MARKS & WEINBERG, P.C.

C & J Leasing Corp. v. Island Sun Enterprises
2005 WL 975544 (Iowa App., April 28, 2005)

Lessee incorporated as ñIsland Sun Enterprises, Inc.ò but adopted the fictitious name ñIsland Sun Tanò for its salon tanning business and subsequently amended its articles of incorporation to change its name to ñISE, Incò.

Lessee and Lessor agreed to engage in a sale-leaseback transaction whereby certain tanning equipment would be sold to Lessor and immediately leased back. Guaranties were executed by co-owners (the ñGuarantorsò) as additional credit enhancement. Unbeknownst to Lessor, Lessee borrowed additional money from another bank (the ñCompeting Secured Partyò) a week before the sale-leaseback was finalized and pledged the same tanning equipment to the Competing Secured Party as collateral.

Although Lessor filed its UCC covering the equipment before the Competing Secured Party, Lessor filed under the Lesseeôs old name and the Competing Secured Party filed under Lesseeôs correct name and, as such, had a prior position.

Several months later, Lessee was unable to pay its bills (with its principal filing for bankruptcy). Competing Secured Party provided a notice of disposition of collateral, stating that it intended to repossess the equipment and sell it at private sale. Competing Secured Party was not only able to satisfy its debt by selling part of the collateral, it was also able to collect a surplus. Competing

Secured Party then notified Lessor it was holding the surplus proceeds for Lessor as junior lienholder. Competing Secured Party also left the remaining equipment on the premises of the former tanning salon business for repossession by Lessor.

The next month, Lessor filed suit against the Guarantors to collect on the guarantees. For nearly 15 months after filing the suit, Lessor did not attempt to repossess the remaining equipment nor collect the remaining proceeds held by Competing Secured Party.

Guarantors sought to escape their obligations under the guaranties by using a variety of theories and both the district court and appellate court agreed. Perhaps the courts were motivated by Lessorôs sloppiness in closing the transaction and/or its total disregard for the concept of mitigating damages. In any event, the Court used the theory of ñmutual mistakeò to rescind the guaranties, holding that: (a) Guarantors and Lessor where mutually mistaken as to whether Lessor would have a first priority security interest in the leased equipment; (b) Guarantors would not have guaranteed the Lesseeôs obligations had they known there would be no collateral; and (c) Lessor should bear the risk of this mistake since it was in the best position to discover this mistake and failed to list the correct name of the Lessee on the UCC financing statement. It should be noted that strong Guaranty forms often address this issue by having Guarantor acknowledge that its obligations are <u>not</u> conditioned on any acts by the Guaranteed Party, explicitly stating that Guaranteed Party is under no obligation to proceed against or exhaust any security granted to it by any party.

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