "[c]omplaint alleges the very vicarious liability the [Graves] Amendment seeks to eliminate."[75] The court therefore held that Chang's claim against Enterprise for vicarious liability was preempted by the Graves Amendment.

Subrogation Division Inc. v. Brown[76] involved a rental vehicle crash in which plaintiff Subrogation Division Inc. ("SDI"), as assignee of causes of actions owned by car rental company Overland West, Inc. ("Overland"), brought suit

69. *Id.* (quoting Caincare, Inc. v. Ellison, 612 S.E.2d 47, 50 (Ga. Ct. App. 2005)).

70. Chang v. United States, No. 19-25195-CIV, 2020 WL 6114880 (S.D. Fla. May 15, 2020).

71. *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).").

72. *Chang*, 2020 WL 6114880, at *2 (quoting the Rental Agreement).

73. *Id.* at *3.

74. *Id.*

75. *Id.*

76. Subrogation Div. Inc. v. Brown, 446 F. Supp. 3d 542 (D.S.D. 2020).

against co-defendants Stanley Brown ("Brown") and 21st Century Indemnity Insurance Company ("21st Century") seeking a declaratory judgment that the Graves Amendment preempted a South Dakota law requiring rental company's insurance to primarily pay claims incurred by a renter. Brown rented a vehicle from Overland, which was a Hertz licensee and in the business of renting vehicles. Pursuant to the rental agreement, Brown's automobile liability insurance would be primary in the event of an accident. On May 3, 2013, Brown collided with a vehicle owned by Dan Claymore ("Claymore"). Brown carried liability insurance from 21st Century in accordance with South Dakota's minimum liability coverage requirements. Neither Mr. Brown nor 21st Century reimbursed Overland or SDI for Claymore's damages. Overland assigned its rights in this action to SDI.

The court noted that the Graves Amendment includes a savings clause, which provides:

> Nothing in this section supersedes the law of any State or political subdivision thereof—(1) imposing *financial responsibility* or insurance standards on the owner of a motor vehicle for the privilege of registering and operating a motor vehicle; or (2) imposing liability on business entities engaged in the trade or business of renting or leasing motor vehicles for failure to meet the *financial responsibility* or liability insurance requirements under State law.[77]

The court noted "Congress did not define what it meant by the term 'financial responsibility' it used in the savings clause."[78] The court further noted "common principles of statutory interpretation lead the court to conclude *financial responsibility* is best understood as describing liability insurance and analogous forms of insurance-like financial instruments designed to compensate for injuries and satisfy judgments."[79] The court acknowledged that "[t]he savings clause protects South Dakota's power to require rental companies to carry insurance."[80] However, the court held that South Dakota law could not "require rental companies to be vicariously liable for damages incurred solely by renters through insurance law or otherwise."[81] The court therefore concluded that, pursuant to the Graves Amendment, Overland was not vicariously liable for Brown's torts.[82]

Cooke v. Ford Motor Co.[83] involved a motor vehicle crash in which Tariq Y. Strong, Jr. ("Strong") and a passenger, Madison C. Cooke ("Cooke"), were killed, and two other passengers, Megan E. Ockerman ("Ockerman") and Gina M. Badia ("Badia"), were seriously injured. Strong was driving a car that had been leased

77. *Id.* at 550–51 (emphases added) (quoting 49 U.S.C. § 30106(b) (2018)).
78. *Id.* at 551.
79. *Id.* at 552 (emphasis added).
80. *Id.* at 553.
81. *Id.*
82. Moreover, the court concluded that SDI, which stood in the shoes of Overland, could recover Claymore's damages from Brown, based upon indemnification provisions in the rental agreement. *Id.* at 555–57. The court noted that no party sought a determination regarding 21st Century's obligation to cover Brown's liability. *Id.* at 557.
83. Cooke v. Ford Motor Co., No. 346091, 2020 WL 5492107 (Mich. Ct. App. Sept. 10, 2020).

by Debra Ockerman through a Ford Motor Company ("Ford Motor") program that allowed management-level employees to lease Ford vehicles from Ford Motor. In June 2015, Debra Ockerman allowed her eighteen-year-old daughter, Ockerman, to use the vehicle to go to a music festival with Strong, Cooke, and Badia. The group was headed home, and Ockerman asked Strong to drive. While Strong was driving, he lost control of the car and hit a tree. The collision killed Strong and Cooke and seriously injured Ockerman and Badia. Cooke's estate, Ockerman, and Badia all sued Ford Motor, alleging that, as an owner of the vehicle, Ford Motor was liable for Strong's negligent operation of that vehicle under Michigan's owner's liability statute. "Ford Motor argue[d] that as a long-term lessor engaged in the business of leasing motor vehicles, it is excluded from the statutory definition of 'owner' and exempt from both statutory and common law liability for negligent operation of the motor vehicle under [Sections 401(2) and 401a of the Civil Liability Act of Michigan's Vehicle Code]."[84]

The court found that, "[w]hile the leased vehicle is a fringe benefit to the lessee Ford Motor employee, and Ford Motor does not necessarily derive a monetary profit from its lease program,"[85] Ford Motor nonetheless "was 'engaged in the business of leasing motor vehicles' as contemplated by [sections 401(2) and 401a] and is exempt from liability under the [Civil Liability Act of Michigan's Vehicle Code]."[86] Although the court noted that "[it] decline[d] to address as moot Ford Motor's alternative argument that the Graves Amendment . . . . preempts any liability that would be imposed against Ford Motor under the owner's liability statute,"[87] the court's finding that Ford Motor's lease program involved "the business of leasing motor vehicles"[88] can be read to suggest that, if the applicable Michigan statute had not itself exempted Ford Motor from liability, the Graves Amendment may have exempted Ford Motor from vicarious liability.

Callejas Trejo v. Overnight Parts Alliance, LLC[89] involved a car accident in which plaintiffs' decedent, Guillermo Lugo-Callejas ("Lugo-Callejas"), and six others were killed when a truck driven by co-defendant Steven McKinney ("McKinney ") crossed over the center line of a highway and collided head-on with the van in which Lugo-Callejas was a passenger. McKinney was acting in the scope of his employment as a delivery driver for co-defendants Overnight Parts Alliance, LLC ("OPA") and Wholesale Parts Alliance, LLC ("WPA"), and driving a vehicle leased to OPA and/or WPA by co-defendant Penske Truck Leasing, LLC ("Penske").

Plaintiffs did not dispute that, under the Graves Amendment, Penske could not be held vicariously liable for any negligence by OPA, WPA, or McKinney

84. *Id.* at *5 (citing MICH. COMP. LAWS ANN. §§ 257.401(2), 257.401a (West, Westlaw through P.A. 2021, No. 15, of the 2021 Reg. Sess.)).

85. *Id.* at *6.

86. *Id.* (quoting MICH. COMP. LAWS ANN. §§ 257.401(2), 257.401a (West, Westlaw through P.A. 2021, No. 15, of the 2021 Reg. Sess.)).

87. *Id.* at *7.

88. *Id.* at *6.

89. Callejas Trejo v. Overnight Parts All., LLC, No. 20-CV-539, 2020 WL 5983895 (S.D. Miss. Oct. 8, 2020).

but only for its own negligence. "The issue . . . [was] whether plaintiffs . . . stated a viable claim against Penske for its own negligence."[90] The court noted that, "[t]o be potentially liable, . . . Penske must have owed plaintiffs' decedent a duty of care."[91] However, the court concluded that Penske neither owed nor breached any such duty of care, noting that "plaintiffs allege only that because Penske knew the subject leased vehicle would be used by OPA/WPA for long-distance driving, then it was reasonably foreseeable to Penske that OPA/WPA drivers might be (or become) fatigued or impaired."[92] The court found that "mere knowledge by Penske, as the vehicle lessor, that the leased vehicle would likely be driven long distances did not give rise to a duty by Penske to equip the vehicle with unspecified 'alarms, controls, or safety devices' designed to protect against fatigued or impaired driving."[93] The court concluded that Penske had not committed its own independent negligence and therefore was protected from vicarious liability under the Graves Amendment.

Forum Selection Clauses

Canon Financial Services, Inc. v. Palomar Reprographics[94] involved an equipment lease between Palomar Reprographics ("Palomar") and Canon Financial Services, Inc. ("CFS"). CFS brought a collection action in a New Jersey state court. Palomar removed the suit to the U.S. District Court for the District of New Jersey, and then sought to transfer venue to the U.S. District Court for the Southern District of California. The court stated, "[i]n the removal context, the proper venue is 'the district court of the United States for the district and division embracing the place where [the state court] action is pending.'"[95] The court found that "[t]his suit was removed from New Jersey state court, therefore the District of New Jersey is the proper venue by operation of [section] 1441(a)."[96]

The court further found that forum selection clauses "are prima facie valid and should be enforced unless the enforcement is shown by the resisting party to be 'unreasonable' under the circumstances."[97] The court noted that Palomar had not met this high standard by alleging that it was not free to alter the form contract provided by CFS.[98] This decision highlights that merely using a preprinted, non-negotiated lease form that contains a forum selection clause does not equate to such clause being unreasonable or unenforceable.

The court also noted "[l]itigants are not necessarily deprived of their day in court because they have to use deposition testimony rather than live testimony

90. *Id.* at *4.
91. *Id.*
92. *Id.*
93. *Id.* (quoting complaint) (citing Novek v. Avis Rent-A-Car Sys. LLC, 446 F. App'x 370, 373 (2d Cir. 2011)).
94. Canon Fin. Servs., Inc. v. Palomar Reprographics, No. 18-16332, 2020 WL 4463177 (D.N.J. Aug. 4, 2020).
95. *Id.* at *3 (second alteration in original) (quoting 28 U.S.C. § 1441(a) (2018)).
96. *Id.* (citing 28 U.S.C. § 1441(a) (2018)).
97. *Id.* at *4 (quoting Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 10 (1972)).
98. *Id.*

in a trial. The use of deposition testimony for some witnesses in the event of trial is sometimes more cost effective and regularly used."[99] The court therefore denied Palomar's motion to transfer the suit to the Southern District of California.[100]

LEAF Capital Funding, LLC v. Tuskegee University[101] involved an equipment lease ("Lease") between LEAF Capital Funding, LLC ("Leaf") and Tuskegee University (the "University"). Leaf brought a breach of contract action against the University in the U.S. District Court for the Middle District of Alabama. The Lease provided: "CHOICE OF LAW: THIS LEASE WILL BE GOVERNED BY PENNSYLVANIA LAW. YOU CONSENT TO JURISDICTION IN THE STATE OR FEDERAL COURTS OF PENNSYLVANIA AND WAIVE ANY RIGHT TO A TRIAL BY JURY."[102] The court noted that "[a] forum selection clause can either be mandatory or permissive. A mandatory clause designates a specific forum as the exclusive forum in which to litigate the dispute. A permissive clause merely consents to jurisdiction in the designated forum and does not foreclose litigation in an alternative forum."[103] The court further noted that "consent to jurisdiction in one state does not cut off jurisdiction elsewhere."[104] The court concluded that "LEAF and [the] University have agreed to the jurisdiction of Pennsylvania courts, but they also have not excluded this Court from having jurisdiction, either."[105] The court therefore ordered that it had jurisdiction and was an appropriate forum for the suit.[106] This decision highlights the importance of clarifying in the lease whether a forum selection clause is intended to be mandatory or merely permissive.

RECO Equipment, Inc. v. Custom Ecology of Ohio, Inc.[107] involved two equipment leases (collectively, the "Lease") between RECO Equipment, Inc. ("RECO") and Custom Ecology of Ohio, Inc. ("Custom Ecology"). RECO brought a collection action against Custom Ecology in an Ohio state court. Custom Ecology removed the case to the U.S. District Court for the Southern District of Ohio. RECO filed a motion to remand, asserting that "[t]he contractually agreed upon forum of Belmont County amounts to a waiver of Defendant's right to remove the Belmont County case to this Honorable Court."[108] The forum selection clause in the Lease provided:

> IT IS EXPRESSLY AGREED THAT ALL OBLIGATIONS OF THE PARTIES CREATED HEREIN ARE PERFORMABLE IN THE COUNTY OF BELMONT, IN THE

99. *Id.* at *5 (quoting McNair v. Monsanto Co., 279 F. Supp. 2d 1290, 1302 (M.D. Ga. 2003)).
100. *Id.* at *7.
101. LEAF Cap. Funding, LLC v. Tuskegee Univ., No. 20-CV-538, 2020 WL 7129036 (M.D. Ala. Dec. 4, 2020).
102. *Id.* at *2 (quoting the Lease).
103. *Id.* (quoting Cardoso v. Coelho, 596 F. App'x 884, 885–86 (11th Cir. 2015) (per curiam)).
104. *Id.* at *3.
105. *Id.*
106. *Id.*
107. RECO Equip., Inc. v. Custom Ecology of Ohio, Inc., No. 20-CV-2968, 2020 WL 4434876 (S.D. Ohio Aug. 3, 2020).
108. *Id.* at *1 (quoting the motion).

> STATE OF OHIO, THE MAIN OFFICE OF RECO EQUIPMENT, INC., AND THE LAWS OF THE STATE OF OHIO SHALL GOVERN ALL TRANSACTIONS. SUIT MAY BE BROUGHT IN BELMONT COUNTY, OHIO.[109]

The court found that "the [forum selection] clause provides only that '[s]uit *may* be brought in Belmont County, Ohio.'"[110] The court noted that, "under basic contract principles, either RECO or Custom Ecology would have been free to commence an action in this [c]ourt (or any other court in which jurisdiction and venue requirements are met) in the first instance."[111] The court went on to say, "more importantly . . . , the clause makes no reference to the right of removal or Custom Ecology's waiver of that right."[112] Thus, the court found "[t]he [forum selection] clause [to be] irrelevant because it [said] nothing about the defendants' right to remove."[113] The court concluded that "Custom Ecology properly exercised its right to remove this action under [section] 1441 and did not waive that right by agreeing to a forum selection clause that references neither removal nor Custom Ecology's waiver of the right to remove."[114] The court therefore declined to remand the action.[115] This decision highlights the importance of explicitly addressing removal in forum selection clauses.

Canon Financial Services, Inc. v. Edwin F. Kalmus, LC[116] involved an equipment lease ("Lease") between CFS and Edwin F. Kalmus, LC ("Kalmus"). CFS brought a collection action against Kalmus in the Superior Court of New Jersey. A co-defendant of Kalmus, Joan Galison, removed the case to the U.S. District Court for the District of New Jersey.

The court noted that "[a] defendant can contractually waive his right to remove . . . an action brought . . . in a state court."[117] The forum selection clause at issue provided:

> The rights of the parties under this agreement shall be governed by the laws of the State of New Jersey without reference to conflict of law principles, and action between [Kalmus] . . . and [CFS] shall be brought in any state or federal court located in the County of Camden or Burlington, New Jersey, or at [CFS's] sole option, in the state where [Kalmus] or the equipment is located. [Kalmus] . . . , by [its] . . . execution and delivery hereof, irrevocably waive[s] objections to the jurisdiction of such courts and objections to venue and convenience of forum.[118]

109. *Id.* (quoting the Lease).
110. *Id.* at *2 (alterations in original) (quoting the Lease).
111. *Id.*
112. *Id.*
113. *Id.* (quoting EBI-Detroit, Inc. v. City of Detroit, 279 F. App'x 340, 346 (6th Cir. 2008)).
114. *Id.* (citing 28 U.S.C. § 1441 (2018)).
115. *Id.*
116. Canon Fin. Servs., Inc. v. Edwin F. Kalmus, LC, No. 19-CV-20919, 2020 WL 4333744 (D.N.J. July 28, 2020).
117. *Id.* at *3 (quoting New Jersey v. Merrill Lynch & Co., 640 F.3d 545, 547 (3d Cir. 2011) (quoting 14B Charles Alan Wright et. al., Federal Practice & Procedure § 3721, at 97 (4th ed. 2009))).
118. *Id.* (quoting the Lease).

The court concluded "[Kalmus] 'irrevocably waive[d]' [its] right to challenge forum where an action was brought in either a New Jersey State or Federal District Court sitting in Camden or Burlington counties. Because an appropriate forum was selected upon initiation of this action by [CFS], [Kalmus] agreed, through the forum selection clause, not to object to that selection; such necessarily includes a waiver of the right to change that forum."[119] The court held that the parties clearly waived the right to remove to a federal court.[120] The court therefore remanded the case to the Superior Court of New Jersey.[121] This is another example of the importance of clearly addressing removal in forum selection clauses and not merely forum selection itself.

Hell-or-High-Water Clauses

Highland Capital Corp. v. Pasto[122] involved a three-way business arrangement gone sour. Matthew Pasto, MD ("Pasto") entered into a partnership with the Sacramento Valley Affiliate of the Susan Komen Breast Cancer Foundation ("SVA"), under which SVA would pay Pasto for reading ultrasound and mammography images for the diagnosis of breast cancer. SVA advised Pasto that it would arrange leasing and financing of the necessary equipment, but that Pasto would have to "execute these equipment leases himself because only a licensed physician can obtain such equipment."[123] In a separate agreement, SVA agreed—but only with Pasto—to guarantee his obligations under two separate equipment leases with Highland Capital Corporation ("Highland"). When neither Pasto nor SVA made any lease payments, Highland sued Pasto, citing the hell-or-high-water clause in each lease, but its summary judgment motion was denied because delivery of the equipment to Pasto (as opposed to SVA) was never alleged or proven.[124] This decision emphasizes the importance, even in a hell-or-high-water lease, of obtaining the lessee's certificate of delivery and acceptance.[125] It also demonstrates the wisdom of having any guaranty enforceable by the financier.

Peyton Holdings, LLC v. Clover Aviation Co.[126] is another split decision involving a hell-or-high-water clause. Although the lessee conceded that it was liable for damages for nonpayment of rent, and the court, in granting partial summary judgment for the lessor, affirmed that hell-or-high-water clauses "are generally

119. *Id.* at *4 (quoting the Lease).
120. *Id.*
121. *Id.*
122. Highland Cap. Corp. v. Pasto, No. 19-CV-14282, 2020 WL 5542781 (D.N.J. Sept. 16, 2020).
123. *Id.* at *2.
124. *Id.* at *10.
125. Pasto lodged a third-party complaint against SVA, seeking to have the guaranty adjudicated in the Highland litigation, but the district court in New Jersey lacked jurisdiction over the California-based SVA, thereby forcing Pasto to deal with SVA in a separate California action. *Id.* at *1, *5–8.
126. Peyton Holdings, LLC v. Clover Aviation Co., No. 18-CIV-3165, 2020 WL 4273981 (S.D.N.Y. July 24, 2020).

enforceable" under New York law,[127] the lessor was denied accelerated damages because there is "no provision in the contract providing for the acceleration of payment in one lump sum upon default."[128] The court granted the lessor only the right to "[p]resent and future rent payments . . . as they become due."[129] The decision illustrates the wisdom of including the full assortment of remedies, especially an acceleration clause, in every lease.

Rights of Assignees

Inland Bank & Trust v. LL Flex, LLC[130] involved two contracts between Oracle Flexible Packaging, Inc. ("Oracle") and Alpha Aluminum, LLC ("Alpha"): a Transition Services Agreement ("TSA") and a Product Supply Agreement ("PSA"). Under the PSA, Oracle agreed to purchase specific quantities of aluminum from Alpha. However, because Alpha's lender would not finance too many receivables owed by any one buyer, Alpha assigned a portion of the purchase orders to Metallic Conversion Corporation ("Metallic"). Oracle subsequently did not fully perform under the PSA, failing to pay invoices due to both Alpha and Metallic. Inland Bank and Trust ("IBT"), Metallic's secured creditor, sued LL Flex, LLC ("LL Flex"), the successor to Oracle. LL Flex unsuccessfully argued that Alpha had not validly assigned the accounts to Metallic but prevailed on the affirmative defense of set-off rights under section 9-404 of the U.C.C. by the amount Alpha allegedly owed LL Flex under the TSA and PSA.[131] Consequently, IBT was granted summary judgment on its breach of contract claim but LL Flex was permitted to invoke its set-off rights under section 9-404.[132] This decision highlights the necessity for the lessee or account debtor to sign the customary waiver of defenses that it may have against the payee (in this case, Metallic).

Alternatively, in *Prosperity Funding, Inc. v. Act 1 Group, Inc.*,[133] the court rejected the debtor's set-off defense. Hibrid Staffing, Inc. ("Hibrid") and Prosperity Funding, Inc. ("Prosperity") entered into a factoring agreement, where Hibrid assigned accounts to Prosperity and third parties paid Prosperity directly. The Act 1 Group, Inc. ("Act 1") wrongfully paid Hibrid after receiving notice of the account assignments. When Prosperity sued Act 1 for its refusal to pay amounts due, Act 1 argued that it was entitled to set-off rights under section 9-404 in the amount Act 1 paid to Hibrid. Prosperity argued that allowing such a defense would "eviscerate Section 9-406,"[134] which states "[a]fter receipt of the notification, the account debtor . . . may not discharge the obligation by paying the

127. *Id.* at *3–4 (citing ReliaStar Life Ins. Co. of N.Y. v. Home Depot U.S.A., Inc., 570 F.3d 513, 519 (2d Cir. 2009)).
128. *Id.* at *4.
129. *Id.* at *5.
130. Inland Bank & Tr. v. LL Flex, LLC, No. 17-C-604, 2020 WL 1304739 (N.D. Ill. Mar. 19, 2020).
131. *Id.* at *6–7 (interpreting "LL Flex's [set-off] defense as also sounding in recoupment").
132. *Id.* at *7–9.
133. Prosperity Funding, Inc. v. Act 1 Grp., Inc., No. CV-18-03692, 2020 WL 1652346 (C.D. Cal. Feb. 12, 2020).
134. *Id.* at *5.

assignor."[135] The court agreed, holding that section 9-406 clearly prohibited Act 1 from making payments to Hibrid after receiving notification of the account assignment, and granted Prosperity's motion for summary judgment.[136]

Produce Pay, Inc. v. Izguerra Produce, Inc.[137] involved a distribution agreement under which Izguerra Produce, Inc. ("Izguerra") would receive produce on behalf of Produce Pay, Inc. ("Produce Pay") and sell it to third parties as a consignment agent for Produce Pay. When Izguerra accepted a shipment of avocados on Produce Pay's behalf, sold the avocados, and failed to pay Produce Pay, Produce Pay sued Izguerra, attempting to invoke a trust under the Perishable Agricultural Commodities Act ("PACA"),[138] and arguing that it was the seller of the produce. In denying that there had been a sale by Produce Pay, the court applied the "transfer-of-risk test,"[139] which includes, among other factors, whether Produce Pay had the right to recover from Izguerra any shortfall between actual sales proceeds and the expected sale proceeds.[140] The court relied upon that factor to deny Produce Pay's claim to PACA proceeds, but failed to address U.C.C. section 1-201(35), which defines "security interest" to include "any interest of a consignor and a buyer of accounts [or] chattel paper,"[141] and Official Comment 2 to section 9-319, which states, "in a true consignment . . . , the consignee acquires only the interest of a bailee."[142]

In re Shoot the Moon, LLC[143] involved a Merchant Agreement by which CapCall, LLC ("CapCall") provided capital to restaurants affiliated with Shoot the Moon, LLC ("STM") in return for a portion of all future receivables of those restaurants. STM subsequently filed for bankruptcy, and CapCall argued that it was entitled to all outstanding receivable amounts not yet paid. Entitlement to payment turned on whether the account assignments were true sales or disguised loans. The court identified multiple factors in favor of characterizing the transaction as a disguised loan, including a broad asset description in the UCC-1 financing statement, a personal guaranty by STM, various protections against default in the Merchant Agreement, and evidence that payments to CapCall were made from a deposit account owned by a STM entity.[144] However, the court also identified some factors in favor of characterizing the transaction as

135. *Id.* (citing CAL. COM. CODE § 9406(a) (West, Westlaw through ch. 19 of the 2021 Reg. Sess.)); *see* U.C.C. § 9–406(a) (AM. L. INST. & UNIF. L. COMM'N 2010).

136. *Prosperity Funding*, 2020 WL 1652346, at *7.

137. Produce Pay, Inc. v. Izguerra Produce, Inc., No. 19-CV-10165, 2020 WL 6588741 (C.D. Cal. Oct. 13, 2020).

138. 7 U.S.C. § 499e(c) (2018).

139. S&H Packing & Sales Co. v. Tanimura Distrib., Inc., 883 F.3d 797, 804 (9th Cir. 2018) (en banc).

140. *Produce Pay*, 2020 WL 6588741, at *3.

141. U.C.C. § 1-201(35) (AM. L. INST. & UNIF. L. COMM'N 2001).

142. U.C.C. § 9-319 cmt. 2 (AM. L. INST. & UNIF. L. COMM'N 2010).

143. *In re* Shoot the Moon, LLC, No. 15-BK-60979, 2020 WL 6588407 (Bankr. D. Mont. Nov. 6, 2020).

144. *Id.* at *4 (citing Robert D. Aicher & William J. Fellerhoff, *Characterization of a Transfer of Receivables as a Sale or a Secured Loan Upon Bankruptcy of the Transferor*, 65 AM. BANKR. L.J. 181, 186–94 (1991) (cataloging the factors courts most often use when analyzing the substance of a transaction)); *id.* at *6–8 (applying certain of those factors).

a true sale, including language in the Merchant Agreement stating that nothing in the agreement should be construed as a secured loan, and the absence of any provisions allowing STM to repurchase the receivables.[145] The court denied summary judgment but stated the evidence provided was "deeply inconsistent with true sales of receivables,"[146] thereby demonstrating that assignees should not rely on those latter factors in trying to structure a true sale.

145. *Id.* at *8–9.
146. *Id.* at *8.