

Lease Contracts: Your Terms and Conditions

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Summary. Lease contracts are traditionally standard documents, created by the lessor, written for the benefit of the lessor's organization, and usually will contain requirements and clauses that can be very detrimental to the lessee's organization. This session will spotlight some of the lease caveats to watch out for, and then suggest principled alternatives that will mitigate your company's risk exposure and enhance your lessor/supplier's performance. Two characters, Mr. Trouble-Clauser and The Terms-minator, will help us illustrate both the typical potentially negative aspects of lease agreements and then the positive alternatives to them. Last, a standard boilerplate example will be offered that you can use as a framework to create your own lease contract. Come join us for an interesting, informative, interactive, and fun session.

The Puzzle. Ever had the misfortune of having your lease automatically renewed? Maybe due to not giving notice properly? Experienced cost or price increases in multi-year deals that you have no control over? Ever had to pay exorbitant late fees due to unrealistic payment cycles? Rigid default conditions with tough accelerated payment kickers? Ever signed a new deal with an existing lessor because the existing deal was so bad you had to get out of it?

What about not so serious but just as potentially bothersome conditions like "permission to move," "jurisdiction," insurance, fees: application, late, end of term or other restrictions? How about dates- do you know when your lease officially begins and when it ends? Do you have a copy of the final, authorized, executed documents? Are you sure? Are there any "time bombs" in your Purchasing files right now that are going to cause you a problem sometime soon?

Buyers Beware - Lease Caveats To Watch Out For. The Trouble-Clauser Inserts Himself.

Automatic Renewals. Legal clauses that say if you don't give notice to your lessor, in a specific format or method (e.g. via Certified mail, return receipt requested), by a certain time (e.g., 30-180 days prior to the expiration of the contract) the lessor can then automatically extend your lease, usually for a period of one to five years. And, the same lease rates and terms as were on the original term can continue.

Cost Increases. Often lease agreements have cost escalators included in them. Typically they state the lessor can increase your costs, at will, at any, or after a set amount of time, say, after the first twelve months.

Payment Terms. Lease agreements normally have very short payment terms, for instance, net 7 days. Technically, if we do not meet these payment terms in a timely manner, we can incur late fees, finance charges, and, even default of the lease.

Payment Cycle. Some lease agreements have a payment cycle that is very difficult to comply with. For instance, the invoice is generated in one part of the country, sent via standard mail, takes days to arrive to your locale, and then has a remit to address to receive your payment on the other side of the country. Again using standard mail, it can be very difficult to pay your supplier without incurring late fees, finance charges, and even technically, default.

Fees. Application Fees, Late Fees, End Of Term Fees Or Misc. Fees. A lessor can charge these fees, and they can add up fast, and to a lot of money. Sometimes they are not necessarily the responsibility of the lessee.

Official Commencement/Expiration Dates. Often, your signature on a lease document is not the official starting date. The lessor must countersign your signed lease document officially. Often this takes time. Your lessor is required to give you a copy of that finally executed document. Sometimes they don't.

Defaults. Defaulting on a lease contract may be easier than you think. Late payments, late payment history, moving leased equipment (or using software) in a place not specially listed on a lease document, and other conditions, can create a default, kicking in a clause to make all lease payments immediately due and obliging you to buy or just return, the equipment. (That's right, pay for it entirely, but still not own it.)

Assignment. Often, due to merger, sale of business, or just financial capabilities, your lessor may exercise their typically included right to assign your lease to another lessor. You'll have to deal with new remit to payment addresses, new lease processing methods, new supplier representation, and, if you're not careful, new demands on the terms and conditions of your lease with the newly assigned lessor. These changes can result in some of the issues already mentioned, new application fees, payment terms non-compliance, late fees, and new insurance requirements, even default.

UCC Rights Waiver. Most lease agreements will ask you to waive your rights granted under the UCC. Generally this waiver refers to rights under section 2A.

Personal Guarantee. Sometimes a lessor will ask you to sign a personal guarantee contained on the lease document. It means: if your company doesn't pay the lessor, you will, personally.

End Of Lease Options. Usually the lessor will give you the option to purchase the equipment at the end of the lease term. Or return the equipment. Or extend the lease. How is this executed properly?

Condition Of Equipment, Normal Wear And Tear Excepted. What is meant by "normal wear and tear?" And what happens if the equipment is not returned with "normal wear and

tear?" It can mean you the lessee is responsible to bring the equipment up to acceptable standards, or be required to purchase the equipment.

Remedies. Can be a precursor to default conditions. Often the lessor will require remedies for, say, late payments, that are punitive with completion time requirements that are unrealistic to execute.

Deposit Monies. Often required, they are sometimes forgotten, or difficult to collect back.

Prevailing, Controlling Party And Document. Always theirs.

Lessors-evils- Principled Solutions Equitable To Both Parties. The Terms-minator Comes, He Sees, And Counters.

Automatic Renewals. Simply, don't sign them. Also hidden in a clause called "term", or referring to length or duration of term, ask yourself (and then your supplier representative), wffm, "what's in it for me?" "What does an automatic renewal clause do for me and the company I represent?" "What value does it add and what is the purpose of the clause?" "Why does the lessor want me to sign it." Your own answer will convince you not to sign them.

A Notice On Giving Notice. Typically, avoidance of automatic renewals entails giving notice by a certain amount of time, via a specific method (see above.) If you are required to give notice, do it exactly as the contract specifies. And, do it early. The best time to give notice is before you need to. You can give notice early in the contract (as long as there are no cost escalators in it), give it the day after you sign it if you like. On the front end of a lease contract negotiation, transfer the responsibility of giving notice from you the lessee to the lessor. Get a clause saying it is their responsibility to give you notice via a confirmed method as to the status of your lease, option dates, and options.

Cost Increases. Generally, the Supply Management profession expects to receive additional discounts for multi-year agreements. With leases, often there is an escalator clause in the agreement. When you think about it, it doesn't make much sense. In some situations, it's probably acceptable to allow cost increases, but in most it's best not to. Any increases should always be tied to a verifiable, mutual index, like the Consumer Price Index (CPI), or a specific industry index like paper. But the best situation for Supply Managers is to not have any prices increases in their contracts, and in the case of multiple year agreements, to include annual de-escalators per year.

Payment Terms. A standard, fair payment term like net 30 days to pay, taking into consideration the times involved for travel of invoice from lessor to lessee, lessee's internal accounting processes to produce a check or electronic payment, and the subsequent travel time needed for sending payment to lessor's remit to address needs to be considered prior to signing a lease contract. Of course, tools like Electronic Funds Transfer (EFT) can mitigate payment terms challenges. Ask for a discount if you pay this way.

Fees, Fees, And More Fees. There is no valid purpose for a lessee to have to pay fees. The simple availability of multiple potential suppliers to compete should encourage any bidding participant to waive any application fees. Late fees, often 10% to 20% of the monthly payments are not justifiable. A simple willingness on the part of the lessee to pay market (vs. maximum) interest rates, on monies 30 days past due, should satisfy both parties involved. Taxes, except sales tax, should be borne by the lessor. After all, you don't own the equipment you're leasing it!

Official Commencement/Expiration Dates. Your contract should include a requirement on the part of the lessor to provide you a copy of a completed, countersigned agreement, dated, highlighting the commencement and expiration dates, and duration of the term.

Defaults. Read the proposed default conditions over carefully if contained in the lessor's document. The only eventuality that should cause a default is a failure of the lessee to meet their main obligations, mostly in regards to making payments and other serious offenses like using the equipment for illegal purposes, or modifying or damaging the equipment far beyond its original condition, thereby affecting its end of lease return. Negotiate to eliminate the small stuff, and take the responsibility for the main issues you'd be concerned with if you were the lessor holding the paper.

Assignment. There is a case to be made for a lessor having the right to assign your lease to another lessor if it's in their business interest to do so. Selling their company, for instance. It's ok to accept the lessor's condition of right of assignment as long as the original deal remains the same. The new lessor has no rights to change the agreement you and the original lessor have signed. If they try to, make sure the original agreement says that you, the lessee, may declare a default and have the following options- a.) Get out of the lease without obligation, b.) Accept the new term in exchange for some additional term beneficial to you.

UCC Rights Waiver. Maintain all rights accorded you under the UCC. If the supplier asks you to waive your rights, ask them to explain why they want you to do that. Their answer will enable you to make a decision on whether to waive your rights or not.

Personal Guarantee. Do not sign under any conditions as typically you are not an owner of your company, and there is no reason for you to assume any financial obligations on the behalf of your employer.

End Of Lease Options. Here are the options you need that are fair to the lessor-supplier. A) Return the equipment to the lessor without obligation as long as you have fulfilled your payment consideration. Market rate transportation costs via standard industry mode (typically, over the road carrier), to a reasonable location (no farther than the contiguous United States.) can be assumed by the lessee. Try to have the lessor cover these costs though. You'll probably pay delivery fees on the front end, so it's fair. B) Extend the lease- it may be advantageous to your company to continue leasing the equipment. If so, negotiate an extension, keeping in mind all the above-mentioned caveats to watch out for with our principled solutions. Make sure you get a lower than original term monthly payment since the equipment has been depreciated. C) Purchase the equipment. If it's in your best interest, negotiate a fair price to buy the equipment. Use normal references and

indexes to ascertain a fair price. Whatever the end result, make sure all terms of the agreement are documented. If you return or purchase the equipment, get a document from the lessor stating all lessee obligations have been met.

Condition Of Equipment. The term "normal wear and tear" can have many interpretations and definitions. Don't get hung up on this term. What's more important is which party has the right to say whether or not the equipment exceeds normal wear and tear. Ask for your side to have it, but settle for something fair, such as an independent 3rd party assessor, paid evenly by each party, chosen together at random. If costs are required on the part of the lessee if below standard, insist that the lessee be able to chose the repairer and negotiate the cost.

Remedies. Prevailing party and document-always your P.O. Always. If they don't agree to it, ask them what they need to be able to. Decide from there, but always your p.o.

Deposit Monies. On the front end make it part of the agreement that all deposit monies will be used for final payment(s.) They're easy to forget about. Include a clause on the original contract that states if for any reason, lessor does not credit or use your deposit money, they will have to refund it double.

Happy Medium- Summary. Using these principal-based techniques, you'll have clear-cut, equitable agreements that you and your lessor can both live with. You'll minimize risk exposure of your company, reduce costs, and avoid your future goals and direction being sidetracked. You'll be able to get out of your leases as scheduled, and be more prepared for the next go round. Although primarily for IT and business equipment, these techniques will work with many types of leases, including software maintenance.

Lease Terms Comparison Chart

<u>Issues</u>	<u>Trouble-Clauser Says</u>	<u>Terms-minator Counters</u>
1. Automatic Renewal	Sign them. Result is term can be extended. Tricky methods of notice.	Don't sign them. Term can only be extended if lessee wants it that way. Agree to any confirmed, traceable method.
2. Cost Increases	Annual increases included.	No annual or other cost increases. If you allow, tie to an index such as CPI – Consumer Price Index.
3. Payment Terms	Net due, Net 7, Net 10 days.	Net 30 days with a realistic payment cycle capability.
4. Payment Cycle	Often unrealistic system, foments late charges, and progressive breach to default.	Insist on demonstrable capability to pay in time. Alternative payment method. E.g. EFT Electronic Funds Transfer.

5. Fees	Application, late, property tax fees, end of term, and others.	No fees allowed. Market rate interest if lessee is markedly late due to own actions.
6. Start/Expiration Dates	Often not confirmed, no executed documents supplied.	Make contract require it. Lessor to supply final executed documents countersigned by both parties.
7. Assignment	Always included.	Can allow but modify that any changes may cause lessor default, lessee may then cancel lease without obligation.
8. UCC Rights Waivers	Usually included.	Waive none of your rights.
9. Personal Guarantee	Sometimes requested.	Do not sign. Provide company financials as needed.
10. End of Lease Options	Typically extend lease, return equipment, purchase equipment. Often include auto renewals.	No auto renewals. Return equipment without obligation; extend lease, purchase equipment. Specify these conditions and exactly how these options are to be executed in front end of contract.
11. Condition of Equipment	Broad definition subject to interpretation. Will want monies if not met.	Normal wear and tear as defined by you or impartial third party. Lessee to maintain supplier selection if to be repaired.
12. Remedies.	Multiple triggers, often progressive and punitive, and technicality in nature.	Opportunity for lessee to remedy. Only apply to substantive issues vs. technicalities.
13. Prevailing party	Lessor	Lessee, your purchase order.
14. Deposits	Often "forgotten", or hard to retrieve at end of lease.	Use as final or settlement payments. Refunded double by lessor if "forgotten".

Lease Terms and Conditions

1. **Renewal-** Lessee will advise lessor at least 30 days prior to any expiration date as to their intentions in regards to the lease equipment. This is contingent upon the supplier/lessor notifying lessee at least 90 days in advance that an expiration date is approaching and also supplying that expiration date to lessee. Notices on both sides must be sent via a confirming method (fax confirmation, e-mail confirmation, overnight traceable carrier service.)

In all cases, if none of the above criteria is executed, the agreement will revert to a month to month continuation at the same or a discounted monthly rate until such time that lessee has advised lessor/supplier of their intentions.

In all cases, lessee's intentions will consist of the following options: a.) Extension of the lease for a set period b.) Buyout of the lease c.) Return of the equipment d.) Some other type of arranged settlement.

2. **Assignment-** In the event lessor/supplier assigns the instrument, the original contract will remain in place without change unless agreed to by lessee in writing. Any attempts to make a change to the original contract without lessee approval will be considered a default and lessee will have options as noted in the Performance/default sections of these terms and conditions.

In the event of assignment lessor/supplier will allow lessee necessary time to adjust any payment cycle as needed.

3. **Payment cycle-** The payment cycle involved in this lease must be such to allow lessee to successfully make payments via traditional methods on time (lessee standard payment terms are net 30). Any payment cycle involving multiple addresses will add 30 days to the payment terms. This would include separate addresses of invoicing location and remit to location. Actual received date at lessee and postage stamp dates will define the start and completion dates of the 30-day payment terms. Any late payment or fee claims from lessor/supplier must be supported by documentation evidencing payment outside of the process described above.
4. **Late fees-** late fees are not allowed on lessee leases. If lessee is more than 30 days late on any valid due payment, and supplier produces the documentation mentioned in the payment cycle terms, lessee will pay Market Rate interest charges if they are late according to the protocol mentioned above on two separate occasions during a calendar year.
5. **Application or other fees-** Lessee does not pay application or other fees.
6. **Lessee Purchase order numbers-** Lessor/supplier will reference lessee purchase order number on invoices and related documents to the lease/software.
7. **Agreement document-** Lessor/supplier will provide lessee a copy of a complete document with all counter signatures showing all inclusions as to the agreement including description of equipment or service, start and finish dates, lease rate factor, and all cost information.
8. **Change of status-** Lessor/supplier will inform lessee of all changes in status of lessor/supplier company including moves, mergers, insolvency, etc., at least 30 days prior to the event. Failure to do so may be grounds for default at lessee's discretion.
9. **Movement- Lessee** shall retain the right to move the equipment or software as dictated by business needs. Lessee will inform the lessor/supplier of these intentions. Lessor/supplier protesting the movement will constitute a default, enabling lessee to terminate the lease without obligation if they so choose.
10. **Incorrect billing-** Incorrect billing on the part of the supplier shall be rectified in 10 days or constitute a default on the part of the lessor/supplier.
11. **Agreement completion certification-** Upon completion of lease/supply agreement, Lessor/Supplier will provide lessee a written certification confirming completion of the agreement, all payments received, disposition of any deposit monies, and that no further obligations exist for lessee.
12. **Physical address-** Supplier will provide a physical address capable of receiving overnight mail vs. a P.O. box remit to in the contingency lessee payments need to be sent overnight mail.
13. **Entire agreement-** The lessee purchase order and any referenced documents on the purchase order will have precedence. Any changes must be agreed to in writing by both parties.
14. **Performance-** Any breach in performance by the lessor/supplier will result in a breach of contract and allow lessee the option of terminating the agreement without obligation.