

**In the United States Bankruptcy Court**  
**for the Northern District of Iowa**  
**Western Division**

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DIRECT TRANSIT INC.  
*Debtor(s).*

Bankruptcy No. 96-52691XS  
Chapter 11

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**ORDER RE: MOTIONS FOR SUMMARY JUDGMENT**

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Textron Financial Corporation (TEXTRON) has requested allowance and payment of an administrative expense claim on account of debtor's post-petition use of trailers under a pre-petition lease (docket no. 602). It also asks to recover trailer repair and recovery costs. The Official Committee of General Unsecured Creditors (COMMITTEE) resists the motion, contending that Textron's agreement with debtor is not a lease but rather is a debt-financing arrangement creating only a security interest in the trailers. The committee says that Textron was at most entitled to adequate protection of its security interest, but that it is not entitled to post-petition rent. The committee alleges that Textron has received excessive adequate protection and that the estate is entitled to a recovery of overpayments.

Both parties have moved for partial summary adjudication on a single issue: whether the contract between Textron and Direct Transit is a true lease or a debt-financing arrangement in which Textron's security interest in the trailers is "disguised as a lease." Hearing was held on the motions on October 8, 1997, in Sioux City. David B. Altman appeared for Textron; Stephen E. Garcia appeared for the committee.

I have considered the oral arguments, the excellent briefs, and Textron's statement of uncontested facts, and I conclude that the motions should be denied. Because I agree with the parties that resolution of this issue may be dispositive of other issues in this proceeding, I will schedule a telephonic conference with counsel to discuss a separate trial of this issue pursuant to Fed.R.Civ.P. 42 (b).

The parties agree that California law governs the determination of whether Textron's transaction with the debtor created a true lease or a security interest. California's Uniform Commercial Code defines a "lease" as 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 retention or creation of a security interest is not a lease." Cal. Commercial Code § 10103(a)(10).

Section 1201(37) of California's Commercial Code prescribes certain features of an agreement which mandate a conclusion that the agreement is a security interest. Cal. Com. Code § 1201(37)(b)(i)-(iv). Examination of Textron's agreement in light of these features does not compel the conclusion that the agreement creates only a security interest in the trailers.

"In such a case, the court must then resort to an examination of the facts of the case to determine whether the lessor has retained a 'meaningful residual interest' in the goods." Addison v. Burnett, 41 Cal.App.4th 1288, 1296, 49 Cal.Rptr.2d 132, 136 (1996). This interest has also been called an "entrepreneurial stake in the residual." Huddleson, *Old Wine in New Bottles: UCC Article 2A--Leases*, 39 Ala.L.Rev. 615, 632 (1988). The search for residual rights has been a traditional test in distinguishing between true leases and security interests. Jeanne L. Schroeder, *Death and Transfiguration: The Myth that the U.C.C. Killed "Property,"* 69 Temp.L.Rev. 1281, 1322-23 (1996).

The Textron agreement contains a TRAC provision, a terminal rental adjustment clause, which is relevant to a determination of whether the lessor retained a meaningful reversionary or residual interest. Textron's agreement with Direct Transit provides adjustment to the rental payments based on the disposition of the trailers at the end of the seven-year lease period. If a trailer is sold to the debtor or a third-party for more than a projected value, the lessee gets the excess. However, if it sells for less, the lessee must pay additional rent up to 10.84% of the original cost of the trailer.

The presence alone of a TRAC in the lease is irrelevant to the determination of whether the agreement is a lease or a security interest. Cal. Com. Code § 1201(37)(c)(vi). However, TRACs can take many forms. The particular provisions of a TRAC are relevant to the determination of whether the lessor has retained a meaningful residuary interest in the property.

The 53' trailers covered by the lease had an original cost of \$22,357. The projected value of each trailer at the end of the seven-year lease was \$4,471. At the end of the lease, Direct Transit could buy the trailer at an appraised price, or it could sell the trailer to a third party. If the trailer were not sold within 30 days after the expiration of the lease, the trailer was presumed to have a zero realized value. Ultimately, however, the trailer must be sold. Therefore, I disagree with Textron's contention that it could retain ownership of the trailers.

If the value realized by sale exceeded the projected value, the excess would be paid by Textron to Direct Transit. If it were less, Direct Transit would owe additional rent. However, the additional rent obligation was limited to 10.84% of the original purchase price. In the case of the 53' trailers, the limit of the lessee's further obligation was \$2,420. At the end of the lease period, Textron retained no interest in the trailer's value above the projected value. It gave that to Direct Transit. However, it did retain a risk. If the 53' trailer sold for \$2,051 or less, it would lose the difference between the sale price and \$2,051. As to the 48' trailers, which originally cost \$21,563, if one sold for \$1,976 or less, Textron would lose the difference between the sales price and \$1,976.

Here it can be said that the parties have split the "entrepreneurial stake." 4 White & Summers, Uniform Commercial Code § 30-3 at 23 (4<sup>th</sup> ed. 1995). But one can be a lessor even when one "[deals] away one-half of his entrepreneurial stake." Id.

As to the trailers, Textron has retained a risk. The risk is that any of the trailers will sell at the end of the seven-year lease for less than 9.17% of its original cost. The question is whether that is a meaningful risk. There is a paucity of evidence on which to decide that question. The affidavit of John L. Grissom, an employee of Textron, provides the only evidence on this issue. He affirms the facts stated in paragraphs 12-15 of Textron's Statement of Uncontested Facts (docket no. 878). He affirms that at about the date of the delivery of the trailers to the lessee, "seven year old 53' trailers of similar make, model and specifications ... were valued at between 15% and 35% of their original cost," and that "seven year old 48' trailers with similar make, model and specifications ... were valued at between 15% and 35% of their original cost" (docket no. 878, ¶¶ 12 and 13). He affirms that the "spot" market

for such trucks can vary according to certain conditions (§ 14) and that "trailers are generally considered to be commercially useful and to have value for approximately 12-15 years" (§ 15).

Although these facts are relevant, I do not consider that they are sufficient to permit a full evaluation of the meaningfulness of the risk retained by Textron. That risk may be evaluated by considering the likelihood at the outset of the lease that seven years later any of the 53' trucks would sell for less than \$2,051 or any of the 43' trucks would sell for less than \$1,976. How the risk might be quantified or qualified will be left to trial. I will have the clerk set a telephonic conference with counsel to discuss separate trial of the lease/security interest issue.

IT IS ORDERED that Textron Financial Corporation's motion for summary judgment on the issue of whether its agreement with the debtor is a true lease is denied.

IT IS ORDERED that the Unsecured Creditors Committee's motion for summary judgment on the same issue is denied.

The clerk shall set a telephonic conference on the advisability and scheduling of a separate trial on this issue.

SO ORDERED THIS 24<sup>th</sup> DAY OF OCTOBER 1997.

William L. Edmonds  
Chief Bankruptcy Judge

I certify that on I mailed a copy of this order by U.S. mail to counsel for debtor, counsel for Unsecured Creditors Committees, David Altman and U.S. Trustee.