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 chair's 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 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-

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't 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." Id.; see, e.g., E. Carolyn Hochstalter 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


Mentoring the Next Generation. Rob Cox’s comments, cloaked in a creative Star Wars movie analogy (he aptly called last year’s Lifetime Achievement Award recipient, Al Durham, the Yoda of Chapter 11), encouraged attorneys new to bankruptcy practice to reach out to more experienced members of the bar for advice, and further urged more “seasoned” section members to be open to helping younger attorneys. John Bircher promoted social interaction among the section, “getting to know each other outside the courtroom,” which includes mentoring younger colleagues in a more relaxed setting such as watching the sunset over the Neuse River in New Bern.

I want to give a personal shout out to a good friend and former section chair, Bob Gourley, Jr., who epitomizes these qualities. In 1996, I was thrown into bankruptcy when a partner in my firm, Stacy Cordes, left on maternity leave earlier than expected. After only a couple months doing bankruptcy, I attended the 19th Annual Institute in Asheville, and I did not know anyone. I had met Bob Gourley Jr. briefly in court and he introduced me to everyone at the seminar and let me tag along to dinner with his dad, Bob Sr., and his wife, Heather. By the way, Bob’s son Alex, who was in a baby carrier at the restaurant that night, is now 6’1”, 290 lbs. and plays center on Duke’s football team! Time flies!

It was fun seeing everyone in Asheville at the 40th Annual Bankruptcy Institute, November 30 – December 1. Shelley Abel and her committee did a great job with the program. Thank you, Shelley! She is passing the baton to Brian Anderson and JP Cournoyer, the planners for next year’s program. Feel free to reach out to Brian and JP if you want to get a jump start and help with the 41st.

Kristin Ogburn is a member of Horack Talley in Charlotte. She has served on the NCBA Bankruptcy Section Council since 2015 and was previously on the Council from 2003-2006. She represents creditors in consumer and business cases throughout the state and thus has had the good fortune to get to know the attorneys, judges, trustees, bankruptcy administrators and clerks in the three districts!

Lease Or Security Agreement, continued from the front page

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:
(1) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or greater than the fair market value of the goods at the time the lease is entered into;

(2) The lessee assumes risk of loss of the goods;

(3) The lessee agrees to pay, with respect to the goods, taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;

(4) The lessee has an option to renew the lease or to become the owner of the goods;

(5) 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

(6) 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.

(d) Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if:

(1) When the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or

(2) When the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.

(e) The "remaining economic life of the goods" and "reasonably predictable" fair market rent, fair market value, or cost of performing under the lease agreement must be determined with reference to the facts and circumstances at the time the transaction is entered into.

N.C. Gen. Stat. § 25-1-203; see U.C.C. § 1–203, cmt. 2 (2004) (stating that "[s]ubsection (b) further provides that a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee . . . and if one of four additional tests is met."). The party seeking to reclassify or establish the characterization of the underlying agreement bears the burden of proof. See, e.g., Purdy, 763 F.3d at 515 (explaining that "at all points in this analysis, the party challenging the lease bears the burden of proving that [it] is something else"); In re Triplex Marine Maint., Inc., 258 B.R. 659, 664 & n.8 (Bankr. E.D. Tex. 2000) (placing burden of proof on "the party who asserts that the transaction is other than what it purports to be in a written agreement"); In re Edison Bros. Stores, Inc., 207 B.R. 801, 812 & n.14 (Bankr. D. Del. 1997) (imposing the burden of proof on "the party seeking to characterize the Lease Agreement as an instrument other than a lease").

In some instances, however, the lease agreement may be disguised as a sale and security agreement. "[W]hether a financing transaction denominated as a 'lease' is a true lease or a disguised security agreement is one of the most vexatious and oft-litigated issues under the Uniform Commercial Code." Grubbs Construction, 319 B.R. at 709–10; Carlson v. Giacchetti, 35 Mass. App. Ct. 57, 616 N.E.2d 810 (1993) ("Whether, under the Uniform Commercial Code, an equipment lease is to be treated as a 'true lease' or as a security agreement is an issue that has been litigated extensively for two decades . . . ."). Courts, as a result, have had great difficulty distinguishing a lease from a disguised security agreement. See Ronald M. Bayer, Personal Property Leasing: Article 2A of the Uniform Commercial Code, 43 BUS. LAW. 1491, 1497 (Aug. 1988) (recognizing an "enormous amount of confusion" in the case law); Michael W. Gaines, Security Interests Under Article 2A: More Confusion in the Leasing Arena, 18 STETSON L. REV. 69, 69 (1988) (describing the "plethora of litigation regarding lease agreements and leased equipment"); Peter J. Coogan, Reflections of a Drafter, 43 Ohio St. L. J. 545, 550 (1982) (observing that courts "struggle with the idea of whether a lease with certain attributes is a 'true lease[,]'" resulting in "loads of cases that just cannot be reconciled").

Courts, in arriving at the proper characterization of a lease that may be a disguised secured transaction, employ the two-step analysis codified in N.C. Gen. Stat. § 25-1-203(b), the first step of which is commonly referred to as the "bright-line" test. Southeastern Materials, 433 B.R. at 180-181; accord Johnson, 571 B.R. at 172. The "bright-line" test is satisfied, and a security interest exists as a matter of law, where a lease is not terminable by the lessee and any of the four remaining factors set forth in N.C. Gen. Stat. § 25-1-203(b)(1), (b)(2), (b)(3), or (b)(4), is present, such that no further inquiry is necessary. See In re Phoenix Equip. Co., No. 08–13108, 2009 WL 3188684, *3–4 (Bankr. D. Ariz. September 30, 2009) ("If the lease is not terminable by the lessee and one or more of the enumerated conditions is present, then the contract is a per se security agreement, and the court's analysis may conclude"); see also In re Pillowtex, Inc., 349 F.3d 711, 717 (3d Cir. 2003); In re Brankle Brokerage & Leasing, Inc., 394 B.R. 906, 911 (Bankr. N.D. Ind. 2008) (emphasizing that N.C. Gen. Stat. § 25–1–203(b) "lays out a bright-line test or per se rule which, if satisfied, mandates the conclusion that the
agreement constitutes a security interest, rather than a lease, as a matter of law"); accord In re Wing Foods, Inc., No. 09-08062, 2010 WL 148637, *4 (Bankr. D. Idaho Jan. 14, 2010) (2010 WL 148637) ("The Agreement ... may not be terminated earlier [than the full lease term] by Debtor [and] also gives Debtor the right to buy the goods at the conclusion of its term by payment of the nominal amount of one dollar. [Idaho’s version of U.C.C. § 1-203] and pertinent case law require nothing more to deem this transaction a sale rather than a lease.").

If, however, the "bright-line" test is not satisfied, where the lease is not terminable by the lessee, "then a security interest will not be conclusively found to exist, and the court will need to consider other factors." Southeastern Materials, 433 B.R. at 181. The other factors, considered by the Court during the second step of the "bright-line" test, include an examination of the economic realities surrounding the transaction, including whether the lease term is equal to or greater than the remaining economic life of the underlying asset, the nominality of the option price and early purchase option, and the ability of the lessee to acquire ownership of the goods. N.C. Gen. Stat. § 25-1-203(b).

When assessing the economic realities of the transaction, courts examine "whether the creditor-lessee retained a ‘meaningful reversionary interest’ in the collateral at issue[,]" and [i]f the creditor-lessee retains a reversionary interest, an agreement may . . . be classified as a true lease." In re Johnson, 571 B.R. 167, 173 (Bankr. E.D.N.C. 2017). Two factors, prevalent in this assessment, are "whether the proposed purchase option price is nominal[" and "whether a debtor-lessee acquires equity in the collateral at issue." Id. at 173-174 (citations omitted). Where both of these factors are satisfied, a reversionary interest does not exist, and the purported lease can be classified as a security agreement. Some courts, in addition, examine whether, and to what extent, a purported lessee "develops equity in the property, such that the only economically reasonable option for the lessee is to purchase the goods." Purdy, 763 F.3d at 520. In this situation, and if the "only economically sensible option is to exercise the purchase option, then the agreement will be considered to create a security interest." In re Lash, No. 10-51171, 2010 WL 5141760, at *6 (Bankr. M.D.N.C. Dec. 9, 2010).

There is at least one additional instance under North Carolina law, apart from the "bright-line" test set forth in N.C. Gen. Stat. § 25-1-203(b), where the underlying agreement must be characterized as a lease, as opposed to a security agreement. See, e.g., N.C. Gen. Stat. § 25-1-201(37) (defining the term, "security interest," as "an interest in personal property or fixtures which secures payment or performance of an obligation.").: In re Frady, 141 B.R. 600, 602 (Bankr. W.D.N.C. 1991); accord In re Marhoefer Packing Co., Inc., 674 F.2d 1139, 1142-43 (7th Cir. 1982); In re Huffman, 63 B.R. 737, 738-39 (Bankr. N.D. Ga. 1986). In this instance, and where a lessee has a right to terminate the lease, at any time with no further obligation, a "security interest" cannot exist and the lease must be characterized and treated as a true lease under the U.C.C. Frady, 141 B.R. at 602. The Frady Court, construing and applying the definition of "security interest" under N.C. Gen. Stat. § 25-1-201(37), held that rental agreements for a videocassette recorder and a washing machine did not grant the purported creditor-lessee a security interest in the items due to the fact that the lessee could unilaterally terminate the lease without any further obligation to continue remitting payments. Id.

III. Consequences and Treatment Under the Bankruptcy Code


The consequences and effects of characterizing the arrangement as a true lease, as opposed to a security agreement, include, inter alia:

1. The underlying personal property is owned by the lessor, not the lessee, and, therefore, is not considered “property of the estate,” as defined by 11 U.S.C. § 541;

2. By virtue of its exclusion from the definition of “property of the estate,” the value of the underlying personal property is not available for distribution to creditors of the bankruptcy estate, Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 Yale L.J. 857, 927 (Jan. 1996);

3. The interest of a lessor, under a lease, is not subject to the “strong arm” powers set forth in Chapter 5 of the Bankruptcy Code, whereas an unperfected security interest is subject to avoidance for the benefit of the bankruptcy estate, 11 U.S.C. § 544; In re Price, No. 17-00067-5-DMW, 2017 WL 4119031, at *4 (Bankr. E.D.N.C. Sept. 14, 2017) (citation omitted); accord Grubbs Construction, 319 B.R. at 710; and

4. The post-petition payments to which the creditor-lesser is entitled until rejection, under a true lease, are entitled to priority as administrative expense claims pursuant to 11 U.S.C. §§ 365(d)(10) and 503(b), see In re Midway Airlines Corp., 406 F.3d 229, 236 (4th Cir. 2005);

5. Prior to rejection, and as a condition to assumption, of the true lease under 11 U.S.C. § 365, the lessee is required to continue to perform its obligations under the lease, including the remittance of contractual payments to the lessor in exchange for the continued use of the underlying asset; and

6. Where the true lease is ultimately rejected—prior assumption—said rejection is deemed a breach of the lease arising immediately prior to the filing of the bankruptcy proceeding, with the lessor entitled to a general unsecured claim for damages incurred on account of such rejection and resulting breach of the lease, see 11 U.S.C. § 365(g).

Although lessors have options similar to those available to secured parties, they possess the powerful mechanism for assumption or rejection of an unexpired lease set forth in 11 U.S.C. § 365, which is not available to a secured party. John D. Ayer, On the Vacuity of the Sale/Lease Distinction, 68 Iowa L. Rev. 667, 691-92 (May 1983). Therefore, and pursuant to 11 U.S.C. § 365, a lessee in bankruptcy must either "assume the lease (after curing any existing defaults), or reject the lease and return the assets to the lessor."
& Fried, supra, at 927. Assumption or rejection of the lease must occur “at any time before the confirmation of a plan but the court, on the request of any party to such . . . lease, may order the trustee to determine within a specified period of time whether to assume or reject such . . . lease.” 11 U.S.C. § 365(d)(2); see id. § 365(d)(5) (granting a sixty-day breathing spell for those entities seeking relief under chapter 11 of the Bankruptcy Code, by not requiring that the debtor-in-possession “timely perform” its obligations under the lease until “60 days after the order for relief”). Essentially, a creditor-lessor has two options when a lessee seeks relief under the Bankruptcy Code: “(1) to seek relief from the automatic stay under section 362; or (2) to force assumption or rejection under section 365.” Laurie L. Dawley, The Continuing Debate Regarding the Lease Versus Disguised Security Interest Issue: Did the Edison Court Correctly Find A True Lease?, 24 J. Corp. L. 169, 171 (1998) (citation omitted). In either event, the creditor-lessor is “assured of receiving either the asset[] or the contract payments after the lessee enters bankruptcy.” Id. (citation omitted).

On the other hand, the consequences and effects of characterizing the arrangement as secured transaction, as opposed to a lease, include, inter alia:

1. The underlying asset is owned by the debtor-borrower, not the secured party and, therefore, is considered “property of the estate,” pursuant to 11 U.S.C. § 541;
2. By virtue of its inclusion, as “property of the estate,” the value of the underlying personal property is available for distribution to creditors of the bankruptcy estate, Bebchuk & Fried, supra, at 927;
3. The debtor-borrower, as opposed to a lessee under a true lease, may use, sell, or lease the assets and property pledged as collateral and encumbered by any lien or encumbrance asserted by the secured party therein, 11 U.S.C. § 363;
4. Any increase in the value of the asset or property, post-petition, inures to the benefit of the debtor-borrower and the underlying bankruptcy estate, not to the secured party;
5. The debtor-borrower, to the extent that the amount owed to the secured party exceeds the fair market value of the asset or property, may bifurcate the secured party’s claim under 11 U.S.C. § 506; and
6. The interest of a secured party, contrary to that of a lessor, is subject to avoidance pursuant to the “strong arm” powers under 11 U.S.C. § 544(a), if the security interest is unperfected, Price, 2017 WL 4119031, at *4 (citation omitted); 11 U.S.C. § 544; accord Grubbs Construction, 319 B.R. at 710.

To avoid the consequences of recharacterization, parties should be mindful of the factors set forth in N.C. Gen. Stat. § 25-1-203. Careful attention should be paid to the terms of any agreement, purporting to be a lease, to ensure that the lease term is less than the economic life of the underlying asset, the lessee is not required to renew the lease for the remaining economic life of the underlying asset, and sufficient additional consideration be required to support the exercise of any option to either renew the lease term or purchase the underlying asset, be for sufficient additional consideration. Creditors-lessees, in addition, should take certain precautionary measures to avoid severe consequences in the event the transaction is characterized as a secured transaction disguised as a lease, including the filing of financing statements with the appropriate authorities to ensure that any purported security interest is properly perfected and, therefore, protected from avoidance by a trustee under 11 U.S.C. § 544(a).

IV. Recent Applications of the ‘Bright-Line’ Test

Two recent decisions by the Honorable David M. Warren and the Honorable Joseph N. Callaway, both of the United States Bankruptcy Court for the Eastern District of North Carolina, illustrate the application, analysis, and resulting consequences involved in the characterization of a lease agreement either a lease or as a disguised security agreement. See, e.g., Johnson, 571 B.R. at 169; Price, 2017 WL 4119031, at *1.

The debtor in Johnson, prior to seeking relief under chapter 13 of the Bankruptcy Code, entered into an agreement, entitled “Consumer Rental Purchase Agreement,” to buy or lease a storage shed and barn from RTO National, LLC (“RTO National”) through a stream of fifty-seven (57) monthly installment payments in the amount of $52.64. 571 B.R. at 169. At the conclusion of the monthly installment payments, the agreement provided for a balloon payment of $183.81, at which point the lease terminated and the debtor became the owner of the barn. Id. at 169-170. The chapter 13 plan, proposed by the debtor, sought to retain his purported ownership of the barn and pay RTO National the sum of $600.00 as a secured claim, representing the alleged value of the barn as of the petition date. Id. at 170. RTO National, upset at the treatment proposed in the chapter 13 plan, move to compel the assumption or rejection of the agreement pursuant to 11 U.S.C. § 365, which it contended was a true lease. Id. at 171.

The primary issue according to Judge Callaway, before him in Johnson, was “whether the [a]greement is a true lease or a disguised secured transaction.” 571 B.R. at 171. In framing the issue, Judge Callaway recognized the significance of the characterization:

If the [a]greement is a true lease, Mr. Johnson must assume or reject it as an executory contract pursuant to 11 U.S.C. § 365(d)(2) and amend his chapter 13 plan accordingly. On the other hand, if the [a]greement is a disguised sale and secured transaction, then the [d]ebtor must treat the claim as secured through his chapter 13 plan and make monthly payments (presumably “inside” the plan) to RTO [National] based on the actual value of the consumer good. See 11 U.S.C. §§ 506 and 1325(a) (5).

Id. at 171.

Judge Callaway found that the first step of the “bright-line” test, set forth in N.C. Gen. Stat. § 25-1-203(b), was not met because the
agreement in Johnson specifically provided the debtor, as the lessee, "with a right to terminate the [agreement] at any time and for any reason." 571 B.R. at 172-173 ("Because the right to terminate is clearly established in the [agreement], the first prong of the bright line test . . . is not met"). Having failed the first step of the "bright-line" test, Judge Callaway was forced to examine the economic realities of the transaction. Id. at 173. After consideration of these economic realities of the transaction at issue, including the relevant factors, the Johnson Court was unable to determine, and therefore, could not ascertain, whether RTO National retained a meaningful reversionary interest in the barn. Judge Callaway's analysis, however, was strained by the debtor's failure to present any evidence concerning the fair market value of the barn, or the nominality of the balloon payment or purchase option. This failure to present the necessary evidence relating to these essential factors resulted in the debtor failing to carry its burden of recharacterizing the agreement as a sale and security agreement, as opposed to a lease. Id. at 173-175.

Judge Warren, on separate facts and circumstances, reached a contrary classification of the underlying arrangement between the parties. Prepetition, the co-debtor in Price entered into four (4) separate lease agreements, for the lease and use of (4) separate equipment trailers from Peak Leasing, LLC. 2017 WL 4119031, at *1. Each of the lease agreements, in turn, were supplemented by purchase options, which provided that once all payments were made to Peak Leasing, the co-debtor had the option to purchase each of the trailers for the fixed sum of $1.00. Id. at *2. The chapter 13 plan filed by the debtors in Price proposed to surrender one (1) of the trailers to Peak Leasing and provide it with a secured claim in the amount of $40,000.00 (representing the alleged value of the three (3) trailers retained by the debtors), with the remaining balance, estimated at $82,026.00, treated as a general unsecured claim. Id. at *2-3. Peak Leasing, understandably upset at the bifurcated treatment proposed, moved for relief from the automatic stay pursuant to 11 U.S.C. § 362(d). Id. at *2-3.

Judge Warren, in determining whether to grant Peak Leasing relief from the automatic stay, was required to determine whether the lease agreements were, in fact, true leases, or merely security agreements disguised as leases. 2017 WL 4119031, at *3-5. After applying the "bright-line" test articulated in N.C. Gen. Stat. § 25-1-203(b), Judge Warren found that none of the lease agreements provided the lessee with the ability to terminate the lease agreement and the option, at the completion of the initial lease term, to purchase the trailers for the sum of $1.00, constituted the "nominal additional consideration" required by N.C. Gen. Stat. § 25-1-203(b)(4). Id. at *5-7. Because both steps of the "bright-line" test were satisfied, the court concluded—as a matter of law—that the lease agreements "were not true leases, but rather security agreements to finance the purchase of the [t]railers." Id. at *6-7.

V. Conclusion

The dramatic increase in the lease, as opposed to purchase, of equipment and other personal property, particularly in the agricultural industry, will undoubtedly continue to spurn extensive litigation over the characterization of the arrangements and agreements between transacting parties. With proper planning and execution, parties may be able to avoid the consequences and effects arising from any such litigation over the characterization of their arrangements and agreements. The recent decisions, in Johnson and Price, will undoubtedly assist practitioners, parties, and business entities in addressing, evaluating, and protecting their respective options and interests to particular transactions, and evaluating the anticipated consequences of each characterization in the event—heaven forbid—a party to the transaction seeks relief under the Bankruptcy Code.

Joe Frost is an associate with Stubbs Perdue in Raleigh, North Carolina. His practice includes bankruptcy, agriculture, civil litigation, business litigation, corporate restructuring, tax disputes, tax representation, and consumer protection litigation.

Seven Questions With Shelley Abel


Vita: 37, born Florence, S.C. and grew up primarily in Gastonia, N.C.; “double Heel” with undergraduate and law degrees from UNC Chapel Hill; married to college sweetheart with two children.

Prior experience: 12 years as an associate and shareholder with Rayburn Cooper & Durham, P.A. in Charlotte, working primarily in business-related cases representing a wide range of clients, including debtors, creditors and equity holders.

Why she chose to specialize in this field: Mostly dumb luck – when I showed up at RCD after taking the bar exam, the bankruptcy group was busy filing adversary proceedings in the J.A. Jones case (RCD represented the Unsecured Creditors’ Committee) and I was hooked! I’ve always enjoyed the way bankruptcy can flip the script and change the power dynamics.

Memorable case: While Garlock was a wild ride, I hold a soft spot for my much smaller cases. A favorite client’s near-bankruptcy filing ended up settling a series of long-running disputes, including a partnership dissolution, land partition, and administration of a decedent’s estate, all the way down to who was getting mama’s vacuum. That was a good day’s work.

Favorite quote: A classic applied often by Judge Wooten and still heard from the WDNC bench – “Main strength and awkwardness.”

Recent Reading: “Fraud: An American History from Barnum to Madoff” by Duke Professor Ed Balleisen.