MARKS & WEINBERG, P.C.

In re Grubbs Construction Co.

319 B.R. 698 (Bankr. M.D. Fla. 2005)

The issue in *Grubbs* was whether the leases between Grubbs (ñLesseeò) and Banc One (ñLessorò) were true leases or secured transactions. In 1998, Grubbs and Lessor entered into a master lease and this master agreement was incorporated into five separate schedules which each represented an individual stand-alone lease transaction. Four of these schedules contained early buyout options and renew-or-purchase addenda which operated as a typical first amendment lease. The fifth schedule contained a terminal rental adjustment clause (i.e. it was a TRAC lease).

The court explicitly noted that the leases contained provisions which made Lessee unconditionally liable for payment of rent notwithstanding any defect in the equipment, placed the risk of loss on Lessee and required Lessee to indemnify Lessor for various tax benefits associated with ownership of the leased equipment. However, it rightfully refused to base its holding on such provisions and, instead, focused its analysis on the economic realities of the transactions.

When considering the leases with the early buyout options, the court focused on a variety of purchase and return options provided under those leases and considered the economic realities of such options. Under those leases, Lessee could exercise the early buyout at set time(s) prior to expiration of the term. If the EBO was not exercised, Lessee was required to purchase the equipment or renew the lease for more than a year. At the end of any renewal period, Lessee could return the equipment or purchase it for fair market value. The court analyzed the numbers and decided that the ñonly economically sensible courseò for Lessee was to purchase the equipment under the Early Buyout Option. The court also added that ñ[i]t was the clear intent of [Lessee], based on the economics of the Leases at their inception, to exercise the Early Buyout Options as they became available.ò

When considering the TRAC Lease, the court described a TRAC provision which not only required Lessee to pay any deficiency but also allowed it to keep any surplus if the proceeds from the sale of the leased equipment at the end of the term did not equal the ñEstimated Residual Valueò specified in the lease. The court determined that ñ[t]he economic substance of the TRAC Lease is no different than a typical installment loan in which the lender has agreed to a balloon payment in lieu of a down payment.ò Indeed, the court even described the ñEstimated Residual Valueò that is part of the TRAC provision as a ñBalloon Payment.ò

The court continued its analysis by considering the manner in which the casualty loss provisions in the leases operated. The court also noted that the default provisions in the leases provided that the lessor may repossess, but that the lessee's equity was preserved by requiring the lessor to pay over to the lessee any surplus received from a sale of the repossessed equipment.

The court also went through a lengthy analysis of prior decisions discussing the differences between leases and secured transactions before officially declaring that it was going to take an "economic realities" approach. The court noted that "[t]he Economic Realities Test requires an analysis of all terms and conditions of a purported lease transaction to determine whether the lessee has no sensible alternative other than to exercise the purchase option." The court then concluded by holding that "the facts of this case clearly establish . . . that the transactions . . . are security agreements governed by U.C.C. Article 9."

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