

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF GEORGIA
MACON DIVISION

In the Matter of:	:	Chapter 13
	:	
VICTOR LATAE BONNER,	:	
	:	
Debtor	:	Case No. 06-50472 RFH
	:	
FREEWAY AUTO CREDIT,	:	
	:	
Movant	:	
	:	
vs.	:	
	:	
VICTOR LATAE BONNER	:	
CAMILLE HOPE, Chapter 13 Trustee,	:	
	:	
Respondents	:	
	:	

BEFORE

ROBERT F. HERSHNER, JR.
CHIEF UNITED STATES BANKRUPTCY JUDGE

COUNSEL:

For Movant:

Ms. Molly L. McCollum
3727 Vineville Avenue
Macon, Georgia 31204

Ms. Michael M. Custer
Post Office Box 2023
Albany, Georgia 31702

For Victor Latae Bonner:

Mr. Jason M. Orenstein
Post Office Box 4086
Macon, Georgia 31208

For Chapter 13 Trustee:

Ms. Laura D. Wilson
Post Office Box 954
Macon, Georgia 31202

MEMORANDUM OPINION

Freeway Auto Credit, Movant, filed on June 1, 2006, its Objection To Chapter 13 Confirmation. Movant's objection came on for a hearing on June 14, 2006. The Court, having considered the evidence presented and the arguments of counsel, now publishes this memorandum opinion.

Victor Latae Bonner, Respondent, as Lessee, and Movant, as Lessor, signed a Closed End Motor Vehicle Lease dated January 18, 2006. Respondent leased from Movant a used 1997 Cadillac Deville (the "vehicle"). The lease provides that the agreed upon value of the vehicle is \$7,850. The term of the lease is thirty-six months.¹ The monthly payments are \$341.48. Respondent has the option to purchase the vehicle for \$1,962.50 at the end of the lease term.

The lease requires that Respondent maintain insurance on the vehicle with Movant shown as additional insured and loss payee. Respondent must keep the vehicle in good working order and repair. Respondent must pay the taxes on the vehicle and purchase a tag.

The lease provides that Respondent's total obligation was determined as follows:

¹ Respondent made a monthly payment when he signed the lease. Thus, Respondent is to make a total of thirty-seven monthly payments.

Gross capitalized cost ²	\$ 9,475.00
Capitalized cost reduction (Respondent's "net" down payment)	- 1,516.37
Residual value of vehicle ³	- 1,962.50
Rent charge ⁴	+ 5,812.05
Monthly sales tax (\$22.34 x 37 months)	<u>+ 826.58</u>
Total of Payments	\$12,634.76

The lease provides in part as follows:

Early Termination. You may have to pay a substantial charge if you end this Lease early. The charge may be up to several thousand dollars. The actual charge will depend upon when the Lease is terminated. The earlier you end the Lease, the greater this charge is likely to be.

...

Purchase Option at End of Lease Term. You have an option to purchase the Vehicle at the end of the Lease term for \$1,962.50 and a purchase option fee of \$ N/A. The

² The gross capitalized cost is the sum of the agreed upon value of the vehicle (\$7,850), the lease acquisition fee (\$250), and the gap contract (\$1,375).

³ Residual value is "The value of the Vehicle at the end of the Lease used in calculating your base monthly payment." See item 3 of the lease.

⁴ Rent charge is "The amount charged in addition to the depreciation and any amortized amounts." See item 3 of the lease.

purchase option price does not include official fees such as those for taxes, tags, licenses, and registration.

...

NOTICE TO THE LESSEE: YOU HAVE NO OWNERSHIP RIGHTS IN THE VEHICLE UNLESS AND UNTIL YOU EXERCISE YOUR OPTION TO PURCHASE THE VEHICLE.

...

14. Terms Concerning Your Early Termination Liability

- (a) You may terminate (end) the Lease before the end of the Lease term under the following conditions: If you are not in default of the Lease, you may end the Lease by returning the Vehicle to us and paying us, within five business days of the date we make demand, your early termination liability (see below).

...

Upon early termination you agree to pay the following charges: * Any unpaid monthly payments then due. * The Early Termination Fee, if any, shown in Item 10. * Any official fees and taxes imposed in connection with termination. * The amount by which the adjusted lease balance exceeds the Vehicle's realized value at termination. If the total of these four amounts is more than the total of your remaining monthly Lease payments, you instead agree to pay the total of your remaining monthly Lease payments. * If we have to repossess the Vehicle from you, you will pay us the amount we have to pay for expenses in doing so. * If we have to store the Vehicle and pay storage charges, you will pay us the amount of the storage charges. We will apply some or all of your security deposit

to what you owe.

...

Option to Purchase Lease Vehicle Upon Early Termination. You have an option to buy the Vehicle prior to the end of the term. The price will be the adjusted lease balance (see “Terms Concerning Early Termination Liability” above) plus any other charges due and unpaid under this Lease. You must also pay any taxes or official fees (for taxes, tags, licenses and registration) imposed on the sale of the Vehicle to you.

Movant is listed as the “owner” of the vehicle on the certificate of title.

Leedoh Financial Services LLC is listed as the sole lienholder.

Respondent filed on March 24, 2006, a petition under Chapter 13 of the Bankruptcy Code. Respondent also filed on March 24, 2006, a proposed Chapter 13 plan. Respondent’s plan proposes to pay Movant as a secured creditor \$7,850⁵ plus 8 percent interest by making monthly payments of \$225. The proposed Chapter 13 plan provides in part:

(e) Special provision: Lease of Freeway Auto Sales to be treated as a disguised security agreement and upon completion of Chapter 13 plan payments and Chapter 13 discharge, Freeway Auto Sales shall cause clean title to be issued to debtor.

Justin Barker testified at the hearing on June 14, 2006. Mr. Barker has been in

⁵ The lease provides that the “agreed upon value” of the vehicle is \$7,850.

the used car business for ten years. Mr. Barker testified that Respondent's vehicle is on "its last legs." Mr. Barker testified that the vehicle may have one or two years of remaining life. Mr. Barker testified that the current wholesale value of the vehicle is \$1,000 and that the current retail value is \$2,000. Mr. Barker testified that, in his opinion, at the end of the lease term the vehicle's value will be \$1,000 or "maybe" \$1,500. Mr. Barker testified that at the end of the lease term the vehicle will not be worth the option purchase price of \$1,962.

Respondent contends that the lease is a disguised security agreement rather than a true lease. If the lease is a true lease, Respondent must either surrender the vehicle or assume the lease and fully perform all of its obligations. If the lease is a disguised security agreement, Respondent may retain the vehicle by paying Movant's claim in accordance with Section 1325(a)(5) of the Bankruptcy Code.⁶ State law determines whether the lease is a true lease or a security agreement. The substance of the transaction will prevail over the form of the transaction. United Air Lines, Inc. v. U.S. Bank. National Assoc. Inc., (In re United Air Lines, Inc.), 447 F.3d 504, 506-07 (7th Cir. 2006).

A lease is "a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or

⁶ Respondent, through his proposed Chapter 13 plan, offers to pay almost four times, plus interest, the current retail value of the vehicle which is on "its last legs."

retention or creation of a security interest is not a lease.” O.C.G.A. § 11-2A-103(1)(j)(2002).

Georgia Code Section 11-1-201(37)⁷ provides, “a codified distinction between

⁷ O.C.G.A. § 11-1-201 (37)(2002) provides:

(37) “Security interest” means an interest in personal property or fixtures which secures payment or performance of an obligation. The term also includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9 of this title. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Code Section 11-2-401 is not a “security interest,” but a buyer may also acquire a “security interest” by complying with Article 9 of this title. Except as otherwise provided in Code Section 11-2-505, the right of a seller or lessor of goods under Article 2 or 2A of this title to retain or acquire possession of the goods is not a “security interest,” but a seller or lessor may also acquire a “security interest” by complying with Article 9 of this title. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Code Section 11-2-401) is limited in effect to a reservation of a “security interest.”

Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration 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 not subject to termination by the lessee, and

- (a) The original term of the lease is equal to or greater than the remaining economic life of the goods,
- (b) 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,
- (c) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
- (d) The lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that

- (a) 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

documents creating security agreements and lease agreements.” Mr. C’s Rent To Own v. Jarrells, (In re Jarrells) 205 B.R. 994, 996 (Bankr. M.D. Ga. 1997), affd. (M.D. Ga.

substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,

(b) The lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,

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

(d) 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

(e) 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.

For purposes of this subsection (37):

(x) Additional consideration is not nominal if (I) 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 (ii) 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. 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;

(y) “Reasonably predictable” and “remaining economic life of the goods” are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and

(z) “Present value” means the amount as of a date of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

1997).

In Lamar v. Mitsubishi Motor Credit of America, Inc., (In re Lamar),⁸ the debtor contended that a vehicle lease agreement was a disguised secured transaction.

The Bankruptcy Court for the Southern District of Georgia stated:

In *Summerhill v. Telerent*, the Georgia Court of Appeals held that an agreement is a lease, and not a secured transaction, if two factors are present: one, the lessor clearly owns the property, the lessee has only the right to possess and use, and the lessor regains possessions at the end of the agreement; two, the lessee's option to purchase at the completion of the lease requires payment of fair market value, not merely a nominal sum. 242 Ga. App. 142, 528 S.E.2d at 890.

249 B.R. at 825.

In Carter v. Tokai Financial Services, Inc.,⁹ Carter contended that a lease agreement was a security agreement rather than a true lease. The Georgia Court of Appeals disagreed and stated:

Here, the Agreement's initial term was for five years, ARC was not required to renew the lease or purchase the telephone equipment at the end of the term, and ARC did not have the option to renew the lease or purchase the property at the end of the term for nominal consideration. Therefore, the Agreement does not fit within the definition

⁸ 249 B.R. 822 (Bankr. S.D. Ga. 2000).

⁹ 231 Ga. App 755, 500 S.E.2d 638 (1998).

of a secured transaction provided by OCGA § 11-1-201(37).

Furthermore, “it is commonly held that the ‘best test’ for determining the intent of an agreement which provides for an option to buy [] is a comparison of an option price with the market value of the equipment at the time the option is to be exercised. Such a comparison shows whether the lessee is paying actual value [or] acquiring the property at a substantially lower price.... If, upon compliance with the terms of the ‘lease,’ the lessee has an option to become the owner of the property for no additional or for a nominal consideration, the lease is deemed to be intended for security. See OCGA § 11-1-201(37).” (Punctuation omitted.) *Third Century v. Morgan*, 187 Ga. App. 718, 720(2), 371 S.E.2d 262 (1988). ARC was given the option to purchase the telephone equipment in this case at the end of the lease term for its fair market value. “Additional consideration is not nominal if ... 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.” OCGA § 11-1-201(37)(x). Accordingly, the Agreement in this case must be considered to be a true lease, not a secured transaction.

500 S.E.2d at 756-57.

Turning to the case at bar, Respondent signed a Closed End Motor Vehicle Lease with a term of thirty-six months. Respondent must surrender possession of the vehicle at the end of the lease term, unless Respondent exercises his option to purchase. Respondent is not obligated to purchase the vehicle or to renew the lease. Respondent may have to pay a substantial charge if he terminates the lease early. Respondent must pay \$1,962.50 to exercise his option to purchase at the end of the lease. The vehicle has not been maintained and is on “its last legs.” At the end of the

lease the vehicle will be worth less than the option price. The Court is not persuaded that Respondent, at the end of the lease, can purchase the vehicle for a nominal price as that term is used in O.C.G.A. §11-1-201(37).

The Court is persuaded that the lease agreement is a true lease and not a security agreement.

An order in accordance with this memorandum opinion will be entered this date.

DATED this 19th day of July 2006.

/s/ Robert F. Hershner, Jr.
ROBERT F. HERSHNER, JR.
Chief Judge
United States Bankruptcy Court