

# NorVergence Maelstrom Rolls On: Floating Forum Clause Invalidated As Unreasonable

by John C. Kilgannon

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A recent decision from the Ohio Supreme Court may have an impact on the marketability of commercial lease agreements. In *Preferred Capital, Inc. v. Power Engineering Group, Inc.*, 112 Ohio St. 3d 429, 860 N.E.2d 741 (2007), the court held that an open-ended forum selection clause, often referred to as a "floating forum clause," was not enforceable. The Preferred Capital court found that a floating forum clause in a lease agreement, which provided that any lawsuit arising from the lease would be venued in the state of the lessor's or its assignee's principal place of business, was unreasonable and contrary to public policy. While one might conclude that the subject forum clause is innocuous, the court took issue with the fact that the designated forum could be transferred to another jurisdiction if the lease agreement were assigned. In other words, if the lease were assigned to an assignee with a principal place of business that differed from that of the lessor, the appropriate forum would change. Another significant consideration for the court was the disparity of information between the parties. At the time the lease agreements were executed, the lessor was aware that the leases would be assigned to a company that was based in a foreign jurisdiction. The court's refusal to enforce the forum clause was based, in large part, on the lessor's failure to disclose that information at the time the parties entered into the lease.

The Preferred Capital decision should be required reading for leasing company executives and managers that do business in Ohio or with Ohio-based companies. However, the potential significance of this opinion extends beyond Ohio's borders. While Preferred Capital is not binding on courts in the other 49 states, the key question for those in the leasing industry is whether this opinion represents the first step toward increased judicial oversight and restriction of floating forum selection clauses.

## Case History

The facts of Preferred Capital are as follows. NorVergence, Inc. ("NorVergence"), a New Jersey corporation, entered into separate lease agreements (the "Lease Agreements") for telecommunications equip-

ment with 12 out-of-state commercial entities (the "Lessees"). Significantly, the Lease Agreements contained a floating forum clause that provided as follows:

This agreement shall be governed by ... the laws of the State in which Rentor's principal offices are located or, if this Lease is assigned by the Rentor, the State in which the assignee's principal offices are located ... and all legal actions relating to this Lease shall be venued exclusively in the state or federal court located within that State.

Prior to the execution of the Lease Agreements, NorVergence entered into an assignment agreement with Preferred Capital, Inc. ("Preferred Capital"), pursuant to which NorVergence agreed to assign its interests in various equipment leases to Preferred Capital. At the time that the Lease Agreements were executed, Preferred Capital's principal offices were located in Ohio; NorVergence's principal place of business was in New Jersey.

One day after the Lease Agreements were signed, NorVergence assigned its interests in the Lessees' lease payments to Preferred Capital. Subsequent to that assignment, the Lessees refused to make payments on the grounds that NorVergence had breached certain representations in the Lease Agreements. This action, in turn, compelled Preferred Capital to sue each of the Lessees in Ohio, where its principal place of business was located. Thereafter, the Lessees moved to dismiss the cases asserting that the Ohio trial court did not have personal jurisdiction over them. The trial court granted the motions to dismiss. On appeal, the Ohio Court of Appeals consolidated each of the cases and reversed the trial court. The Court of Appeals reasoned that the floating forum selection clauses were valid and enforceable and provided the trial court with personal jurisdiction over the Lessees.

## The Ohio Supreme Court's Decision

On appeal of the appellate court's decision, the central question before the Ohio Supreme Court was whether the floating forum clauses were enforceable. The court commenced its analysis by recognizing the baseline presumption that parties to a contract may

freely consent to the jurisdiction of a particular forum. Additionally, the court observed that in light of the realities of modern commercial transactions, a forum selection clause in the commercial contract should be enforced unless there is “a strong showing that it should be set aside.”

The court then reviewed the standard that it had established in an earlier decision, *Kennecorp Mtge. Brokers, Inc. v. Country Club Convalescent Hosp., Inc.*, 66 Ohio St. 3d 173, 610 N.E.2d 987 (1993), which adopted a three-part test to determine the validity of a forum selection clause. Although the forum selection clause in *Kennecorp* designated a specific forum, the Preferred Capital court found that the following test should be employed to determine whether floating forum clauses are enforceable:

- 1) Are the parties to the contract commercial entities?
- 2) Is there evidence of fraud or overreaching?
- 3) Would enforcement of the clause be unreasonable and unjust?

With respect to the first prong of this test – whether the parties to the Lease Agreement were commercial entities – the court rejected the Lessees’ argument that they were small, unsophisticated enterprises and therefore should not be considered commercial entities. The court observed that the contracts were between two commercial entities and documented a commercial transaction. Thus, despite the relative disparity in the size and sophistication of the parties, the court concluded that the first prong was satisfied. Similarly, the court found that the second prong was met because there was no evidence of fraud or overreaching because the forum selection clause was clearly and legibly printed on the second page of the Lease Agreements.

The final issue under the *Kennecorp* test was whether the enforcement of the floating forum clause would be unjust and unreasonable. The court answered this question in the affirmative and held that the forum selection clauses were not enforceable. Two primary explanations were offered in support of this holding. First, at the time the Lease Agreements were executed, there was no definitive indication as to where any suit arising out of the contract would be litigated. At that time, the appropriate forum would have been the location of NorVergence’s principal place of business, to wit, New Jersey. However, one day after the agreements were executed, the assignment of the Lease Agreements to Preferred Capital effectively transferred

the designated forum to Ohio. The court observed that nothing prevented Preferred Capital from assigning its interests under the contract, thereby creating yet another forum. It was abundantly clear from the opinion that the court was troubled by the fluidity of the designated forum. The court highlighted the distinction between a clause that waived personal jurisdiction to a specific forum, which was the situation in *Kennecorp*, and a floating forum clause that subjected the Lessees to the jurisdiction of any court in the nation.

The second basis of this holding was the disparity of the information between the parties. Norvergence and Preferred Capital had superior information in that they knew that the Leases were going to be assigned. Thus, the court held that when one party to a contract containing a floating forum selection clause possessed undisclosed information of its intent to assign its interest to a company in a foreign jurisdiction, the clause is unreasonable and cannot be enforced absent a clear showing that the second party knowingly consented to waive objections to the jurisdiction of any forum.

## Conclusion

Because this decision is not binding on courts outside of Ohio, its impact on the leasing industry is limited. Clearly, Preferred Capital could have a significant affect on leasing companies that may find themselves litigating a lease agreement in Ohio state courts. Those companies would be well advised to closely examine the forum selection clauses in their lease agreements to determine whether they would be upheld under the new framework established by the Ohio Supreme Court. While Preferred Capital left open the possibility that floating forum clauses would be enforceable under certain circumstances, there is no question that the court does not favor such clauses. A concern arises as to whether an Ohio trial court or appellate court would view the Preferred Capital court’s concerns regarding floating forum clauses as a blanket prohibition against such clauses. To pass muster under the Preferred Capital framework, leasing companies that do business in Ohio would be well advised to ensure that their lease agreements expressly state that: 1) the lease may be freely assigned; and 2) that the lessee has consented to resolve any dispute arising out of the agreement in any forum. In other words, the lessor should obtain the lessee’s express blanket waiver of any objections to personal jurisdiction and venue to any forum. In addition, to the extent the information is available at the time of execution, the lease should provide full disclosure of the lessor’s intent to assign the lease

to a company based in a foreign jurisdiction as well as the timing of such assignment.

It remains to be seen whether the Preferred Capital decision represents a harbinger of similar restrictive opinions from other jurisdictions. Significantly, the dissenting opinion highlights several considerations that may significantly detract from Preferred Capital's value as persuasive authority. First, the dissent highlights several inconsistencies in the majority's reasoning that contradict some of the well-settled tenets of contract interpretation. Second, the dissent cites a decision that was authored by one of the most revered judges from the U.S. Circuit Court of Appeals that upheld an identical floating forum clause. The dissent criticized the majority's holding because it ignored a fundamental principle of contract law: Contracts should be interpreted as written. The Lease Agreements at issue in Preferred Capital expressly stated that: 1) they were freely assignable; and 2) the designated forum would be the principal place of business of the lessee or its assignee. Thus, the dissent reasoned, at the time the Lease Agreements were executed, the Lessees were fully aware that the agreements could be assigned and that the assignment could change the designated forum. Additionally, the parties to the Lease Agreements were commercial entities negotiating a commercial contract. Absent any evidence of fraud or overreaching, the dissent concluded that these factors were a sufficient basis to enforce the floating forum clauses as written.

The failure to identify any sound public policy that compelled the court to refuse to enforce the agreements as written was also problematic to the dissent. The fact that the Lessees did not know exactly where any disputes arising out of the Lease Agreements would be litigated was not a sufficient reason to void the floating forum clause. Rather, in the dissent's view, the parties expressly agreed to an open-ended arrangement, and it was the court's role to enforce this agreement.

Significantly, the dissent highlighted an opinion from the U.S. Court of Appeals for the Seventh Circuit, *IFC Credit Corp. v. Aliano Bros Gen. Constrs. Inc.*, 437 F.3d 606 (7th Cir. 2006) (Posner, J.), which involved the same floating forum selection clause, and the same lessor, Norvergence, that was considered in Preferred Capital. In *IFC*, the Seventh Circuit concluded that regardless of whether federal or Illinois state law controlled, the floating forum clause was enforceable. The *IFC* court reasoned that forum selection clauses should be treated like any other contractual provision and should be enforced unless they are subject to "any

sorts of infirmity, such as fraud or mistake, that justify a court's refusing to enforce a contract." Judge Richard A. Posner, who authored the *IFC* opinion, observed further that the forum selection clause at issue was not confusing and clearly stated that the venue of any suit would be governed by the principal place of business of the lessor or its assignee. The centerpiece of the *IFC* decision was the well-recognized principle that parties to a contract may freely waive objections to personal jurisdiction and venue by agreeing to an open forum selection clause.

Critics of the Preferred Capital holding will argue that it impermissibly interferes with the parties' freedom of contract – the principle that individuals should be free to bargain over the terms of their own contracts. However, the potential economic impact of this decision may be of even greater significance. If courts in other jurisdictions adopt Preferred Capital's approach to floating forum clauses, it would have a direct and significant affect on the marketability of leases. In essence, if such clauses are not enforced, parties to a lease would be precluded from negotiating and assigning the anticipated costs and risks of litigating in a foreign jurisdiction. In other words, if an assignee is required to bring suit to enforce a lease in a foreign jurisdiction (i.e., the principal place of business of the lessor), the attendant incremental costs of litigating in an inconvenient forum would presumably be factored into the amount that the assignee would be willing to pay to acquire the lease. It is likely that this price adjustment would be passed along to the lessee in the form of higher lease payments.

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