MARKS & WEINBERG, P.C.

In re Buehne Farms, Inc.

321 B.R. 239 (Bankr. S.D. Ill. 2005)

Whereôs the beef? Itôs in the Lesseeôs estate if lessee has an option to purchase it at a significant discount.

AG Lease or Loan LLC (ñLessorò) entered into two agreements with a dairy farmer, each titled "Dairy Cattle Lease." The leases were virtually identical, for 122 head and 90 head of cattle respectively. The leases provided that the cattle would be returned to Lessor upon termination of the agreements at a guaranteed minimum value, with any shortcomings being paid by the farmer. The leases did, however, give the farmer the option to purchase the cattle for that minimum value.

The leases contained clauses stating that each agreement could not be cancelled by the farmer at any time and that Lessor retained all right, title and interest in the cattle. The farmer could not sell any of the cattle without prior permission and had to replace any cow injured or lost while in his possession. The farmer filed for bankruptcy and Lessor and its assignees moved to compel the farmer to assume or reject the two agreements which they contended were leases. The farmer argued that the ñleasesò were better characterized as disguised security agreements.

The court applied the Illinois UCC test and resolved the issue under the bright-line-test it provides. Under that bright line test, an agreement is a security agreement, despite language purporting it to be a lease, if the lessee can not terminate the lease and one of four other factors are present. Those factors are: (1) the original term of the lease is equal to or greater than the remaining economic life of the goods, (2) the lessee is bound to renew the lease for the remaining economic life, (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no new consideration or nominal consideration, or (4) the lessee has an option to purchase the goods for no new consideration or for nominal consideration.

Here the court found the leases to be disguised security agreements because the farmer could not terminate the agreement AND the farmer had an option to purchase the cattle for nominal consideration at the expiration of the agreement. The court based this conclusion on the fact that the purchase price if the farmer exercised that option came to roughly $160 per head, while the cattle could be sold for slaughter at that stage for $600-$800 per head. The court also cited the fact that the purchase price amounted to only 6% of the total rent expenditures the farmer would have incurred at that point.

It should also be noted that the Court described the test more broadly as the ñeconomic realities testò and stated that since the farmer was basically left with no rational choice but to exercise his option to purchase the cattle, the agreements had to be disguised security agreements.