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17 THINGS TO CONSIDER BEFORE SIGNING AN EQUIPMENT LEASE

By Mark Cohen

Equipment leasing can grow a business without large out-of-pocket expenses because it allows the lessee to spread the cost out over the term of the lease. Too often, though, contractors needing equipment sign a lease without reading it. And often those who read it do not understand some provisions or dismiss them as "legal mumbo jumbo." Equipment suppliers (lessors) can be equally negligent; some may deliver expensive machines without a written contract at all while others may rely for years on a questionable template plucked from the Internet.

The failure to use a written lease, or the failure to understand one, can be disastrous. The parties may think they are in agreement when, in fact, they are not. They may not discover that their understandings conflict until an event weeks or months later. Only then do they call their lawyers, and the money they pay their lawyers to help resolve the dispute always far exceeds the amount they would have paid their lawyers to make sure they were in agreement before they signed the lease. This article will help lessors and lessees understand 17 important legal issues they should consider before entering into an equipment lease. This article is not a complete list of every issue a lease should address, but these 17 issues are critical.

1. The Equipment: What is being leased? It's a simple question, but some machines can be equipped in certain ways to accomplish a specific objective. For example, a user can fit a screener with screens of a certain size to produce the desired product. Are the screens part of the leased equipment or does the lessor charge separately for the screens?

2. The Term: What is the term of the lease in weeks or months? Generally, the lessor benefits by requiring a minimum term as opposed to renting the machine out on a week-to-week or month-to-month basis.

3. The Rent: How much will the lessee pay to use the equipment? Do not confuse the amount of rent with the timing of the payment of the rent. If the lease term is three months and the rent for the term is $6,000, the parties must agree on how that $6,000 will be paid. They may agree to three monthly payments of $2,000 or they may agree to some other schedule, but the lease should be clear on this issue.

4. Sales and Use Taxes: If the jurisdiction where the lessee will use the equipment imposes a sales or use tax, the lease should specify who will pay that tax (usually the lessee). If the lessee will pay the tax, the lease should make clear that sales or use tax charges are in addition to the rent.

5. Hours: Equipment wears as it is used. Even when the parties agree on the lease term, the lessor will want some assurance that the lessee will not cause excessive wear to the equipment by operating it 24 hours a day. To address this concern many leases provide that operation of a machine for more than a specified number of hours in a week or month will result in additional rent charges for each hour the lessee uses the machine beyond the specified number. We have represented clients in lawsuits where people testified that it was "the custom in the industry" to allow so many hours per day or week before additional charges become applicable; don't rely on that – make sure the lease clearly addresses this issue.

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6. Insurance: Does the lease require the lessee to insure the equipment at the lessee's cost? If so, for how much? The lessor should insist on seeing a certificate of insurance before transferring possession of the equipment.

7. Place of Installation: Where will the lessee use the equipment? Who will set it up if it requires specialized setup? If the lessor will install the equipment, is there an additional charge for that service? Another reason to specify the place where the lessee will use the equipment is that the lessor must know where and how the lessee used it in case the lessor later needs to take possession of it or file a mechanic's lien against the property on which the equipment was used to perform work.

8. Transportation Costs: Who will pay the cost of transporting the equipment? FOB is an abbreviation for "free on board" or "freight on board." Traditionally, the term specified whether the buyer or seller would pay for delivery and when responsibility would transfer, but the abbreviation often appears in leases as well as sales contracts. In the context of a lease, it generally specifies which party will pay for transportation of the equipment. If the equipment is "FOB shipping point," the lessee pays the transportation costs and takes responsibility for the equipment when it leaves the lessor's premises.

9. Maintenance and Repairs: The lease should specify who will be responsible for maintaining and repairing the equipment. If the lease requires the lessee to pay for replacement parts provided by the lessor, it should specify whether the charge for the parts will be the lessor's cost or the lessor's retail price.

10. Ordinary Wear and Tear: An equipment lease almost always requires the lessee to return the equipment in good condition, "ordinary wear and tear excepted." For this reason the lessor should have a procedure in place to document the condition of the equipment before it leaves and immediately upon its return. We recommend that equipment lessors use a checkout and check-in checklist for each rental to document the condition of the equipment. We also recommend that lessors immediately photograph any damage beyond ordinary wear and tear when the equipment is returned.

11. Warranties: What warranties, if any, has the lessor made? If the lessor has made warranties, the lease should describe the nature and extent of them. Certain warranties exist as a matter of law unless the lessor disclaims them; the lessor should make sure the lease disclaims such warranties unless the lessor intends to by bound by them.

12. Default: What constitutes a default by the lessee, and what remedies may the lessor exercise in the event of default? The most common default is failure to make a required rental payment. From the lessor's standpoint, the lease should allow the lessor to immediately take possession of the equipment in the event of a default.

13. The "Merger" or "Integration" Clause: A good lease will contain what lawyers call a "merger" or "integration" clause. This may seem like "legal mumbo jumbo," but it is crucial. The purpose of this clause is to prevent the parties from later claiming that the lease does not reflect their entire understanding or was changed by a subsequent oral agreement. For example, a merger clause can protect a lessor from a lessee's claim that the lessor represented that the equipment would perform to a specific standard or accomplish a specific task.

14. Governing Law: Where the lessor and lessee are in different states, which state's laws will govern the lease transaction?

15. Dispute Resolution: Sometimes the parties can resolve their dispute simply by talking to each other, but when that fails a dispute may be resolved by mediation, arbitration or litigation.

Mediation is a non-binding process in which a neutral mediator helps the parties reach a mutually agreeable resolution. Most mediation clauses provide that the parties will share the costs of mediation equally. The lease should specify how a mediator will be selected if the parties are unable to agree on one. The advantages of mediation are that it is relatively inexpensive, it may lead to a quick resolution, and it sometimes helps preserve good relations between the parties so they can do business together in the future.

In arbitration a neutral arbiter acts like a judge; the arbiter may hear testimony, review evidence and enter binding rulings. Once an arbiter makes a final award, the prevailing party may file that award in the appropriate court and convert it to a judgment. Arbitration sometimes leads to resolution sooner than a lawsuit would. Another advantage of arbitration may be the opportunity to select an arbiter who has specialized knowledge. For instance, in a construction dispute the parties might choose an arbiter with experience in construction law.

There may be disadvantages to arbitration. First, arbitration may be as expensive as litigation because most arbiters charge $250-$350 per hour. Second, the right to engage in discovery (take depositions and issue subpoenas) may be quite limited. Third, unless the lease is drafted properly the parties may end up with an arbiter with little expertise in the relevant area of law. Fourth, it is virtually impossible to seek review of an arbiter's decision; in many states a court may not overturn an arbiter's decision even if the arbiter did not properly apply the law to the facts of the case.

Litigation, of course, is the filing of a lawsuit. Litigation is expensive, but it may offer several advantages. First, litigation is governed by established rules of law, procedure and evidence. Knowing these rules ahead of time helps the lawyers for the parties evaluate the strengths and weaknesses of their respective cases. Second, litigation allows a party to engage in discovery that may be necessary to find relevant evidence and/or obtain information from non-parties that do not want to become involved. Third, litigants may opt for a jury trial, and there may be cases in which a jury trial is advantageous. Finally, a party may appeal the trial court's decisions on matters of law to a higher court.

Mediation and litigation are not mutually exclusive. We often draft contracts that require the parties to participate in mediation, yet allow any party to file suit if mediation is not successful.

16. Venue: If there is litigation between the parties, what court will host that litigation? No party wants to be hauled into court in a distant county or state where it will be forced to hire local counsel. We encourage lessors to insist that their lease forms contain a clause mandating that the exclusive venue for any litigation will be in the county where the lessor has its principal place of business.

17. Attorney's Fees and Costs: In most states a party to a lawsuit pays its own attorney's fees and costs – even if it wins in court. However, the parties can alter that rule by including a clause in the lease providing that the prevailing party in any lawsuit will be entitled to collect its attorney's fees and costs from the other party.

Conclusion

When others learn that I am a lawyer, they often ask whether I do transactional work or litigation. In equipment leasing this distinction is artificial; lease litigation is almost always the result of a poorly drafted lease or a negotiation that failed to consider all the "what if" contingencies. The good news is that the parties to an equipment lease can greatly reduce the risk of misunderstandings and costly litigation by taking time to make certain the lease is both unambiguous and complete.

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