

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
Charlotte Division

IN RE:)	Case No. 01-31190
)	Chapter 7
CATHERINE'S DISTRIBUTION, INC.))	
)	
Debtor.)	
)	
A. BURTON SHUFORD, TRUSTEE,)	Adversary No. 01-3180
)	
Plaintiff,)	FINDINGS OF FACT, LEGAL
vs.)	CONCLUSIONS AND ORDER
)	
PARK LEASING COMPANY,)	
)	
Defendant.)	
)	

A trial was conducted on May 7, 2002 to determine the validity, priority, and extent of a lien/interest in five refrigerated trailers held by the Debtor, Catherine's Distribution, Inc. ("Catherine's") at the time of its bankruptcy. The trailers in question were provided to Catherine's by Defendant Park Leasing Company ("Park") under a "Master Lease." Catherine's Bankruptcy Trustee, Burton Shuford ("Trustee") has attacked this agreement as being a disguised financing arrangement, and not a true lease. He contends the trailers are property of the estate, and that Park holds only an unperfected and avoidable security interest in the same.

Park recognizes that under NCGS 25-2A-201(37) the agreement would be conclusively presumed to be a financing lease. However,

the trailers are titled vehicles, and on the titles, Park is shown as "Owner." Since any search of the public record would reveal this fact, Park argues that third parties could not have been misled, and substantial compliance has been had with the recording statutes. Thus, Park believes that its security interest is both perfected and unavoidable.

ISSUE PRESENTED

The issue to be decided then is: Where, (1) an agreement is found not to be a true lease, but instead a disguised financing transaction, but (2) the underlying res is titled property, and (3) on those titles, the "lessor" is shown as "owner," is the security interest unperfected so as to be avoidable in bankruptcy under 11 USC 544?

FINDINGS OF FACT

The facts are not in dispute.

1. Prior to bankruptcy, Catherine's operated a frozen foods warehouse.
2. In the course of its business, on July 29, 1988, Catherine's acquired five refrigerated trailers (two '91 Great Dane 48' x 102x 13'6" Reefer Trailers & three '94 Great Dane 48'x 102x 13'6" Reefer Trailers) from Park, pursuant to a "Master Lease."
3. The Master Lease agreement made Catherine responsible for the taxes, maintenance, repairs and insurance on the trailers. Catherine's also bore the risks of loss for their theft or

destruction. The lease could not be terminated by the lessee prior to the end of the term.

4. Significantly, Catherine's could acquire the five trailers at the end of the lease, for the nominal sum of \$10. The trailers had an expected residual value significantly greater than this amount.

5. The trailers are titled vehicles, and the North Carolina certificates of title show Park as being their owner. Park at all times, has been in possession of the title certificates.

6. When Catherine's business failed, the company filed a voluntary Chapter 7 petition with this Court on April 27, 2001. At the time, the trailers were in Catherine's possession. The "Master Lease" was in default.

7. After bankruptcy, the Trustee disputed Park's ownership claim to these vehicles. The trailers were sold at auction by Order, under 11 USC 363(f)(4). Park's disputed ownership/lien interests have attached to the net proceeds, and these monies are being held by the Trustee pending the outcome of this action.

LEGAL CONCLUSIONS

1. Clearly, under Article 2A of the Uniform Commercial Code, the "Master Lease" is a disguised financing transaction and not a "true" lease. Under the UCC, an agreement will be conclusively presumed to create a security interest rather than a lease if the rental obligation is not terminable by the lessee, *and, either: (i)*

the lease term is equal to or greater than the remaining economic life of the goods: (ii) the lessee is bound to purchase the goods at the end of the lease; or (iii) at the end of the lease, the lessee has an option to purchase the goods or renew the lease for the remaining economic life of the goods for no or nominal consideration. NCGS 25-1-201(37) (2002).

2. Contractually, Catherine's could not terminate the lease agreement, and it had an option to purchase for nominal consideration (\$10.00). This makes the agreement a disguised financing transaction.

3. Additionally, Catherine's was responsible for maintenance, insurance, taxes, and risk of loss. These are also indices of a disguised financing transaction. The North Carolina Court of Appeals has held that a one dollar option to purchase, coupled with a lessee's responsibility for maintenance, taxes, and risk of loss constituted "precisely the type of transaction anticipated by N.C.G.S. § 25-1-201(37) (a) and defined thereunder as a security interest, not a lease." *Williams Oil Co. v. NAFCO Capital Corp.*, 130 N.C.App. 286, 291 (1998).

4. Because the "Master Lease" was a financing transaction, Park was obliged to perfect its security interest. Under 11 USC 544, the Trustee possesses the rights of a hypothetical lien creditor and may avoid unperfected security interests. The UCC expressly states that an unperfected security interest is

subordinate to a lien interest and to the bankruptcy trustee. NCGS 25-9-301.

5. As to the manner of this perfection, NCGS § 20-58 states that a security interest in a titled motor vehicle can be perfected only by having the notation of the security interest noted on the certificate of title, and by having the title transferred into the name of the purchaser. The purpose of this requirement is, of course, to put other potential lender creditors on notice of the ownership of the property and of the existing debt.

6. Here, the Trustee contends that as a disguised financing transaction, the Debtor should have been listed as owner of the trailers on the titles, and Park should have been shown as a lienholder. Because Park was instead shown "Owner," the Trustee contends that the security interest is unperfected.

7. Park thinks that such a requirement is unreasonable. To Park, any party searching the records of the Department of Motor Vehicles for these trailers would have discovered its interest, and could not have been prejudiced by the listing. Moreover, in the leasing industry, titled vehicles are uniformly titled in the name of the lessor. To Park, treating this as an unperfected security interest would not only be unfair, it would defy commercial reality.

8. This is a question of first impression in this District, but one that has garnered much attention in other courts over the

years. Ultimately, the decision depends on the requirements of the particular state titling statute. However, these are relatively standardized in this regard, and thus the case law is almost uniform. For a financing lease of titled property, where the lessor/secured creditor's name is listed on the certificate of title as "owner," the lender has substantially complied with the state titling statutes, and its security interest is perfected and unavoidable. See *In re Circus Time*, 641 F.2d 39 (1st Cir.1981) (applying Maine and New Hampshire law); *In re Load-It*, 774 F.2d 1077 (11th Cir. 1985) (Georgia law); *In re Coors of the Cumberland, Inc.*, 19 B.R. 313 (Bankr.M.D. TN 1982) (Tennessee law); *In re Yeager Trucking*, 29 B.R. 131 (Bankr.D. CO 1983) (Colorado); *In re Skyland, Inc.*, 28 B.R. 354 (Bankr.W.D. MI 1983) (Michigan law); *In re McCall*, 27 B.R. 106 (Bankr.W.D.N.Y.1983) (New York); contra, *In re Otasco, Inc.*, 111 B.R. 976 (Bankr. M.D. Okla. 1990) (based upon a literal interpretation of an Oklahoma statute requiring a secured creditor to submit a separate lien entry form).

10. The common thread in these decisions is that sufficient public notice has been afforded by the notation of the lessor as owner on the title to satisfy both Article 9¹ and the relevant state title statute. *Id.*

¹ NCGS 25-9-402(8) cautions that "absolute compliance with the requirements of the Certificate of Title Acts is not necessary to perfect a security interest in a vehicle." See also *In re Circus Time*, 641 F.2d 39, 42 (1st Cir. 1981).

12. Such a view makes both common and business sense. As one of the early commentators on this point explained:

The lessor of a motor vehicle usually obtains and holds a certificate of title for the leased motor vehicle in the lessor's name. Since the 'lessee' of a motor vehicle under a lease 'intended as security' will normally be considered the 'owner,' it might be argued that it is the 'lessee' in such a case which is required to apply for and obtain a certificate of title.

Taking the literal application of a 'typical' certificate of title one step further, an imaginative trustee in bankruptcy for such a 'lessee' might seek to cut off the 'lessor's' rights in the motor vehicle by arguing that the 'lessor' has not perfected its security interest by an indication on the certificate of title. Since the certificate, in this hypothetical, is in the 'lessor's' name, as owner, it would not indicate that the 'lessor' claimed a security interest in its own property.

Returning to the 'real world,' it is not likely that a court would take such a formalistic and literal approach. After all, the usual purposes of certificate of title acts (e. g., the prevention of theft, fraud, etc.) and the purposes of perfection (public notice of a claimed security interest) are satisfied by a certificate of title held by the lessor in its name presumably, the 'lessee' would not be in a position to mortgage or sell the motor vehicle without the certificate of title in its name. Coogan, Hogan & Vagts, Secured Transactions under the Uniform Commercial Code s 29A.04(6), at 2931 (1980).

13. The authors are correct. The "formalistic and literal" approach argued by the Trustee, while no doubt appreciated by the unsecured creditors of this estate, would elevate form over substance and would serve no public purpose in the process.

14. Moreover, if adopted, this theory would put the financing lessor on the horns of a dilemma. If being listed as owner on a vehicle title is not sufficient to protect his interests, neither

is filing a financing statement. Since Section S 9-302(3) provides that a security interest in a certificated motor vehicle may be perfected only by notation on the certificate and not by filing a financing statement, filing is a futile act. The Court seriously doubts the Legislature intended such a result.

15. In this case, by virtue of being listed as "owner" on the trailer titles, Park substantially complied with the UCC and Motor Vehicles Act requirements for perfecting its interests in these trailers. Its security interests are not avoidable under 11 USC 544.

This Court hereby ORDERS:

1. The aforementioned trailers constitute property of this bankruptcy estate.

2. Park has a perfected, nonavoidable security interest in the same.

3. The net proceeds of sale of the trailers, up to the balance of Park's debt, shall be released by the Trustee to Park.

SO ORDERED.

This the ____ day of May, 2002.

U.S. Bankruptcy Judge