

**DISPATCHES FROM THE TRENCHES**

**IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING**

This issue of the Dispatches From the Trenches discusses the implied duty of good faith and fair dealing. Whether a given equipment lease constitutes a true lease, tax lease, FMV lease, dollar-out lease, mandatory purchase lease, dirty lease, financing lease, finance lease, lease intended as security, disguised security interest, non-tax lease, ALIAS or whatever colorful term you would like to use to describe the transaction, it is governed by the Uniform Commercial Code (the "UCC") as long as it is a lease of personal property. Article 2A governs true leases and Article 9 governs non-true leases.

Section 1-304 of the UCC provides that "every contract for duty within [the UCC] imposes an obligation of good faith in its performance and enforcement." This duty is sometimes referred to as the implied duty of good faith and fair dealing.

This duty is often raised by aggrieved lessees complaining of lack of fairness or equity. Such claims are frequently heard simultaneously with claims of unfair and deceptive trade practices, unjust enrichment and unconscionability. A classic example is *Bradstreet Personal Group, Inc. v Wells Fargo Fin. Leasing*, 2005 WL 1252333 (N.J. Super. L., 2005). In that case, various lessees brought a class action lawsuit against Wells Fargo, as assignee under equipment leases originated by another institution. The assigned leases contained a clause which required the lessee to provide not less than ninety (90) and not more than one hundred fifty (150) days prior written notice of its intention to purchase or return the equipment. If a lessee failed to do so, the lease is automatically renewed.

The lessees complained that the equipment lease was deceptive with respect to when notice was required and that Wells Fargo's enforcement of those leases breached the implied covenant of good faith and fair dealing. Wells Fargo prevailed on summary judgment as the court found that it would be unreasonable to conclude that Wells Fargo engaged in any conduct that had the capacity to mislead.

In its discussion of the implied covenant of good faith and fair dealing the Court noted that "we are mindful of the potential pitfalls in enforcing the covenant of good faith and fair dealing [and that if] courts construe the covenant too broadly, it could become an all embracing statement of the parties' obligations under contract law, imposing unintended obligations upon parties and destroying the mutual benefits created by legally-binding agreements." *Id.* at 10. The Court further noted that "Contract law does not require parties to behave altruistically toward each other [and] it does not proceed on the philosophy that I am my brother's keeper." *Id.*

Similar discussions of the implied covenant of good faith and fair dealing can be heard in various equipment lease transactions. For example, in *AdvancMed, LLC v. Pitney Bowes Credit*

*Corporation*, 58 UCC Rep. Serv. 2d 507 (E.D. Ky., 2006), an aggravated lessee leased equipment from Pitney Bowes Credit Corporation (öLessorö) which later malfunctioned. The lessee's claims included breach of contract, breach of express warranty and breach of the implied warranties of fitness and merchantability as well as the breach of implied duty of good faith and fair dealing.

The lessee lost on its breach of contract and warranty claims since the lease included standard finance lease language and a proper disclaimer of warranties. The Court acknowledged that the UCC makes such a covenant of good faith and fair dealing implicit in single contract governed by the UCC. However, the court also held that breach of such a covenant does not create a separate cause of action but, rather, that the covenant is more of an interpretative rule. Quoting the official comments of UCC §1-304, the Court noted stated that the implied covenant of good faith and fair dealing:

ödoes not support an independent cause of action for failure to perform or enforce in good faith. Rather, [it] means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of the contract or makes unavailable, under the particular circumstances, [a] remedial right or power. This distinction makes it clear that a doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.ö

Since the lessee was unable to succeed in this breach of contract and warranty claims, its breach of implied good faith and fair dealing also failed.

In *Human Resources Development Press, Inc v. Ikon Office Solutions Company*, 2006 WL 149143 (D. Mass., 2006), the Court expressed similar sentiments in holding against a lessee who claimed that a lessor breached the implied covenant of good faith and fair dealing by imposing and collecting charges for the use of leased equipment that allegedly malfunctioned after it was surrendered to it by the lessee. The Court noted that the plaintiff-lessee's claims were not based on the terms of the documents executed by the parties but rather on an alleged oral representation made by the lessor prior to the execution of the applicable documentation

As the court explained, öevery contract implies good faith and fair dealings between the parties to it [but such an implied obligation only] insures that neither party shall do anything that will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract [and] the requirement of good faith performance ultimately is circumscribed by the obligation ó the contractual fruits ó actually contained in the agreement [--] thus, without a breach of contract, there can be no claim for a breach of an implied covenant of good faith and fair dealing.ö

Given the nature of these types of cases, the implied covenant of good faith and fair dealing rarely gets much press. Although it is sometimes raised by lessor counsel as the justification for not scattering the word öreasonablyö fifty-odd times through-out an equipment lease as is sometimes requested by lessee counsel.

Every once in a while, however, the implied covenant of good faith and fair dealing asserts itself in a case which should make lessors and lenders stand up and take notice. Such a case recently occurred in *MACEast LLC v Shoney's*, No. 07-11534 (11<sup>th</sup> Cir. , Al. Mid. Dist., 2008). In this case, a commercial real estate lease was assigned by Shoney's (öAssignorö) to MACEast (öAssigneeö) who later sought to sublease the property to a third party.

The assignment agreement clearly provided that öAssignee shall not enter into any assignment or sublease of any portion of the [real property] or the improvements thereon without the prior

written consent of Assignor . . . which Assignor may withhold in its sole discretion.ö When Assignee found a third party to sublease the premises at a substantial profit, Assignor refused to consent unless Assignee paid an additional fee. Assignee refused and brought a claim for breach of contract and for tortious interference with business relations.

The District Court originally hearing the case stated that ðalthough the Assignment Agreement gave [Assignor] the ðsole discretionö to consent to the proposed sublease, it did not permit [Assignor] to arbitrarily and capriciously refuse consent, in part, because the Assignment Agreement does not explicitly express such a standard of discretion.ö As such, the court held that Assignor's consent rights were subject to a commercial reasonableness standard. Indeed, the District Court further held that extracting the additional payment was unreasonable as a matter of law.

The Court of Appeals noted that there was no controlling Alabama precedent with regard to whether an Assignor's exercise of ðsole discretionö to withhold consent to an Assignee's proposed sublease is subject to ðcommercial reasonablenessö standard. As such, it certified the question to the Alabama Supreme Court and withheld judgment on this particular issue.

Although the case in question involves real estate rather than the UCC law noted earlier in this issue of *Dispatches from the Trenches* and although the Assignor has not yet lost this case, the cost of trying it at the District Court, Appellate Court and Supreme Court levels should be a message to everyone--- acting reasonably is sometimes in your best interest. Obviously, lessors prefer to have a sole discretion standard when obtainable. However, they should be mindful that it is not a panacea and that it is still prudent to act reasonably.

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