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FREEDOM OF CHOICE(?): CHOICE-OF-LAW ISSUES IN LEASES (1998)

Despite the general uniformity between states' laws created by the adoption of UCC Article 2A, there are many issues which are resolved by a determination of which state's law will apply to a leasing transaction.

For this reason, well-drafted equipment leases always provide that the law of a specific state will apply. This provides uniformity and certainty for the lessor as well as choosing the law of a favorable state and avoiding idiosyncrasies, such as adverse usury laws and limitations on the lessor's ability to enforce remedies provisions.

When will a judge refuse to enforce such a provision?

First, it should be remembered that we are not dealing with a "forum selection clause". These clauses require litigation to be maintained in a state selected in the lease. Usually, that state is the same state designated in the choice of law provision. In other words, the lessor usually (and wisely) states that the laws of its home state will be applied to all questions and that litigation will be maintained in a court located in its home state.

Where the lessee gets to the courthouse first and commences litigation in its own state, the lessor is faced with a prospect of convincing the judge either (1) to honor forum selection clause and allow the litigation to be removed or (2) to hear the case, but apply the law specified in the contract.



Judges are generally willing to enforce a choice of law provision, but there are exceptions. For example:

In *National Glass, Inc. v. J. C. Penney Properties, Inc.*, 650 A.2d (Md. 1994), the parties agreed that Pennsylvania law would apply to a contract for repair of equipment, but the Maryland court determined that Maryland public policy would not permit enforcement of a waiver of mechanic's lien contained in the contract.

In *Universal C.I.T. Credit Corporation v. Hulett*, 151 So.2d 705 (La. 1963), a Louisiana court did not have a choice of law provision in a contract before it, but ruled as a matter of public policy that Louisiana law should apply to an attempted repossession of a vehicle which was located in that state. The case might be used as authority for a similar refusal to enforce a choice of law provision in a lease agreement to a Louisiana lessee.

The most common concern in this area regards usury issues. Most courts are willing to apply the law stated in the contract where usury questions are involved. *Sarlot - Santarjian v. First Pennsylvania Mortgage Trust*, 599 F.2d 915 (9th Cir. 1979), *Kronovet v. Lipchin*, 415 A.2d 1096 (1980) and *Continental Mortgage Investors v. Sailboat Key, Inc.*, 395 So.2d Fla. 1981)). However, the *Restatement of Law, 2d, Conflict of Laws*, states that a court may refuse to enforce such a provision if the interest rate stated in the contract greatly exceeds the interest rate allowed in the state whose laws would apply, but for the choice of law provision. In other words, if the law of the state having an 18% usury rate would normally apply (it is where the borrower is located), but the parties choose to apply the law of another state which permits a higher rate, and if the contract rate is greatly in excess of 18%, the court may refuse to enforce the choice of law provision and enforce the 18% limitation.

Consider, for example, the follow two cases: *O'Brien v. Sherson Hayden Stone, Inc.*, 586 P.2d (1978), supplemented 605 P.2d 779 (1980) [state?] and *Swindell v. Federal National Mortgage*



Association, 409 S.E.2d 892 (N.C. 1991). (The *Swindell* case based its decision not on the restatement, but on general public policy concerns.)

For this reason, many lessors and lenders will rely on a choice of law and forum selection clause to avoid bad local law, but not if the issue involves apparent public policy concerns or is a contract rate greatly in excess of local usury limitations.

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