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*Representing the Equipment Leasing and Finance Industry*

***LEGAL PRINCIPLES UNDERLYING  
COMMERCIAL BUSINESSES'  
ACCESS TO EQUIPMENT  
LEASING AND FINANCE***

**A White Paper**  
December 2004

## **Introduction:**

**Equipment leasing has grown to be a primary method of acquisition for businesses of all types in the United States and throughout the world. In 2004, it is estimated that \$218 Billion in equipment will be acquired through leasing in the U.S. alone. Each business day, 20,000 transactions characterized as leases are completed. The transaction sizes vary from several thousand dollars to tens of millions of dollars for everything from fax machines to commercial aircraft.**

**The growth of equipment leasing in the past forty years has been driven primarily by the concept that equipment's value comes from its use not from ownership. Studies have shown that leasing leverages the ability of businesses, particularly small, new or fast growing businesses, to acquire equipment that they would not otherwise have been able to acquire. This equipment acquisition alternative results in increased growth, productivity and profits.**

**The most recent statistics for the equipment leasing business indicate that 35% of the dollar leasing volume is made up of small transactions (<\$250,000) with the balance in mid to large transactions. However, smaller ticket size transactions represent the fastest growing segment of the business.**

**Businesses lease for specific strategic reasons:**

- **Match cash flows of revenue with the expense of production or providing services.**
- **Protect against the risks of technological obsolescence.**
- **Conserve cash and borrowing lines.**
- **Tax planning.**
- **Financial accounting planning.**
- **Convenience.**

**The growth of equipment leasing, and by inference the expansion of available credit for many businesses, has been made possible by the enactment of commercial credit laws and court decisions that have made the repayment of leases almost certain. Indeed, one of the reasons equipment leasing companies are able to provide financing for businesses, particularly for smaller businesses, has been the very low rate of delinquency or loss due to established legal concepts.**

**Because the rapid growth of leasing primarily has occurred in the past few decades, specific provisions of the Uniform Commercial Code dealing with leases and contract law as it relates to equipment leasing have received attention relatively recently. Revised Article 9 and Article 2A of the UCC are relatively recent legislative events and court decisions have added further legal certainty to contracts.**

**Without the important principles contained in the current law, the credit markets for equipment financing would of necessity shrink. Credit risk is a very important issue for lessors, lenders and those who invest in receivables through securitization and other funding mechanisms. Legal provisions that make business contracts enforceable and repayment of obligations relatively certain make it possible to sell or assign leases in secondary markets with the beneficial result of increasing capital. Without the liquidity of lease paper, many new or small businesses would not be able to obtain financing for productive assets.**

**This paper is intended to describe these standard provisions, how they fit into lease contracts and to provide the important legal sources and references related to these provisions.**

**For further information about equipment leasing and its contribution to the economy go to [www.elaonline.com](http://www.elaonline.com) or contact the Equipment Leasing Association.**

**Michael Fleming, CAE, President  
December 2004**

## I. A SUMMARY OVERVIEW OF SMALL TICKET LEASING

This outline is intended to describe briefly certain aspects of the business of small ticket leasing in a general manner without reference to particular lessors or particular factual situations. While some characteristics may apply to middle and large ticket leasing as well, the object is to focus on the aspects of small ticket leasing that have enabled it to become an important part of our economy. Only commercial transactions will be addressed, i.e., transactions between lessors and business entities intending to use the leased equipment for commercial purposes. Such business-entity lessees might be large or small corporations, partnerships, limited liability companies or sole proprietorships.

The leasing industry is generally divided into three segments, based on average transaction size: small, middle and large ticket leasing. The Equipment Leasing Association of America (ELA) estimates that approximately thirty percent of the \$220 billion in annual new leasing business is attributable to small ticket transactions below \$250,000. The average size of a small ticket leasing transaction is less than \$100,000.

### **Why Businesses Choose Leasing to Finance Equipment They Need to Use**

As a general rule, businesses of all sizes choose leasing because it is capable of providing financing that can be customized to their business needs. This outline describes the customization that drives businesses to choose the leasing option. Although some or all of the following features may be available through other funding sources, small ticket leasing companies generally deliver these features in a more timely and efficient manner (see “The Small Ticket Business Approach” below).

- **Convenience**

Small ticket leasing often results in savings for the lessee in terms of the costs to obtain financing and the time involved in completing the transaction, as compared to more traditional financing such as loans from banks. In many cases only a simplified (usually one side of one page) credit application is required, and the credit decision is made within hours, if not minutes. The lease document itself is usually quite brief compared with larger sized transactions, rarely more than the front and back of one piece of paper (and often only one side of one page). This approach to documentation and transaction turn-time simplifies the process, allowing lessees to return to the activities that yield the best return, the operation of their core business.

- **Flexibility**

Lessees enjoy another significant advantage by leasing their equipment, namely, the ability to custom tailor payments to fit their needs. Lessors provide flexible payment timing and payment schedules such as deferred payments, seasonal payments, skip payments, payments of varying amounts over the term of the lease, shorter terms (e.g., 12 months) and longer terms (e.g., 72 months). Schools provide an illustrative example of the flexibility provided through lease financing, as some schools prefer skipping summer payments so that their required payment stream mirrors their school year operations. The ability to quickly customize a payment schedule and efficiently administer these payments is enabled by flexible platforms developed by small ticket leasing companies over the years to serve the needs of their customers.

- **100% Financing**

At times, it may be difficult for a lessee to obtain equipment financing without a significant down payment. Leasing commonly allows a lessee to obtain equipment with no down payment obligation.

- **Preserving Working Capital**

A working capital line serves as the primary source of capital for many businesses. These funds are best employed in the core operations of a business, where they will yield the greatest return. Many businesses also need equipment not directly employed in their core business (e.g., a copier for the office of a construction company). Using leasing as the financing tool to obtain equipment helps businesses retain full access to their working capital line.

- **Risk Shifting**

Depending on the structure used, businesses can reduce certain risks through leasing. For instance, leasing equipment with a contractual end-of-term purchase option allows a business to use equipment for a defined period of time while limiting risks associated with the residual value and technological obsolescence of the equipment. Although payments are non-cancelable during the term of the lease, lessees can evaluate whether the equipment is sufficiently valuable at the end of the lease term to exercise the purchase option at that time. In this way, the residual and technological obsolescence risk remains with the lessor. Certain lease structures thus allow a business the opportunity to determine the level of risk they are comfortable assuming with regard to their equipment acquisitions.

## **The Small Ticket Business Approach**

Each small ticket lessor approaches the market differently, focusing on different equipment, different customers, etc. Nevertheless, there are certain similarities in the way many of them go about the business of serving their customers.

The small ticket market is very competitive in virtually every critical aspect, including pricing, product offerings and service levels. This competitive and efficient market places a premium on the development of delivery platforms (staffing, systems, etc.) that promote flexibility and quick turn-time at competitive prices. These platforms, developed over time, enable the administration of a high volume of small transactions quickly and cost effectively. Smaller transactions generate less finance income but still require many of the same administrative fixed costs of larger transactions. Consequently, developing efficiencies and reducing costs remain constant struggles for small ticket lessors. The efficient administration of a large volume of small transactions serves as the differentiator for the small ticket leasing industry as it competes against other forms of financing. To carry out their mission of providing superior turn-time and flexibility at competitive rates, small ticket lessors rely heavily on a few critical business practices, including those set forth below.

To expedite credit turn-time, small ticket lessors rely on limited credit information about each lessee before entering into a transaction. Over time, a great number of small transactions provide sufficient data for most small ticket lessors to quickly determine creditworthiness based on credit scoring models developed from past loss experience. These scoring models constantly evolve, based on delinquency and loss experience. ELA data show that the median credit decision turn-time for transactions under \$50,000 is three hours. Many decisions are made in a fraction of that time. Although generally accurate, reliance on past performance does not serve as a flawless indicator of future performance.

Likewise, in order to make attractive and workable pricing available to lessees for their equipment financing, due to the size of these smaller transactions, lessors must limit the amount of time they spend examining the financed equipment, equipment providers and equipment servicing issues. As opposed to the broad range of considerations relied upon by middle ticket and large ticket lessors, small ticket lessors rely primarily on each lessee's credit when determining whether to approve a transaction. One illustration of the strong reliance on lessees' credit, rather than equipment values, is that many small ticket lessors do not file UCC financing statements or perform UCC searches to protect their interests in the leased equipment (or they may limit UCC filings to larger transactions).

The duty to investigate the equipment and any required servicing of the equipment remains with the lessee. Each lessee independently chooses the equipment and the vendor, whereas lessors serve only as the financing source for the lessee. Lessors rely on the written contractual commitment, made by each lessee, that they have selected the vendor and the equipment, that the equipment has been delivered, and that the equipment is acceptable to the lessee.

Finally, small ticket lessors strive to streamline not only their lease originations, but also their collections. Although delinquency and loss rates for the industry are generally very low, high loss levels would not only threaten a lessor's financial viability, but also its ability to offer competitive rates. Because of these factors, small ticket lessors carefully determine how they employ their resources to collect past due payments. Litigation expenses can be substantial, especially litigation in a foreign forum. Although lease contracts generally award fees and costs to the prevailing party, courts do not uniformly enforce these clauses, thus requiring lessors to carefully balance their recovery prospects against their enforcement costs. Many small ticket leases include forum selection clauses that allow lessors to litigate in their home forum, reducing costs such as witness travel expenses. This approach to lease enforcement helps small ticket lessors continue to provide competitive rates to the great majority of lessees that do not default on their payment obligations.

In the end, small ticket leasing companies serve a convenience-based niche in the financial markets. The brief overview set forth above demonstrates why equipment leasing remains such a popular choice for thousands of businesses and how small ticket leasing companies approach the task of delivering a source of financing vital to the economy.

## II. SOME SIGNIFICANT PRINCIPLES OF COMMERCIAL LAW

Commercial law in the United States has developed in response to the need for rules that are capable of efficiently facilitating commercial transactions in our increasingly complex economy and that are predictable and fair to the parties involved. Companies that help large and small businesses finance the purchase and use of equipment and payment for services – banks, finance companies, leasing companies, etc. – make it their business to understand the relevant commercial law and operate their enterprises accordingly in order to fulfill the important role they play in this economy.

Over the years, and in particular since the adoption throughout the country of the Uniform Commercial Code beginning in the 1950's and 1960's, financing companies have come to rely on certain commercial law principles that help ensure repayment of money that they have advanced. Such advances may have been made directly to the users of the goods and services or to the suppliers of those goods and services who have entered into contracts with the users. Insofar as they are generally not in the business of manufacturing or selling goods or of providing services, other than providing the funding which enables these other commercial events to happen, financing companies rely on applicable law to be repaid and to avoid disputes as to which they bear no responsibility. If the buyer or user of the equipment or user of the service is unhappy with the equipment or service, commercial law affords that party remedies against the other party who provided the equipment or service. In order to encourage financing of commercial transactions, commercial law has – in certain specific circumstances – entitled the financing source to continued payment notwithstanding disputes between the other parties.

### **“Finance” and “Hell or High Water” Leases**

One example of such a commercial law principle is found in Article 2A, Leases, of the UCC. If a transaction is a true lease that is not a “consumer lease”<sup>1</sup> and it also satisfies the requisite criteria for being a “finance lease,” the obligations of the lessee to pay the lessor become irrevocable and independent of the lessee’s satisfaction with the goods.<sup>2</sup> Even if a lease does not qualify as a finance lease, Article 2A acknowledges that a lessee’s obligations to pay may be made unconditional under so-called “hell or high water” clauses.<sup>3</sup> The definition of “finance lease” and its legal implications were designed to encourage financing by leasing companies that play only a financing role –

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<sup>1</sup> “Consumer lease” is defined in Section 2A-103(1)(e) to mean leases made to lessees who are individuals primarily for personal, family or household purposes.

<sup>2</sup> The definition of “finance lease” is found in Section 2A-103(1)(g) and the irrevocable nature of a lessee’s obligations under a finance lease is set forth in Section 2A-407.

<sup>3</sup> This is made clear in Section 2A-407(3) and in Official Comment No. 6 to Section 2A-407. Section 2A-407(e) states, “This section does not affect the validity under any other law of a covenant in any lease contract making the lessee’s promises irrevocable and independent upon the lessee’s acceptance of the goods.” Official Comment No. 6 cites a case decided before Article 2A was enacted as an illustration that courts have enforced “hell or high water” clauses in leases.



i.e., companies that are not involved in the manufacture, supply or selection of the goods and whose lessees have been adequately informed of their rights with respect to the goods. Understanding such commercial law has enabled financing companies to purchase goods to be used by prospective lessees with the expectation of being repaid – without having to worry about the lessees’ eventual happiness with the goods. Both state and federal courts have appreciated the importance of these principles of leasing law and have uniformly been willing to enforce lessees’ obligations under finance and “hell or high water” leases despite issues surrounding the equipment, delivery of services or other third party issues.<sup>4</sup>

### **Waivers of Defenses**

Another important example of this type of commercial law principle is found in that part of the UCC concerning assignments of (meaning both sales of and grants of security interests in) certain rights to payment such as leases, installment sales contracts and accounts receivable arising from sales or services. While Article 9 of the UCC provides generally that assignees of such payment rights are subject to the same defenses to payment that the obligors may have with respect to the parties to whom those obligations are owed, there is also a rule that permits the obligor to agree with the party to whom it owes the obligation that it will not assert such claims or defenses against an assignee: a “waiver of defenses” provision.<sup>5</sup> Official Comment No. 2 to the UCC provision setting forth this rule states that this provision “generally validates an agreement between an account debtor [e.g., the lessee under a lease, buyer under an installment sales contract, or obligor paying for services under a service contract] and an assignor that the account debtor will not assert against an assignee claims and defenses it may have against the assignor. These agreements are typical in installment sale agreements and leases.”

Such an agreement by an obligor may then be enforced by the assignee, but only under certain conditions. The assignee must have taken the assignment for value<sup>6</sup> and in good faith.<sup>7</sup> The assignee must also have taken the assignment without notice of claims of

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<sup>4</sup> See, for example, *Preferred Capital, Inc. v. Sturgil*, 2004 WL 1882865 (Ohio App. Aug. 25, 2004); *Great America Leasing Corp. v. Star Photo Lab, Inc.*, 672 N.W.2d 502 (Iowa App. 2003); *Information Leasing Corp. v. King*, 800 N.E.2d 73 (Ohio App. 2003); *Canon Financial Services v. Medico Stationery Service*, 300 A.D.2d 66, 751 N.Y.S.2d 194 (App. Div. 2002); *Wells Fargo Bank Northwest, N.A. v. TACA International Airlines, S.A. and JHM Cargo Express, S.A.*, 247 F.Supp.2d 352 (S.D.N.Y. 2002); *Leasetec Corp. v. Orient Systems, Inc.*, 85 F.Supp.2d 1310 (S.D.Fla. 1999); *Colorado Interstate Corp. v. CIT Group/Equipment Financing, Inc.*, 993 F.2d 743 (10<sup>th</sup> Cir. 1993); *In re O.P.M. Leasing Services, Inc.*, 21 B.R. 993 (Bankr. S.D.N.Y. 1982).

<sup>5</sup> The general rule entitling the obligor to assert defenses against an assignee is found in Section 9-404, while the rules concerning a waiver of defenses are found in Section 9-403.

<sup>6</sup> Section 9-403(a) indicates that “value” in that section is to have the same broad meaning as in Section 3-303(a) of Article 3, Negotiable Instruments.

<sup>7</sup> “Good faith” is defined in Article 1, General Provisions – in Section 1-201(19) of the version of Article 1 prior to its revision in 2001 (still in effect in most states) and in Section 1-201(b)(20) of Article 1 as revised in 2001. In the pre-revised version it is defined as honesty in fact. In the revised version it is defined as honesty in fact and being observant of reasonable commercial standards of fair dealing. In Official Comment No. 4 to Section 3-103, there is an explanation that the concept of reasonable commercial standards of fair dealing is more directed at fairness of conduct than at the care with which an act is performed.

rights to the assigned property and without notice of defenses or claims in recoupment of the type that may be asserted against persons entitled to enforce a negotiable instrument under a particular provision of negotiable instruments law.<sup>8</sup> In connection with these last conditions concerning lack of notice, it is important to realize that Article 1 of the UCC explains that, for purposes of the entire UCC, a person has notice of a fact either when the person has actual knowledge of the fact or, based upon all the facts and circumstances actually known to the person, when the person has reason to know of the fact.<sup>9</sup>

This section of Article 9 goes on to state that its provisions concerning enforcement of a waiver of defenses do not apply to certain defenses – the same defenses that are available to a maker of a negotiable instrument against even that favored party under Article 3 known as a holder in due course.<sup>10</sup> These defenses (sometimes referred to as the “real defenses”) are infancy, duress, lack of legal capacity, illegality of the transaction that would nullify the obligation of the obligor, discharge of the obligor in insolvency proceedings, and a very specific kind of fraud (sometimes referred to as “real” or “essential” fraud) – i.e., fraud that tricked the obligor into signing something without knowledge of, or a reasonable opportunity to learn, what the obligor was signing.

This section of Article 9 also evidences a special concern for consumers who are entering into agreements primarily for personal, family or household purposes. For example, it states that if some other law (such as the “Holder-in-Due-Course Regulations” established by the Federal Trade Commission) requires a notice on an agreement that the rights of an assignee of that agreement are subject to the claims and defenses of the obligor, and if the agreement does not contain such a notice, the agreement will nevertheless be interpreted as if that notice had been included and the obligor may assert the same claims and defenses as if the notice had been included.<sup>11</sup> This section of Article 9 also makes clear that it will not apply if other law (state or federal) establishes a different rule for individuals who are incurring an obligation for personal, family or household purposes.<sup>12</sup>

Although these Article 9 rules concerning an assignee’s ability to enforce waiver of defense provisions are somewhat lengthy, the bottom line is that financing companies that take assignment of commercial transactions (e.g., installment sales contracts, true leases and contracts labeled leases that are not true leases – as long as the obligation is

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<sup>8</sup> These conditions for enforcing a waiver of defenses are found in Section 9-403(b). The referenced types of defenses or claims in recoupment (a term not defined in the UCC, that means a right to reduce one’s liability under a contract by deducting for damages caused by the other party’s failures under the same contract) that may be asserted against a person entitled to enforce a negotiable instrument are found in Section 3-305(a): defenses such as infancy, duress, a very specific kind of fraud, discharge of the obligor in insolvency proceedings, ordinary defenses to payment on a contract, and deductions for other damages under the same contract.

<sup>9</sup> The explanations of “notice” and “knowledge” that apply to all of the UCC can be found in Sections 1-201(25) of Article 1 prior to revision in 2001 or in Section 1-202 of revised Article 1.

<sup>10</sup> Section 9-403(c) states that a waiver of defenses provision is not enforceable under that Section in the case of the defenses that can be asserted against a holder in due course of a negotiable instrument according to Section 3-305(b), which defenses are listed in Section 3-305(a)(1).

<sup>11</sup> This protection for consumers is found in Section 9-403(d).

<sup>12</sup> This protection for consumers is found in Section 9-403(e).

not incurred primarily for personal, family or household purposes) are entitled to enforce such provisions in nearly all circumstances as long as they are acting in good faith and do not have actual knowledge of defenses or of facts that would give them reason to know of such defenses. A long history of state and federal court decisions reinforces this commercial law principle.<sup>13</sup>

### **Conclusion**

Recognizing the important role that financing companies play in our economy, the Uniform Commercial Code has provided a number of means by which such companies can help finance the purchase and use of various goods and services without becoming embroiled in disputes concerning the nature of those goods and services. Were it not for legal recognition of the ability to collect an obligation notwithstanding such disputes, such financing would no doubt become a more expensive and less effective part of economic life.

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<sup>13</sup> See, for example, *Rhythm & Hues, Inc. v. The Terminal Marketing Company, Inc.*, 2004 WL 941908 (U.S. Dist. Ct. S.D.N.Y. 2004); *BRM Industries, Inc. v. Mazak Corp.*, 42 F.Supp.2d 176 (D.Conn. 1999); *Karmich Investment Group, Inc. v. W.M.R. Restaurant Corp.*, 621 N.E.2d 561 (Ohio App. 1993); *Equico Lessors, Inc. v. Ramadan*, 493 So.2d 516 (Fla. App. 1986); *Chase Manhattan Bank v. Lake Tire Co., Inc.*, 496 N.E.2d 129 (Ind. App. 1986); *J.I. Case Credit Corp. v. Foster*, 384 N.W.2d 610 (Minn. App. 1986); *Laurel Bank and Trust Co. v. Mark Ford, Inc.*, 438 A.2d 705 (Conn. Sup. Ct. 1980).

### III. FORUM SELECTION CLAUSES

It is well settled under federal law and in most states, that parties to a contract may agree, at the time the contract is entered into, to bring all lawsuits and disputes arising out of the contract in a specific court or the courts in a specific state.<sup>14</sup> This contractual provision, which gives the specified state or court what is called personal jurisdiction over the parties, is often referred to as a forum selection clause. The policy factors cited by courts and legal experts in favor of enforcement of this type of clause are: freedom of contract, certainty of where a lawsuit will be brought, and economic savings that arise from such certainty.<sup>15</sup> Forum selection clauses are common provisions, typically found in interstate commercial and consumer contracts,<sup>16</sup> as well as in international contracts.<sup>17</sup>

In commercial finance and lease transactions, forum selection clauses have been held to be just, reasonable, and enforceable.<sup>18</sup> In a consumer lease setting, a forum selection clause will be upheld if the forum otherwise has jurisdiction over the parties.<sup>19</sup>

#### **Recognition Under Federal Law**

It is well established under federal law, that parties may consent by contract to personal jurisdiction before a legal action begins.<sup>20</sup> Forum selection clauses are *prima facie* valid and enforced by the courts, unless the clause is unjust or unreasonable under the circumstances.<sup>21</sup> Courts have upheld forum selection clauses that were contained in form contracts, or contracts of adhesion, such as those printed in fine print on the back of a passenger cruise ticket.<sup>22</sup>

A forum selection clause obviates a federal court's need to apply the minimum contacts test, that is, the test used by courts to determine if it is fair for a party to be required to

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<sup>14</sup> *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15, 20, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972); Walter W. Heiser, Forum Selection Clauses in State Courts: Limitations on Enforcement After Stewart and Carnival Cruise, 45 Fla. L. Rev. 361 (1993).

<sup>15</sup> *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15, 20, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972); *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 593, 111 S. Ct. 1522, 113 L. Ed. 2d 622 (1991); Walter W. Heiser, Forum Selection Clauses in State Courts: Limitations on Enforcement After Stewart and Carnival Cruise, 45 Fla. L. Rev. 361 (1993).

<sup>16</sup> Walter W. Heiser, Forum Selection Clauses in State Courts: Limitations on Enforcement After Stewart and Carnival Cruise, 45 Fla. L. Rev. 361 (1993).

<sup>17</sup> *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 18, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972).

<sup>18</sup> *See Commerce Commercial Leasing, LLC v. Jay's Fabric Center*, CA No. 04-4480, 2004 U.S. Dist. LEXIS 22262 (E.D. Pa. Nov. 2, 2004).

<sup>19</sup> *See* UCC § 2A-106.

<sup>20</sup> *See, e.g., The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972); *Commerce Commercial Leasing, LLC v. Jay's Fabric Center*, CA No. 04-4480, 2004 U.S. Dist. LEXIS 22262 (E.D. Pa. Nov. 2, 2004).

<sup>21</sup> *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 18, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972). *See infra*, p. 14 for a discussion on when forum selection clauses are unreasonable.

<sup>22</sup> *See Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 111 S. Ct. 1522, 113 L. Ed. 2d 622 (1991).

litigate in that court.<sup>23</sup> In the absence of such a contractual forum selection provision, a defendant normally must have some connection with—for example, doing business or having property in—the state where the lawsuit is brought, in order for that state to have personal jurisdiction over the defendant. But even if the minimum contacts test is met, without a contractual forum selection clause, a business still may not be able to sue consumers in the business' home state.<sup>24</sup> With a contractual forum selection clause, since the parties have agreed beforehand to designate the forum where the dispute will be resolved, a court need not apply the minimum contacts test.<sup>25</sup> In that case, the court must only look to the clause itself and determine its validity and effect.<sup>26</sup>

Even Congress has given its approval of forum selection clauses. As mentioned above, in *Carnival Cruise Lines v. Shute*,<sup>27</sup> the Supreme Court held that a forum selection clause printed in fine print on the back of a cruise ticket was valid and enforceable. The *Shute* case involved a consumer contract between the passenger and cruise line, and the forum selection clause was not negotiable. In response to this case, Congress amended the existing federal act covering vessel owners' liability,<sup>28</sup> such that contractual forum selection clauses would not be enforceable under such circumstances. But the following year, Congress restored the federal act to its prior version, and thus restored the Supreme Court's interpretation and ruling that contractual forum selection clauses should be enforced.<sup>29</sup>

Where contracting parties are business entities, a contractual forum selection clause will be enforced even if the clause is not discussed by the parties during contract negotiations.<sup>30</sup> Furthermore, a contractual forum selection clause needs no special language to make it enforceable, which means it can be part of the "boilerplate" of a contract.<sup>31</sup> The forum selection clause may be located in the "fine print" of a contract,<sup>32</sup> even "on the reverse side,"<sup>33</sup> and the clause does not need to specifically name the applicable forum. For example, simply stating that any dispute arising between the

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<sup>23</sup> *Jay's Fabric Center*, CA No. 04-4480, 2004 U.S. Dist. LEXIS 22262 (E.D. Pa. Nov. 2, 2004); *Fuller Co. v. RDM Tech. BV*, No. 99-CV-1684, 1999 U.S. Dist. LEXIS 16460 (E.D. Pa. Oct. 15, 1999).

<sup>24</sup> *Compare Spiegle, Inc. v. FTC*, 540 F.2d 287 (7th Cir. 1976) with *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 111 S. Ct. 1522, 113 L. Ed. 2d 622 (1991). In *Spiegle*, in the absence of contractual forum selection clauses, Spiegle nonetheless brought collection suits and forced individual mail order consumers to defend themselves in Illinois, regardless of where the consumer lived. This practice, while legally proper, was successfully enjoined by the FTC for violating the FTC Act.

<sup>25</sup> *Jay's Fabric Center*, CA No. 04-4480, 2004 U.S. Dist. LEXIS 22262, \*1 (E.D. Pa. Nov. 2, 2004)

<sup>26</sup> *Jay's Fabric Center*, CA No. 04-4480, 2004 U.S. Dist. LEXIS 22262, \*1 (E.D. Pa. Nov. 2, 2004)

<sup>27</sup> *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 111 S. Ct. 1522, 113 L. Ed. 2d 622 (1991).

<sup>28</sup> The act is the Limitation of Vessel Owner's Liability Act, 46 U.S.C. App. § 183c.

<sup>29</sup> Debra D. Burke, *Cruise Lines and Consumers: Troubled Waters*, 37 Am. Bus. L.J. 689, n.63 (2000).

<sup>30</sup> *Foster v. Chesapeake Ins. Co., LTD*, 933 F.2d 1207, 1219 (3d Cir. 1991).

<sup>31</sup> See, e.g., *Silva v. Encyclopedia Britannica Inc.*, 239 F.3d 385, 389 (1st Cir. 2001); *Jewel Seafoods Ltd. v. M/V Peace River*, 39 F. Supp. 2d 628, 634 (D.S.C. 1999).

<sup>32</sup> See, e.g., *Shore Slurry Seal, Inc. v. CMI Corp.*, 964 F. Supp. 152, 156-57 (D. N.J. 1997).

<sup>33</sup> *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 111 S. Ct. 1522, 113 L. Ed. 2d 622 (1991).

parties will be brought in the state where one of the party's or an assignee's principal office is located has been determined to suffice.<sup>34</sup>

### **Recognition Under State Law**

Most state courts recognize the validity of contractual forum selection clauses, following the reasoning of the federal courts.<sup>35</sup> Some states even enforce contractual forum selection clauses by statute.<sup>36</sup>

### **When is a forum selection clause not valid or enforceable?**

Courts have held that a forum selection clause may not be enforced when the clause is clearly unjust and unreasonable.<sup>37</sup> Unreasonable does not mean that the court or forum selected is inconvenient. The law is well settled in both federal and state courts that inconvenience or additional expense to a party does not make a contractual forum selection clause unfair or unreasonable.<sup>38</sup> The contractual clause contemplates such inconveniences, which factors parties may use in considering the contract price.<sup>39</sup> For a contractual forum selection clause to be held to be unjust or unreasonable, it must be so grave as to effectively deprive a party of a meaningful day in court.<sup>40</sup>

Forum selection clauses are also subject to the same defenses that render other contracts or contract terms invalid, such as fraud or overreaching.<sup>41</sup> But a contractual forum selection clause will not be invalidated simply because a dispute arising out of a transaction is based upon general fraud allegations.<sup>42</sup> Furthermore, courts have held that inexperience or lack of sophistication of one party, even when faced with the other party's superior bargaining power, does not constitute a basis for finding that fraud or overreaching was used in obtaining a forum selection clause.<sup>43</sup> More specifically, it has

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<sup>34</sup> See, e.g., *Commerce Commercial Leasing, LLC v. Jay's Fabric Center*, CA No. 04-4480, 2004 U.S. Dist. LEXIS 22262 (E.D. Pa. Nov. 2, 2004); *Danka Funding, LLC v. Page, Scrantom, Sprouse, tucker & Ford, P.C.*, 21 F. Supp. 2d 465 (D. N.J. 1998).

<sup>35</sup> Walter W. Heiser, *Forum Selection Clauses in State Courts: Limitations on Enforcement After Stewart and Carnival Cruise*, 45 Fla. L. Rev. 361, 370 (1993).

<sup>36</sup> See, e.g., Neb. Rev. Stat. § 25-415; N.H. Rev. Stat. § 508-A; N.Y. Gen. Oblig. Law § 5-1402; Ohio Rev. Code § 2307.39.

<sup>37</sup> *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 16, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972).

<sup>38</sup> *Commerce Commercial Leasing, LLC v. Jay's Fabric Center*, CA No. 04-4480, 2004 U.S. Dist. LEXIS 22262 (E.D. Pa. Nov. 2, 2004); *Information Leasing Corp. v. Jaskot*, 784 N.E.2d 1192, 151 Ohio App. 3d 546 (Ohio Ct. App. 2003).

<sup>39</sup> *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972).

<sup>40</sup> *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 19, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972); *Information Leasing Corp. v. Jaskot*, 784 N.E.2d 1192, 1196-97, 151 Ohio App. 3d 546 (Ohio Ct. App. 2003).

<sup>41</sup> See, e.g., *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 19, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972); *Information Leasing Corp. v. Jaskot*, 784 N.E.2d 1192, 1196, 151 Ohio App. 3d 546 (Ohio Ct. App. 2003).

<sup>42</sup> *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519, n.14, 94 S. Ct. 2449, 41 L. Ed. 2d 270 (1974); *Sisk v. Kelleher*, 879 So. 2d 1156 (Ala. Sup. Ct. 2003)

<sup>43</sup> *Silva v. Encyclopedia Britannica Inc.*, 239 F.3d 385, 389 (1st Cir. 2001); *Bernath v. Potato Servs. of Michigan*, No. 3:02CV7105, 2002 U.S. Dist. LEXIS 18871, \*8 (N.D. Ohio Sept. 30, 2002); *Information Leasing Corp. v. Jaskot*, 784 N.E.2d 1192, 1196, 151 Ohio App. 3d 546 (Ohio Ct. App. 2003).

been held that lack of knowledge of legal terms and unfamiliarity with lease agreements cannot invalidate a contractual forum selection clause.<sup>44</sup> A contractual forum selection clause may be held to be unenforceable, however, if the inclusion of that particular clause in the contract was itself the product of fraud or coercion.<sup>45</sup>

### **Conclusion**

The commercial finance and leasing business is not different than other businesses in its use of contractual forum selection clauses, either from a legal or economic standpoint. Forum selection clauses are a necessary part of the equipment finance and leasing business world. The certainty that is afforded to parties in interstate business and the resulting savings that flow to businesses and consumers are just some of the more practical reasons cited by courts in the enforcement of these contractual clauses. The legal and economic factors that support the enforcement of contractual forum selection clauses in commercial transactions generally, are equally applicable to commercial lease transactions in particular. The courts, Congress, and the states have all recognized the validity of these contractual clauses in consumer and commercial transactions, including commercial leases.

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<sup>44</sup> *Information Leasing Corp. v. Jaskot*, 784 N.E.2d 1192, 1196, 151 Ohio App. 3d 546 (Ohio Ct. App. 2003).

<sup>45</sup> *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519, n.14, 94 S. Ct. 2449, 41 L. Ed. 2d 270 (1974); *Sisk v. Kelleher*, 879 So. 2d 1156 (Ala. Sup. Ct. 2003)