

MARKS & WEINBERG, P.C.

In re Shores

2005 WL 1212591 (E.D. Fla. 2005)

Courts continue to find new ways to erroneously apply the UCC true lease test. In this case, the Court finds a lease that is terminable by the lessee at any time to create a security interest (i.e. a loan) rather than a true lease.

Lessee entered into a lease agreement with Lessor covering a portable warehouse. Lessee subsequently filed for bankruptcy under Chapter 13 and the standard battle over whether the underlying transaction was a true lease or a loan began.

The court cited the UCC 1-201(37) definition of a security interest and properly noted the bright line rule which requires the court to hold that a "lease" actually constitutes a loan in the event: (1) the lease cannot be terminated by the lessee without further obligation; and (2) one of four other facts is present. The court correctly held that, since Lessee had the option to terminate the lease without penalty, the bright line test did not require the court to find the transaction to be a loan as a matter of law.

However, the court then began the facts and circumstances test provided for in Section 1-201(37) which states "[w]hether a transaction creates a lease or security interest is determined by the facts of each case." During this analysis, the court noted that "in determining whether a lease is a true lease courts have traditionally focused on whether or not the lease contains an option to purchase [and that] if the lease contains an option to purchase for a nominal sum at the end of the



lease term, then it is argued that the lessee has been purchasing the item over the term of the lease and, thus, it is a financing arrangement and not a true lease.ö Based on this logic and the fact that the lease in question had a nominal purchase option, the court held that the transaction constituted a loan rather than a true lease.

In making this holding the court missed the boat by failing to realize that the presence of a nominal purchase option *only* assures that the lessee (and not the lessor) will retain the equipment and that it will never be returned to lessor possession *if* the lessee cannot terminate early without penalty. If, however, as is the case here, the lessee has the option to terminate the lease early without penalty, it could reasonably decide to terminate the lease early and return the equipment to lessor. For example, if the lessee decided three months into the lease term that it no longer wanted the leased equipment, it would likely return the equipment to lessor rather than continue making payments throughout the lease term. In that case, the presence of the nominal purchase option is irrelevant. Obviously, the facts and circumstances test still has a role to play even when the terms of the lease allow the lessee to terminate early without penalty. *See e.g. In re Triplex Marine Maintenance, Inc*, 45 UCC Rep. Serv.2d 977 (Bankruptcy Ct., Texas, 2000)(court determined that a ðleaseö constituted a loan under the "sensible person test" *solely* because the lease covered all of the lessee's assets and the court felt that the lessee's only sensible choice was therefore to exercise its purchase option). However, the court in this case applied the facts and circumstances test inappropriately.

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