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What's New In the Law

By Robert W. Ihne

Ability to Collect Rentals Under Article 2A Finance Leases or Leases with 'Hell-or-High-Water' and/or Waiver of Defenses Provisions

Lyon Financial Services, Inc. v. Oxford Maxillofacial Surgery, Inc., 2009 WL 2170999 (U.S.Dist. Ct. D.Minn. July 17, 2009)

Although an equipment vendor's representative (alleged by the lessee to have made various misrepresentations regarding the equipment) assisted the lessee in obtaining financing, the lessee did not demonstrate an agency relationship between the rep and the lessor. The court finds here that summary judgment against the lessee on the issue of liability with regard to the finance lease at issue is appropriate. (See discussion below under Measures of Lessors' Damages with regard to the lessor's request for damages.)

True Lease vs Security Interest: In General

Park Western Financial Corporation v. Phoenix Equipment Company, Inc. (*In re Phoenix Equipment Company, Inc.*), 2009 WL 3188684 (Bankr.D.Ariz. Sept. 30, 2009) (not for publication — electronic docketing only)

In this memorandum decision, the court considers whether a number of leases of trailers (originated through sales

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Braving Tempestuous Times

Hell-or-High-Water Obligations Maintain Their Viability Despite Leasing Scams and a Troubled Economy

Part One of a Two-Part Article

By Raymond W. Dusch

In a decade marked by credit crises and financial fraud, lenders, factors, securitization entities and other funding sources that, in good faith, provide lease and accounts receivable financing to leasing companies and vendors must increasingly rely on the absolute, unconditional "hell-or-high-water" nature of the obligations they choose to finance. Hell-or-high-water protection has long been considered a commercial necessity to ensure the free flow of equipment lease financing and now, bolstered by recent changes to the Uniform Commercial Code (UCC), it has been extended to accounts receivable financing of goods and services.

Through this crucible of a faltering economy, combined with the growth of financing scams and Ponzi schemes (such as the infamous "Matrix Box" in the *NorVergence* cases), courts have had a fresh opportunity to examine the limits of enforcing hell-or-high-water obligations. This article discusses several recent court decisions that suggest practical strategies to assure wary funding sources that hell-or-high-water obligations will remain a viable route for navigating treacherous economic seas.

What Are 'Hell-or-High Water' Obligations?

A "hell-or-high-water obligation" is one in which a lessee or buyer of goods or services (the Obligor) becomes absolutely and unconditionally obligated to pay its financial obligations to a third-party funding source to which its lease or sale (*i.e.*, accounts receivable) obligations are assigned (the Assignee), notwithstanding any defense, setoff or counterclaim that the Obligor may have against the lessor or seller of the goods or services. Hell-or-high-water obligations are often set forth in the basic lease or sale agreement/invoice as a "hell-or-high water provision" with respect to the obligations owed directly to the seller or lessor

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of the goods or services. However, they are more frequently couched as third-party "waiver-of-defenses provisions" set forth in a lease, notice of assignment, or delivery and acceptance certificate (D&A), in which the Obligor agrees not to assert against an Assignee of its lease or accounts receivable obligations any defenses, setoffs or claims it may have against the lessor or seller of the goods or services leased or purchased by the Obligor.

Statutory recognition of hell-or-high water provisions, however, is limited to certain non-consumer equipment leases, where the lessor is not also the vendor of the equipment (*i.e.*, "finance lease" obligations) under UCC Section 2A-407 (upon acceptance of the goods, the lessee's obligations are "irrevocable and independent" of the lessor's obligations under the lease), and UCC Section 2A-508(6) (restricting a lessee's rights of setoff in a finance lease). However, UCC Section 9-403 (enacted as part of Revised Article 9 of the UCC in 2001) now expressly gives effect to waiver-of-defenses provisions to Assignees of any non-consumer lease or sale obligations for any types of goods or services.

A valid waiver-of-defenses provision under UCC Section 9-403 provides the Assignee of the obligation with the rights of a "holder-in-due course" of a negotiable instrument under UCC Section 3-305(b), and similarly requires that the Assignee take the assignment for: 1) value; 2) in good faith; and 3) without notice of a claim or defense to the assigned obligation. A waiver-of-defenses provision is likewise only subject to so-called "real defenses" that may be asserted against a holder-in-due course, which are limited to: 1) infancy; 2) duress, lack of legal capacity or illegality that nullifies the obligation; 3) fraud in the inducement; and 4) discharge in insolvency proceedings. As with a holder-in-due course of a negotiable instrument, a valid waiver-of-defenses clause allows an Assignee the distinct advantage of obtaining summary judgment in an enforcement action against the Obligor, irrespective of any claims or defenses asserted by the Obligor against the lessor or seller of goods or services.

The *NorVergence* Cases: Fraudulent Promises to Supply Services Under a Lease

Liberty Bank F.S.B. v. Diamond Paint and Supply, Inc., 60 UCC Rep. Serv.2d 1334 (Iowa Ct. App. 2006): The lessor, NorVergence, Inc. (NorVergence), verbally promised to supply the lessee with certain telephone and data services with equipment (consisting of a so-called "Matrix Box") under a lease that contained both hell-or-high-water and waiver-of-defenses clauses. When the lessor failed to provide the telecommunications services, the lessee refused to pay its lease obligations and was sued by the Assignee of the lease.

The lessee argued that the lease did not fall within the scope of Article 2A of the UCC because the agreement was "predominantly for services, not goods," and thus did not qualify as a "finance lease." The court noted that the lease, on its face, only covered equipment and that there was "no genuine dispute" that the lease covered goods and not services. The court also noted that the lease stated that it "will be considered a finance lease" under Article 2A, and held that the agreement of the parties that the lease was a "finance lease" under Article 2A would be given effect. The court then held that the protections provided by the hell-or-high-water provisions in the lease became effective upon the lessee's acceptance of the

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VENDOR ISSUES

BBAS, Inc. v. Marlin Leasing Corporation, 289 S.W.3d 153 (Ark.App. 2008)

This appellate court affirms a lower court grant of summary judgment in favor of a lessor which, after its lessee defaulted, learned that the vendor had delivered only a small portion of the equipment to the lessee for which the lessor had paid in full and that the vendor had "refunded" the value of the undelivered equipment to the lessee instead of to the lessor. Rejecting the vendor's argument that awarding the lessor damages would amount to recourse against the vendor — recourse to which the vendor had never agreed — the court finds that summary judgment in favor of the lessor for the value of the equipment not delivered to the lessee was appropriate based upon the common law tort of conversion committed by the vendor.

FORUM SELECTION, JURISDICTION AND CHOICE OF LAW

Merchants and Farmers Bank v. Marquette Equipment Finance, LLC, 2009 WL 2767678 (U.S.Dist.Ct. N.D.Miss. Aug. 27, 2009) In granting a motion by the original lessor's successor-in-interest to transfer venue to Utah of an action regarding a lease option brought by the lessee, this court decides that it should not rely solely on the lease clause providing for venue in Utah. The court finds that the clause at issue did not clearly provide for exclusive venue in Utah. However, after considering convenience factors under the federal statute regarding motions to transfer, it ultimately decides to grant the finance company's motion.

Frontier Leasing Corp. v. Singh, 2009 WL 2782681 (Conn. Super. July 31, 2009) (unpublished opinion)

This Connecticut court grants a motion for summary judgment by the leasing company recognizing a default judgment against the lessee obtained in Polk County, IA. In doing so, the court cites other Connecticut cases that have upheld forum selection clauses absent a showing of fraud or overreaching.

WAIVERS OF TRIAL BY JURY

AEL Financial LLC v. City Auto Parts of Durham, Inc., 2009 WL 2778078 (U.S.Dist.Ct. N.D.Ill. Aug. 31, 2009)

In granting the lessor's motion to strike defendant's jury demand, the court finds that the jury waiver provision in the equipment lease and related guaranty are not unconscionable, notwithstanding the lessee's claims that the provision was inconspicuous and that the lessee did not see the provision. The court goes on to state that evidence of fraud in the inducement by the lessor would not change this result, but appears to leave the issue open in the event that fraud in factum had occurred with respect to defendants' entry into the documents containing such a waiver (in which case the entire agreement could be void).

LESSORS' RIGHTS IN BANKRUPTCY PROCEEDINGS

Barber v. Reynolds Motor Leasing Company (I*n re My Type, Inc.*), 2009 WL 1705851 (Bankr.C.D.Ill. June 17, 2009)

This bankruptcy court decision begins with the following sentence: "Rearing its ugly head in this case is the issue of whether a lessor of a fleet of trucks whose leases are recharacterized as disguised security agreements is thereby rendered unperfected because the lessor is identified on the titles as owner instead of lienholder." After certain of the lessor's leases were so recharacterized by the court, the trustee alleged that the lessor was unperfected on such leases. This court, however, agrees with the majority of decisions holding that in cases where leases are determined in fact to create security interests, the lessor/secured party is nevertheless properly perfected in the vehicle when its name appears on the certificate of title as owner and not as lienholder.

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goods, as evidenced by a duly executed D&A, and affirmed summary judgment of the lower court in favor of the Assignee of the lease.

Popular Leasing USA, Inc. v. Mortgage Sense, Inc., 66 UCC Rep.Serv.2d 719 (Cal. Ct. App. 2008): the lessee executed a lease with NorVergence containing both a hell-or-high-water clause and a waiver-of-defenses clause on terms similar to the *Diamond Paint* case (above), and executed a D&A that certified that it had received and accepted all of the equipment covered by the lease. After failing to make rental payments and being sued by the Assignee of the lease, the lessee claimed that the Assignee could not enforce the lease because the equipment had never been installed or accepted, and that the D&A had been procured by the lessor's fraud.

The court first held that the Assignee had the rights of a holder-in-due course under the hell-or-high water provisions of the lease. Although it found that the lease did not require acceptance of the goods as a pre-condition to its commencement, the court examined whether any fraud in connection with the execution of the D&A might constitute a defense to the Assignee as a holder-in-due course.

The lessee stated that the lessor had told it to sign certain forms (which were attached together on a clipboard) solely to confirm that the leased equipment had been delivered "and for no other purpose." The lessee further stated that the forms bearing the heading "Delivery and Acceptance Certificate" were partially obscured by other papers on the same clipboard, and that these headings were not visible at the time the lessee signed the forms.

The court held that if these facts were to be evidence of fraud, they did not show the type of fraud that would constitute a defense to a claim by a holder-in-due-course. The court stated that "the only type of fraud available as a defense against a holder-in-due-course [*i.e.*, known as "fraud in the

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inducement"] is 'fraud that induced the Obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn its of its character or its essential terms'," as provided in UCC Section 3-305(a)(1)(iii). The court held that, when the lessee's representatives executed the D&A, they had an opportunity to learn what it was they were signing and, if they chose not to do so, any fraud by the lessor in connection therewith did not meet the requirements to constitute a defense to a holder-in-due course under UCC Section 3-305, as incorporated by UCC Section 9-403.

IFC Credit Corporation v. Specialty Optical Systems, Inc., 252 S.W.3d 761 (Tex. Ct. App. 2008): IFC Credit Corporation (IFC) began to purchase leases from NorVergence in October 2003. In January 2004, at about the time it was scheduled to start receiving payments from the first group of leases it purchased from NorVergence, IFC began to receive letters and calls from unhappy NorVergence customers, complaining that they were getting billed but not receiving telecommunications services or the promised savings from their Matrix Boxes. In March 2004, IFC and NorVergence amended their master lease purchase agreement to provide IFC with greater financial protections, including a 25% holdback from the amount it paid for the leases. When lessees refused to pay because they were not receiving the promised telecommunications services, IFC was not obligated to pay the amounts withheld.

IFC continued to receive a steady stream of customer complaints about NorVergence, and experienced a high rate of default on NorVergence's leases. Accordingly, by late April or early May 2004, IFC planned to terminate its relationship with NorVergence, but changed its mind, and amended the master lease purchase agreement a second time to provide for steeper discounts on the purchase price of the leases and increasing the holdbacks from 25% to 50%.

In April 2004, Specialty Optical Systems, Inc. (Specialty) entered into a lease for a Matrix Box, after a representative had convinced it to cancel its existing telephone services contract. On May 18, 2004, NorVergence countersigned the lease and an IFC representative contacted Specialty as part of a "verbal audit" to confirm that the Box had been received and that Specialty had signed the D&A, and to assure Specialty that it would receive the savings promised by NorVergence. Shortly thereafter, IFC took assignment of the lease.

Because the Box had no value other than to enable delivery of telecommunications services, Specialty firmly believed that the monthly payments under the lease included the Box as well as the promised telephone service and internet access. Despite the lessee's belief, the lease contained both hell-or-high-water and waiver-of-defenses provisions that obligated it to make payments to IFC even if Specialty never received the services it thought it was purchasing, as long as the Box was delivered in outwardly good condition.

Specialty never received the telecommunications services, and at some point prior to June 30, 2004, NorVergence defaulted on its contracts with common carriers (with which it had contracted to provide telecommunications services to lessees), and was forced into involuntary bankruptcy. Specialty then attempted to cancel the lease due to its failure to receive the services, returned the Box to IFC, and ceased making payments under the lease. In an action by IFC to enforce the lease, the trial court declared the lease unenforceable and *void ab initio*.

The Texas Court of Appeals analyzed the waiver-of-defenses and hell-or-high water provisions set forth in the lease, under a standard good-faith holder-in-due course analysis. The court noted that the test for "good faith" is whether the purchaser had actual knowledge of facts and circumstances amounting to bad faith, and that a person has "notice of a fact" includes when, from all of the facts and circumstances, he has reason to know it exists. It noted that the more a holder knows about the underlying transaction and controls or participates in it, the less the need for giving him "the tension free rights [of a holder-in-due-course] considered necessary in a fast moving, credit-extending commercial world."

The court found that IFC was fully aware that NorVergence's failure to provide services had resulted in a high default rate and was sufficiently concerned about NorVergence's deteriorating financial condition that it amended the master program agreement twice to enhance its level of protection through considerable holdbacks. Although the leases referenced the Matrix Box only, the court found that IFC knew that NorVergence was marketing the leases by promising services and savings in conjunction with the leasing of the Matrix Box, and that in the absence of T-1 service or telephone service the Box had no value whatsoever. The court found that, despite IFC's awareness that customers were not receiving the promised services, IFC continued to reassure new customers like Specialty (by means of its "verbal audits") that the services would be forthcoming. Accordingly, the court held that IFC's level of participation in the underlying transaction moved the transaction beyond the realm of innocent acquisition of commercial paper. IFC was thus not entitled to the protections of a holder-in-due-course, and upheld the trial court's verdict that IFC took the lease subject to the lessee's defenses and therefore could not enforce the lease.

Conclusion

Next month, we will discuss the effect of several other recent cases on the financing of hell-or-high-water lease obligations and accounts receivable obligations, and suggest some techniques to help ensure that the enforceability of hell-or-high-water obligations can continue to be relied upon by funding sources.

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Braving Tempestuous Times

Hell-or-High-Water Obligations Maintain Their Viability Despite Leasing Scams and A Troubled Economy

Part Two of a Two-Part Article

By Raymond W. Dusch

Part One of this Article discussed the impact of some of the recent NorVergence cases on the viability of hell-or-high-water obligations for third-party financing of lease obligations. This second installment discusses the effect of several other cases on the financing of hell-or-high-water lease obligations and accounts receivable obligations in a decade marked by credit crisis and financial fraud, and provides some practical strategies to assure wary funding sources that hell-or-high-water obligations will remain a viable route for navigating treacherous economic seas.

The Wells Fargo Cases: Failure to Pay for or Deliver Equipment

Wells Fargo Bank, N.A. v. Brooks-America Mortgage Corporation, 419 F.3d 107 (2d Cir. 2005): A lessee sought sale-leaseback financing by selling certain equipment to a lessor, Terminal Marketing Co. ("Terminal"), and then leasing it back for a period of time, but was never paid for the equipment by Terminal. The lessee signed a lease containing both a hell-or-high-water clause and a waiver-of-defenses clause, and a delivery and acceptance certificate (a "D&A") for the equipment that also contained a waiver-of-defenses clause. Negotiations then continued between the parties over the following months, even though the legal documents had already been signed. During this period, Terminal assigned the lease to Wells Fargo as an indenture trustee for a group of investors in a securitization transaction and, after the lessee failed to make its payments, Wells Fargo sued for collection.

Making no distinction between the hell-or-high-water clause in the lease, and the waiver-of-defenses clauses in both the lease and the D&A, the court noted that courts have uniformly given full force and effect to hell-or-high-water provisions and, despite the fact that the lessee had never received payment for its equipment, stated that "[n]onperformance by the lessor is irrelevant, at least when the lessee was a sophisticated party and the party asserting the right to rental payments is a *good-faith Assignee*." The court held that the lease was enforceable by the Assignee, but cautioned that it did not need to reach the issue of whether, under New York law, hell-or-high-water clauses "are enforceable in all circumstances." The court thus left open the possibility that had Terminal sought to enforce the hell-or-high-water clause *directly* without first assigning the lease to Wells Fargo, the potentially fraudulent act of entering into the transaction without ever intending to pay for the underlying equipment may well have rendered the otherwise "hell-or-high-water" lease obligations unenforceable by Terminal itself.

Wells Fargo Bank Minnesota, N.A. v. B.C.B.U., 49 Cal.Rptr.3d 324 (Cal. Ct. App. 2006): While the lessee and lessor were still negotiating the transaction, the lessor sent a lease and D&A to the lessee for signature. A representative of the lessor assured the lessee that it was "common industry practice" to execute these documents in advance, but not date them, and said that the lessor would hold the documents in escrow until a deal was reached. The lessee signed the documents but, without its knowledge, they were dated and assigned to a third party for use in a securitization pool with Wells Fargo. Meanwhile, the lessor and lessee were unable to come to terms and, two months later, the parties rescinded the lease, with the lessor returning the lessee's first and last month's payments under the lease, which had been paid at the time the documents were signed. No equipment was ever paid for by the lessor or delivered to the lessee under the lease.

The lease recited that it was intended to qualify as a "finance lease" under Article 2A of the UCC, which would mean that, under UCC Section 2A-407, the lessee's obligations became "irrevocable and independent upon the lessee's acceptance of the goods." The lease also contained a waiver-of-defenses clause, and the D&A stated that the lessee had received the equipment in good condition and had accepted it unconditionally. Despite an explicit warning in the D&A for the lessee not to sign the document unless it had received all of the equipment and was "completely satisfied with it," the lessee had signed the D&A.

The court observed that a lessee's obligations under a finance lease do not become irrevocable under UCC Section 2A-407 *until acceptance* of the goods, and only then may the obligations be enforced by the lessor and its Assignee. It also observed that an Assignee that meets the holder-in-due-course requirements of UCC Section 9-403 may enforce a waiver-of-defenses clause in its own right, subject only to the defenses good against a holder-in-due-course of a negotiable instrument, even if other law would prohibit the enforcement of the lease by the lessor. The court read these two apparently conflicting Sections together and held that while UCC Section 2A-407 governs the relationship among the lessee, the lessor, and the lessor's Assignee *prior* to acceptance of the goods, once the lessee "accepts the goods, or as here, the lessee executes documents that on their face *say* he has accepted the goods," the lessee's rights against a qualifying Assignee are governed by UCC Section 9-403. Accordingly, it is important to understand that an Assignee

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may become insulated from an Obligor's claims and defenses against an Obligee/Assignor in two distinct ways: 1) by virtue of the Assignee succeeding to the hell-or-high-water rights of the Assignor, as set forth in the underlying agreement or as otherwise provided for leases covered by UCC Article 2A, and 2) in the Assignee's own right, by obtaining the rights of a holder-in-due-course under UCC 9-403.

The court noted that the lessee had taken "a substantial risk in signing documents that reflected a completed transaction when it was still negotiating for a deal that ultimately fell through," despite language "that fairly shouted 'Do not sign me.'" It also observed that even if the unauthorized dating of the lease documents by the lessor constituted a material alteration, this did not render the lease an "illegal contract" that would constitute a "real defense" to a holder-in-due-course, and that a holder-in-due-course is not subject to the contract defense of material alteration. The court thus held that Wells Fargo had acquired holder-in-due-course status under UCC Section 9-403 and could enforce the lessee's obligations despite a complete failure of consideration by the lessor.

Wells Fargo Bank Minnesota, N.A. v. Nassau Broadcasting Partners, L.P., 52 UCC Rep.Serv.2d 249 (S.D.N.Y. 2003): In another sale-leaseback transaction involving Terminal and Wells Fargo, documented in the same manner as in *BrooksAmerica* (above), the lessee signed the lease and the D&A but was never paid for the equipment, and Terminal assigned the lease to Wells Fargo. After it defaulted and was sued by Wells Fargo, the lessee claimed that, at the time the lease was assigned, Wells Fargo had knowledge of non-payment by the lessor and thus took the lease subject to the lessee's defenses against the lessee. Wells Fargo countered that the good faith and lack of notice requirements of UCC Section 9-403 had "no relevance" to the facts of the case because the lease had a hell-or-high-water clause.

The court examined whether a hell-or-high-water clause is "simply one variant" of a waiver-of-defenses clause under UCC Section 9-403, and thus requires the Assignee to prove its status as a holder-in-due-course in order to enforce the hell-or-high-water clause. It observed that while some courts have required this, other courts have drawn a distinction between the two clauses, maintaining that an Assignee's status as a holder-in-due-course is "irrelevant" to the enforceability of a hell-or-high-water clause. Without attempting to resolve the disagreement in the courts, the court concluded that even if it assumed that holder-in-due-course status under UCC Section 9-403 *was* required, Wells Fargo had met this standard and was able to enforce the hell-or-high-water provision.

The court observed that Wells Fargo's role in the sale-leaseback transaction was largely administrative and, despite the lessee's claims that Wells Fargo failed to act in good faith because it had notice (or should have had notice) that the equipment had not been paid for by Terminal, the court found little evidence that Wells Fargo knew that Terminal had not paid the lessee. The court also held that Wells Fargo had acted in a commercially reasonable manner when it relied on the lessee's representation and warranty in the D&A that Terminal had satisfactorily performed all of its covenants and conditions required under the lease.

Waiver-of-Defenses Clauses And Assignments of Accounts Receivable

Private Capital, Inc. v. J&K Engine & Rig Repair, 984 So.2d 929 (La. Ct. App. 2008): Private Capital, Inc. ("Private Capital"), an accounts receivable factor, sued Coastal Drilling Company, LLC ("Coastal") to recover sums due on an invoice it purchased from J&K Engine & Rig Repair ("J&K"), an oil rig repair service. On the day that the invoice was issued to Coastal, J&K had forwarded to Coastal a notice of assignment of the invoiced account to Private Capital. The notice included an agreement by Coastal not to assert any defenses that it may have against J&K against Private Capital as Assignee, and was signed by Coastal and returned to J&K. Coastal then claimed that the invoiced work was not performed by J&K and refused to pay Private Capital.

The court analyzed the waiver-of-defenses clause under UCC Section 9-403, which applies to assignments of accounts receivable under factoring arrangements, as well as to assignments of obligations under leases of personal property. Coastal claimed that a waiver-of-defenses clause is only effective if bargained for contemporaneously with the underlying contract, noting some jurisprudence indicating that "consideration" may be an issue with waivers created *after* execution of the underlying contract. The court noted, however, that under Louisiana law at least, the fact that Coastal chose to acknowledge and accept the notice and waiver as part of its ongoing business relationship with J&K, particularly in light of Coastal's desire for conclusion of the repair project, was sufficient "cause" for the waiver-of-defenses agreement to be enforced by Private Capital under UCC Section 9-403.

Capital City Financial Group v. Mac Construction Inc. (Ohio Ct. App. 2002): A plumbing company assigned its accounts receivable to a factor for work performed for an account debtor, and sent notice to the account debtor to make all payments to the factor. The factor subsequently sent the account debtor a form seeking the account debtor's agreement to make the payment of the invoiced amounts without defense or offset, which the account debtor signed and returned to the factor. The account debtor then claimed that the invoiced plumbing work had not been performed by the assignor, and raised this as a defense to payment against the factor.

The court examined the claim under former UCC Section 9-206 (the predecessor to revised UCC Section 9-403), noting that pursuant to that Section, an account debtor generally retains the right to assert contract defenses against an Assignee unless the account debtor enters into an enforceable agreement *with the seller/assignor* not to assert claims or

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defenses. It noted that in this case, the contract by which the account debtor allegedly agreed to waive contractual defenses was between the buyer/account debtor and the factor/Assignee, and not between the buyer/account debtor and the seller/assignor, as required by former UCC Section 9-206, and thus held the waiver-of-defenses agreement with the factor to be unenforceable.

It is important to be aware that the same requirement that a waiver-of-defenses agreement must be between an account debtor and a seller/assignor still applies under revised UCC Section 9-403. Thus, any such agreement required by a factor/Assignee is best embodied in a tri-party acknowledgement and assignment agreement among the account debtor, the seller, and the factor.

Brookridge Funding Corp. v. Northwestern Human Services, 175 F.Supp.2d 1150 (D. CT. 2001): A factor purchased accounts receivable for construction services performed by the seller/assignor for an account debtor. The seller, the factor, and the account debtor executed a notice of purchase of accounts receivable under which the account debtor was instructed to make all payments pursuant to the invoice directly to the factor. The notice also contained a representation and warranty by the account debtor that it had no right of counterclaim, setoff, or any other right of deduction for the invoiced amount. The account debtor later defaulted, citing breaches by the seller/assignor in the performance of its construction services, and the factor sued the account debtor to collect the account.

The court analyzed former UCC Section 9-206, specifically as to whether it applies to a waiver of defenses against an Assignee executed by an account debtor who is a "buyer" of *services* rather than *goods*. It noted that the court in *Suburban Trust & Savings Bank v. University of Delaware*, 910 F.Supp. 1009 (D. Del. 1995), held that such a waiver did not apply because, by its implicit terms, former UCC Section 9-206 pertained only to waivers signed by buyers of *goods* — not buyers of *services*. The court nevertheless refused to follow *Suburban Trust*, stating that such a senseless restriction was never intended and any suggestion of such a restriction should be disregarded, and held that the account was enforceable by the factor.

It is important to recognize that revised UCC Section 9-403 has eliminated any ambiguity in former UCC Section 9-206 that waiver-of-defenses provisions apply to buyers of services, as well as buyers of goods, since it applies to all "accounts" which, under revised UCC Section 9-102, now expressly includes any right to payment, whether or not earned by performance, 1) for property that has been sold or leased, or 2) for services rendered or to be rendered.

Compressors Plus, Inc. v. Service Tech de Mexico, 54 UCC Rep.Serv.2d 50 (D. ND 2004) and *CapitalPlus Equity, LLC v. Prismatic Development Corp.*, 2008 WL 2783339 (D. NJ 2008): In two similar cases, the account debtor signed a notice of assignment of an account receivable by the seller to a factor, in one case, containing an acknowledgement that "[t]he merchandise is in accordance with the quality and quantity requested and *will be paid in full* according to the terms specified in the invoice" and, in the other case, verifying that the "invoices are true and accurate and *due and payable* by [the account debtor]."

In each case, the factor argued that the acknowledgements contained in the notice of assignment constituted an enforceable waiver-of-defenses provision that allowed it to enforce the account despite claims and defenses raised by the account debtor. However, the court in each case held that neither acknowledgement constituted an *explicit* waiver of defenses that the account debtor had against the seller of the goods and that, absent such an explicit waiver of defenses, the factor took the accounts subject to the claims of the account debtor against the seller.

Conclusion

As demonstrated by the foregoing cases, despite the economic troubles and scandals of the past decade, the enforceability of waiver-of-defenses provisions remains robust and can still be relied upon by funding sources that, in good faith, provide hell-or-high-water financing to leasing companies and vendors, but with certain caveats.

- The closer the Assignee is to the underlying transaction, the more the courts will scrutinize what facts the Assignee may have known or should have known about potential claims and defenses of the Obligor, which can fatally endanger the good faith nature of the assignment.
- Obligors will be strictly held to the express terms of the documents they sign, even if they choose not to carefully review or understand the impact of (or receive any tangible benefits from) such provisions, and the execution of any documents at any point in the transaction will be at the Obligor's sole risk.
- Ordinary fraud that induces an Obligor to enter into a transaction will not constitute a bar to a waiver of defenses against an Assignee, unless the Obligor can prove that it had neither knowledge nor a reasonable opportunity to learn of the character or essential terms of the transaction, even if it feels it was rushed into signing documents.
- The explicitness of the terms of the lease, D&A, or notice of assignment are vital to an Assignee establishing an enforceable waiver-of-defenses agreement that allows the Assignee to take the obligation free from any claims or defenses of the Obligor, and it is essential that, at the very least, both the Obligor *and* the lessor or vendor be parties to any such waiver-of-defenses agreement.

Mindful of these caveats and the other strategies suggested by these cases, funding sources can continue to utilize the safe harbors of hell-or-high-water and waiver-of-defenses provisions to minimize their losses during turbulent economic times.

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