In the United States Bankruptcy Court

for the Northern District of Iowa

MARTIN R. BIELENBERG
Debtor(s).

Bankruptcy No. 97-03063-S
Chapter 12
Contested No. 7210

ORDER RE MOTION FOR RELIEF FROM AUTOMATIC STAY

On December 5, 1997, the above-captioned matter came on for hearing pursuant to assignment. Debtor Martin R. Bielenberg appeared in person with Attorney Donald Molstad. Movant Stearns County National Bank appeared by Attorney Ryan Crayne. Evidence was presented after which the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. sect;157(b)(2)(G).

STATEMENT OF THE CASE

Debtor filed his voluntary Chapter 12 Petition on October 3, 1997. Movant Stearns County National Bank filed its Motion for Relief from Automatic Stay on November 19, 1997.

The evidence establishes that Debtor Martin Bielenberg lives in Sloan, Iowa and is 58 years of age. He has farmed in this general area since 1971. His present farming operation consists of approximately 1,140 acres on which he grows primarily soybeans and corn. He has a small hog operation involving 25 sows and 40 gilts.

Since he began farming, he has owned and operated a variety of farm machinery. Much of this farm machinery has been financed at some time. This Motion for Relief from Automatic Stay involves two pieces of machinery. The first is a vac-u-vator, a piece of machinery designed to remove grain from bins or other storage areas by a vacuum process and transfer it to trucks, wagons or other vehicles. The second item of machinery is a John Deere tractor.

The vac-u-vator was purchased from Mark Polanski in Nebraska in April of 1993. Debtor could not pay cash and the seller proposed to go through Stearns County National Bank on a lease-purchase arrangement. Mr. Bielenberg testified that the general terms were discussed but no papers were signed. He recalls that the documents were sent to the seller/dealer and the dealer brought them to Debtor for signature. The "Equipment Lease", the "Options of Lessee" and a standard form financing statement were executed on April 12, 1993.

The John Deere 8770 tractor was purchased in February of 1995. It was purchased from Logan Valley Implement. Debtor could not pay cash and told the dealer that he would pursue financing through Stearns County National Bank. He had already discussed the purchase with the Bank and had verbal approval to discuss a purchase up to a fixed amount. The final purchase price of the tractor was within that range. Having reached agreement with Logan Valley, he again talked to the Bank to finalize the

terms of the purchase. Mr. Bielenberg testified that if he were unable to pay cash at the end, Stearns County National Bank indicated that it would handle refinancing on the final 30%. The documents including the "Lease", "Options of Lessee", and financing statement were executed in February, 1996.

Mr. Bielenberg testified and presented Exhibits 1 through 4 which were received into evidence. These are the documents memorializing this series of transactions. The Bank offered Exhibit B which was received. It is an affidavit. Exhibit A was offered consisting of copies of the financing statements. Objection to Exhibit A was sustained because additional and unexplained language appears on the copies tendered by Stearns Bank.

VAC-U-VATOR

Debtor offered Exhibit 1 which consists of the documents executed by Stearns County National Bank and Debtor relating to this item of equipment. These documents were executed on April 12, 1993. Debtor testified that he and representatives of the Bank discussed the various options involved in the lease. He testified that he recalled that the purchase option could be anywhere from a final payment of $1.00 up to 10% or more of the purchase price. This is reflected in a document entitled "Options of Lessee".

This document provides that the lessee has three options at the end of the lease term. First, the lessee could buy the vac-u-vator. If the lessee chose to purchase the vac-u-vator, there were three described methods to determine the purchase price. The first was a denominated percentage of "the equipment cost at the end of the lease term." Secondly, lessee could choose to purchase the equipment for $1 at the end of the lease term or, third, the lessee could forfeit a 10% security deposit to purchase the equipment at the end of the lease term. The obvious disparity in these amounts was adjusted in the periodic payments.

If the lessee chose not to exercise a purchase option at the end of the lease, the lessee had the option of renewing the lease. If the lessee chose not to exercise the option or to renew, the final option provided that the lessee could "return the equipment to Stearns County National Bank of Albany with no further obligation".

Debtor testified that the purchase options were discussed with representatives of Stearns Bank. He testified that the purchase option could be anywhere from a final payment of $1 all the way up to 50% of the purchase price. Debtor elected to lease the vac-u-vator for five years with a purchase buyout option at the end of the lease of 10% of the equipment cost. Debtor testified that he chose the smaller percentage even though the smaller percentage at buyout increased the amount of payments during the term of the lease.

Debtor testified that, at all stages of this process, he intended this transaction to be a lease purchase agreement, "plain and simple" and that it was not a lease as Stearns Bank now argues. Debtor testified that it was always his philosophy that he would not pay money toward an item of machinery that he would not eventually own and, therefore, he intended a purchase at the completion of the periodic payments.

Stearns Bank states in its brief that the original cost of the vac-u-vator was approximately $15,625. While this figure may be correct, it is not established in the evidentiary record. Debtor testified that he does not recall the full purchase price and an examination of the various documents offered into evidence does not establish a specific purchase price. Nevertheless, the terms of the "Equipment Lease" established that the term of the lease was for 60 months with payments to be made semi-

annually. Debtor was required to make one advance payment of $1,930.94 which was required to accompany the lease application. Thereafter, Debtor was to make ten payments of $1,930.94 in semi-annual installments. The final option payment was to be 10% of the purchase price.

All payments were made until the second payment in 1996. Debtor did not make this payment and a notice of default was sent to Debtor by Stearns Bank in November of 1996. A replevin action was commenced in Iowa District Court. This replevin was eventually stayed by the provisions of the automatic stay when the pending Chapter 12 bankruptcy case was filed.

The "Equipment Lease" is a document separate from the "Options of Lessee". The "Equipment Lease" contains a section entitled "End of Lease Options". This section, like the "Options of Lessee", recites that the lessee has three options at the end of the lease term:

1. Purchase the equipment for the fair market value.
2. Renew the lease agreement.
3. Return the equipment as provided in paragraph 14 of the "Lease Agreement".

These terms are compatible with the "Options of Lessee" except for the language concerning the purchase option. The "Options of Lessee" document states that the purchase of the equipment would consist of 10% of the equipment cost. The language in the "Equipment Lease" states that the purchase would be for the fair market value. Stearns Bank, in its brief, seems to take the position that the parties agreed that 10% of the purchase price would, in advance, be agreed upon as the fair market value at the completion of the lease. However, the evidentiary record does not establish this connection. There is some discussion in the terms and conditions of the "Equipment Lease Agreement" under "Remedies" (paragraph 18), which collaterally discusses value of the equipment at the expiration of the lease. This section indicates that a separate measure of damages has been included in the lease because the value of the equipment at the expiration of the lease agreement is uncertain. A figure of 10% is included as a portion of the elements of damages in case of a breach with language in the paragraph which states that "10% of the original cost of such item represents compensation for loss of lessor's anticipated residual value." However, this is insufficient to establish that the parties discussed and agreed in advance that 10% of the purchase price would constitute an agreed upon fair market value at the completion of the lease.

The "Lease Agreement" and the "Options of Lessee" are inconsistent in the way the option price would be determined. Debtor testified that the 10% payable at the completion of the lease was unmistakably 10% of the purchase price and not 10% of any fair market value which would be determined. Debtor testified affirmatively that there was no discussion about or agreement concerning the fair market value of this item at the end of the lease agreement.

While there was no direct testimony concerning the purchase price or value of the vac-u-vator at the commencement of the lease period, based upon the amount of the payments made, the figure postulated by Stearns of $15,600 may well be the purchase price. Exhibit C, an affidavit of Kollath Equipment of Stanton, Nebraska states that, in the opinion of the affiant, the fair market value of the vac-u-vator as of November 3, 1997 was $4,500.

JOHN DEERE TRACTOR

Debtor purchased the John Deere tractor from Logan Valley Implement in February of 1995 for an agreed price of $120,000. Since Debtor did not have the cash to purchase this tractor, he suggested to Logan Valley Implement that he contact Stearns County National Bank for financing similar to that

which he had used for the purchase of the vac-u-vator two years previously. He again discussed the available options with Stearns Bank and elected to enter into a lease-purchase option with a final buyout of 30% of the purchase price.

The identical forms used in the lease-purchase of the vac-u-vator were used in this transaction. The documents include the "Equipment Lease" and an attached sheet setting out the "Options of Lessee". The parties also prepared a Financing Statement which was filed in Iowa.

Initially, the lease did not include the downpayment and periodic payment amounts. This was added by an additional document entitled "Addendum to Rental Terms" and was dated February 6, 1996. The Addendum provided that Debtor was required to make an initial $14,000 downpayment. He was required to make an additional $11,000 payment in October of 1996. Thus, the initial payments totaled $25,000 for the year 1996. Debtor was to make four periodic payments on an annual basis of $24,000. These payments were to be made in February of 1997, February of 1998, February of 1999 and the final payment to be made in February of 2000. The 30% payout option in the amount of $36,000 was payable after completion of the lease term.

The remainder of the documentation is identical to that contained in the previous lease purchase arrangement. Again, Stearns Bank asserts that the 30% of purchase price payment to be made at the end of the lease constitutes fair market value for purposes of lease language and Debtor claims that none of the options in the lease provide for payment at fair market value. He testified that at no time during the discussions with Stearns Bank was there any discussion as to an agreement whereby 30% of the purchase price would be an agreed upon figure as fair market value at the end of the lease. The 30% figure was agreed upon to keep the periodic payments lower. The lease payments were determined, in part, based upon the percentage payment at the conclusion of the lease term.

The tractor was purchased for $120,000 in February of 1996. Debtor made the payments totaling $25,000 in 1996. The February, 1997 payment was not made and no additional payments have been made. Debtor testified that as of December 1997, the fair market value of the tractor was between $96,000 and $112,000. He testified that the condition of the tractor is above average and the tractor will continue to have significant value. He testified that the tractor is well maintained and the passage of time alone is not as important in determining the value of a tractor as the condition. Debtor testified that the $36,000 option payout would be considerably less than the value of the tractor at the end of the lease period.

CONCLUSIONS OF LAW

The Bankruptcy Code does not define the term "lease" and defines security interest as a "lien created by agreement". 11 U.S.C. sect;101(51). The legislative history establishes that the Bankruptcy Code defers to applicable State or local law in making the determination whether a lease constitutes a security interest. In re Peacock, 6 B.R. 922, 924 (Bankr. N.D. Tx. 1980); In re Charles Herman Welter, No. 92-31850XF, slip op. at 11 (Bankr. N.D. Iowa March 19, 1993).

The parties have stipulated that, pursuant to the terms of the lease (paragraph 24), interpretation of the agreement is to be governed by and construed in accordance with Minnesota law.

Stearns Bank takes the position that both agreements entered into between Debtor and Stearns Bank constitute leases. Debtor takes the position that both agreements constitute security interests under the Uniform Commercial Code. While the distinction would not necessarily be significant outside of

bankruptcy, the distinction between a lease and a security interest has significant ramifications in the treatment of these claims in this Chapter 12 reorganization.

While the Iowa and Minnesota courts may interpret their respective Uniform Commercial Code language differently, the provisions applicable to leases and security interests are Uniform Commercial Code language and are identical in both Iowa and Minnesota.

The controlling language in determining whether a lease or a security interest exists is found in Minnesota Statutes sec. 336.1-201(37). The identical language is found in Iowa Code sec. 554.1201 (37). Both Minnesota and Iowa have passed changes to this Code section to clarify interpretation problems caused by previous Code language. Minnesota law previously provided that:

> Whether a lease is intended as security is to be determined by the facts of each case; however,
>
> a. the inclusion of an option to purchase does not of itself make the lease one intended for security, and
> b. an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does not make the lease one intended for security.

Minn. Stat. sect;336.9-102(37) (1988).

The Minnesota legislature amended this section in 1989 and adopted changes made in the official 1987 Uniform Commercial Code text. The amendment applied to lease contracts executed on or after January 1, 1990. See FBS Business Finance v. Edison Financial, 464 N.W.2d 304, 305 (Minn. App. 1990). Iowa has taken a similar approach as Minnesota and amended this Code section in 1995 to reflect the model language.

Whether a lease was a true lease or one intended as security under the previous Code section was largely determined by the intent of the parties. Many courts established a list of factors in an attempt to distinguish a lease and a security interest. To some extent, Minnesota did use a factors' test in this analysis. Chemlease Worldwide, Inc. v. Brace, Inc., 338 N.W.2d 428 (Minn. 1983); Pointe Sanibel Dev. Corp. v. Sundial Beach and Tennis, Inc., 1993 WL 500529 (Minn. App.). Some of these factors include who pays insurance premiums, who bears the risk of loss, who pays sales use or property taxes, whether warranties are disclaimed, and whether the lessee has the option to renew or to become the owner of goods for a fixed price. This criteria analysis was criticized by many commentators and, as a result, the second portion of revised Minnesota Statutes sec. 336.1-201(37) was passed to address and eliminate this type of analysis. The second portion of this statute provides that a transaction does not create a security interest merely because it contains certain factors. Five specific examples are provided in the statute. How and when to consider these factors is not abundantly clear. However, most commentators are of the opinion that the first portion of the statute must be considered first and that analysis completed before the excluded factors are even considered. It remains an open question whether these factors can be considered at all, and if considered, the amount of weight to be given to them in determining whether a document is a lease or a security interest in a very close case. 4 James J. White Robert S. Summers, Uniform Commercial Code, sect;30-3, at 24 (4th ed. 1995) (hereinafter White Summers).

Different courts use different methodologies to determine whether a document was a lease or security interest. Minnesota courts periodically did consider certain factors in their analysis. Pointe Sanibel Dev. Corp. v. Sundial Beach and Tennis, Inc., 1993 WL 500529 (Minn. App.). However, Minnesota courts relied primarily on an examination of any option to purchase clause at the end of the lease. The Minnesota courts consistently held that if the property could be purchased for no additional consideration or nominal consideration, the transaction created a security interest. If the additional consideration was more than nominal, the transaction was a lease. Chemlease Worldwide, Inc. v. Brace, Inc., 338 N.W.2d 428 (Minn. 1983); Talcott, Inc. v. Franklin Nat. Bank of Mpls., 194 N.W.2d 775 (Minn. 1972); FBS Business Finance v. Edison Financial, 464 N.W.2d 304 (Minn. App. 1990).

This Court has not been able to identify any case in Minnesota or in Iowa since the passage of the new version of Minnesota Statutes sec. 336.1-201(37) which does a complete analysis of the new Code language. However, it is clear that the new section was intended to provide consistency in the determination of whether a transaction constitutes a lease or a contract intended to create a security interest. In so doing, the language of the modified section establishes different criteria and guidelines to be applied in making this analysis.

The new Minnesota Statute states:

> 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 the 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 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 reasonable 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.

Minn. Stat. sect;336.1-201(37).

While the focus of the previous Code language was on the intent of the parties, the focus of the new section is upon the nature and extent of the interests of the parties at the completion of the lease. If there is a substantial reversionary interest to the lessor, the analysis dictates the conclusion that a true lease exists. If, however, no meaningful reversionary interest remains for the lessor, the parties created a security interest. The new statute provides some guidance as to how to complete this analysis.

The statute consists of two parts. The first half of the statute provides the framework for determining whether or not a disguised security interest exists. The second portion of the statute describes five examples of criteria which do not establish a security interest. This section was previously described in this opinion. As this Court's analysis of these documents is resolved under the first half of this statute, the Court does not reach the negative criteria contained in the second half of the statute.

The first half of this statute requires the court to examine five specific areas or criteria. The first of these requires the Court to examine whether or not the lessee has the ability to terminate the lease. If the court concludes that the lease is terminable by the lessee, the analysis need go no further because a lease exists and not a security interest. However, if the Court determines that the first condition is met and that the lease provides that the lessee must pay the lessor for the right to possession and use of the goods for a term not subject to termination by the lessee, the Court must then examine four additional criteria. If any one of the four remaining criteria is established, a security interest is ipso facto determined to exist.

Of the four criteria under the first section of Minnesota Statutes sec. 336.1-201(37), the first two address those instances in which no significant economic value will remain in the property at the end of the lease. The second two focus upon the circumstances under which the lessee has the option to renew the lease for the remaining economic life of the property or the lessee has the option to purchase the property. Both options envision the payment of no additional consideration or nominal consideration.

The lease documents are identical in both the vac-u-vator transaction and the John Deere tractor transaction. These criteria will be discussed together as to both transactions.

The first general criteria requires the Court to consider whether the consideration the lessee must pay for the right to possess and use the goods is an obligation for the term of the lease and not subject to termination by the lessee. The terms and conditions of the equipment lease agreement address this issue. Paragraph 2 of the document provides that:

> The rental payment and term of this lease with respect to each item of equipment shall commence when the lessee has received equipment which is equal to 50% of the value at cost to lessor of all equipment to be leased hereunder, and shall continue thereafter for the number of consecutive months in the amount specified and for the total number of payments as set forth above unless earlier termination as provided herein.

Paragraph 20 provides that:

> This lease is a completely net lease and lessee's obligation to pay the rent and amounts payable by lessee under paragraphs 12 and 18 is unconditional and not subject to any abatement, reduction, set off or defense of any kind.

Paragraph 21 provides that:

> This lease cannot be cancelled or terminated except as expressly provided herein.

These paragraphs undeniably establish that Debtor's right to possession and use of both the vac-u-vator and the tractor was for the complete term of the lease and was not subject to termination by the lessee. The first general criteria under Minnesota Statutes sec. 386.9-102(37) is satisfied.

The Court must next examine the four alternative theories which establish a security interest ipso facto. The first requires an examination of whether the original term of the lease is equal to or greater than the remaining economic life of the goods. The purchase price of the vac-u-vator was apparently approximately $15,600. It was purchased in 1993 with a completion date on the lease of 1998 if all payments were made. The value of the vac-u-vator as of November, 1997 was approximately $4,000.

The evidence establishes, based on the reduction in value during the existing term of the lease, that at the end of the term of the original lease there would remain some economic life to the vac-u-vator.

The tractor was purchased for the sum of $120,000. Its present value is between $96,000 and $112,000. The testimony establishes that the tractor will decline relatively slowly in value as long as it is maintained in good operating condition. The tractor will retain significant economic life after the term of the original lease.

Based on these values, the first criteria is not met because the complete economic life of neither of these items will be exhausted during the original term of the lease.

The second criteria requires that the lessee must renew the lease for a period which exhausts the remaining economic life of the machinery. Paragraph 25 provides that "unless lessee 60 days prior to the expiration of the lease notifies lessor in writing of its intention to terminate this lease at its expiration date, then this lease shall automatically be extended upon all the terms and conditions as stated herein for a period of one year from its expiration date without the necessity of execution of any further instrument or document." This term applies to both the vac-u-vator and the John Deere tractor.

While the lease can automatically be renewed, there is nothing in the lease arrangement requiring the lessee to renew the lease. Also, while the lease may be extended for one year, there is no language in the lease which mandates that the lessee extend the lease for an indefinite period during which the remaining economic life of the property would be exhausted. The evidentiary record does not establish that the residual value would be exhausted if the leases were extended for one year.

Therefore, the second criteria has not been met because there is no mandatory renewal language in the lease nor is an indefinite lease period extension required to exhaust the life of the property.

The third criteria is satisfied if the lessee has an option to renew the lease for the remaining economic life of the goods for no consideration or a nominal consideration. The terms of both leases are for a specific period of time; five years. The only renewal language is contained in paragraph 25. This renewal option does not contemplate an extension for the remaining economic life of the property. Additionally, the language of this paragraph reflects that the terms would automatically renew under

the same conditions for one additional year with a full year of payments. As such, the third criteria is not established by this evidentiary record because the lease does not provide for an option to renew for an extended period of time during which the economic life of the goods would be exhausted for no consideration or for a nominal consideration.

The final criteria of sec. 336.1-201(37) is met if the lessee has an option to become the owner of the goods for no additional consideration or a nominal consideration upon compliance with the lease agreement. This provision requires a more complete examination and analysis. This condition speaks alternatively. The first allows a purchase for no additional consideration and the second is for a nominal consideration.

Lessee/Debtor has an option to purchase the vac-u-vator for 10% of the purchase price and an option to purchase the tractor for 30% of the purchase price. Lessee does not have the option to purchase either of these items for no additional consideration.

The second alternative allows the fourth criteria to be met if debtor can purchase the machinery for a "nominal consideration". This term has a technical legal meaning which must be examined. This Court has not found any Minnesota Supreme Court or Court of Appeals cases which have discussed this new Code language. However, the Minnesota Supreme Court did have an opportunity in several cases to discuss the meaning of "nominal consideration" under previous Code language. The lead case on this matter appears to be Talcott, Inc. v. Franklin Nat. Bank of Mpls., 194 N.W.2d 775 (Minn. 1972). The option to purchase in Talcott consisted of $1 which the Minnesota Supreme Court determined to be a nominal sum. Subsequent cases in Minnesota discussing this issue have declined to provide a more expansive application to the term "nominal". See Chemlease Worldwide, Inc. v. Brace, Inc., 338 N.W.2d 428 (Minn. 1983). If this narrowly focused definition of "nominal" remains the test in Minnesota, the option price of 10% on the vac-u-vator and 30% on the tractor would undoubtedly be considered more than nominal additional consideration. If this were true, this criteria could not be met under any circumstances where the consideration for the option was more than a $1 or some other very small amount.

However, it is not fair to conclude that the prior analysis will be applied to the new statute. The drafters of the new language intended to provide an entirely new focus to this issue. In so doing, they intentionally deleted language concerning intent of the parties and refocused the analysis on the value of any reversionary interest at the completion of the lease. They also intended to give a more expansive meaning to the term "nominal consideration". Committee notes indicate that the drafters envisioned amounts substantially larger than those previously considered nominal by the Minnesota Supreme Court. This matter is discussed in White and Summers, sect;30-3, at 25 n.62 , where it states:

> Specific proposals, considered by the Drafting Committee, of formulae to determine whether an option price is nominal include: (1) finding a true lease where the purchase option was greater than 10% of the fair market value at the time the lease was entered into, and (2) according true lease status where the purchase option was greater than 75% of the reasonably predictable fair market value at the time the option was to be exercised as estimated at the time the lease was signed. The drafting committee rejected all of these proposals as being too rigid to apply to the wide array of leasing transactions, and as sanctioning "bargain" options as consistent with true lease status. See Huddleson, Old Wine in New Bottles: UCC Article 2A Leases, 39 Ala. L.Rev. 615, 628-30 (1988).

These issues are discussed fully by White and Summers and the authors argue that what is determined to be a nominal amount must be measured by standing at the beginning of the lease and predicting the

relationship between the option price and the value of the goods at the time that the option is exercised. They argue that a more expansive definition of nominal must be used than under prior case law. They state that:

> We would allow a substantial deviation from that value and yet conclude that the amount is not "nominal". In our view, anything less than 50 percent of the projected fair market value at the option date smells of nominality and anything above 50 percent should normally be accepted as not nominal.

White and Summers, sect;30-3, at 26.

Other commentators discussing the state of the Minnesota law have also concluded that a broader definition of nominal must be applied under the new text of Minnesota Statutes sec. 336.1-201(37). See Eric Larson, True Leases and Sales as Defined by Minnesota Law and Minnesota Courts, 16 Hamline L. Rev. 319, 335 (1993). While predicting how another court will interpret a statute is always risky and somewhat presumptuous, this Court must make such a decision. Based on the prior discussion, this Court concludes that the Minnesota courts will provide a broader definition of nominal than has been the case in previous decisions. To limit this critical term to $1.00 or some other small sum, would negate the entire purpose of the revised code section.

The Court will apply these legal conclusions to the facts of this case to determine whether the option price of these items of machinery is nominal. In so doing, the Court recognizes that many of the figures which would be useful to an analysis under this statute are not well established or must be estimated from the evidentiary record. The vac-u-vator was presumably purchased for approximately $15,000 or $16,000. There is no direct evidence as to what the parties intended to be the fair market value at the completion of the lease terms.

Stearns Bank has attempted to persuade the Court that it was the intent of the parties to use the 10% and 30% option price as fair market value. However, the Court remains unconvinced that the parties truly intended this to be their agreement. Debtor testified that no discussions were held and there is no evidence in the record to contradict his testimony.

The value of the vac-u-vator as of November, 1997 was approximately $4,500. This lease was for a period of five years commencing in April of 1993. The option would have been exercisable in April of 1998. The vac-u-vator will deteriorate somewhat more in value between November of 1997 and the date of the exercise of the option in April of 1998. Assuming a value of approximately $4,000 at the time of the exercise of the option and assuming that the purchase price was indeed approximately $15,600, this would mean that Debtor would be paying approximately $1,500 or $1,600 for an item with a residual value of approximately $4,000. Utilizing the broader definition of nominal contained in the commentaries, the option price would be approximately 39% or 40% of the fair market value at the time the option was exercised. Also, 10% of the fair market value at the time the lease was entered into would satisfy the initial thinking of the drafting committee when these issues were discussed. Even though this language was abandoned and is not part of the statute, it is informative because the drafting committee considered it within a reasonable range for this analysis.

It is the ultimate conclusion of this Court that the 10% figure constitutes a nominal amount under the language contained in new sec. 336.1-201(37)(d). The parties agreed that the option price would be 10% of the purchase price of the vac-u-vator at the time the lease was executed. The option price is approximately 39% of the fair market value at the end of the lease term. These sums are well within the range considered appropriate by the commentators.

The record establishes that the Lessee was to pay the Lessor for the right to possession and use of the goods for the term of the lease. The lease was not subject to termination by the Lessee and the Lessee had an option to become the owner of the goods for a nominal consideration upon compliance with the lease agreement. Therefore, the required criteria are established and the transaction involving the vac-u-vator is a security interest as defined by sec. 336.1-201(37).

The tractor was purchased for $120,000. The purchase option was 30% of the purchase price or $36,000. Debtor testified that, in his opinion, the value of the tractor in November, 1997 was between $96,000 and $112,000. Mr. Kollath, who provided an estimate on behalf of Stearns Bank, estimated the value of the tractor as of November, 1997 to be $90,000.

The tractor transaction occurred in February, 1995. The option would be exercisable sometime after February, 2000. The anticipated fair market value at that time was not determined by the parties in advance. However, between the date of purchase and approximately one-half of the five year lease period, the value of this tractor had declined approximately $30,000. If the tractor continued to decline in value at a similar rate, the value at the end of the lease period would be between $60,000 and $70,000.

The option price is 30% of the original purchase price or $36,000. Under any analysis used by the commentators, $36,000 must be considered more than a nominal sum because it is substantially higher than 10% of the purchase price and in excess of 50% of what would be considered an anticipated fair market value at the completion of the lease. It is the conclusion of this Court that the evidence does not support a finding that the Lessee/Debtor can purchase the tractor for nominal consideration upon compliance with the lease agreement.

The first general criteria has been proven but none of the four alternative criteria have been satisfied which would establish, ipso facto, that the transaction involving the tractor constitutes a security interest. However, this conclusion does not end the analysis. It establishes only that a security interest has not been established by applying these criteria. The analysis must proceed an additional step. Under the revised code section, if none of the four criteria establish a security interest, the Court must turn to the new point of emphasis under this code section. This emphasis is away from the intent of the parties and to an analysis of whether the lessor retains a reversionary interest. If no substantial reversionary interest exists, a security interest may exist despite the earlier analysis. White Summers state this as follows:

> Finding economic life beyond the lease term and seeing no nominal consideration option what should a court do? The court must then answer whether the lessor retained a reversionary interest. If there is a meaningful reversionary interest-either an up side right or a down side risk-the parties have signed a lease, not a security agreement. If not, vice versa.

White Summers, sect;30-3, at 25.

The residual value in this case is not crystal clear from the evidentiary record. However, the evidence establishes that while the tractor has declined in value since its purchase, it still retains a significant value. Debtor testified that the tractor is well-maintained and the $36,000 option payout would be considerably less than the value of the tractor at the end of the lease period. Assuming a gradual reduction in value through the course of this lease, the residual value will still remain probably somewhere between $60,000 and $70,000. Even if the figure is significantly less than this and the

testimony of Debtor is correct, the residual value at the completion of the lease will be substantially in excess of $36,000.

Because of this residual value, there exists a meaningful up side right to the lessor involving this tractor. As this reversionary interest is of substantial value, the new code section requires the conclusion that the parties executed a lease and not a security agreement. As this was a lease from its inception, Debtor has no ownership interest.

Debtor failed to make the 1996 payment and received a notice of default on November 20, 1996. This was a ten day right-to-cure letter to which Debtor did not reply or cure during the allowable period. When Debtor failed to cure, Stearns Bank commenced its replevin action in State court on October 13, 1997. This replevin action was stayed by the filing of Debtor's Chapter 12 petition. Judge Dewey Gaul entered an Order on October 20, 1997 recognizing the automatic stay and staying further proceedings until the stay was modified. As Debtor has no ownership interest in the tractor.

Debtor does retain possession of the tractor at this time. Simple possession may constitute a property interest under 11 U.S.C. sect;541. See In re Delex Mgmt., 155 B.R. 161, 167 (Bankr. W.D. Mich. 1993); In re Scribner, No. 96-61972KW, slip op. at 2 (Bankr. N.D. Iowa Oct. 7, 1996). However, any possessory interest in this case is so minimal that to the extent any residual property interest exists, the stay must be lifted under sect;362(d)(1) for cause. Being a defaulted lessee, the Court concludes that the stay must be modified as to the tractor to allow lessor, Stearns National Bank, to proceed with its replevin action.

In summary, the record establishes that the transaction involving the vac-u-vator between Debtor and Stearns National Bank constitutes a security interest as defined by sec. 336.1-201(37). The record establishes that, in this transaction, the lessee was to pay the lessor for the right-to-possession and use of the goods for a term of five years. The lease was not subject to termination by the lessee and contained an option that the lessee could become the owner of the goods for a nominal consideration upon compliance with the lease agreement. Therefore, the requirements of this Code section are met ipso facto and this transaction constitutes the creation of a security interest.

The record establishes that the transaction between Debtor and Stearns National Bank, involving the tractor, constitutes a lease. In this transaction, the lessee did pay the lessor the right-to-possession and use of the goods for a term of five years. The lease was not subject to termination by the lessee and the lessee had an option to become the owner of the goods upon compliance with the lease agreement. However, the option contained in the transaction was for a sum greater than nominal consideration. As such, the threshold analysis established that none of the criteria under sec. 336.1-201(37) is established which would make this a security interest ipso facto. The subsequent analysis involving the existence of a reversionary interest establishes a substantial reversionary interest to Stearns National Bank. This establishes the existence of an up side reversionary interest to the lessor thereby establishing the existence of a lease and not a security interest.

For all of the foregoing reasons, the Court enters the following Orders:

1. As to the vac-u-vator, the Court concludes that this transaction constitutes the creation of a security interest. As a security interest exists, Debtor has a property interest in this item of machinery. The Court concludes that adequate protection does exist in this case and, therefore, the Motion to Modify Stay to foreclose on this item of machinery is DENIED.
2. The Court concludes that the transaction involving the John Deere tractor is a true lease. As a true lease, Debtor breached the terms of the lease prior to the commencement of this Chapter 12

case. Debtor has no ownership interest cognizable under 11 U.S.C. sect;362. The Court concludes that the automatic stay entered at the inception of this case should be and is hereby modified to allow the lessor, Stearns National Bank, to proceed with its replevin action commenced in State court on October 13, 1997. Wherefore, the automatic stay under sect;362 is modified to allow Stearns National Bank to take any action in State court consistent with State remedies in this replevin action.

SO ORDERED this 26 day of January, 1998.

Paul J. Kilburg
U.S. Bankruptcy Judge