Leases

I. **Governing Law:** Article 2A governs “[a]ny transaction, regardless of form, that creates a lease.” § 2A-102.

A. **Basic Issues**

1. **“Lease”:** “[A] transfer of the right to possession and use of goods for ... consideration”; but not a sale, sale on approval, return, or security interest. § 2A-103(1)(j).

   ![Diagram]

2. **§ 1-203:** Whether a lease transaction is a “disguised sale” *as a matter of law* depends on whether the lease agreement

   a. allows the lessee to **terminate the lease** prior to the end of the lease term;

   b. extends for the **full “economic life”** of the goods (so that, at the end of the term, the goods will have little or no market value);

   c. **obligates the lessee to renew the lease** until the goods have no expected economic life;

   d. **allows the lessee to purchase** the leased goods at the end of the lease term for **little or no additional consideration**; and

   e. **obligates the lessee to purchase** the leased goods at the end of the lease term.

3. **Economic Realities Test:** Whether a lease transaction is a “true lease” *as a matter of fact* depends, in part, on the likelihood, at the time the parties entered into the transaction, that the lessee would return the goods to the lessor while the goods still have meaningful economic life. If there is a
reasonable likelihood the lessor will retain some residual interest in the goods, the transaction is probably a true lease; if not, the transaction is probably a disguised sale intended for security.

4. The major distinction between a sale and a lease:
   a. In a sale transaction, title passes from the seller to the buyer – even though the buyer may owe money on the item.
   b. In a lease transaction, the lessor retains title; the lessee acquires only the right to use the goods for the lease term.

B. Special Types of Leases

1. “Consumer Lease”: a lease made by someone in the business of leasing to an individual for the individual’s personal use. § 2A-103(1)(e).
2. “Finance Lease”: Subject to the conditions imposed by § 2A-103(1)(g)(iii), any lease made by a lessor who
   a. does not select, manufacture, or supply the goods; and
   b. acquires from a third party, in connection with the lease, title or the right to possess and use.

   ![Diagram of lease transactions]

II. Lease Contract Basics

A. Formation

1. The Article 2A formation rules are very similar to those in Article 2 except that Article 2A contains no counterpart to § 2-207. Compare UCC §§ 2A-204 to 2A-206 with UCC §§ 2-204 to 2-207.
2. Three major differences between UCC Article 2A and common law:

   a. **Open Terms:** Even if one or more terms are left open, a lease contract does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy. UCC § 2A-204(3).

   b. **Irrevocability:** A written offer signed by a merchant purporting to give the offeree an irrevocable option to accept for some stated period of time will bind the merchant to keep the offer open for the stated time, or for a reasonable time if no time is stated, but in no event for more than three months. UCC § 2A-205.

   c. **Manner of Acceptance:** Unless an offer’s language or the circumstances surrounding its making unambiguously indicate otherwise, an offer to make a lease contract invites acceptance in any manner and by any medium reasonable in the circumstances. UCC § 2A-206(1)(a).

B. **Enforceability**

1. **Article 2A Statute of Frauds: Basic Requirements**

   a. A party cannot enforce, by way of action or defense, a contract for the lease of goods for which total lease payments amount to $1,000 or more unless there is some writing

   i. signed by the party against whom enforcement is sought or by his authorized agent,

   ii. indicating that the parties have made a lease contract, and

   iii. describing

      a). the goods being leased and

      b). the term of the lease. § 2A-201.

   ♦ A writing that misidentifies the term or the quantity of goods, is only be enforceable up to the term and quantity stated; or, if no term is stated, for (1) a reasonable term or (2) such other term as is judicially admitted by the party against whom enforcement is sought. § 2A-201(3), (5)
2. **Article 2A Statute of Frauds: Exceptions**

a. **Specially Manufactured Goods**: An oral or written agreement that does not otherwise satisfy the statute of frauds may be enforced, notwithstanding the statute of frauds, if

   a. the lessor *specially manufactured* (or obtained) the goods in question for the lessee,

   b. the goods are *not suitable for sale to others* in the ordinary course of the lessor’s business, and

   c. the lessor *substantially began* their manufacture or made commitments for their procurement (i) before receiving notice that the lessee repudiated and (ii) under circumstances that reasonably indicate the goods are for the lessee. § 2A-201(4)(a).

b. **“Judicial Admission”**: An oral or written agreement that does not otherwise satisfy the statute of frauds may be enforced, notwithstanding the statute of frauds,

   i. if the party against whom enforcement is sought admits the existence of the contract in her pleadings, testimony, or otherwise in court, but

   ii. only to the extent of the *quantity admitted* by the party against whom enforcement is sought. § 2A-201(4)(b).

c. **Partial Performance**: An oral or written agreement that does not otherwise satisfy the statute of frauds may be enforced, notwithstanding the statute of frauds, with respect to goods that the lessee has *received and accepted*. § 2A-201(4)(c).

3. **Unconscionability**: Article 2A begins with the same basic scheme as Article 2, then affords *consumer* lessees the ability to

   a. establish unconscionability solely on procedural grounds, see § 2A-108(2), and

   b. recover attorney’s fees, if the court finds the clause or contract at issue to be unconscionable, see § 2A-108(4)(a).

   ♦ Be wary: If the court finds the lessee’s unconscionability claim to be groundless, Article 2A directs the court (“shall”) to award the lessor reasonable attorney’s fees. § 2A-108(4)(b).
C. Article 2A Parol Evidence Rule: Terms set forth in

1. a writing that
   a. the parties intended
2. as a final expression of their agreement
3. with respect to such terms as are included therein

2. may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement,

3. but may be explained or supplemented
   a. by evidence of a relevant course of dealing, usage of trade, or course of performance, § 1-303,
   b. to the extent not clearly negated or varied by the terms of the written agreement, any relevant UCC gap fillers, and
   c. if the written agreement of the parties is not fully integrated, by evidence of consistent additional terms. § 2A-202.

III. Lease Warranties

A. Express Warranty: A lessor makes an express warranty in the form of

1. an affirmation of fact or promise
2. that the goods conform to the affirmation or promise. § 2A-210.
   ♦ The basic § 2-313 rubric applies to express Article 2A warranties.

B. Article 2A Title Warranties

1. Lessor’s Warranty of “Quiet Possession”: A lessor warrants that, for the term of the lease,
   a. no one (other than the lessor) holds a claim to or interest in the goods (other than a claim of infringement or the like),
   b. as a result of any act or omission of the lessor,
   c. that will interfere with the lessee’s use and possession of the goods. § 2A-211(1).
2. **Merchant Lessor’s Warranty Against Rightful Claims of Third Parties:** A merchant lessor further warrants that the goods are free of any rightful claim of any person other than the lessor. § 2A-211(2).

   ♦ This warranty does not apply in case of finance leases.

C. **IWOM:** A *merchant lessor* makes an **implied warranty**, if not waived or modified by agreement, that the leased goods are *merchantable*, in that they

1. pass without objection in the trade; and
2. if fungible, are of “fair average” quality; and
3. are fit for the ordinary purpose for which such goods are used; and
4. run, within variations permitted by agreement, of even kind, quality, and quantity within each units and among all units; and
5. are adequately contained, packaged, and labeled; and
6. conform to any promises or affirmation of fact on container or label. § 2A-212.

D. **IWOF:** A *lessor* makes an **implied warranty**, if not waived or modified by agreement, that the leased goods are *fit for the lessor’s particular purpose* if

1. the lessor knows or has reason to know the lessee’s *particular purpose*;
2. the lessor knows or has reason to know that the lessee is relying on the lessor’s advice and expertise in choosing a product suitable for that purpose; and
3. the lessee actually relies on the lessor’s advice and expertise in selecting the leased goods. § 2A-213.

E. **Lease Warranty Defenses**

1. **Statute of Limitations**, § 2A-506;
2. **Assumption of Risk** (if available under state non-UCC law);
3. **Lack of Notice:** § 2A-516(3) requires a lessee to notify the lessor of any breach within a reasonable time after he discovers or should have discovered any breach.
4. **Lack of Privity:** § 2A-216 follows the § 2-318 formula, right down to the three alternative versions for state legislators wanting less or more expansive warranty liability.
5. **Quality Warranty Disclaimers/Limitations:** § 2A-214 is virtually identical to § 2-316 except that
   a. a lessor **must** disclaim the IWOM **in writing**; and
   b. a lessor **must** use **“magic words”** to disclaim the IWOF,

6. **Waiving/Modifying Title Warranties:** Any attempt by the lessor to exclude or modify any warranty created by § 2A-211 must
   a. be **in writing**,
   b. use **specific language**, and
   c. be **conspicuous**, unless
   d. the circumstances, including course of performance, course of dealing, or usage of trade, give the lessee **reason to know** that she is leasing the goods **subject to a third party’s claim or interest.**
   § 2A-214(4).

F. **Special Case: Finance Leases**

1. § 2A-209(1): The supplier’s warranties run **to the lessee.**

2. The **finance lessor** makes **no implied warranties** to the lessee. §§ 2A-212 & 2A-213.
   ♦ By definition, the finance lessor has nothing to do with the selection, manufacture, or supply of the goods. If it does, then it is not a finance lessor, and the normal lease warranty rules apply.

3. § 2A-407: The supplier’s breach of warranty does **not** relieve the lessee of her **obligation to pay** the finance lessor, unless
   a. their contract provides otherwise, or
   b. the finance lease is also a **consumer lease,** § 2A-209 cmt. 3.

4. § 2A-209(3): The supplier and finance lessor may **modify or rescind** their contract, and any change **binds the lessee** unless the supplier has prior notice that the lessee has an interest under a finance lease.
   ♦ Thus, any warranty disclaimers included in the contract between the supplier and the finance lessor bind the lessee, provided that the lessee had the opportunity to read agreement between the supplier and the finance lessor before the lessee signed the lease agreement.
IV. Performance, Breach, and Excuse

A. Risk of Loss: Article 2A generally tracks Article 2, compare §§ 2A-219 & -220 with §§ 2-509 & -510, the lessor retains the risk of loss throughout the transaction,

1. unless the lease is a finance lease, § 2A-219(1), in which case
2. risk of loss passes to the lessee at the same point it would pass to the buyer under Article 2, § 2A-219(2), and
3. the supplier bears the risk of loss to the extent a seller would under Article 2, §§ 2A-219(2)(c) & 2A-220(1)(a) & (2), except that
4. the finance lessor bears the risk of loss if the lessee rightfully revokes, § 2A-220(1)(b) & cmt.

B. Nonconforming Goods

1. Perfect Tender Rule: If the goods or their tender fails in any way to conform to the lease contract, § 2A-509(1) empowers a lessee to
   a. reject the goods,
   b. accept the goods or despite their nonconformity or the nonconforming manner of their tender, or
   c. accept one or more commercial units and reject the rest.

   ♦ § 2A-510 limits a lessee’s rejection powers in an installment lease in the same manner as §2-612 does in an installment sale.


3. Exception: Revocation of Acceptance in Finance Lease Transactions: A finance lessee may revoke accepted leased goods only if the finance lessee failed to discover their nonconformity prior to acceptance because of the finance lessor’s assurances. § 2A-517(1).
   a. This exception will apply only in rare cases. Recall that one of the conditions of a finance lease under § 2A-103(1)(g) is that the lessee, not the finance lessor, selects the goods to be leased.
   b. However, the finance lessee may sue the supplier for breach of warranty.
C. **Insecurity, Assurances, and Repudiation:** Article 2A’s provisions addressing reasonable grounds for insecurity, the lessee’s right to demand assurances and to suspend performance, if commercially reasonable, while awaiting assurances, anticipatory repudiation, and the repudiating party’s right to retract parallel those in Article 2, compare §§ 2A-401 to -403 with §§ 2A-609 to -611, and make no exception for finance leases.

D. **Excuse:** The Article 2A excuse rules are very similar to those in Article 2, compare §§ 2A-211 & 2A-404 to -406 with §§ 2-613 to 2-616, except that a finance lessee who elects to accept damaged goods or to accept a ratable portion of less than the contract quantity may not deduct from the payment(s) it owes the finance lessor allowance for the diminished quality or quantity of the goods, see §§ 2A-221(b) & 2A-406(1)(b).

V. **Lessee’s Remedies**

A. **Types of Breach by Lessor**

1. Lessor’s **failure to deliver**

2. Lessor’s **anticipatory repudiation**

3. Lessee’s **rightful rejection**

4. Lessee’s **justifiable revocation** of acceptance. § 2A-508(1).

B. **Non-Accepted or Revoked Goods:** If the lessee has not accepted, has rightfully rejected, or has timely and justifiably revoked acceptance, the lessee may

1. **cancel** the contract; and

2. recover any **rent** and **security deposit** paid; and

3. **“cover”; or**

4. recover **damages** for nondelivery under § 2A-519.

And, if the lessor fails to deliver or repudiates, § 2A-508(2) entitles the lessee to:

5. recover any **identified goods** per § 2A-522; or

6. sue for **specific performance** or **replevin** under § 2A-521.

And, in any event, the lessee may also recover

7. **Incidental** and **consequential** damages, as permitted by § 2A-520.
C. **Cover Damages**

1. A lessee who, in good faith, makes a commercially reasonable replacement lease may recover from lessor

   a. the present value, as of the date the substitute lease commences, of the rent due under the substitute lease for the period remaining under the original lease, minus the present value, as of the same date, of the rent still due under the original lease,

   b. plus any incidental and consequential damages permitted by § 2A-520,

   c. minus expenses saved by the lessee as a result of the lessor’s breach. § 2A-518(2).

2. A lessee who fails to make a commercially reasonable replacement lease, including but not limited to a lessee who elects to “cover” by purchasing or contracting to purchase substitute goods, may recover under § 2A-519. § 2A-518(3).

D. **Contract-Market Differential Damages**

1. If the lessee fails to or elects not to cover by making a commercially reasonable replacement lease, the lessee may recover

   a. the present value, as of the date of the lessor’s default, of the difference between the then-market rent and the contract, computed for the period remaining under the original lease,

   b. plus any incidental and consequential damages permitted by § 2A-520,

   c. minus expenses the lessee saved as a result of the lessor’s breach. § 2A-519(1).

2. Market rent is determined at the place for tender; or, in the case of rejection or revocation after delivery, at the place of delivery. § 2A-519(2).

E. **Accepted Goods**: If the lessee has accepted the goods and the time for timely revocation has passed, the lessee may, upon proper notice to the lessor (per § 2A-516(3)), sue to recover

1. any “loss resulting in the ordinary course of events from the [L]essor’s default, as determined in any manner that is reasonable,” § 2A-519(3),

2. plus any incidental damages recoverable under § 2A-520(1),
3. plus any **consequential damages** recoverable under § 2A-520(2),

4. minus any **expenses saved** as a consequence of the lessor’s default.

♦ If the lessor’s default is the **breach of some express or implied warranty**, the “loss resulting” to the lessee is the difference, at the time and place of acceptance, between the use value of the goods as warranted and the use value of the goods as accepted. § 2A-519(4).

**F. Incidental Damages:** Commercially reasonable charges, expenses, or commissions

1. incurred as a result of the lessor’s breach in
   a. inspecting goods,
   b. transporting goods,
   c. care and custody of goods, or
   d. effective “cover”, or

2. otherwise resulting from the lessor’s breach. § 2A-520(1).

**G. Consequential Damages:** The lessee may recover consequential damages

1. including, but not limited to, purely economic loss,

2. of which the lessor had reason to know or foresee at the time of contracting (ala *Hadley v. Baxendale*),

3. which were “caused in fact” (not proximately caused) by the lessor’s breach,

4. and which the lessee could not have prevented or mitigated by “cover” or otherwise. § 2A-520(2)(a).

5. Moreover, the lessee may recover *any and all* personal injury or property damage proximately caused by the lessor’s breach or warranty, irrespective of its foreseeability or of the lessee’s failure to mitigate. § 2A-520(2)(b).
VI. **Lessor’s Remedies**

A. **Types of Breach by Lessee**

1. Wrongful rejection of conforming goods;
2. Wrongful revocation of acceptance;
3. Failure to pay when payment is due; or

B. **Lessor’s Remedies – Generally**

1. Cancel the lease contract, § 2A-505(1);
2. Identify goods to the repudiated contract and proceed under § 2A-524;
3. Withhold delivery of goods not delivered and repossess delivered goods, per § 2A-525
4. Stop delivery by a bailee or carrier, per § 2A-526;
5. Dispose of the goods (by sale or lease) and recover damages under § 2A-527;
6. Retain the goods (by sale or lease) and recover damages under § 2A-528;
7. Sue for rent under § 2A-529; or
8. Exercise any contractual right or remedy the lease agreement provides.

C. **Lessor’s Incidental Damages:** Commercially reasonable expenses

1. incurred as a result of the lessee’s breach in
   a. stopping delivery,
   b. transporting goods,
   c. care and custody of goods,
   d. return of goods,
   e. resale of goods, or
2. otherwise resulting from the lessee’s breach. § 2A-530.