

# MARKS & WEINBERG, P.C.

## WHAT IS A UCC “FINANCE LEASE”?

“Lease financing” has been described by one commentator as possibly “the most important single source of funds to support business expenditures for capital equipment” Amelia H. Boss, *The History of Article 2A: A Lesson for Practitioner and Scholar Alike*, 39 Ala. L.Rev. 575, 577 (1988). Lease financings involve three or more parties – the lessee, the lessor, and the equipment supplier(s). The lessee selects the equipment and negotiates particularized modifications with the equipment supplier. The lessor then purchases the selected equipment and leases it to the lessee. Traditionally, lessors involved in “lease financings” have been thought of as passive lessors, whose transactions remain functionally the equivalent of an extension of credit. *See e.g.* *Nath v. Nat. Equipment Leasing Corp.*, 439 A.2d 633 (Pa. 1981)(noting that this type of lessor “is not in the business of selling or marketing merchandise [but rather, it is in] the business of circulating funds”). Given the limited function of the lessor, the lessee relies entirely on the supplier for representations, covenants and warranties. Edwin E. Huddleston III, *Old Wine in New Bottles: UCC Article 2A & Leases*, 39. Ala. L. Rev. 615, 616 Notes 1 (1998).

### A. What is a UCC “Finance Lease”?

Lease financings can take various forms, one of which is a “Finance Lease” as defined under Article 2A of the Uniform Commercial Code (the “UCC”). Unfortunately, the terminology “finance lease” is sometimes a source of confusion. Many people in the leasing industry use that term to refer to a transaction which, although called a “lease”, is actually a loan from the lessor to the lessee with the



leased property serving as collateral for the loan such as a lease with a one dollar purchase option. Those people distinguish the finance leases from "true leases" which are also called "tax leases" or "operating leases." To avoid any confusion we will use the term a "Lease Intended as Security" to refer to leases that are actual loans and the term "True Lease" to refer to leases which are not simply disguised security interests.

Under Article 2A of the Uniform Commercial Code (the "UCC"), the term "Finance Lease" is defined to be a true lease which "consists of an overall three-party transaction in which: (1) the lessor does not select, manufacture, or supply the goods, (2) the lessor did not own the goods before the lease was arranged, and (3) the lessee either approves the purchase contract or receives specified warranty and supplier information before signing the lease agreement." Ian Shrank and Arnold G. Gough, *Equipment Leasing-Leveraged Leasing* (PLI 4<sup>th</sup> ed.,1999), Vol. 1, §3:1.5[C].

## **B. Consequences of Finance Lease Status under Article 2A**

Due to the limited role that a lessor plays in a Finance Lease and the important role that such transactions play in our economy, Article 2A offers special statutory protection to lessors who lease goods in this manner. As noted in the comments to the UCC, the various sections of Article 2A operate to "substitute the supplier of the goods for the lessor as the party responsible for warranties and the like." UCC §2A-101, comments (emphasis added). For example §2A-209 automatically extends the seller's warranties (and their exclusions) to the lessee and automatically excludes any implied warranties of fitness or merchantability by the lessor. Shrank, *supra* at §3:1.5[B]. In addition, §§2A-516, 517 state that, once the lessee has accepted the property, it has no right to revoke that acceptance. Most importantly, §§2A-407 and 508 create a statutory "hell or high water" clause by making the lessee's obligations (including payment obligations) irrevocable and independent of the lessor's or supplier's obligations. *Id.* at §3:1.10[A]. In other words, once the lessee accepts property under a Finance Lease, that lessee is obligated by statute to perform under that lease "come hell or high water." As Shrank explains, the interplay of these UCC provisions: "allows a computer lessor to promise vital services to



the lessee, then to breach this promise entirely, yet requires the lessee to continue paying rent without set-off, all without any express clause in the lease agreement.ö Id.

All of the aforementioned protections afforded lessors under Finance Leases can be obtained through contractual provisions. The Official Comments to the UCC state that ö[i]f a transaction does not qualify as a finance lease, the parties may achieve the same result by agreement.ö UCC §7-2A-103, comment (g). Indeed, the UCC öprovisions are merely codifications of standard commercial leasing practices that previously were achieved by contract rather than by statute.ö Shrank, supra at §3:1.10[A]. Well respected authorities therefore encourage lessors to öinclude express -hell or high waterø clauses if for no other reason than to avoid arguments about whether a -finance leaseø is involved.ö Id. at §3:1.[D].

Marks & Weinberg, PC is law firm with significant experience in dealing with virtually every type of equipment and facility lease financing. The lawyers of the firm have participated in leasing financings for more than a billion dollars of equipment and are recognized throughout the industry. If you would like more cases or articles on leasing, or have any questions or comments about this Article or other leasing issues, please visit [www.lease lawyer.com](http://www.lease lawyer.com) or contact Barry Marks at 205-251-8303 or Ken Weinberg at 205.251.8307.

