UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

In Re:	)	Case No. 94-31226
	)	Chapter 13
ALFRED K. AIKEN,	)	
	)	
Debtor.	)	ORDER

This matter came before the Court on December 13, 1994, upon the Motion of Lease Atlanta, Inc. ("Lease Atlanta") for Relief from the Automatic Stay; Motion for Order Compelling Debtor to Assume or Reject Unexpired Lease; and Objection to Confirmation of Plan, and upon the Debtor's Response thereto. After hearing the evidence presented and upon a review of applicable law, the Court is persuaded that Lease Atlanta's Motion to Compel Assumption or Rejection of Unexpired Lease should be **denied**, and the Objection to Confirmation of the Plan and Motion for Relief from Stay should be **continued for further hearing.**

This case presents the question of whether a prepetition agreement between the Debtor and Lease Atlanta is a true lease and entitled to the protections of 11 U.S.C. § 365, or is, alternatively, a disguised security interest under the Uniform Commercial Code, § 1-201 (1987), and subject to treatment as a secured claim in the Debtor's Plan. The material facts are not in dispute.

On January 7, 1994, the Debtor, as "Lessee," entered into a "Vehicle Lease and Disclosure Statement" (the "Agreement") with Lease Atlanta ("Lessor") with respect to a used 1990 Kenworth tractor. The agreement terms itself a lease, although the Debtor testified that he thought he was purchasing the vehicle and to

that end put down almost one-third of the vehicle's value when the contract was signed.

On September 30, 1994, the Debtor filed Chapter 13. In his proposed Plan, he seeks to treat Lease Atlanta as a partially secured creditor rather than a lessor. As the proposed Plan does not propose to assume, cure and secure its debt as required for lease claims by 11 U.S.C. § 365, Lease Atlanta objects to confirmation of that Plan and seeks relief from stay to permit it to recover the tractor.

While the determination of whether the Debtor's Plan is confirmable, or whether assumption, rejection, or relief from stay should be granted are matters of federal bankruptcy law, the determination of a Debtor's property rights is generally a question of state law. Butner v. United States, 440 U.S. 48, 54, 99 S.Ct. 914, 917-18, 59 L.Ed. 2d 136 (1979). In particular, whether a lease is a "true lease" under the Uniform Commercial Code which would be entitled to the protections of 11 U.S.C. § 365, or is instead a disguised financing arrangement, is a question of state law. In re Merritt Dredging Co., Inc., 839 F.2d 203 (4th Cir. 1988). In this case, the Agreement stipulates that the applicable law is that of the state in which the document was signed. Therefore, the Court looks to Georgia law to determine the nature of this agreement.

Under Georgia's enactment of the Uniform Commercial Code, whether an agreement creates a lease or instead a security interest depends upon the intent of the parties, as deduced from

the language of the contract. The determination is fact-driven, and decided on a case-by-case basis. Ga. Code Ann. § 11-1-201(37); accord, U.C.C. § 1-201(37) Official Comment (1987). Self-serving statements of the parties are not dispositive. In re Fulton Textiles, Inc., 116 B.R. 302, 304 (Bankr. N.D.Ga. 1990). Rather, under the 1987 Amendments to Section 1-201, the focus of the inquiry is on the economics of the agreement. U.C.C. § 1-201(37) Official Comment (1987).

However, U.C.C. § 1-201 conclusively presumes that a transaction creates a security interest, and not a lease, when it contain certain terms:

> (A)...if the consideration of the lessee is to pay the lessor for the right to possession and use of the goods as an obligation for the term of the lease not subject to termination by the lessee, and
>
> > (a) The original term of the lease is equal to or greater than the remaining economic life of the goods,
> >
> > (b) The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,
> >
> > (c) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
> >
> > (d) The lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A review of the Agreement reflects that this is such a transaction. First, the Agreement was not, in any practical sense, subject to early termination by the Debtor. Paragraph 17 provides there is no right by the lessee to terminate the con-

tract in the first twelve (12) months of the forty-eight (48) month term. Even thereafter, while the agreement purports to allow early termination, to do so makes the lessee liable for all rentals for the remaining lease term, plus future rental taxes, a $500 disposition charge and any deficiency remaining after the lessor's sale of the vehicle.

Penalties of this extent are akin to those which would be imposed due to a default and foreclosure of a security interest. Indeed, Paragraph 16 of the Agreement states that the penalties charged to the lessee for a termination due to his default under the Agreement are the same penalties specified in Paragraph 17 for his voluntary termination. As such, effectively there is no right to an early termination under the Agreement.

This Agreement also provides that the lessee may acquire the vehicle at lease end for nominal additional consideration, thereby meeting the second requirement of the Section 1-201(37) presumption. Under Georgia law, additional consideration is deemed nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Ga. Code Ann. § 11-1-201(37)(x).

While the Agreement contained a blank to provide a purchase option at fair market value, due to the Debtor's lack of credit history, Lease Atlanta wanted to recover more of its money before the option was exercised. Therefore, in Paragraph 19 the parties agreed to a flat purchase option price of $3,650.00. This amount

was less than the anticipated residual value of the tractor, which Lease Atlanta believed would be up to $10,000.00.

Since the option price was less than the estimated fair market value, common sense would suggest that the additional consideration was nominal. This becomes even more apparent when the option price is compared to the Debtor's predictable cost of performing under the lease if the option were not exercised. In that eventuality, the lessee would be liable for the following:

(a) a $500.00 disposition charge (Item 27); plus

(b) any amounts or charges arising from his failure to keep his promises under the lease; and

(c) any charges for excess mileage under Item 20, and the amount required to put the vehicle in good operating order and appearance under Item 20.

These charges could be expected to be much more than the $3,650 option price. This is particularly true since the Agreement provides an excess mileage charge of 25 cents per mile for mileage over 396,000 miles. The Debtor testified that he drove about 150,000 miles per year, which would exceed the allowable mileage under the Lease by 204,000 miles. At 25 cents per mile, this cost alone would result in a $51,000 mileage charge, or fourteen times the $3,650 option price.

In like measure, under paragraph 20, "Wear and Use Standards," the Debtor is obligated to replace worn or mismatched tires; to "repair all mechanical defects," and "to repair or replace all dented, scratched, chipped, rusted or mismatched body panels; all cracked, scratched, pitted or broken glass; all faulty window mechanisms; all broken lights; and all interior

rips, stains, burns or worn areas." With an eight year old tractor being leased for a four-year period and expected driving of almost 400,000 miles over that time, the contract charges for repairs alone would likely exceed the option price. When added to the excess mileage fee, it is apparent that the option price is nominal when compared with the cost of not exercising the option. The Court therefore concludes that the agreement meets the presumption of Section 1-201(37) and must be considered a security interest, not a true lease.

This conclusion is buttressed by additional terms of this agreement which reflect a security interest and not a lease. Section 1-201(37) was amended when Article 2A was added to the Uniform Commercial Code in 1987. Those amendments, while adding the aforementioned presumption to the statute, also included a statement that the presence in an agreement of any one of several other factors would not, ipso facto, make the agreement a financing arrangement:

> A transaction does not create a security interest merely because it provides that
>
> > (a) The present value of the consideration the lessee is obligated to pay the lessor for the right of possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,
> >
> > (b) The lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,
> >
> > (c) The lessee has an option to renew the lease or to become the owner of the goods,

> (d) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or
>
> (e) The lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

Under the amended version of Section 1-201(37), none of these factors alone creates a financing arrangement. However, in close cases where the presumption is not met, these elements remain relevant, particularly where several of the factors are found within the agreement. For example, the Official Comment to § 1-201 (37) notes that the presence of a fixed price option in a lease does not by itself make the agreement a financing transaction. But the Comment then states that situations will arise where an option price is not nominal (and therefore not within the presumption), but is still less than fair market value. In these situations, the authors conclude, the Court should deduce whether a lease or security interest financing arrangement was intended by reviewing all of the facts of the case.

Several such factors are found in the present Agreement. For example, even excluding the backside lease charges, total rents to be paid under this Agreement by the Debtor would exceed $67,000.00 on a tractor with an initial value of less than $40,000.00. The Agreement therefore yields a full cost recovery to the lessor, plus a healthy rate of interest.

Similarly, under the Agreement, risk of loss is upon the lessee (Item 8), and he agrees to indemnify the lessor from all

claims, liabilities and expenses regarding the subject property (Item 9). The lessee is liable for taxes and registration fees (Item 3), insurance (Item 4) and all vehicle maintenance (Item 5).

The Agreement also contains other factors, not itemized in the current Statute, which were considered under the prior version of Section 1-201 to be indicative of a security interest. For example, the lessor is not in the equipment business. Chapman v. Avco Fin. Serv. Leasing Co., 387 S.E.2d 391, 11 U.C.C. Rep. Serv. 2d 1224 (Callaghan) (1989). And more significantly, the Debtor made a sizeable down payment on this vehicle when the document was signed. On a vehicle estimated to be worth $35,000.00 - $40,000, the Debtor paid a security deposit of $1,150.00, plus "capitalized cost reductions" of $10,375.00, for a total down payment of 25-33% of the value of the tractor. This suggests a financed purchase, not a lease.

Taken as a whole, the contract reflects an agreement intended to finance the purchase of this vehicle, not simply to pay for the use of the same. As such, the Court concludes that this obligation is disguised financing, and will treat the obligation as a secured claim in the Debtor's Chapter 13 case. The Court therefore denies that portion of Lease Atlanta's Motion seeking to compel the Debtor to assume or reject this Agreement. In order to consider the Debtor's valuation of this collateral, and the remaining issues attendant to treatment of a secured claim in this Plan, the Court continues the hearing on Lease Atlanta's

Objection to Confirmation and Motion for Relief from Stay until January 10, 1995, at 9:30 a.m.

IT IS SO ORDERED.

This 30th day of December, 1994.

United States Bankruptcy Judge