As I began to write this column, I was not sure what to share so I did what I usually do when faced with something new or different, I looked to those who have gone before me. I am “old school” so I dusted off my 3-ring binder labeled Disclosure Statements, in which I had printed and hole-punched paper copies of the newsletters, and started reading. In looking over the past decade, I am amazed that in many ways, very little has changed. In 2007, 10 years ago, Billy Brewer’s feature article was entitled, “LISTSERV Debate,” followed by Max Gardner’s column on Chapter 13 modifications, called “The Blind Leading the Blind,” and lastly, Jim Angell’s “Understanding Mediation Through Ethics.” Need I say more?

I noticed three recurring themes throughout the years in the chairs’ comments (or “muscings” as Bill Janvier referred to his thoughts):

Commitment to Pro Bono Service. Our immediate past chair, Ashley Rusher (whom I must say is a tough act to follow as chair), summarized in her comments and thorough section updates the various pro bono opportunities. Our section has a long history of promoting pro bono activities to our members. Please contact current co-chairs Rebecca Redwine and Jill Walters about our 3 initiatives:

- CARE Project – we are asking volunteers to present the CARE (Credit Abuse Re-

The Chair’s Comments

Kristin D. Ogburn

Disclosure Statement

Lease Or Security Agreement: A Characterization With Consequences

By Joe Frost

I. Introduction

In modern commercial transactions, especially in the agricultural industry, participants have been utilizing leases, disguised as security agreements, of personal property, as opposed to the traditional purchase of the personal property accompanied by a security agreement. See U.S. Dept of Commerce, Int’l Trade Admin., A Competitive Assessment of the U.S. Equipment Leasing Industry 6-8 (1985). The justification for this increasing trend varies, depending upon the industry involved, but it “has been largely influenced by federal income tax considerations.” Laura J. Paglia, U.C.C. Article 2A: Distinguishing Between True Leases and Secured Sales, 63 St. John’s Law Review 69, 69 n.1 (2012).

The characterization of whether an agreement constitutes a lease, as opposed to a security agreement, is “one of the most frequently litigated issues under the Uniform Commercial Code.” James J. White & Robert S. Summers, 4 Uniform Commercial Code § 30–3, and 30-14 n. 18 (5th ed., West 2002). This characterization is even more complex, given that the title or form of the agreement is not determinative of whether it is, in fact, a true lease or a secured transaction (security agreement). In re Grubbs Const. Co., 319 B.R. 698, 710 (Bankr. M.D. Fla. 2005).

The major distinction between a lease and a secured transaction is that the former, involves “temporary possession of the item” for which “the possessing party is contractually obligated to return the subject good or property to the owner ‘with some expected residual interest of value remaining at the end of the lease term.” In re Johnson, 571 B.R. at 171 (quoting In re QDS Components, Inc., 292 B.R. 313, 322 (Bankr. S.D. Ohio 2002)); In re APB Online, Inc., 259 B.R. 812, 817 (Bankr. S.D.N.Y. 2001) ([W]hen we speak of the intent to sell or lease, we mean the intent to convey the use of the property for its remaining useful life to the lessee, or alternatively, to vest a reversionary interest in the lessor at the end of the term.); In re New Items Co., Inc., 72 B.R. 1017, 1019 (Bankr. N.D. Ohio 1987)). The essential component of a lease, as opposed to a sale of a particular asset, “is that there be something of value to return to the lessor after the term.” In re Marhoefer Packing Co., 674 F.2d 1139, 1145 (7th Cir. 1982). On the other hand, “[w]here the term of the lease is substantially equal to the life of the leased property such that there will be nothing of value to return at the end of the lease, the transaction is in essence a sale.” Id.; see, e.g., E. Carolyn Hochstader Dicker & John P. Campo, FF & E and the True Lease Question: Article 2A and Accompanying Amendments to UCC Section 1–201(37), 7 Am Bankr. Inst. L. Rev. 517, 533 & n.48 (1999) ([T]he principal
Victoria Wright, our dedicated past pro bono chair for many years has transitioned to a new role as chair of the NCBA pro bono committee but will continue to keep our section council updated. Thank you for your service, Victoria!

And kudos to council member, Matthew Crow, this year’s winner of the Bankruptcy Section Pro Bono Award! Matthew’s incredible service to the people of North Carolina is truly an inspiration to our section and its members.

**Collegiality and Camaraderie Among Bankruptcy Attorneys.** Lee Hogewood put it simply, “the meaningfulness of the outstretched hand or the simple invitation to lunch, extended to another lawyer – especially a frequent adversary, cannot be overstated. In your commitment to collegiality in your daily courtesy to one another, you serve our profession well.” Elizabeth Repetti similarly applauded bankruptcy attorneys “helping each other with insight and guidance when needed.” And, Jennifer Ledford recounted going to bankruptcy court with her dad, Trip Adams, and her amazement that “the lawyers treated each other with respect and civility, as friends.”

Some of my favorite comments on the camaraderie among bankruptcy attorneys are summarized in Bill Janvier’s musings. He described the culture of collegiality as well as creativity and cooperation; “[it] is what we do, and I hope we keep doing it.” He enumerated the top rules or reminders for bankruptcy practitioners; my favorites are No. 2, “opposing counsel is your colleague, not your enemy . . . remember that today’s adversary is tomorrow’s co-counsel,” and No. 8, “when angry with another attorney, write them a letter. Then put it on your credenza for 24 hours. Then decide if you really want to send it.” This is especially salient when hitting “send” on emails.

This year’s Lifetime Achievement Award winner, David Badger, exemplifies collegiality. He chaired our section in 1984-85 and has stayed involved with the council over the past decades, attending council meetings, serving on committees, speaking at seminars and frequently functioning as the yin to Frank Drake’s yang. Congrats Dave!
characteristic of a lease, which distinguishes it from a secured transaction, is that it allows the lessee the right to use the leased property with an attendant opportunity to return the property to the lessor while it still has some ‘substantial economic life’.” (citation omitted)). A secured transaction, on the contrary, involves the sale of a particular good, resulting in the passage of “ownership title to the possessing party without condition or retention of ownership interest even if the item is pledged back.” Johnson, 571 B.R. at 172 (observing that “[t]he collateralization of the item does not defeat ownership, as ‘a security interest is only an inchoate interest contingent on default and limited to the remaining secured debt.” (citations omitted)); see In re Purdy, 763 F.3d 513, 518 (6th Cir. 2014) (“In contrast, a sale involves an unconditional transfer of absolute title to goods, while a security interest is only an inchoate interest contingent on default and limited to the remaining secured debt.”).

II. Characterization

Whether the underlying agreement between the adverse parties, is characterized as a lease or a secured transaction, is governed by applicable state law. Butner v. United States, 440 U.S. 48, 54 (1979) (“Congress has generally left the determination of property rights in the assets of a bankrupt’s estate to state law”). The North Carolina General Assembly has adopted the Uniform Commercial Code (the “U.C.C.”), codified in N.C. Gen. Stat. § 25-1-101 et seq., which controls the determination of whether an agreement constitutes a lease or a secured transaction. See Johnson, 571 B.R. at 171. This characterization, as illustrated below, is “focus[ed] on economics, not the intent of the parties.” In re Se. Materials, Inc., 433 B.R. 177, 181 (Bankr. M.D.N.C. 2010) (citation omitted).

Section 1-203 of Chapter 25 of the North Carolina General Statutes, entitled “‘Lease Distinguished from Security Interest,” provides as follows:

(a) Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.

(b) A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and:

(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 of the goods or is bound to become the owner of the goods;

(3) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or

(4) The lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

(c) A transaction in the form of a lease does not create a security interest merely because: