

“True Lease” Versus Disguised Security Interest: Is the *United* Trilogy Truly the Last Stand?

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INTRODUCTION

Conflict is an inevitable part of the human condition, so much so that it even extends into our worlds of law and business. As to the former, that is why we have an adversarial system, and courts of law to resolve these difficulties. As to the latter, the pursuit of commerce is by nature a constant battle among priorities, objectives, and resources.

One arena in which the two domains clash is in the financing of business. In modern commercial enterprises (as has been done for decades, if not centuries), businesses of all size and manner expand via acquisition.

Some acquisitions are with money borrowed from others, those others willing to lend funds for asset purchases because the thing to be owned by the borrower is itself the collateral for the loan. Of course, we call that final element a security interest.

Standing in parallel, other expansions are accomplished not by borrowing money, but by “borrowing” the asset itself, of course, for a set time with a set schedule of payments to compensate the true owner for permitting this temporary use of its property. Quite naturally, we call that a lease.

However, these are antiseptic, academic definitions, a mere point of entry into the real world. Unlike the stark black and white of the foregoing, the pragmatic world of business is almost entirely shades of gray, with that gray coming in every imaginable hue and contrast.

Yet this gray is not a mere color. It is more the amorphous gray of a fog, a fog of war that blankets the true conflict within. For hidden within this mist, we find the true battle waged amongst law and business, the struggle to ascertain and properly characterize what is truly a genuine lease of property, to the distinguished from a security interest, which in fact may be masquerading as a bona fide lease.

This is the controversy, then: the "true lease" versus the disguised security interest. As we will see, fortunes are made, companies saved or lost upon such distinctions, for this is no mere labeling exercise. Each of the two categories is legally distinct, and each carrying differing sets of legal rights and responsibilities that can turn the tide of battle.

Thus the stakes are high, and nowhere are they higher than in cases before the nation's bankruptcy courts. While certainly there are available enough state cases to fill an ocean, we have focused on how this controversy had played out in the federal courts. Why? Two reasons: one, a federal insolvency proceeding truly provides the most severe test of both the law and the participants; and two, it is most recently that one of the most renowned and erudite federal tribunals has resolved the issue in such a high profile case that, as our title suggests, the "true lease" versus disguised security interest war may once and for all be over.

Indeed, if victory truly is at hand, it could not have come at a better time. Forbes recently reported that an estimated 80% of U.S. companies lease some or all of their equipment. According to research done by Matthew Magilke, an assistant professor of accounting at the University of Utah, an analysis of the footnote disclosure of over 4,700 public U.S. companies in 2005 revealed an astonishing \$1.04 trillion in off-balance sheet operating leases.¹

It would be outlandish to say that the fate of free enterprise hinges upon this new resolution of the legal issue herein. We refuse to go so far. Nevertheless, it is fair to say that, after years of controversy and interminable court cases, and with trillions of dollars in the current American economy dependent upon these outcomes, a great deal is at stake here.

In expositing the controversy and bringing it what we hope to be its final word,² we shall commence by establishing the statutory baseline, discuss some cases of recent vintage expositing various aspects of the issue in light of modern business, set out the more

recent lower courts decisions that were necessary precursors, and then finally move to and expand upon the juggernaut of the penultimate appellate trilogy that we contend is the last stand, and closes the “true lease” versus disguised security interest controversy. That said, let us begin.

UCC Provisions on the “True Lease” v. Security Interest Question

The natural starting point for this analysis is the text of the Uniform Commercial Code (the “UCC”) itself, for state commercial law determines whether a contractual agreement is to be characterized as either a lease or security agreement.³ We can be grateful that the close identity of the commercial codifications from state to state forestalls a quagmire of balkanization between the varying jurisdictions. This is attributed to the fact that the UCC has been adopted by all 50 states, and given the uniformity of purpose of the UCC, courts freely borrow relevant decisions from other jurisdictions.⁴ Indeed, one could say this is what puts the “Uniform” in the Uniform Commercial Code.

Moreover, it allows for an unprecedented migration of case precedents from one venue to another, as all these courts, the federal tribunals in particular, readily adopt and adapt the standards approved by their brethren across the land.⁵

As courts have consistently recognized, whether a “lease constitutes a security interest under the bankruptcy code will depend on whether it constitutes a security interest under applicable state or local law.”⁶ Here the opening definitions of the Code confront the issue head on. UCC section 1-201(37) holds that “[w]hether a transaction creates a lease or security interest is determined by the facts of each case.”⁷ Clearly, the UCC demands that every determination on this controversial matter be fact-specific.

The prevailing codification “shifts the focus away from the intent of the parties and toward the economic realities of the transaction.”⁸ The subjective intent of the parties has been soundly rejected as a determinant. “Reference to the intent of the parties led to unfortunate results” under the former UCC codification. “Accordingly, amended Section 1-201(37) deletes all references to the parties’ intent.”⁹ In sharp contradistinction, “the parties’ expectations and predictions are properly considered objective facts” that

reflect "the economic realities and context in which the agreement was made."¹⁰

This certainly explains the plethora of cases on this issue, given today's complicated financial transactions. Thus it is more than mere prelude; it determines the very substance of all that follows.

The statutory text first tackles the question in the affirmative and posits when a transaction is to be deemed a security interest. A transaction creates a security interest if the lessee's obligation to make payments cannot be terminated by the lessee during the agreement's term, and any one of the four additional factors applies.¹¹ The key element is that the erstwhile lessee has an unavoidable obligation to pay the supposed lessor for the possession and use of the asset, and this duty to pay extends over the life of the arrangement and cannot be terminated by the lessee.¹²

Interestingly, the UCC sets forth that first vital attribute, and then adds the quartet of other characteristics that must also be found if the transaction is to be deemed a security interest, and not a lease. The four items are: 1) the original term of the supposed lease is equal to or greater than the economic life of the asset; 2) the putative lessee must renew the lease for the remaining economic life of the property or is required to take ownership of it; 3) there is an option to renew for the remaining economic life of the asset, but no additional or only nominal consideration need be paid to exercise that option; or 4) the supposed lessee has an option to purchase the property for little or no additional consideration.¹³

Plainly, any and all of the above are indicia of true ownership by the lessee. A so-called "lease" whose original or extended term encompasses the entire economic life of an asset indicates ownership and therefore lacks intent to return the goods to the putative lessor. The lack of a requirement to pay any additional money or an insignificant amount of cash to extend a lease says much the same as to the true intent as the parties to create a security interest.

Finally, compelling the supposed lessee to eventually own the asset is the final straw; without question it demonstrates that the "lessor" has no real intention of retaking the asset. Thus a "fundamental inquiry is whether the purported lessor retained a reversionary interest in the property."¹⁴

Concluding that a particular deal is not a security interest solely in light of U.C.C. 1-201(37)(a)(1) to (4) does not end the inquiry.¹⁵ An examination of all relevant facts and circumstances must fol-

low to further decide if the arrangement might still be a disguised security interest and not a true lease under other determinants, none of which is solely decisive.¹⁶

Conversely, the Uniform Commercial Code goes on to declare when a security interest cannot be created out of what is truly a lease transaction. The Code enumerates these exclusionary characteristics, and the first of them is the situation where the present value of the consideration to be paid by the lessee to the lessor is substantially equal to or greater than the fair market value of the goods when the arrangement is entered into. A purchase option is not nominal if, at the time the option is granted, the price of the option's exercise represents the anticipated fair market value of the goods as projected for the option exercise date.¹⁷

Second, an assumption of risk by the lessee for the loss of the asset or an agreement to pay taxes, insurance, maintenance, or similar costs and fees does not by itself convert a true lease into a security interest.¹⁸

Third, an option to renew the lease or to purchase the asset at the end of the lease term does not by itself make the arrangement into something else. Notwithstanding the presence of a purchase option, an arrangement is still a lease when: 1) the lessee is not obligated to buy the asset; 2) rental payments are not applied to purchase price; and 3) the option price is fixed at the fair market value of the equipment.¹⁹

Fourth, a security interest is not created merely because the lessee has an option to renew for a fixed payment that is equal to or greater than the reasonably predictable fair market rent of the property. Finally, an option to own the asset for a fixed price that is equal to or greater than the fair market value of the property at the time the option is to be performed does not necessarily convert the lease into a secured transaction.²⁰

A final observation; the attributes listed in subsections (a) and (b) of UCC section 1-201(37) are set out in the disjunctive. The presence of any characteristic listed in the former will create a security interest where a lease may have been intended, while the mere presence of the provisions catalogued in the latter will not necessarily convert an intended lease into a security interest. Note well the required linkage for subsection (a) to transmogrify a lease into a security interest; one of the four characteristics must be found in conjunction with the putative lessee's unavoidable ob-

ligation to pay the possession and use for the agreement's full term without a right to terminate. That final conjunctive requirement makes it somewhat more difficult under the UCC to call a lease a security interest, as opposed to the reverse.

Putting the statute into perspective, a number of points become evident. Firstly, merely affixing a label to a transaction is not dispositive. Clearly, the UCC elevates substance over form, and a court is obligated to look at the merits of a transaction as opposed to mere titles imposed by the parties. This, of course, fits hand in hand with the statute's direction for a court to make its determination based upon the facts of each individual case. One must then proceed to an examination of a number of factors that, if found, would likely result in a determination that the transaction is a security interest disguised as a lease.

In counterpoise, we see listed a number of attributes that could very well be found in any plain vanilla lease transaction. Most likely for reason of the very commonality of these traits, the UCC warns that their mere presence does conclusively establish that the transaction creates a security interest and is not a lease. Courts must therefore balance these factors as well. This all being said, let us now turn to examine the various entries into the "true lease" versus security interest controversy, and see how they lead us to today's ultimate conclusions.

Being Different Matters: The Importance of Distinguishing Between "True Leases" and Disguised Security Interests

It has been said that the only things worth fighting over are the things that make a difference. That being true, little wonder then that parties constantly bicker over the actual characterization of a transaction as a "true lease" versus a disguised security interest. For in bankruptcy cases, among others, the answer to the above question significantly alters the outcomes among the interested parties.

One of the most worthy expositions of these divergent outcomes was given by Bankruptcy Judge Michael G. Williamson of the Middle District of Florida in *In re Grubbs Construction Co.*²¹ In fact, Judge Williamson's total analysis was so comprehensive, we shall return to it later in this article to cement some further points. But for now, we will focus on the singular point at hand.

Grubbs begins from strength, citing the hornbook work of the legendary Professors White and Summers for the proposition

that the “lease v. security interest” question is one of the most frequently litigated issues throughout the entire Uniform Commercial Code, a “fecund source of disputes,” unabated over the years.²² Equally emphatic are the innumerable judicial decisions that have labeled the controversy as “one of the most vexatious” and litigated matters in the nation’s courts, state as well as federal, and indeed with a chronology that even predates the enactment of the modern UCC.²³

The issue takes on heightened importance in bankruptcy cases, noted *Grubbs*, where it pits a trustee or debtor-in-possession arguing for a “disguised security interest” characterization against a financier or putative “lessor” determined to preserve the “true lease” status of its deal. Bankruptcy Judge Williamson turns to the venerable White and Summers to explain the many reasons why the warring factions are so persistent in their arguments.²⁴ To be sure, most of the reasons are obvious in bankruptcy cases, said the court.

The key, explains the *Grubbs* court, is that true lessors are treated far better in bankruptcy cases than holders of security interests.²⁵ Pursuant to Bankruptcy Code section 365,²⁶ a “true lease” must eventually be assumed or rejected.

Lease assumption promises a number of tangible benefits for the lessor; defaults must be cured, adequate assurance of future performance must be satisfactorily given, and the return to the status quo for the lease is promised.²⁷ In addition, and after a 60-day respite, lease payments accruing postpetition must be made,²⁸ and deficiencies in such postbankruptcy payments are bumped up to a much higher status of administrative claims, typically paid first in the bankruptcy repayment matrix.²⁹ In all, a bounty of good things to be harvested by the true lessor in a bankruptcy scenario.³⁰

Secured creditors certainly have their place as parties in a position of superiority in a bankruptcy context; after all, are they not miles ahead of unsecured creditors, let alone equity holders? While the above is beyond dispute, the sky is not completely cloudless. *Grubbs* tacitly notes the weaknesses in the secured creditor’s armor: defaults will not be cured; the secured claim can be reduced to the present fair market value of the underlying collateral,³¹ and, in a reorganization case, restructured payment terms can be unwillingly “crammed down” upon the dismayed security holder.³² Clearly, a notable distinction from the treatment accorded the true lessor.³³

But there is more. In bankruptcy cases, the trustee or debtor-in-possession holds certain statutory "strong arm" powers:³⁴ in sum, the ability to invalidate supposed security interests and relegate them to the lesser status of ordinary unsecured claims (this of course frees up previously secured, and hence untouchable, assets to be distributed to the larger body of all general creditors). A leaseholder is immune from such strong arm tactics. For a financing entity, classification of its "lease" as a disguised security interest exposes it to just such an attack upon the veracity of its proclaimed secured status.³⁵

Bankruptcy Judge Williamson exemplified other, major distinctions, particularly those that obtain in the context of a Chapter 11 case. In the matter of a reorganizing debtor, the struggling company is permitted to use the asset at issue, yet the holder of the secured claim against that asset is merely entitled to "adequate protection," a bankruptcy term of art and statute for a payment "fashioned to compensate for the decline in value of the collateral."³⁶ Should the asset be valued at less than the amount of the secured claim, postpetition interest does not accrue (hence a lost opportunity cost, among other things, for the creditor).³⁷

The *Grubbs* court found that this "advantageous treatment" afforded lessors as compared to secured creditors is "an obvious financial incentive for equipment financiers to structure their financing arrangements as leases, as opposed to security agreements." The resultant tension is evinced as financiers endeavor to coax agreements into a format of what is passably a true lease, efforts that, in turn, compel judges to interpret such documents based upon their actual economic substance, rather than pure form.³⁸

Lastly, the definitional provisions of the Bankruptcy Code themselves call for security agreements vis-à-vis leases to be defined according to actual circumstances on a case-by-case basis. Mere denomination of a particular deal as a so-called lease is not enough, the *Grubbs* court agreed; it is the true substance of the transaction that rules the day.³⁹

The above led the *Grubbs* court to make the following legal holding, which shall be the last such conclusion we draw from this case for this part of our analysis. Undeniably, the disparate treatment that the Bankruptcy Code affords true lessors and secured creditors drives such parties to be controversial in defending their avowed status in the courts of bankruptcy, which in turn

compels the bench to look beyond mere form and closely examine economic realities. This standard resonates in the UCC, Bankruptcy Judge Williamson found, noting that both past and more modern codifications of the uniform commercial statutes declare allegiance to an “economic realities” test when making this lease versus security interest distinction.⁴⁰

While we shall return to *Grubbs*' erudite discussions to draw additional teaching further on in our analysis, for the moment we conclude here, well satisfied that we have comprehensively set forth the “why” behind the “true lease” versus disguised security interest controversy. It is now time to examine some of the preliminary outcomes in this conflict.

THE FOUNDATION CASES

Rebel Rents

Our next case is entitled *In re Rebel Rents, Inc.*⁴¹ There Bankruptcy Judge Peter Carroll of California was presented with a rather convoluted set of transactions between the debtor Rebel Rents and asset-based lender Zions Credit. While not explicitly stated by the court, those familiar with the leasing industry would likely recognize the arrangements at issue as classic “sale/leaseback” deals.

At the end of November 2000, Zions purchased 55 construction vehicles from Rebel Rents for nearly \$4 million. After the sale was completed, Rebel Rents leased back the 55 construction vehicles for a term of three years under two separate leases. The monthly installments were approximately \$90,000 per month, totaling nearly \$3.5 million, obviously very close to the original sale price between the lender and the debtor.

In late September of 2002, Rebel Rents filed for Chapter 11 and listed the two leases with Zions in its bankruptcy petition as unexpired leases of personal property.⁴²

Notably, Rebel Rents made an unusual disclaimer, declaring that its cataloging of the purported leases with Zions was not to be construed as any admission or denial that these transactions constituted leases, executory contracts, or secured transactions. In an odd way, Rebel Rents drew attention to these very transactions, essentially setting the stage for the court battle that was to come.⁴³

Understandably, Zions was not at all pleased with this turn of events. It quickly moved in the bankruptcy court for an order compelling Rebel Rents to assume or reject the vehicle leases, demanded payment of postpetition lease payments as priority administrative expense claims, and related relief. More to the point, Zions alleged that it had not received debt service on either of the two leases for the past year and had not received regular monthly payments since Rebel Rents entered Chapter 11. Asserting that the debtor had no equity in the vehicles, and they were not necessary for an effective reorganization, Zions sought relief from the restrictions of the automatic stay of the Bankruptcy Code so it could repossess. In short, Zions employed the full panoply of rights available to it as a true lessor.

In opposing Zions, Rebel Rents now attacked the very leases themselves, claiming that they were not true leases, but were in fact disguised secured transactions. The debtor further disclosed that of the 50-odd vehicles, nearly half of them were sold in early 2002, and the sales proceeds were paid to Zions and deducted from the end of the leases. Rebel Rents furthermore contended that the remaining vehicles were necessary to its reorganization because its business operations were based in large part upon it subleasing the subject vehicles to others. It would be difficult, if not impossible, claimed the debtor, to obtain and finance replacement vehicles, and the resulting revenue shortfall would exceed \$1 million per year.

As an interesting and important procedural sidebar, Zions originally sought relief via motion practice in the bankruptcy court, pursuant to the provisions of Bankruptcy Rule 9014. By its very nature, and for good business reasons, motion practice in bankruptcy courts traditionally runs at an accelerated pace.

Then, however, Zions alleged that the opposition filed by Rebel Rents was actually an attempt to challenge the validity, priority, or extent of any security interest in the vehicles, which according to bankruptcy court procedure had to be brought in the context of an adversary proceeding. An adversary proceeding is a "mini-law-suit" in the bankruptcy court and generally takes longer to resolve than simple motion practice. This would have put the litigation on a more laborious track. Nevertheless, since Zions itself originally sought relief via motion practice, the court ruled that the controversy would continue to be heard in that expedited fashion.

Bankruptcy Judge Carroll noted that all the claims for relief before him turned upon “whether the transaction between Zions and the Debtor is a true lease or a disguised security transaction. The burden is upon the debtor to demonstrate by preponderance of the evidence” that the supposed leases were in fact disguised security agreements.⁴⁴ Clearly, such matters must be decided under the Uniform Commercial Code, as adopted by the State of Utah where the parties originated the transaction.⁴⁵

Seeking to carry its burden, Rebel Rents claimed that it entered into the agreement with Zions with the intent of financing the purchase of the vehicles and deliberately structured the agreement as a purported lease to avoid characterizing the transaction as a capital acquisition. Rebel Rents argued that Zions is a finance company, and not a true lessor. For evidence, the debtor pleaded that it was absolutely obligated to make the rental payments, bore all risk of loss or damage to the vehicles, had to pay all charges and taxes of a typical owner, was bound to pay all rent on an accelerated basis in the event of a default, and, lastly, had waived all implied warranties of fitness for a particular purpose.⁴⁶

Against these claims, Bankruptcy Judge Carroll turned to make his decision. He noted that the relevant Utah adoption of the Uniform Commercial Code was identical or substantially similar to the UCC codifications of other states, including Georgia, Pennsylvania, Idaho, and Illinois. Thus the *Rebel Rents* court was in good company in declaring first that the UCC requires any court inquiry be focused upon the economic realities of the transaction at issue, and not the subjective intent of the parties.⁴⁷

First closely examining subsection (a) of the UCC definition, the court held that the party claiming the creation of a security interest and not a true lease must establish that there is no right to voluntarily terminate the lease, and in addition there can be found one of the other four characteristics in the agreement between the parties. There was no language in the relevant leases that authorized an early termination of the lease by Rebel Rents, found the bankruptcy judge. The leases specifically stated that the obligation of Rebel Rents to make rental payments was unconditional and must be made without defense, offset, or counterclaim. There was no right to unilateral termination by the debtor, thereby meeting the first requirement that the parties had actually created a security interest.⁴⁸

But the court was not finished. None of the other provisions dispositive of a security interest was present in the relevant documentation, the judge found. The original lease periods were less than the economic life of the vehicles. The underlying documents did not require Rebel Rents to renew the lease for the remaining economic life of the assets or become owner of the vehicles upon expiration of the lease term.⁴⁹

In sharp contrast, the lease required at its end for the lessor to sell or otherwise dispose of the equipment. Implicitly, this called for return of the vehicles to Zions. Further, none of the leases contained an option to renew the lease or an option permitting Rebel Rents to purchase the vehicles for little or no additional consideration. The surrender provisions of the pertinent leases required Rebel Rents to return the equipment to Zions at their own cost and expense at a location to be specified by Zions, and in the same condition as they were first received, reasonable wear and tear excepted.⁵⁰

The lack of any of these factors militated against any finding that this lease was anything other than a true lease, found the court. *Rebel Rents* declared that "the economic reality of the situation is that the transaction provided debtor only with the use and possession of the vehicles which were at all times owned by Zions."⁵¹ The continuing ownership of the lessor was acknowledged, and Zions would have a significant residual interest in the property. At best, Rebel Rents could have only purchased the vehicles at the end of the lease term by paying fair market value.⁵²

For all these reasons, the court found that the debtor had not met its burden of demonstrating that the leases were disguised security interests, rather than true leases. The mere facts that Rebel Rents bore the risk of loss and had to pay taxes, maintenance, and insurance did not by themselves transform the leases into security agreements.⁵³

The issue being resolved in favor of Zions as a true lessor, the bankruptcy court moved on to address other aspects of Zions' rights. The court agreed with the debtor that its unexpired leases with Zions were important to its business and its eventual reorganization and thus would not permit the lessor to repossess.⁵⁴

Fashioning relief for the lessor, the bankruptcy court first ordered the debtor to make an expedited decision on whether it would assume or reject the leases. It furthermore required the debtor to make the regular monthly postpetition payments to Zions to safeguard the lessor's financial interest, and prohibited the debtor from

using the leased vehicles unless the postpetition payments were regularly and timely made. To be certain, all of the above relief flowed from the court's ultimate ruling that the transactions at issue were true leases and not disguised security interests.⁵⁵

Rebel Rents gathers interest mostly because of its unique, specialized facts, quite fitting since the law itself demands that one closely examine the particular facts of each and every situation to be decided in controversies such as these.

Notably, this case began with what appeared to be a routine sale/leaseback. If plainly executed, the transaction would have most likely lacked all subtlety.

Once the debtor/lessee entered Chapter 11, we began to see all the nuances of the underlying transactions. The apparent lessee had to labor under a number of requirements that might give the appearance of a disguised security interest.

While generally considered to be indicia of ownership, the mere presence of these factors without more is not conclusive. The bankruptcy court carefully took note of the countervailing facts, such as that the agreement was rather clear and unequivocal that the lessor had the right to retake and then sell or otherwise dispose of the equipment. Implicitly, the final requirement of the absolute return of the vehicles to the lessor erased all doubt that this was a true lease and not a disguised interest.

Rebel Rents tells us that every transaction in this arena is unique. Like snowflakes, no two leases are ever alike.⁵⁶

This of course explains the multiplicity of cases but in no way detracts from the principled decisionmaking that *Rebel Rents* exemplifies. Let us now turn to more of these cases that espouse such sound modes of reasoning on the "true lease" versus disguised security interest controversy.

APB

We now refer back to the earlier landmark of *In re APB Online, Inc.*,⁵⁷ from the bankruptcy court of New York's Southern District. The debtor was a web-based information services company, which ironically gained notoriety when it sought to disseminate financial disclosure forms filled out by federal judges. Like many dot coms, it succumbed to the hi-tech shakeout, and was forced to seek reorganization under Chapter 11 of the Bankruptcy Code.⁵⁸

As could be expected, its major physical assets consisted of computers and related telecom equipment. These assets were purportedly leased from Leasing Technologies, Inc. ("LTI"), under two separate agreements denominated as leases. Subsequent to the debtor utilizing the computers for two months into its bankruptcy, LTI moved to obtain payment for the lease's stated rent as a priority postpetition administrative claim. Both the debtor and the official creditors committee opposed the lessor's demand, arguing that the agreements were not "true leases," but instead were disguised security agreements.⁵⁹

If they prevailed, the lessor would be left without priority on the debtor's operating cash, instead having to rely on recovering its claim first from its collateral, like any other secured lender. Significantly, the parties stated their contrasting positions to the court on affidavits and asked the bench to make a decision on the papers alone, without live testimony. As we will see, that tactic created more problems than it solved.⁶⁰

Chief Bankruptcy Judge Stuart M. Bernstein first posited that the case before him "presents a familiar dispute"; the classic battle of true lease versus disguised security interest.⁶¹ Marshalling the initial facts, the court noted the purported leases each ran for three years, and the rent was a function of the purchase price and the prevailing prime rate. Early termination was out of the question; the opinion, quoting an unknown source, said the rent had to be paid come "hell or high water." At lease end, APB could: a) purchase the equipment for a little less than 15% of the purchase price; b) extend the leases for another year at 60% of the original monthly rate, and then purchase the equipment outright at the end of that fourth year for \$1; or c) finally, recondition the computers and peripherals, return it to LTI, and pay 5% of the original price as a remarketing charge.⁶² As is very true in lease versus secured interest disputes, the claims of competing parties almost always turn upon vital facts such as these.

Turning to the applicable law, Judge Bernstein commenced with the axiom that state law normally determines the extent of an interest in property, absent a compelling federal policy to the contrary.⁶³ Given the parties' agreement had a choice of law clause selecting Connecticut law, that state's statutory scheme would determine if the arrangement was a lease or created a security agreement. Notably, that jurisdiction places great emphasis on the

parties' intentions in answering the question, truly making it a case-by-case determination.⁶⁴ Furthermore, form must give way to substance, said the bankruptcy court, in adding that parameter to its necessary deliberations.⁶⁵

With common law as a starting point, Chief Judge Bernstein noted that a true lease transfers a property interest to the lessee, and said interest reverts to the lessor at the agreement's end. "[R]egardless of what the parties call their deal," its character will ultimately be shaped by how much of the remaining economic life of the asset is enjoyed by the putative lessee. As one erudite federal tribunal declared over two decades ago, an essential characteristic of a true lease is that it returns something of value to the lessor; if the term of the lease is substantially equal to the economic life of the property, then it is not a true lease, but a sale with a disguised security interest.⁶⁶

Next, the "true lease" versus disguised security interest conflict is resolved by the Uniform Commercial Code. Connecticut at the time employed the 1972 version of the UCC, which defined a "security interest" as, among other things, an agreement whereby the "lessee" will or may become the owner of the asset at the end of the "lease" for little or no additional money.⁶⁷ Courts have interpreted this clause to conclusively presume that the agreement is in fact a disguised security interest when the end of "lease" purchase option involves negligible consideration.⁶⁸

Accordingly, said the chief bankruptcy jurist, the first item to be scrutinized was whether or not the debtor's purchase option negated the transaction as a lease. The instant situation had an interesting wrinkle. As we have seen, APB had two options: buy the computers at the end of the original three-year term, or renew for another year and then purchase the assets for only a buck apiece at the end of the fourth year. This bankruptcy court implied that if we were indeed addressing the latter situation, then the UCC definition would conclusively demand that the transaction be deemed a disguised security interest because of the miniscule purchase price.⁶⁹

However, we are not at that juncture, noted Chief Judge Bernstein, since the debtor never had an opportunity to exercise the \$1 purchase option. APB and LTI were still within the original three-year term, so the more substantial purchase price would obtain.⁷⁰

Examining the buyout clause, the *APB* court applied various factors to determine if it was "nominal," and hence rendered the

deal not a lease. To be sure, a purchase term could be "sizeable yet still be nominal," said the court. Comparisons must be made between the purchase option price and fair market value at time of exercise, the property's original price, and the aggregate rent paid under the "lease."⁷¹ Courts have long preferred the first comparison, that to the fair market value, as the most reliable. To be sure, a further nuance is it matters not what the FMV is at the time of the exercise, but rather what the parties contemplated it would be at the time they entered into the deal.⁷²

Unfortunately, this court found the evidence put before it on this issue to be sketchy at best. While first indicating that, on its face, the consideration appeared to be substantial and thus saving the lease, the court expounded on a seemingly innovative theory. Judge Bernstein opined that if a purported lease "lack[ed] a meaningful choice, i.e., no rational person would decline to exercise the [purchase] option," this would indicate the price was nominal, and the agreement was not a true lease but a disguised security interest.⁷³ However, given the lack of solid data, this court could reach no decision, and moved on to other determinative legal points.⁷⁴

Now *APB* looked to the traditional "laundry list" for determining the "true lease" versus disguised security interest question, a set of nearly 20 factors that rely heavily upon the terms of the alleged lease. In brief, when the majority of these points place substantially all the burdens normally associated with ownership upon the purported "lessee," then the agreement is declared to be a disguised security interest accompanying an outright sale.⁷⁵

In the case at bar, the debtor had to pay all taxes, assumed all risk of loss, had to procure its own insurance, permitted the "lessor" to file UCC financing statements, and would be subject to acceleration of the "rent" if it defaulted. In sum, *APB* fell rather heavily on the disguised security interest side of the equation.⁷⁶

However, the court was still not convinced. It took note that while many of the above facts were indicative of an outright sale here, they were equally consistent with terms found in modern lease finance transactions.⁷⁷ Not to be put off by this quandary, the bankruptcy court continued looking at other factors.

Influential here was the fact that "extrinsic factors" pointed to a sale and not a lease.⁷⁸ *LTI* had tied its monthly "rent" to the prime rate, apparently to insure a good return on its investment. The debtor selected the equipment, and *LTI* financed it. "Finally, the

aggregate rent charged by LTI exceeded the purchase price of the Equipment, indicating a sale.”⁷⁹ Nevertheless, the court found this to merely be “some evidence” of a sale, but not conclusive enough for the bankruptcy judge to award LTI its claim.⁸⁰

Finally, the bankruptcy court was compelled to address a very creative argument put forth by the creditor. As aforementioned, the Connecticut law that controlled here was the state’s 1972 codification of the UCC. Nonetheless, a 1987 revision to the model code, made in connection with the promulgation of the then-new Article 2A, made certain changes pertinent to the true lease versus security interest issue.⁸¹

By deleting references to the parties’ subjective intent, the newer text moved to a more objective standard; moreover, it “eschews the laundry list of factors” previously mentioned, according to the *APB* court. LTI asserted that the court should apply the 1978 amendments, which, in its view, would lead the court to conclude it was a true lessor and not a secured creditor in disguise.⁸²

Alas for the creditor, the bankruptcy judge refused. While the 1987 revisions are effective in a majority of states, Connecticut has refused to adopt them in the over 10 years they have been available.⁸³ Most interesting, the court further opined that even the 1987 changes still have the same touchstone; the residual value of the asset is still highly significant in determining if the agreement is a true lease.⁸⁴

Apparently left unchanged, said Chief Judge Bernstein, is the maxim that the presence of residual value makes the deal a true lease, but its absence deems the transaction a security interest attached to a sale.⁸⁵ As before, this court found the evidence before it insufficient to determine what residual value, if any, existed. Absent that, it could not make a conclusion as to the transaction’s true nature, even if it were to apply the revised 1987 UCC text.⁸⁶

For all these reasons, the chief bankruptcy judge put aside LTI’s claim, refusing to reach any conclusions as to whether or not it held a true lease or a secured claim. Needing more facts to correctly apply the foregoing legal principles, the bankruptcy court judiciously set the matter down for a full-blown trial.⁸⁷

The *APB* decision brings us elements both old and new to our analysis. As to the former, New York’s chief bankruptcy judge rightly adhered to the traditional notions that state law controls, and, more importantly, it controls as it is written.

As to the latter, *APB* was progressive to note that some of the terms traditionally indicative of a disguised security interest are today equally valid in true lease finance arrangements. Moreover, this bankruptcy court placed emphasis on the "meaningful choice" test. Here the court posited the theory that if a lessee lacks any sensible alternative but to exercise a purchase option, the lack of choice is highly indicative that the deal was intended to be a sale and security interest. *APB* was a portent of things to come.

Integrated Health

At almost the same time *APB* was decided in New York, the equally prestigious federal bankruptcy court in Delaware weighed in with its decision in *In re Integrated Health Services, Inc.*,⁸⁸ a strikingly similar case, but with much different results.

In *Integrated Health*, the debtor and its numerous subsidiaries purchased and operated several health care facilities. A major bank creditor had loaned the debtor approximately \$53 million to finance these ventures, and enjoyed a claim to the rents from various intracompany leases. When the debtor entered into Chapter 11, the bulk of the principal was still due and owing.⁸⁹

The bank claimed an immediate right to payment of the rents due under the leases. The debtor countered that assertion with its own argument that the agreements were not true leases but were instead disguised financial arrangements. Significantly, if the debtor were proven right, the bank's claim to the "lease" payments would evaporate.⁹⁰

Addressing the controversy, Bankruptcy Judge Mary F. Walrath trod upon familiar ground. It is axiomatic, began the court, that substance and not mere form determines if a transaction is a true lease or a disguised security interest.⁹¹ Moreover, as the challenge to the status of the deal, the debtor bore the "substantial" burden of proof to show the purported leases were not leases at all.⁹²

Of critical note was the fact that the opposing sides also took contrary views of what law applied. The debtor urged the bankruptcy court to apply federal law, primarily that of an economic substance test in examining the alleged leases.⁹³ In contradistinction, the bank asserted that state law controls in determining if a transaction is a mere security interest or a true lease.⁹⁴ To be sure, which state law would be Texas, since a clause in the documents selected the laws of that jurisdiction.⁹⁵

Interestingly, Judge Walrath noted that her controlling tribunal, the federal Third Circuit Court of Appeals, had suggested, but not yet then decided, that state law governs in disputes such as this.⁹⁶ More to the point, “it is immaterial which law is applied because the difference between the two tests is not significant here,” declared the court.⁹⁷ Essentially, a court’s adjudication must still turn upon the three traditional factors: one, the presence of a “lease” end purchase option and if its price is substantial or negligible; two, whether the total “rent” payments have a present value equal or greater to the asset’s original cost; and three, does the “lease” term cover all or most of the useful life of the asset? While the court mentioned other factors valuable to this analysis, its discussion placed the greatest stress on the three aforementioned.⁹⁸

In the case at bar, the application of the three most significant tests “clearly support[s] the conclusion that the agreements are true leases,” found Judge Walrath.⁹⁹ Significantly, the relevant agreements utterly lacked a purchase option.¹⁰⁰ They were for one-year terms only, with renewals to be only for a single year, and the sum of the lease payments did not equate the original cost for the underlying assets.¹⁰¹ Probably most telling, the one-year lease terms did not even begin to reach the useful economic lifespan of these long-term assets.¹⁰² Comparing the instant matter to other situations where very lengthy lease terms of 50 or 99 years led courts to declare them to be disguised security interests, the short lease duration and one year at a time renewal options here stood out in sharp contrast.¹⁰³

In addition, the Delaware bankruptcy court had the benefit of more complete evidence on the record. This included convincing testimony that the value of the periodic payments was not calculated to equal the cost of the facilities, but rather to prevailing lease rates.¹⁰⁴ This effectively countered the debtor’s claim that as a “triple net lease,” the transaction was really a disguised security interest because the debtor assumed all the attributes of ownership. Not so, said Judge Walrath, as triple net terms are not unusual, even in a true lease.¹⁰⁵ Lastly, the debtor’s witnesses were not convincing on its claim that a sale and secured interest was the intent here, supposedly to obtain certain tax advantages for the debtor as a putative buyer.¹⁰⁶

Evaluating all the above factors, the Delaware bankruptcy court concluded that the debtor did not overcome “the strong presump-

tion" that these arrangements were in fact true leases and not disguised security interests.¹⁰⁷ The judge therefore ordered the lease payments to be made to the bank.¹⁰⁸

Integrated soundly reaffirmed the notions of traditional lease versus security interest analysis. Significantly, it continued the reliability of state law as controlling in these matters. *Integrated* also reinforced fundamental rules, such as that the burden of proof lies firmly upon the party who claims the transaction is something other than it purports to be, that substance always prevails over form, and that paramount consideration will be given to the economic substance of the arrangement. To be certain, more stones in the foundation for the decisions of present day yet to come, and so we now advance our analysis to today.

Grubbs Revisited: Getting Back on TRAC and Other Issues

At an earlier point in this article we called upon the thoughtful analysis of Bankruptcy Judge Williamson in *In re Grubbs Construction Co.*¹⁰⁹ to exemplify some of the "why" behind the instant controversy of true lease versus disguised security interest. As promised, we now return to that plentiful discussion, for its contextual analysis of the unique transaction before that court is particularly helpful to our analysis.

The dramatis personi before the court were the reorganizing debtor, Grubbs, and Banc One Leasing Corporation, the putative lessor of certain equipment to the troubled company. From the very outset, the bankruptcy court not only characterized the case at bar as the quintessential "true lease v. disguised security interest" confrontation, but further noted that the many cases rooted in this controversy enjoyed a "common thread" of a "fact-intensive analysis" to determine the economic truth behind these individual deals. Bankruptcy Judge Williamson immediately declared his intention to pursue the same tact in the case at bar.¹¹⁰

The purported lease before the court and its terms bear close analysis, and that was the bench's first task. To be sure, the bankruptcy judge noted that there was but one overriding document, encapsulated the Master Lease Agreement; yet for all its grandiose title, it was but a mere shell of generalities. In reality, the true substance of the deal in question could be found in no less than five Lease Schedules, wherein the specific terms of the purported leases could be found.

Grubbs summarized the key ingredients common to all the relevant schedules. The debtor was unconditionally liable for all rent payments, even if the “leased” equipment malfunctioned, it bore all risk of loss, was obligated to insure the assets, and had sole responsibility for repairs, maintenance, and delivery from the third party vendors from whom the equipment was actually acquired. Moreover, the putative lessee had to guarantee to Banc One certain tax benefits the latter was anticipating, and so-called lessor was also the beneficiary of an indemnity clause whereby the debtor promised to compensate the bank for losses of any kind that it might sustain as part of this transaction.¹¹¹ Yet these were still the generalities; now the court turned to the specifics of each of the five deals.

Four of the five underlying “leases” were labeled “EBOs” by the *Grubbs* court, the acronym standing for “Early Buyout Options,” certainly a self-explanatory term. The possibilities offered to the debtor by the EBOs were quite revealing. There were three alternatives, to be precise. Bankruptcy Judge Williamson categorized them as follows.

Option one provided that, five and one half years into a six-year “lease,” *Grubbs* could buy the equipment for approximately one-third of its original cost. In hard numbers, that translated into spending a total of over \$637,000 to purchase an asset originally costing \$525,000. While left unsaid by the court, it was painfully obvious that the total was comprised of the original cost, plus an effective interest charge. And while the court ventures no actual opinion, it took clear note of the evidence, in the form of the testimony of the debtor’s chief financial officer that he measured and then approved this deal over others because the not-so-hidden interest rate was competitive with the company’s other financing choices.¹¹²

The second option for *Grubbs* was, at the expiration of the six-year “lease” term, to purchase the asset for 25% of a so-called “minimum value.” Again, the calculations were most enlightening. Under EBO Option two, the debtor would spend almost \$650,000 to own an asset with, once again, a \$525,000 original cost. Bankruptcy Judge Williamson sharply pointed out the second option was worst than the first possibility.¹¹³

Option third and last: *Grubbs* could renew for 14 months. But at that point, observed the court, *Grubbs* would have paid almost \$660,000, the highest amount under any of these three options, and

would still be forced to return the asset at the end of that renewal period. Better yet, the debtor was required to return the item extensively refurbished, significantly adding to the overall expense. Judge Williamson was plain; this was "a very unattractive proposition from Grubbs' perspective financially and one which Grubbs' financial officer did not contemplate ever occurring."¹¹⁴

In words that were to ring out later in the decision, the *Grubbs* court declared that the debtor had little choice in these matters, the outcome was predetermined by the very terms of the deal, "that sensible economics dictate" the debtor exercise the first, early buyout option, something the company's CFO clearly testified to.

Indeed, the bench did not limit its analysis to the consequences for the debtor by exercising its only sensible economic option.¹¹⁵ Bankruptcy Judge Williamson stated, "[i]t is also clear that under all three alternatives, Banc One will receive back its principal plus interest," and there was zero evidence that the lender "ever had an expectation of actually receiving the Equipment back at the end of the Lease" to lease it out again to other lessees.¹¹⁶ These findings were to resonate again in the opinion.

The court now turned to the fifth and final lease between these antagonists, an arrangement called a "TRAC" lease, standing for "Terminal Rental Adjustment Clause." Judge Williamson's detailed analysis can be easily summarized.

Given that the TRAC lease called for a balloon payment at lease-end equal to 20% of the original amount borrowed to finance the acquisition of the underlying asset, the *Grubbs* court declared that the economic substance of the TRAC deal was "no different from a typical installment loan." The key economic ingredients were identical, said the court: an acquisition financed by a loan, the loan repaid over a set term, and, most of all, the balloon payment to conclude the transaction.¹¹⁷

And so the *Grubbs* court ended its recital of the facts.¹¹⁸ Indeed, Bankruptcy Judge Williamson made his ultimate conclusions quite plain, declaring that these purported leases "are structured to insure a return of full principal and interest to Banc One" without regard for any intervening circumstance. Under the various options, the one consistent element was that it was never a reasonable expectation that the assets would ever be returned to the lender.

As for the predominant four leases, the economic sensibilities dictated that Grubbs would exercise the first and best buyout op-

tion and then own the equipment, and for the final lease, the TRAC deal, the item would be sold off to an unrelated third party, with the debtor liable for any shortfall the bank suffered on its principal and implicit cost of funds. Again, a common characteristic was the obvious expectation that the lender would never retain the assets for purposes of subsequent leases to new parties. “Under all these scenarios,” the *Grubbs* court soundly declared, “Banc One gets paid its principal and interest.”¹¹⁹ This was to prove decisive, as we shall soon see.

As noted earlier in this Article, Judge Williamson provided a pithy analysis of why the “true lease” versus disguised security interest controversy exists, placing in exquisite counterpoise who gains and who suffers by such determinations before a bankruptcy tribunal.¹²⁰ Proceeding from this backdrop, the *Grubbs* court gave further insight as to how we have arrived at the current state of affairs on this matter.

Grubbs makes the simple point that some leases require almost no analysis, and gave as a straightforward example the short-term automobile rental. Without question, the brief duration, the fact that the renter never acquires equity in the vehicle, and finally the rapid turnaround in renting the same vehicle to another squashes any notion that this is anything other than a true lease. Yet standing in sharp contradistinction are the lengths that sophisticated parties now go to in modern times to cast their transactions as leases and not disguised financing arrangements.

Gone are the “simple older cases” of \$1 purchase options or similarly blatant demonstrations of zero residual value. “The drafting of leases has evolved over the years,” noted Bankruptcy Judge Williamson, metamorphosing into “more artfully drafted leases—where a court must dig below carefully crafted language to determine the economic realities of a transaction.”¹²¹ The years of controversy over the “true lease” v. disguised security interest have engendered a vast body of accumulated knowledge and skill held by those that practice in the field, who in turn have employed that experience to craft ever more sophisticated and detailed documentation, sometimes even directing those writings to obscure the true nature of the underlying deal.

The *Grubbs* court sounded a powerful cautionary note here, warning that mere titles of “lease,” “lessor,” or “lessee” might purposely be used to misdirect a tribunal from the parties’ real in-

tentions. As a direct consequence, courts must exercise their own judgment and make their own independent analysis when such transactions are under their review.¹²²

Compelled by his own logic, Bankruptcy Judge Williamson firmly declared the following "basic proposition:" the determination of a true lease v. a disguised security interest must be conducted *sui generis*, and furthermore substance, never form, shall control, when analyzing such arrangements.¹²³

This analysis is aided in no small part by the statutory backing of U.C.C. § 1-201(37)(2), which provides a *per se* test for declaring a transaction with certain attributes to always be a security agreement, and not a true lease. In sum, found the court, the multiple prongs of this *per se* mandate all relate to the residual value of the alleged leasehold.

The instances enumerated by the statute "contemplate that at the end of the lease, the lessor will be paid in full the amounts advanced to purchase the personal property and will thereafter have no anticipation of any remaining investment return from the leased property having received full payment of the financed purchase price." Expressed another way, said Bankruptcy Judge Williamson, should the asset have no economic value at the end of the purported lease or the supposedly lessee can purchase the item for a zero or nominal price, the deal must be deemed a security interest, and not a true lease.¹²⁴ Once again, if the foregoing parameters are met, then by statutory fiat the deal in controversy must be declared a *per se* security interest.

Yet the inquiry does not end there, noted Judge Williamson, implying that *per se* standards are usually the hardest to meet. *Grubbs* continues down the trail, positing the "what if" should the *per se* test not be met. If so, then "it is necessary to examine all facts to determine whether the economic realities of a particular transaction nevertheless create a security interest," and, moreover, to examine the individual case at hand upon its own merits.¹²⁵

Now *Grubbs* made what could prove to be its most precedent-worthy declaration. "The central feature of a true lease is the reservation of an economically meaningful interest to the lessor at the end of the lease term."¹²⁶ Bankruptcy Judge Williamson found that this was evidenced by two things: a) from the outset of the deal all parties share an expectation that the asset will have "significant" residual value to the putative lessor; and b) the lessor

“retains some entrepreneurial stake (either the possibility of gain or the risk of loss) in the value of the goods at the end of the lease term.”¹²⁷ Indeed, one might observe these are truly two sides to the same coin, to wit, an expectation of a remaining value, and the reality of that value, which of course is at risk, as with all things in business.

Again harking to the statutory baseline, *Grubbs* utilizes the proviso merely as ancillary support for its common sense notion that, failing any per se test, logic and equity demand a thorough examination of the economic truth behind any deal under question.¹²⁸ And now in another bold landmark-making step, the mid-Florida bankruptcy court declares this to be the “Economic Realities Test,” requiring “an analysis of all terms and conditions of a purported lease transaction to determine whether the lessee has no sensible alternative other than to exercise the purchase option.”¹²⁹ To be sure, Bankruptcy Judge Williamson acknowledged that other jurists have called this same standard the “sensible person test,” as it provides that when exercise of purchase option at lease-end if the only sensible course for a putative lessee, and it thereby becomes the actual owner of the asset, then the so-called lease was always intended to create a security interest.¹³⁰

Whether entitled the “sensible person” or by the more erudite moniker of the Economic Realities Test, *Grubbs* reiterates that the benchmark calls for a case by case analysis of all relevant facts and circumstances pertaining to the arrangement. Significantly, the anticipations of the parties are to be measured “at contract inception, rather than at the time the [purchase] option arises.”¹³¹

More often than not, such inquiries return us to the seminal question of what constitutes “nominal” as for the price of the exercise of a lease-end purchase option? Yet Bankruptcy Judge Williamson was careful to note that “nominal” is a relative number, and not necessarily a figure that is closest to zero. Referencing a similar controversy before the legendary Bankruptcy Judge Alexander Paskay, the *Grubbs* bench pointed out the a lease-end purchase option of over \$44 million, certainly “real money” as one would say, was in truth nominal when compared to the alternative of the putative lessee to pay \$91 million over the next five years if it failed to spend less than half that number today.¹³²

Here, *Grubbs* bestows one of its better cautionary tales; a option can cost many millions in actual dollars, but it can still be nominal in the overall scheme of the transaction at issue. In other words, context is everything.¹³³

Obviously, the foregoing analysis in *Grubbs* was directed in the main to the four purported leases that held the early buyout clauses. It is beyond argument that the amounts of those EBOs had to be gauged against the standard for what constitutes "nominal." But Judge Williamson did not ignore the fifth deal, the so-called TRAC lease.

Shifting gears ever so slightly, *Grubbs* found most revealing the termination and asset return sections of the TRAC deal. Quite notable therein, found the court, was the stipulation that Banc One would immediately sell off the asset to a third party, and credit any sums received against the debtor's obligation to make the multi-million balloon payment, including, quite distinctly, the return of any surplus to *Grubbs*.

Of equal, if not greater, import was the requirement that the debtor make the financier whole on any deficiency after the return and sale of the asset. "This provision," held the court, "recognizes the creation of an equity or pecuniary interest in the lessee." And that creation, *Grubbs* now ruled, per se creates an undeniable security interest as a matter of law, and thereby denies any possibility that the deal can be recognized as a true lease.¹³⁴

Specifically as to the newfangled TRAC leases (also commonly referred to as "open end" leases, because they lack a purchase option), the *Grubbs* court joined its brethren that, with regard to TRAC leases, this creation of an equity interest to be held by the debtor is often times the pivotal issue in characterizing the subject deal as a disguised security agreement and not a true lease.¹³⁵ As a coda to the above, Judge Williamson finally noted that the mere return of the asset, as a TRAC-type lease so consistently requires, "does not negate the possibility of the agreement being a security agreement."¹³⁶ The absence of a purchase option shall not be dispositive, held the court, if the economic realities otherwise reveal the arrangement to truly be a security interest.¹³⁷

Finally, *Grubbs* held that "the totality of the rights and responsibilities of the parties to the transaction are still relevant in con-

sidering the economic realities of the transaction.”¹³⁸ In sum, the court consistently and unremittingly adhered to an examination eschewing form over substance, directed at economic realities, and placing all those realities in the proper perspective for the circumstances at hand.¹³⁹

Now applying all that wisdom to the case at hand, Bankruptcy Judge Williamson’s ultimate conclusions were unavoidable. Firstly, not only did the court have a wealth of facts (as detailed herein, above), said facts were without material dispute. Cataloguing those revelations, the bench enumerated nearly 20 items. The common thread running through each of these numerous factoids pointed again and again to the debtor’s far ranging responsibilities and liabilities akin to an owner financing an acquisition, as contrasted to a mere lessee of property not its own.

The end result was therefore easily reached. The economic realities of the transaction between Grubbs and Banc One compelled the “proper characterization” of the deal as a security agreement in disguise, and not a true lease.¹⁴⁰

So there we have *Grubbs*, a quite modern dissertation on one of the more up-to-date innovations in leasing, the so-called TRAC lease. Therefore, this Florida bankruptcy case not only stands as a pithy analysis of that current development, but as an exemplar of the federal courts’ ability to adapt the standing precedents on the “true lease” versus disguised security interest controversy to whatever new financing vehicles evolve from modern commerce.

Grubbs also remains steadfast in advocating the better reasoned perspectives of substance over form, of case by case analysis, and of giving paramountcy to the economic realities of any arrangement when determining if it is a true lease or not.

At this time, the table is now set. We have the statutes, their distinct purposes, and the plethora of earlier, lower court cases heard on this issue. We can now move with confidence to the most recent, and highest appellate court decisions that rule over this domain. Indeed, the power of this new trilogy is such, it might well end the controversy of the “true lease” versus disguised security interest in its entirety. To this triumvirate of decisions and the tribunal that issued them, we now turn.

THE UNITED TRILOGY

United I—The Saga Begins

The zenith of jurisprudence on the “true lease” versus disguised security interest controversy may have been reached in three recent Seventh Circuit decisions, all interlocked and arising out of the ill-starred insolvency of United Airlines. The first of this triad is encapsulated *United Airlines, Inc. v. HSBC Bank USA, N.A.*¹⁴¹ Not only must we examine the initial decision first, to do it justice we must commence with the very first words of the insightful opinion.

“What is a ‘lease’ in federal bankruptcy law?” Circuit Judge Frank Easterbrook opens *United I* in his famously direct style, posing the fundamental question that lies at the heart of years of controversy. Next, and characteristic of his philosophy of wedding law and economics in such weighty decisions, he pours out the concrete foundation of the realistic business transactions that preceded the legal controversy before the panel.¹⁴²

“Businesses that do not pay up front for assets may acquire them via unsecured debt, secure debt, or lease,” said the court, setting forth an age-old truism that undergirds what is to come. The common thread is that the expanding business pays over time, leading the tribunal to observe that the similarity of economic function implicates the creation of “leases that work like security agreements, and secured loans that work like leases.” Yet in contradistinction, the modern Bankruptcy Code separates these devices, and accords them distinct and disparate treatment.¹⁴³

Summarizing the Code’s effect, Circuit Judge Easterbrook describes the true lessee’s duty to assume or reject the lease, while a debtor on secured property may retain the property without paying the full-agreed price.¹⁴⁴

Turning to the case at hand, the Seventh Circuit revealed that now before it were actually four controversies, each inextricably linked by the same narrow legal issue. The facts tell us that in the 1990s United entered into “complex transactions” to improve its facilities at four key airports—New York’s JFK, Denver, Los Angeles, and San Francisco.¹⁴⁵ In each instance, a public agency issued bonds that, given the municipal status of the issuer, paid interest free of federal taxation. The funds so raised went to the airline, in return for a promise to repay and cover certain other costs. As part of the deal at each airport, United entered into a leasehold

for operational facilities, with the caveat that the carrier would be evicted if it failed to pay its debts to the respective agencies.¹⁴⁶

In an interesting twist, when United filed for Chapter 11 reorganization, it declared that each one of these quartets of arrangements was not a lease, but a security interest, to be so treated under the Code. As a direct consequence, United proposed to stay in place at each airport facility, while paying only a fraction of the stipulated “rent.”¹⁴⁷

Referring to the decisions below, the circuit court noted that Chief Bankruptcy Judge Eugene Wedoff, the prime overseer of United’s Chapter 11, had opined that the word “lease” was left undefined in federal bankruptcy law, but he had forged ahead to declare that substance ruled over form in divining the true nature of these transactions. And so the bankruptcy court held the arrangement for the Denver airport was a true lease, but the other three were merely disguised security interests. Circuit Judge Easterbrook aptly described what happened next; “Everyone appealed.”¹⁴⁸

The Seventh Circuit then related what transpired before District Judge John W. Darrah. The district bench declared that every one of the four deals was a true lease.¹⁴⁹ Notably, District Judge Darrah first concluded state law controlled the distinction between true lease and disguised security interest, and then applied the respective laws of California, Colorado, and New York.¹⁵⁰

Before the tribunal was the San Francisco controversy alone; the other three were held in abeyance pending its brethren’s outcome, although a flurry of amicus curia briefs were filed, and understandably so. To be clear, at this juncture the Seventh Circuit confined its attention to the San Francisco transaction only.¹⁵¹

Examining the events in the City by the Bay, Judge Easterbrook catalogued the key components of the deal. For over 30 years, United had leased 128 acres of San Francisco International Airport (“SFI”) to use as a maintenance base. Rent was determined by an independent consultant’s estimate of the property’s fair market value. In 1997, with at least 15 years left on the lease, the California Statewide Communities Development Authority (the “CSC-DA”), to be sure, a public agency,¹⁵² issued some \$155 million in bonds, with United receiving the proceeds of the bond issue, slated for use to improve (ironically enough) United’s other facilities at SFI, but not the maintenance facility.¹⁵³

The panel ticked off the four documents that memorialized the transaction. The first was a sublease of 20 of the aforementioned 128 leased acres, the sublease running from the airline to the CSCDA for 36 years. Circuit Judge Easterbrook clearly found it interesting that the sublease term did not match the overall lease; rather, its length matched the debt repayment schedule for the retirement of the bonds. And the CSCDA's total rent to United for 20 acres at San Francisco's sprawling international airport? One dollar. Implicitly, the tribunal was intrigued by these curious terms.¹⁵⁴

Second was the leaseback of the same 20 acres to United by the public agency. The rental amount of the leaseback was worthy of detailed examination. The airline's "rent" equaled the interest due on the CSCDA's bond issue, plus administrative fees. The lease required a \$155 million balloon payment in 2033 to retire the bonds (recall the bond issue was in the exact same amount). United could also postpone the final payment; if it did, the leasehold would be automatically extended. Conversely, if the airline prepaid, the intertwined sublease and leaseback would automatically terminate.¹⁵⁵

There is even more; the CSCDA had the right to evict United from the 20 acres as a penalty for nonpayment. Finally, the sublease included a "hell or high water" clause.¹⁵⁶ The airline had to pay the rent even if the leaseback ended early, some physical or legal event deprived the carrier from the use or economic benefit of the maintenance base or if "the property is submerged in an earthquake" (a prudent precaution since the airport abuts San Francisco Bay, and the geologic tendencies of Northern California are well known).¹⁵⁷

The fourth and last document was the trust indenture, which echoed the procedures already discussed for the public authority to issue the bonds and turn over the \$155 million in proceeds to United, and for the HSBC to distribute the future repayments to the bondholders, among other things.¹⁵⁸

"That the sublease and leaseback have the form of 'leases' is unquestioned," said the court. "But does [section] 365 use form, or substance, to distinguish 'leases' from secured credit?" asked Circuit Judge Easterbrook. The eminent jurist replied to his own question thusly; "Although the statute does not answer the question in so many words," the federal appellate courts are unanimous

in agreeing “substance controls and that only an ‘true lease’ counts as a ‘lease’ under [section] 365.”¹⁵⁹

Declaring that the term “true lease” is “no more self-defining than the bare word ‘lease,’” Circuit Judge Easterbrook promised to return to the former’s true import, but now it was time for the Seventh Circuit to explain why it was joining the unified ranks of its sister circuits. And to do so, this tribunal had to set out some rules of decision to better explain the process.¹⁶⁰

First, federal law determines whether the word “lease” in a federal statute (here, primarily Bankruptcy Code section 365) “has a formal or a substantive connotation...; it could not be otherwise.”¹⁶¹

It is axiomatic that the Bankruptcy Code “specifies different consequences for leases and secured loans,” akin to the differentiation between mergers and asset sales in corporate law, Judge Easterbrook pointed out. Yet, the erudite jurist cautioned here, reminding that the word lease is nothing more than a label. In a simplified example, the panel observed how transitions between an documented installment sale, secured loan or a lease could be made “with only a few changes in verbiage and none in substance.” The Seventh Circuit concluded that it was unlikely that the Bankruptcy Code advocates material economic consequences to pivot on the parties’ mere “choice of language rather than the substance of their transaction.” If that were true, why would the nation’s insolvency law even bother to distinguish specific transactions “if these distinctions can be obliterated at the drafters’ will?”¹⁶²

Again exemplifying the Seventh Circuit’s penchant for straightforward business analysis in the context of legal adjudication, Circuit Judge Easterbrook brought attention to the fact that many Bankruptcy Code provisos, “particularly those that deal with the treatment of secured credit, are designed to distinguish financial from economic distress.” In a pithy summation destined to shape legal and business thinking for years to come, the circuit court characterized the former as a situation where a business concern cannot pay its bills as they came due, but does have positive cash flow from current operations. Such ills are indicative of carrying too much debt, “which can be written down;” precisely what Chapter 11 is all about!

In stark counterpoise, economic distress connotes negative cash flow, and liquidation beckons as probably the best option.¹⁶³ And to tell the two scenarios apart, the Bankruptcy Code effectively

divides the troubled entity into two distinct entities as of the date of the bankruptcy filing; one, a new firm (the notorious debtor-in-possession or "DIP"), "unburdened by the debts of its predecessor," but which in turn "must cover all new expenses; and two, the prebankruptcy entity, destined to reconcile the "old debt" tied to its former, failed operations.¹⁶⁴

Relevant here, found the tribunal, is section 365 of the Bankruptcy Code, which addresses the treatment of leases in bankruptcy cases. As case in point here, the statute classifies payments for retaining airplanes and occupying business premises as new expenses, just like payments for labor and jet fuel. "The rules for credit, by contrast, treat debt service as an 'old' expense to be adjusted to deal with financial distress."¹⁶⁵ That the Seventh Circuit chose to utilize actual elements of United's own business operations to exemplify these concepts should not be mistaken for anything other than intentional.

Continuing a discussion heavily laden by economic thought, the panel ventured that "[t]his works nicely when rent under a lease really does pay for new inputs;" monthly aircraft lease payments guarantee another month's use of a performing asset, just as payments for fuel keep that same aircraft aloft. In sharp contrast, so-called "rent" that services loans used to acquire capital assets or past operations qualifies as debt, and to apply section 365's assumption regimen to the transaction underlying that obligation "would permit financial distress from past operations to shut down a firm that has a positive cash flow from current operations."¹⁶⁶

The appellate court posited this hypothetical: the lease of an airplane with a 20-year economic life, but providing zero rent payments for the first 10 years, but more than double the normal rent for the last 10 years of the deal. If the aircraft owner files for bankruptcy, its financial and economic distress would have to be segregated. That would necessitate stripping out the loan, i.e., "old debt" components of the deal from the current consumption components. Only in this way could the financial versus economic distress benchmarks be measured, in order to restructure the elements that caused the latter, while paying the obligations that comprised the former's costs.

The Seventh Circuit declared that this differentiation was not new when Congress promulgated the modern Code in 1978. Tracking the evolution of the legal system's rules for "disentangling"

the credit and consumption components of leases, the court found that since 1939 “this has been routine in tax law.”¹⁶⁷

Of course, “[d]uring the 1940s and 1950s much state law on the subject was summed up and codified in the Uniform Commercial Code.” The UCC separates credit components, in which the asset serves as security, from consumption components in various ways, noted the panel, including case by case factual determinations on matters such as a purchase option at “lease” end, and a zero or nominal consideration to be paid for the purported “lessee” to retain the asset.

Circuit Judge Easterbrook then made what is sure to be one of the most profound yet succinct determinations on this entire controversy, when he opined:

A lease in which the consumption component dominates often is called a “true lease,” while one in which the asset serves as security for an extension of credit is treated at a security agreement governed by the UCC’s Article 9.¹⁶⁸

With that powerful declaration made, and in view of the history supporting it, the Seventh Circuit went on to make an equally forceful holding, as follows.

Judge Easterbrook pronounced that “[n]o legally sophisticated person writing in 1978,” in other words, the drafters of the modern Code, meant to exalt mere form over substance in characterizing an alleged lease, not when the bankruptcy law itself distinguishes between current consumption as implicitly a true lease and secured debt as an entirely different financing device. Moreover, the need to look beyond form to actual substance is apparent from both the insolvency codification and “the fact that many of the leased assets would be covered directly by the UCC.”¹⁶⁹ The only sensible reading of section 365, opined Circuit Judge Easterbrook, is to deem it as referring to substance throughout its provisions. “Nothing else respects both the structure of the Bankruptcy Code and the way the legal community understood the distinction between leases and security agreements in the 1970s.”¹⁷⁰

The tribunal now paused to address the pertinent legislative history, a necessity because of the emphasis placed upon that text by the parties in the instant controversy. As before, the Seventh Circuit found without hesitation that the drafters of section 365 always intended that substance trump form in the law’s application.

Among the textual references called upon by the appellate court, there was the explicit insistence upon examining economic substance, to review matters on a case-by-case basis, the consideration of an option to purchase for little or no additional consideration, and finally who assumes or retains the risks of ownership.¹⁷¹

"This passage is interesting," noted the panel, "because it illustrates how the legal community thought in 1978 about the rules of form versus substance in dealing with a word such as 'lease.'"¹⁷² To be sure, the Seventh Circuit stipulated it would be a mistake to extract rules of decision from mere legislative background,¹⁷³ "but it does show that Congress shared the legal community's understanding that some transactions with the form of a lease are best treated as security agreements."¹⁷⁴

However, the Seventh Circuit revealed there was more required for this analysis than a pejorative "substance over form" talisman. Such a facile label does not resolve all the details, nor does it even imply that federal law supplies those details. The question to be asked, posited Circuit Judge Easterbrook, is "[w]hich aspects of substance matter?" The legislative history does not provide an answer in this instance, as the confining language of the lawmakers' reports is not legally binding.¹⁷⁵ In a brusque aside, Judge Easterbrook cast the legislative document more as "a reminder to be sensible rather than a formulary."¹⁷⁶

Given that the federal insolvency code does not state which economic features of a transaction have what consequences in this context, the Seventh Circuit properly turned to state law, and with good reason. "All of the states have devoted substantial efforts to differentiating leases from secured credit in commercial and banking law."¹⁷⁷ After all, "[l]eases are state-law instruments," the panel reminds, and the Bankruptcy Code has long relied upon state law to divine property rights.¹⁷⁸

In contrast, continued the appeals court, any state law that exalted form over substance in determining what is a true lease would run counter to the Bankruptcy Code "because it would disrupt the federal system of separating financial from economic distress," whereas state law that gives varying weight to substantial factors is congruent with the federal mode of law.¹⁷⁹

Turning to California law, given the San Francisco situs of the lease in controversy, the Seventh Circuit found that state's law eschews a mechanical conclusion based upon mere labels chosen by

the parties. The tribunal in fact rejected the district court's holding below that form controls unless there is compelling evidence to support a more substance-based analysis. "Burden of proof and persuasion are supplied by the forum, not by the source of substantive law," and bankruptcy law employs a preponderance standard, said Circuit Judge Easterbrook.¹⁸⁰ "Anyway, burdens of persuasion are irrelevant to characterization of documentary transactions."¹⁸¹

The panel then noted that the parties before it sought to find California's law in the jurisprudence of bankruptcy judges sitting in California's federal districts. "Yet federal judges are not the source of state law or even its oracles," declared the Seventh Circuit. The answer here, said the appellate court, is found in California's enacted statutes and the decisions of its courts.¹⁸²

It was beyond peradventure, found Judge Easterbrook, that California had promulgated the UCC, and "there can be no doubt that it uses a functional approach to separating leases from secured credit" in these instances.¹⁸³

Given all this, the Seventh Circuit handily concluded that the transaction between the debtor and the public agency is not a "true lease" under California law. The reasons were plentiful: a) the alleged "rent" was not measured by the fair market value of real estate involved, as one would surmise a real lease would be, but instead by the amount of money the airline borrowed; b) the "hell or high water" clause evinced "the lack of connection between the maintenance base's rental value and United's financial obligation"; c) the public agency enjoyed no residuary interest, and while the CSCDA stressed the airline would still be a tenant at SFI, the tribunal rejected that small fact in light of a full reversion without additional charge as emblematic of the UCC's per se rule for identifying secured credit; d) "[t]he balloon payment has no parallel in a true lease, thought it is a common feature of secured credit"; and e) "here, a prepayment by the airline would terminate the deal immediately," whereas "in a true lease, by contrast," prepayment would secure the tenant's right to continued occupancy.¹⁸⁴ Circuit Judge Easterbrook further noted that the panel was unaware of any case "from any state" holding that an arrangement of the kind found here was a "true lease."¹⁸⁵

Clearing the air for another day, the Seventh Circuit stated, "[w]e do not doubt that many financing devices are true leases." For instance, a lessor owns the property and finances its acquisition, re-

lieving the lessee of the need to raise its own funds. So-called "net leases" measure rent by a lessor's monetary commitments, while allowing the lessee to finance the acquisition. Fittingly, the panel noted that United acquired many of its airplanes in this way.¹⁸⁶

Yet, the cogent distinction in such arrangements is that the lessee acquires the asset, securing it with current value, but with the ability to escape the obligation by surrendering the asset. The instant case is quite different, said the appeals court, because "United did not obtain the maintenance base from CSCDA; it already had the base under its lease" from SFI. The airline could not shed its financial obligation by vacating the premises, like an ordinary tenant in a true lease. What really transpired here, found the court, was United used an asset (its leasehold in the maintenance base) to obtain credit, much like the parties in the California state court cases who agreed to pay supposed "rent" equal to credit given instead of basing payments upon the value of the underlying leased premises.¹⁸⁷

In conclusion, the Seventh Circuit in *United I* decided that the deal between United and the CSCDA was a disguised security interest and not a true lease.¹⁸⁸ So ended one of the most powerful landmarks ever issued by the federal courts on the "true lease" versus disguised security interest controversy.

That its source was one of the nation's most illustrious tribunals, the opinion authored by one of the more preeminent jurists of the era, and it was chock full of economic theory and business practicality might very well have made it the last word on the subject, but that was not to be, for the underlying Chapter 11 case that engendered *United I* was to be replete with even further variations on this same controversy, as this initial decision alludes to.

In short, despite its conclusiveness, *United I* was to be but the beginning, and so we will move on to engage its siblings. However, before we do so, we will pause to examine a relevant lower court decision that, at least in part, exemplifies *United I* already at work.

A Quiet Interlude—*Mason*

As we have seen, the "true lease versus disguised security interest" question is usually complex and hotly contested. However, from time to time a case presents itself that is far more straightforward. Such is the controversy entitled *In re JII Liquidating, Inc.*,¹⁸⁹ which pitted a Chapter 7 trustee against a putative lessor. The mat-

ter came before Bankruptcy Judge John S. Squires on cross-motions for summary judgment.¹⁹⁰

As is usually the case on this issue, the facts are of key significance here. Mason was the trustee of a group of companies that once stood as one of the nation's largest independent providers of high-volume machined and forged parts for the transportation industry. Years before, the debtors and Heller Financial had entered into a master lease agreement, whereby the financial powerhouse agreed to "lease" numerous pieces of equipment to the debtors, pursuant to over a dozen schedules detailing the assets so leased.¹⁹¹

The "lease" terms are most revealing. The cost of the equipment was given at a little over \$5.8 million. Heller was to be paid over \$7 million in rent, spread out in quarterly payments over five years. At the end of that five-year term, the debtors were entitled to purchase the assets outright for \$1.¹⁹²

In 2005, the debtors filed for Chapter 11. The unsecured creditors committee appointed in the case raised the issue that the Heller deal was a disguised security interest, not a true lease. Mason, as the subsequent liquidation trustee, took up the cause, and sought to dispute Heller's status.¹⁹³

Without difficulty, Bankruptcy Judge Squires declared that the "principal issue" was whether the arrangement was a true lease or a disguised security agreement. The answer to that question would lie in the correct characterization of the underlying documents, a point which the court could decide as a matter of law.¹⁹⁴

Judge Squires commenced his legal analysis with these two truisms: first, "[t]rue leases usually govern the temporary use of property and require the return of the leased item to the lessor at the end of a specified term"; and a true lease is subject to section 365 of the Bankruptcy Code¹⁹⁵ and its manifold aspects of assumption, assignment, or rejection.¹⁹⁶ "In contrast," a "lease" deal which is, in truth, a secured transaction imbues the putative "lessee" with the badges of ownership, included the retention of the property.¹⁹⁷

As its parent circuit had previously observed, the similarity in function often enables leases to work like secured transactions and secured loans to act like leases.¹⁹⁸ Therefore, distinguishing true substance over mere form is an ever-present issue, noted Judge Squires, which is why the Uniform Commercial Code seeks to sharpen the line between the two as a matter of statute.¹⁹⁹ Yet, for all of the U.C.C.'s promulgations, the "true lease" vs. security in-

terest issue remains as one of the most frequently litigated issues under the entire Uniform Commercial Code.²⁰⁰

Now the *Mason* court turned to a third axiom; the Bankruptcy Code itself does not define a "lease" and offers precious little guidance in deciding what is a true lease, as opposed to a disguised security interest. Ergo, the determination is made in accordance with state law.²⁰¹

As we have seen before, the statutory marker is section 1-207(37) of the UCC, which the *Mason* court now characterized as a "bright line, *per se* test" to distinguish a true lease from a distinguished security interest.²⁰² The rigorous nature of the proviso is found in its mandate that an arrangement creates a security interest as a matter of law if the supposed lessee is forbidden from terminating the deal, and if one of the other four specific conditions (lease term, nominal consideration, et cetera) is met.²⁰³

If a court so holds, said Judge Squires, the inquiry ends.²⁰⁴ If, however, the *per se* test is not met, then the court must analyze the economics peculiar to the transaction, and without regard to mere labels used by the parties. This represents part of the sea change in the UCC since 1992, which previously required an analysis of the economic realities of a deal, prior to the codification of the *per se* test.²⁰⁵

Nowadays, observed Judge Squires, the statute provides guidance for the *per se* test by enumerating items that do not characterize an arrangement as a security interest. These characteristics, which by themselves do not conclusively prove that a security interest exists, including the lessee assuming risk of loss, agreeing to pay taxes, or holding an option to renew the leasehold, among other things.²⁰⁶

Returning to the case at bar, the *Mason* court found that there is a rebuttable presumption that the underlying agreement here is a true lease, absent compelling factors to the contrary.²⁰⁷ This places the burden squarely on the plaintiff here, said Bankruptcy Judge Squires, to prove that the controversial deal is not a lease.²⁰⁸ Of course, the countervailing axiom is that if the presumption is overcome, then the defendant must adduce evidence that its bargain is not a security agreement in disguise.²⁰⁹

Parsing the documentation, the court noted most if not all the relevant papers were encaptioned "Master Lease" agreement or schedules. Numerous terms therein suggested, at least facially, this

was a true lease, for instance, the repeated references to the parties as “lessor,” “lessee,” the payment of “rent,” and so on.²¹⁰

Nevertheless, opined the *Mason* bench, mere labels do not make a deal a lease. The true nature of a transaction turns on its substance, not the parties’ arbitrary choice of titles.²¹¹ Moreover, the actual circumstances of an arrangement dictate what it truly is.²¹²

That said, the *Mason* court now applied the statutory per se test. Its conclusion was succinct and direct; the contractual documents at issue comprised a disguised security interest. Both prongs of the test were met, and the court elaborated, as follows.²¹³

On the first point, the purported “lease” was noncancelable by its own explicit terms; it could not be terminated by the debtor. As so well put by Bankruptcy Judge Squires, the debtor “could not opt to simply return the [e]quipment... and walk away.” This led to the finding of a security agreement here, not a lease, at least as to the first question.²¹⁴

The second prong of U.C.C. § 1-201(37) provides four possibilities to swing the transaction into the secured interest category. One of those possibilities is the alleged lessee’s contractual right to purchase the asset at the end of the “lease” term for zero or a nominal consideration. The presence of such a stipulation converts the substance of the deal to a conditional sale, with a security interest attached to protect the purported “lessor.”²¹⁵

Here in *Mason*, the parties’ agreement virtually preordained the outcome. The debtor was entitled to purchase the equipment for \$1 at “lease” end.²¹⁶ Comparing that one buck against the property’s original cost of nearly \$6 million, spread out as it were over 20 quarterly payments each in excess of \$360,000, Bankruptcy Judge Squires declared it would have been “foolish” for the debtor to surrender equipment that it was within a dollar of owning outright. “[T]he [d]ebtor[] would have had no reasonable alternative but to exercise the Purchase Option.” Clearly then, the nominal consideration that \$1 represented completed the test of deeming this arrangement a disguised security interest.²¹⁷

Bankruptcy Judge Squires now returned to his two salient points: the debtor could not terminate the arrangement, but, conversely, could purchase the “leased” assets for a nominal sum. “Given this finding, the inquiry is over,” and the other factors in determining true lease versus disguised security interest need not be addressed. The *Mason* court forthrightly concluded that the agreement at is-

sue here was a disguised security interest, and the financing creditor, while it might enjoy the rights of secured status, had no such enjoyment of the contrasting rights of a lessor.²¹⁸

The creditor had one last desperate argument. It alleged that when one of the parties subsequently succumbs to bankruptcy, an arrangement such as this should not be characterized as of the date of its inception. Rather, such judgments should be made as of the date just before the bankruptcy petition is filed, as such an event effectively breaches the deal, specifically invalidating the purchase option.

The court disagreed, stating that subsequent events "do not alter the character of a transaction" and the classification of a contract as a lease or a security interest must be determined *ab initio*, "from the beginning of the transaction." Parties have common goals when they enter into a deal, so determining their true intentions is best done by examining their agreement at the outset.²¹⁹

Focusing on the inception of a deal is the proper way to view whether the contractual documents create a true lease or a disguised security interest, opined Bankruptcy Judge Squires.²²⁰

Mason then becomes one of the first to practically apply the teachings of *United I*. To be sure, it is likewise consistent with the other sound theories espoused on this controversy, but, as we said, this bankruptcy court case was the proverbial pause that refreshes. Thus renewed, we now return to the *United* trilogy and follow the continued growth of these newest and most influential landmarks on the "true lease" versus disguised security interest debate.

United II—Escape from L.A.

Not surprisingly, as we have noted, the Seventh Circuit Court of Appeals had ample opportunity to revisit *United I*. Ironically, the tribunal's second foray involved the City of Los Angeles and its renowned international airport LAX as the purported lessor. As with the court's decision with regard to its northern counterpart of San Francisco, the result was the same.

In the case entitled *In re United Air Lines, Inc. (United II)*,²²¹ the debtor was opposed by U.S. Bank as the indenture trustee for certain bonds issued by the Regional Airports Improvement Corporation ("RAIC"), and the City of Los Angeles (the "City"). RAIC had been created as a public entity to make improvements at LAX, funding that work by issuing bonds and purportedly subleasing

certain airport facilities to United.²²² The “true nature” of the subleases was at the heart of this controversy.²²³

From the outset, the court did not leave the outcome in doubt. Writing for the panel, Circuit Judge Manion succinctly noted the instant case was “substantially similar” to *United I*, and here also the court found the transaction “not a lease for § 365 purposes.” Prior to detailing the underlying transaction, this panel wished to reiterate the key distinction in the lease-versus-loan context.

The Bankruptcy Code compels lessees to either assume the lease and perform all obligations thereunder or surrender the leased asset. By comparison, a debtor might be able to pay a lender less than the agreed price on an asset covered by a security interest, leaving the creditor with an unsecured debt for the difference.²²⁴

Turning to the particulars, the court noted that United has leased space at LAX since at least 1982, and under certain conditions. United leased from the City, but worked with RAIC to arrange financing to improve and construct facilities in United’s space.

RAIC, while formed by the City, was a freestanding public entity empowered to issue tax-exempt bonds. United’s lease with the City anticipated that the airline would utilize RAIC’s power to fund the improvements, and so United and the agency entered into two key agreements.²²⁵

First, United made a partial assignment of its leasehold to RAIC, in exchange for the agency issuing over \$75 million in tax-exempt bonds to develop those airport facilities. U.S. Bank was designated indenture trustee, hence its role in the instant case.²²⁶

The second agreement, encaptioned a “facilities sublease,” called for RAIC to “lease back” the then-to-be developed facilities to the airline. In exchange, United paid a so-called “rent” to the RAIC, equal to the amount necessary to cover payments to the bondholders and related administrative costs.²²⁷ Interestingly, “[t]he term of the sublease is completely dependent upon United’s payment or redemption of the bonds.”²²⁸ Having set forth these salient facts, the panel could begin its legal analysis.

Harking now to the precedent it set in *United I*, the Seventh Circuit reminds us that, in the earlier case, it resolved the two issues key to deciding if a specific transaction is a true lease under section 365 of the Bankruptcy Code. The first issue is whether or not the form of the document should be controlling in this kind

of situation; in other words, does simply entitling a transaction a "lease" or using terms such as "rent" make it the former?

The circuit court, concurring with a number of its brethren, has already decided that "substance... trumps the form of the transaction."²²⁹ Reiterating its own wisdom, in short, that the parties' mere choice of language should never overcome real substance, the Seventh Circuit reaffirmed its view that, as a matter of federal law, "the genuine nature of a transaction will prevail over the titles and terms" selected by the parties.²³⁰

Second, in *United I* this appellate court had also ruled that state law is generally controlling.²³¹ Given that the Bankruptcy Code is silent, and leases are state law instruments anyway, the combination of federal silence and state vocalness decisively tips the scales towards following state law. The sole exception, as already pointed out in *United I*, obtains if a particular state's law calls for a formalistic, not a functional, approach.²³² To be sure, this was of no concern in the instant appeal, because, as in *United I*, the applicable state law was that of California, which passed the test without problem.²³³

Once again, Circuit Judge Manion noted the importance of the similarities between this case, involving LAX, and *United I*, concerning San Francisco's international airport. Both shared longstanding, traditional airport leases with the respective West Coast cities. Both called for United to collaborate with a special public entity dedicated to floating bonds to fund airport facilities improvements. Both required the airline to "sublease" some of its facilities from the respective municipality, and then serve as the lessee in a "lease back" from the agency issuing the bonds. And both tied "rent" payments to sums necessary to pay interest on these bonds, with balloon payments at the end of the "lease" to retire those same bonds.²³⁴

Upon entering Chapter 11, the debtor airline questioned if both its San Francisco and LAX arrangements were in fact true leases. The Ninth Circuit noted that in its decision in *United I*, it devised a five-point test, consisting of the following inquiries: 1) was the "rent" linked to the amount owed bondholders? 2) was a balloon payment to retire the bonds required? 3) was there a "hell or high water clause"?²³⁵ 4) would the prepayment of United's obligations terminate the purported "lease"? and 5) would the bond issuing au-

thority not have a residual interest in the property at the end of the term of the “lease”?²³⁶

“Each of these factors is present in this case as well,” wrote Circuit Judge Manion, and thus the result was identical. The Seventh Circuit declared that the purported lease with LAX at issue in *United II* was not a lease, but a disguised secured transaction, just like the substantially similar arrangement with San Francisco airport in *United I*.²³⁷ The court dissected each point seriatim.

First, United’s rent at LAX was “linked to the amount it borrowed, albeit indirectly, from the bondholders.” The tribunal did not give credence to RAIC’s assertion that the “rent” equaled market value compensation for the debtor’s use of the airport facilities. Rather, Judge Manion wrote that the sublease between the airline and the agency “explicitly equates ‘rent’ to the sum needed ‘to pay the interest on, premium, if any, and principal of the [b]onds.’” Therefore, the reality of *United II* was “more indicative of loan payments rather than traditional rental payments that compensate the lessor for the lessee’s consumption of the lessor’s property.”²³⁸

The second point was closely related to its first, commented Judge Manion, and pertained to the presence of a balloon payment in the purported lease.²³⁹ Referring again to *United I*, the circuit court reiterated that a balloon payment is not an element found in a true lease, but rather is indicative of a secured transaction.²⁴⁰

After all, in simple terms a loan is the delivery of a sum of money, with a contractual agreement that it be repaid in full at a future date. The debtor here was required to make two such repayments to retire the books in 2012 and 2021, respectively. “The balloon payments here are tremendously revealing in this regard,” declared the Seventh Circuit, making it “plain” that the airline borrowed over \$75 million and promised to return that same sum at a future date. The nature of this obligation was “powerful evidence that the design of this transaction was a loan.”²⁴¹

For its third point, the panel observed that this arrangement for the LAX facilities had a “hell or high water” clause, something also found in *United I*’s San Francisco deal, where it demonstrated “a telling disjoint between rental value and United’s actual financial obligations.”²⁴² As with its more northern neighbor, the Los Angeles-based transaction demanded that the airline continue to pay it so-called rent even if the airport facilities were condemned, destroyed, or unusable.

Indeed, the debtor's obligation was remarkably absolute and without conditions. "This clause stands in stark contrast to more typical provision" in other leases between the City of Los Angeles and the debtor, opined Judge Manion, which gave United some rent abatement or escape hatch if the leased premises could not be used. For these reasons, the tribunal declared that "[a]t bottom, the 'hell or high water' clause in the... [lease] is further evidence that the 'rent' here is not payment for the value of using the facilities but rather is for the value of the money borrowed."²⁴³

Fourth, just as in *United I*, the debtor here could prepay the bonds and terminate the entire transaction.²⁴⁴ Such earlier repayment provisions serve a useful function, noted Judge Manion, in a financing context.²⁴⁵

"By contrast," the panel pointedly observed, "such a prepayment/termination provision would be superfluous in the context of a lease."²⁴⁶ There is "little economic sense" for a true lessee to prepay a lease, terminate the transaction, and thereby cause the alleged lease to "evaporate." Yet, another demonstration that this deal was a loan, not a lease, said the tribunal.²⁴⁷

The Seventh Circuit moved on to its fifth point, the fact that the purported lessor held no reversionary interest in the subject property.²⁴⁸ This is a hallmark of a loan, not a lease, "and is to be counted against the instant arrangement being classified as a true lease," said the court.²⁴⁹

The agency made some further arguments in furtherance of having its arrangement with United declared a true lease, but they were all for naught; the tribunal rejected them as inconsequential and incapable of altering the foregoing quintet of conclusions.²⁵⁰ "The presence of these considerations here strongly points to the existence of a secured loan and not a lease," declared the Seventh Circuit.

And so, the appellate tribunal found these five points more than enough to declare that the airline's Los Angeles deal had "all the hallmarks of a secured loan," exactly like the transaction in *United I*. Indeed, the debtor committed to arrangements at both of California's largest cities to acquire financing from bondholders, albeit in the guise of a purported lease, with repayments that did not at all resemble true lease rentals.

This identity preordained the same result, said Judge Manion, and so the Seventh Circuit held that the instant deal was a secured loan and not a true lease for purposes of Bankruptcy Code section

365. And so ended *United II*, with a holding identical to its predecessor—no surprise there. Two down; one to go, and so now we turn to the third and final act of the “true lease” versus disguised security interest controversy.

United III—The Last Stand

All trilogies must come to an end. All that differs is how exciting a climax the third installment reaches. In this otherwise prosaic field, the case widely published as *United III* did not disappoint, as it attained a fitting pinnacle to close out this line of decisions, and quite conceivably the entire “true lease” versus disguised security interest controversy.

As we have already seen, the first two legs of this triad dealt with United’s airport facilities leases in California two largest metropolises, San Francisco and Los Angeles, respectively. This iteration, *In re United Airlines, Inc. (United III)*,²⁵¹ resolved the debtor airline’s arrangement at Denver’s international airport.²⁵²

Once again, Circuit Judge Manion takes up the task as author of the opinion²⁵³ and carefully lays out the facts, facts that were to prove truly distinguishable from the United appeals that had preceded the instant controversy.²⁵⁴ The Seventh Circuit takes us back to 1992, when the Denver International Airport was still new and its owners, the City and County of Denver, pursued a long-term commitment to ground facilities from United.²⁵⁵

United and the municipality entered into a comprehensive arrangement, significant for its caption: a “Special Facilities and Ground Lease.” Circuit Judge Manion informs that the airline leased land and specific facilities yet to be built. For reasons not explained, Denver would not do the construction, however; United would erect the buildings it would occupy. Financing would come from over \$261 million in tax-free municipal bonds issued by the local government. Debt service would be made by the airline, albeit indirectly, by means of payments under the lease called “facilities rentals.”²⁵⁶

As we have seen, United’s Chapter 11 filing threw the status of the deal into contention, bringing the parties before this tribunal.²⁵⁷ Before proceeding, Circuit Judge Manion briefly “set the stage,” by revisiting the crucial distinction between the rights and responsibilities of the parties to a true lease in a bankruptcy scenario, as compared to the differing privileges and obligations of

the holder of a security interest.²⁵⁸ Having done that, the Seventh Circuit turned to a highly detailed analysis of the debtor's arrangement vis-à-vis the Denver airport, and now for the first time began to uncover the nuances that would make *United III* quite different from its predecessors.²⁵⁹

As aforesaid, the Special Facilities and Ground Lease was entered into in 1992 and was to run for 31 years, with a nine-year option to renew. The primary purpose was to persuade United to move into and operate at DIA for that term. The municipality, as the landowner, leased 45 acres to the airline, and certain facilities yet to be built, including a terminal, a concourse, an aircraft maintenance facility, a ground equipment maintenance facility, a flight kitchen, and an air freight depot. "Throughout," said Circuit Judge Manion, the agreement referred to the land and buildings thereupon as a whole.²⁶⁰

The Seventh Circuit found the mode of the airline's payments for the use of the acreage to be "straightforward." United was required to pay so called "ground rentals," monthly payments measured by a square-foot rate, as well as common use charges for airport services such as trash hauling, snow clearance, and security, among others. The ground rent was paid directly to the municipality as the landlord. The panel noted the debtor agreed this arrangement "has all the hallmarks of a true lease."²⁶¹

In contradistinction, a tribunal found the monies due by the airline to Denver for the other facilities to be "slightly more involved," mainly because "the facilities still had to be built" at the time the lease commenced. To construct those assets, Circuit Judge Manion posited that "Denver conceivably could have raised bond money," built the facilities, "and then charged United a traditional form of rent... [But] Denver did not do that."

Instead, the municipality issued tax-free bonds, raised over \$261 million as noted above, and then turned that money over to the airline, and let United build the very facilities it would be using. "Still, the ownership and title of the facilities rest with Denver, and, when the lease ends, possession of the facilities reverts to Denver."²⁶²

Furthermore, the appellate court found "an additional layer of intricacy" to all this. Rather than collect customary rent from United to service the municipal bonds itself, Denver had the airline make the debt service, "albeit indirectly" by so called "facilities

rentals.” United’s schedule of repayments was directly tied to the interest and principal due on the bonds, and the borrower routed its money to a paying agent, not the municipality. This third-party agent then distributed monies to the bondholders.²⁶³

All went well until United’s Chapter 11. Then the debtor airline decided to seek a declaratory judgment that its arrangement at DIA was not a true lease, but a disguised security interest. On cross-motions for summary judgment, the lower courts held that the underlying arrangements for both the acreage and the facilities were one, integrated whole and could not be severed into two, and this unified transaction was in fact a true lease. This appeal followed.²⁶⁴

As viewed by the Seventh Circuit, the airline’s goal was to segregate its deal for the facilities and have it deemed a security agreement. To reach that outcome, Circuit Judge Manion noted “[t]here is no dispute that... United must clear two hurdles.” One: could the deal be severed into two components, to wit, a lease of real property on the one hand, and the facilities transaction on the other? To be sure, the former “is indisputably a lease,” said the panel.²⁶⁵ Second, the agreement for the facilities at DIA “must genuinely be that of a loan and not a lease.”²⁶⁶

There was no surprise when the Seventh Circuit harked back to its recent precedents of *United I* and *United II* on this similar issue.²⁶⁷ However, similar is not identical, as this federal appellate court was quick to point out. “While the cases share similarities,” Circuit Judge Manion wrote, “a critical distinction is the fact that the parties in the present case cemented their deal into one document.”²⁶⁸

In sharp counterpoise, the panel noted, the SFI and LAX deals at *United I* and *II*, respectively, segregated their ground leases into wholly separate documents.²⁶⁹ “Not so here,” declared the *United III* court. “Denver and United tied their ground and facilities arrangements into a single contract,” a distinction that was to prove pivotal to the tribunal’s determination in the case at bar.²⁷⁰

Given such, could (or should) this knot be untied? That is the first order of business for us, declared the Seventh Circuit. Turning to that point, Circuit Judge Manion held that state law provides the rule for decision on the issue of contract severability.²⁷¹ Without question, Colorado law applied here because of the choice of law clause in the parties’ contracts.²⁷²

Notably, “Colorado law places a heavy burden on the party seeking to sever a contract” and stipulates that severability cannot

be had unless the contract's language itself manifests each party's intent to deem the agreement as capable of division.²⁷³ Indeed, the controlling state law is such that "[e]ven if the parties entered a multi-part contract, that contract cannot be severed after the fact" if the contracting parties initiated it as a single, unitary transaction. In other words, if the parties were motivated *ab initio* from the same bargain or set of bargains, then that unity of purpose prevents any promise or promises therein to be struck out.²⁷⁴

Severability obtains only if the contract language provides clear evidence of the parties' individualized assent to successive divisions of the contract, the performance of each subpart unbound to the neighboring provisos. "Thus, it is not the number of items in the contract which is determinative of whether it is severable, but the nature of the object or objects in the contract."²⁷⁵ The Seventh Circuit concluded that the Colorado rule prohibits contract severability if the bargain could not exist when one or more subprovisions of the arrangement are struck out.²⁷⁶

"The same is true here with the Denver-United agreement," declared the tribunal. On its very face, said Judge Manion, "this contract is a inherently integrated bargain," coupling the land lease to the bond financing undertaken to build improvements upon that very acreage.²⁷⁷ Taken in the context of the instant case, the bond component of the deal between the airline and the municipality "is not and could not have been a lone-standing bargain. In other words, the parties would not have entered the bond-related portion in the complete absence of the leasing portion."²⁷⁸

The tribunal could not conceive of Denver handing over bond proceeds to United absent the ground lease. How else would the municipality ensure that the facilities were built with the money Denver raised via the bond issue?

Conversely, said the panel, United is an airline, not a construction firm, and the carrier obviously would not have agreed to build facilities if it had not also secured the land lease as part and parcel of the deal. "Simply stated, without a ground lease, there was no need for this particular bond arrangement." Such was the wisdom of the Seventh Circuit in divining the parties' real intentions.

Circuit Judge Manion further observed that United and the municipality could have easily segregated this arrangement into two distinct contracts (as the court previously pointed out the airline did in San Francisco and Los Angeles), but "they did not, and their

decision to unite their interdependent ground and facilities objectives into a single contract at the outset cannot now be undone after the fact under Colorado law.”²⁷⁹ The Seventh Circuit found its duty clear; the arrangement had to be taken as an indivisible whole, because there never would have been a bargain if any of the countervailing promises were struck out. Thus the contract “cannot be severed.”²⁸⁰

As is typical, the panel was nothing if not comprehensive, and turned to briefly address the debtor’s assertions for severability. For one, the airline cited the differing payment and default provisions for the lease and bond segments of the deal, as well as the distinct objectives of the two components. While true, it is not dispositive, wrote Circuit Judge Manion. The happenstance of apportionment is not conclusive for purposes of determining contract severability, said the panel.²⁸¹

At the end of the day, United’s arguments did not overcome Colorado’s rule prohibiting the severance of contractual provisions. The tribunal pointedly stated that just because parties “*could have* entered two contracts at the outset is not the test.”²⁸² The reality is that Denver and United knowingly and willingly entered into a single contract, and that arrangement cannot now be divided “simply because one party later finds it would have been more advantageous to have entered into two contracts instead of one.”²⁸³

United’s final point relied upon the severability provision within its very agreement with Denver. Characterizing this language as the “standard form saving clause,” the tribunal declared that it did not manifest an intent to single out any particular subpart of the arrangement, “let alone a division of the agreement,” into distinct lease and bond financing components.

The language was merely evidence of “the general and customary intent” of parties to ensure as much of their agreement would survive adverse judicial intervention as possible. “Without more,” this generalized contract boilerplate did not support the airline’s attempt to sever the contract into independent pieces.²⁸⁴

Given all this, and in a Sherlockian twist, the Seventh Circuit found its final conclusions here “elementary.” The arrangement at issue could not be severed, per the controlling state law, and thus had to be treated as a unified whole.

Now the issue becomes, said Judge Manion, whether the entirety is a lease for purposes of the Bankruptcy Code. United had

conceded that the ground lease provisions constituted a true lease. Moreover, the dominant lease of real estate at DIA could never be deemed a financing arrangement, held the court.²⁸⁵

United could offer no persuasive argument to place its accord with Denver outside the purview of the Bankruptcy Code's lease assumption/rejection statute. "Accordingly, . . . as a whole [it] must be treated as a true lease for purpose of [section] 365."²⁸⁶

For its penultimate holding, for both *United III* and the very trilogy that it concluded, the Seventh Circuit ruled that, as a matter of state law, United's deal for land and buildings at DIA "with its interdependent ground and facilities provisions, is a single, inseverable whole," which would never have existed had the parties not knowingly bargained to devise such a unitary construct.²⁸⁷ To be sure, although United and the municipality could have parsed out "this complex arrangement into two contracts, they did not, and their shared willingness to enter into but one deal "cannot now be undone after the fact under Colorado law."

That all said and done, and the arrangement indisputedly a true lease, section 365 alone applied to regulate the rights and responsibilities of the parties in this Chapter 11 case.²⁸⁸ Thus ended the instant opinion, and the *United* trilogy, a triad surely to be the foundation of law for this controversy for a long time to come.

COMMENTARY

After expositing all the above, we strongly considered whether the conventional analytical section in articles such as this was actually necessary. Would it be "mere surplusage," as some courts have characterized superfluous language in statutes or cases? After all, one cannot deny that the cases we selected for discussion are, in the main, so cogent, so succinct, that the trail of their respective legal reasoning is readily apparent. Such clarity of vision is even more undeniable with the concluding cases of *United*. Indeed, when the Seventh Circuit speaks so convincingly, as it does with this trilogy, does it make any sense to embellish such obvious wisdom?

Nonetheless, tradition is tradition, so we struck a compromise. Rather than regurgitate what these outstanding judicial opinions have made obvious, a brief affirming commentary is all that we need to supply prior to making our conclusion.

We first take due note of the statutory underpinnings of the "true lease" versus disguised security interest controversy. Notwithstand-

ing years of application and “fine tuning,” these provisos remain complicated—and they have to be. The law, most especially U.C.C. § 1-201(37), is complex because it must deal with complex issues. And the constant inventiveness of the wheelers and dealers who put together the transactions that this law oversees add new layers of complication at every turn. Simplicity is just not in the cards.

But all is not lost. With a little work, the statutes can be deciphered, and each new case development adds to the body of experiential knowledge. An additional compensation is that the national uniformity of the relevant provisions permits a cross-fertilization across jurisdictional boundaries, as courts freely call upon neighboring precedents, and build upon each other’s notions and principles of what is just and fair. In sum, it takes some time to work through this part of the Uniform Commercial Code, but it is doable, and each day adds to our capabilities.

In a way, the dual complexity of the relevant portions of the UCC and the need to adapt it daily to new forms of transactions helps, because it foments controversy (and a great deal of it, as our learned brethren in the field have often times noted). In turn, such infighting compels courts to carefully analyze the transactions that constantly appear before them, and then render principled decisions for today and the future. The expanding universe of *sui generis* adjudications provides a wealth of precedent.

In these pages, we have seen the paramount lower court decisions that parse the issues so gracefully, among them: *Rebel Rents*, which insists that we take cognizance of the uniqueness of each of these transactions before deciding if they are what they purport to be; *Grubbs*, for aptly demonstrating the agility of the law in dealing with newfangled arrangements such as TRAC leases, and the rest, all of them so well reasoned in unraveling such subtleties as purchase options, residual values, and the now commonplace Economic Realities Test, all of them vital elements in telling the difference between “true leases” and disguised security interests. These lower court decisions all at once not only provide a solid foundation, but are the font of wisdom for cases yet to come.

That brings us to the Seventh Circuit’s trilogy of *United*. We have little to add here, so we will be brief.

Three times the “true lease” versus disguised security interest came before this eminent tribunal. Fittingly, just like the twin jewels of America’s Pacific coast, the controversies regarding the

San Francisco and Los Angeles leases were decided virtually in tandem, and most certainly with the same just result. That the respective panels made their rulings upon formidable principled decisionmaking is obvious; that the same tribunal so convincingly linked the axioms of law to the economic realities of each transaction is what truly makes for enduring landmarks.

Standing in exquisite counterpoise is the different, but no less principled, holding of *United III*. Separated from its peers geographically by the Continental Divide, the legal differentiation was no less vast in its scope. This case arising from the debtor airline's lease in Denver is the precise counterweight for the companion decisions on the West Coast-based transactions, given that the former arrangement qualified as a true lease for the very reasons that the latter deals were, in truth, actual security interests thinly veiled as purported "leases."

We expect the *United* trilogy to be the last word (or nearly so) on the "true lease" versus disguised security interest controversy. First, the applicable statutory provisions are well settled, and that predicate is unlikely to change significantly. Second, and as noted, to reach this pinnacle the tribunal built upon an abundance of precedent, from courts both high and low. Its recent holdings are the sensible result of a natural and logical evolution of the sound judicial opinions which preceded it. Third, the Seventh Circuit was itself nothing less than masterful in the elegance of its own legal reasoning and applying same to modern, cutting edge transactions. Indeed, this connotes the durability of these landmarks, as they shall no doubt continue to be fully applicable to whatever new variations the financial community devises to the parallel themes of "lease" and "security interest."

For our coda on the *United* trilogy, we find it more than sufficient to return to facts set out at the beginning. Trillions of dollars move in the economy every day in complex business transactions that might be characterized as either leases or security interests. The distinction between these two forms of arrangements often comes into question, particularly in bankruptcy cases where the intertwined fates of debtors, creditors, and significant amounts of money all turn upon the different legal rights apportioned between the holders of the "true lease" versus the disguised security interest. With all that at stake, we are most fortunate to have the clear,

concise, and just legal reasoning of the Seventh Circuit to guide our way, now and for many years to come.

CONCLUSION

Too many times in the course of human events have we heard that this is a final battle, the end of conflict, the last battlefield. Controversies fought over in our courts of law are no different, for as often as we have heralded a new landmark as marking the end of conflict, and the beginning of a new judicial peace, our expectations were dashed as some nuance, old or new, forgotten or well remembered, rose again to light the flames of controversy anew. Were we to take that view, then all that was said above would be mere prologue to the next epoch of the “true lease” versus disguised security interest controversy.

But we choose not to be so pessimistic. As the perceptive reader has already gleaned, our optimism outweighs our doubts on the issue, and by a fair margin. Many factors contribute to our ultimate belief that the war between true leases and disguised security interests is now over. May fortune favor the foolish, as we summarize our reasons.

First, time, as it relates to the statutory constructs of the UCC. The natural evolution of commercial law, amplified as it were across 50 distinct but interlocked jurisdictions, has allowed us to work out most of the kinks in the complex question of distinguishing “true leases” from disguised security interests. Certainly, the statutory provisos of our dominant commercial code are not without complication. In equal part, they lend themselves to both simple application and endless debate. Nonetheless, more than sufficient time has passed for the portions of the UCC relevant to this issue to “settle in” and provide an understandable and lasting framework for reasoned decision making.

Second, we have the preexisting body of primarily bankruptcy court decisions that, over time, have answered the multitude of questions that have arisen during the modern history of this controversy. To be sure, in this article we have only touched upon a significant few of the legion of such cases from the federal bench. But like cornerstones in a foundation, their prominence exemplifies not only their own inherent strength, but the fortitude of the less visible, but equally solid, bricks they are aligned with. The fact that such stones have been fashioned from the stresses of the

bankruptcy process is another testament to their durability. Even as each day brought new challenges from the hectic world of high finance, the courts of bankruptcy proved more than up to the challenge, as they drove inexorably towards ending the controversy of their own accord. But even this sturdy foundation has a pantheon erected upon it, to which we now turn.

Last in our triad (and fittingly, since trilogies are an inescapable component of this controversy), we have the penultimate decisions of the Seventh Circuit in the trilogy of the day. We truly believe the teachings of that august tribunal will be the last word on the "true lease" versus disguised security interest controversy. One, as is plainly evident, there shall be no Supreme Court review of the three *United* decisions, so facially the Seventh Circuit has had the last word. Second, the longstanding battle having now been elevated to the circuit level, being dealt with so convincingly (and in a way generally consistent with its fellow circuits, thus diminishing the chance of an internecine circuit conflict), and by panels of such acknowledged preeminence, we think the controversy vanquished.

And third (again, everything here seems to come in threes), the Seventh Circuit's legacy is a set of rules and principles, so cogent, so legally sound, so realistic in the face of business today and business yet to come, their application compels the kind of principled decision making that truly puts this controversy to rest. This should come as a surprise to no one, for the *United* trilogy is more than the sum of the parts that comprise its makeup. We contend that it brings the conflict to an end, because it was unfailingly destined to do so. The fact that it does so in such outstanding fashion is likewise a benefit derived not from mere happenstance, but from all the diligence and fine crafting of judicious lawmaking before it and within the Seventh Circuit's conclusive words.

In closing, we respectfully proclaim that the "true lease" versus disguised security interest controversy is now over. Truly, the *United* trilogy is the last stand.

NOTES

1. MacDonald, "Debt Hazards Ahead," *Forbes* (June 18, 2007), at 80-81. And the trend seems to be accelerating. See, i.e., Gimbel, "Stocks, bonds... or jets," *Fortune* (May 31, 2007), available at <http://cnmmoney.com> (among other things, describing the entry of private equity firms and hedge funds into a "red-hot leasing market" for aircraft, as "the funds bet that the metal could be alchemized into flying gold").

2. See Sabino & Sabino, The Battle Between ‘True Lease’ and Disguised Security Interest Rages on as Courts Add New Chapters, 57 The Secured Lender 42 (September/October 2001); Sabino & Geraci, The ‘True Lease vs. Disguised Security Interest’ Question Continues with a Rebel of a Case, 60 The Secured Lender 8 (January/February 2004); Sabino, Lease v. Security Issues: Code Provides Improved Protections for Lessors, 16 LJN’s Equipment Leasing Newsl. 6 (March 1997); Sabino, Bevis & Beerman Do Leases: Bankruptcy Courts Tackle Lease vs. Security Interest Issue, 16 LJN’s Equipment Leasing Newsl. 6 (February 1997); Sabino, Lease v. Security Interest as a Constitutional Issue, 15 LJN’s Equipment Leasing Newsl. 5 (March 1996); Sabino, *Baker’s Half Dozen: Distinguishing Between a True Lease and a Disguised Security Interest*, 49 The Secured Lender 30 (September/October 1993); Sabino, Lease Purchase Option Found Not to Create True-Lease Agreement, 11 LJN’s Equipment Leasing Newsl. 3 (September 1992).

3. *Butner v. U.S.*, 440 U.S. 48, 54, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979) (“Congress has generally left the determination of property rights in the assets of a bankrupt’s estate to state law”); S. Rep. No. 595, 95th Cong., 1st Sess. 314, reprinted in 1978 U.S.C.C.A.N. 5963, 6271.

4. *In re Grubbs Const. Co.*, 319 B.R. 698, 712, 55 U.C.C. Rep. Serv. 2d 501 (Bankr. M.D. Fla. 2005) (on the whole, choice-of-law provisions have little or no impact in these matters) (citing cases).

5. *In re Edison Bros. Stores, Inc.*, 207 B.R. 801, 809 n.7, 34 U.C.C. Rep. Serv. 2d 594 (Bankr. D. Del. 1997) (“Since the UCC has been adopted by all 50 states, and given the uniformity purpose of the UCC, decisions from other states are relevant”), followed by *In re WorldCom, Inc.*, 339 B.R. 56, 64, 46 Bankr. Ct. Dec. (CRR) 7, 58 U.C.C. Rep. Serv. 2d 913 (Bankr. S.D. N.Y. 2006) (citing cases) (“WorldCom”). See also *In re PSINet, Inc.*, 271 B.R. 1, 41, 43 (Bankr. S.D. N.Y. 2001).

6. *In re Powers*, 983 F.2d 88, 90, Bankr. L. Rep. (CCH) P 75066, 19 U.C.C. Rep. Serv. 2d 689 (7th Cir. 1993).

7. U.C.C. § 1-201(37), reprinted at Unif. Commercial Code § 1-201(37), 1 U.L.A. 159.

8. *In re Bailey*, 326 B.R. 156, 161, 57 U.C.C. Rep. Serv. 2d 605 (Bankr. W.D. Ark. 2005) (citations omitted). See also Paglia, U.C.C. Article 2A: Distinguishing Between True Leases and Secured Sales, 63 St. John’s L. Rev. 69, 75-76 (1988).

9. U.C.C. Official Comment to § 1-201(37), reprinted at Unif. Commercial Code § 1-201(37), 1 U.L.A. 168. See *In re Pillowtex, Inc.*, 349 F.3d 711, 721, 42 Bankr. Ct. Dec. (CRR) 45, 52 U.C.C. Rep. Serv. 2d 18 (3d Cir. 2003).

10. *WorldCom*, 339 B.R. at 70. See also White and Summers, Uniform Commercial Code § 30-3 (4th ed.), at 10; Huddleson, Old Wine in New Bottles: UCC Article 2A Leases, 39 Ala. L. Rev. 615, 633 (1988).

11. *In re Allied Printing, Inc.*, 344 B.R. 153, 157 (Bankr. M.D. Fla. 2005).

12. Compare *In re Shores*, 332 B.R. 31, 39 (M.D. Fla. 2005) (ability of lessee to terminate arrangement at any time without further obligation “bolster[s] the finding that the [a]greement is a true lease”).

13. U.C.C. § 1-201(37)(a), (b), (c), and (d), respectively.

14. White and Summers, Uniform Commercial Code § 30-3 (4th ed.), at 8, cited by *Allied Printing*, 344 B.R. at 158.

15. “If the agreement[] does not meet the *ipso facto* designation as a security interest, then the [c]ourt must exam[in]e the facts.” *In re Parker*, 363 B.R. 769, 773, 62 U.C.C. Rep. Serv. 2d 576 (Bankr. D. S.C. 2006).

16. *Allied Printing*, 344 B.R. at 157.

17. U.C.C. § 1-201(37)(c) 1. Allied Printing, 344 B.R. at 157.
18. U.C.C. § 1-201(37); Unif. Commercial Code § 1-201(37), 1 U.L.A. 159-60.
19. Legends Gym v. ABCO Leasing, Inc., 383 F. Supp. 2d 911, 914-15 (W.D. Tex. 2004), aff'd, 122 Fed. Appx. 167 (5th Cir. 2005).
20. U.C.C. § 1-201(37); Unif. Commercial Code § 1-201(37), 1 U.L.A. 60.
21. In re Grubbs Const. Co., 319 B.R. 698, 55 U.C.C. Rep. Serv. 2d 501 (Bankr. M.D. Fla. 2005).
22. Grubbs, 319 B.R. at 709, citing White and Summers, Uniform Commercial Code § 22-3 (4th ed.), at 760 and White and Summers, Uniform Commercial Code § 30-3 (4th ed.), at 11. As the *Grubbs* court points out, the controversy was at full steam at least from the time of the initial publication of the White and Summers' treatise in 1972. Grubbs, 319 B.R. at 709.
23. Grubbs, 319 B.R. at 709-10 (citations omitted). See also Gaines, Security Interests Under Article 2A: More Confusion in the Leasing Arena, 18 Stetson L. Rev. 69, 69 (1988) (acknowledging the "plethora of litigation regarding lease agreements and leased equipment").
24. Grubbs, 319 B.R. at 710, citing White and Summers, Uniform Commercial Code § 30-3 (4th ed.), at 30.
25. See, i.e., Sabino & Sabino, The New Battle of *Midway*: Appeals Court Finds Middle Ground for Lessors to Recover All Post-Petition Lease Obligations, 24 LJN's Equipment Leasing Newsl. 1, 6-7 (September 2005) (analyzing In re Midway Airlines Corp., 406 F.3d 229, 44 Bankr. Ct. Dec. (CRR) 189, 54 Collier Bankr. Cas. 2d (MB) 109, Bankr. L. Rep. (CCH) P 80276 (4th Cir. 2005), as one example of the unique and arguably superior rights a lessor possesses in a Chapter 11 case).
26. 11 U.S.C.A. § 365.
27. 11 U.S.C.A. § 365(b).
28. 11 U.S.C.A. § 365(d)(10).
29. See 11 U.S.C.A. § 503(a).
30. Grubbs, 319 B.R. at 710. And while left unsaid by the court, the contrary action of lease rejection is not all that bad for the lessor. While certainly less remunerative, the extinguishing of the leasehold gives the lessor the ability to retake and relet the property, providing a singular benefit of certainty and conclusion to its entanglement with the debtor. Furthermore, lease rejection gives rise to a lessor's claim for damages, said damages calculated as if the lessee was in breach of the arrangement on the last day before it filed for bankruptcy.
31. 11 U.S.C.A. § 506.
32. 11 U.S.C.A. § 1129(b)(2)(A)(i) (other citations omitted).
33. Grubbs, 319 B.R. at 710.
34. See 11 U.S.C.A. § 544(a).
35. Grubbs, 319 B.R. at 710-11 (citations omitted).
36. Grubbs, 319 B.R. at 711 (citations omitted).
37. Grubbs, 319 B.R. at 711. See 11 U.S.C.A. § 506(b); see also United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740, 16 Bankr. Ct. Dec. (CRR) 1369, 17 Collier Bankr. Cas. 2d (MB) 1368, Bankr. L. Rep. (CCH) P 72113 (1988).
38. Grubbs, 319 B.R. at 711.
39. Grubbs, 319 B.R. at 711-12. See 11 U.S.C.A. § 101(50). See also In re Lykes Bros. S.S. Co., Inc., 196 B.R. 574, 580-81, 1996 A.M.C. 1488, 30 U.C.C. Rep. Serv. 2d

433 (Bankr. M.D. Fla. 1996) (“Lykes”); S. Rep. No. 989, 95th Cong. 2d Sess. 64 (1978), reprinted in U.S. Code Cong. & Admin. News 1978 at 5787, 5850.

40. Grubbs, 319 B.R. at 711 (citations omitted).
41. In re Rebel Rents, Inc., 291 B.R. 520, 50 U.C.C. Rep. Serv. 2d 352 (Bankr. C.D. Cal. 2003).
42. Rebel Rents, 291 B.R. at 523.
43. Rebel Rents, 291 B.R. at 523 at n. 2.
44. Rebel Rents, 291 B.R. at 524.
45. Rebel Rents, 291 B.R. at 525.
46. Rebel Rents, 291 B.R. at 525-26.
47. Rebel Rents, 291 B.R. at 526. See also In re Lerch, 147 B.R. 455, 460, 20 U.C.C. Rep. Serv. 2d 260 (Bankr. C.D. Ill. 1992).
48. Rebel Rents, 291 B.R. at 527.
49. Rebel Rents, 291 B.R. at 527.
50. Rebel Rents, 291 B.R. at 528.
51. Rebel Rents, 291 B.R. at 528.
52. Rebel Rents, 291 B.R. at 528.
53. Rebel Rents, 291 B.R. at 529.
54. Rebel Rents, 291 B.R. at 530-31.
55. Rebel Rents, 291 B.R. at 534-35.
56. See Sabino & Geraci, The ‘True Lease vs. Disguised Security Interest’ Question Continues with a Rebel of a Case, 60 The Secured Lender 8, 24 (January/February 2004).
57. In re APB Online, Inc., 259 B.R. 812, 45 Collier Bankr. Cas. 2d (MB) 1515, 44 U.C.C. Rep. Serv. 2d 334 (Bankr. S.D. N.Y. 2001).
58. APB, 259 B.R. at 815.
59. APB, 259 B.R. at 815.
60. APB, 259 B.R. at 815-16.
61. APB, 259 B.R. at 815.
62. APB, 259 B.R. at 815-16.
63. APB, 259 B.R. at 816, citing Butner, 440 U.S. at 55.
64. APB, 259 B.R. at 816.
65. APB, 259 B.R. at 817.
66. APB, 259 B.R. at 817, citing Matter of Marhoefer Packing Co., Inc., 674 F.2d 1139, 1145, 6 Collier Bankr. Cas. 2d (MB) 11, 33 U.C.C. Rep. Serv. 370 (7th Cir. 1982).
67. APB, 259 B.R. at 817. See U.C.C. § 1-207(37) and Connecticut’s General Statutes at § 42a, et seq.
68. APB, 259 B.R. at 817-18.
69. APB, 259 B.R. at 818.
70. APB, 259 B.R. at 818.
71. APB, 259 B.R. at 818, citing Orix Credit Alliance, Inc. v. Pappas, 946 F.2d 1258, 1261-62, 16 U.C.C. Rep. Serv. 2d 502 (7th Cir. 1991); In re Beker Industries Corp., 69 B.R. 937, 940-42, 3 U.C.C. Rep. Serv. 2d 1105 (Bankr. S.D. N.Y. 1987).
72. APB, 259 B.R. at 818-19. Notably, an agreement calling for a purchase price at a fair market value to be determined at the exercise has been held to infer the price is not nominal, and thus the “lease” is in fact a true one. See In re Celeryvale Transport,

Inc., 822 F.2d 16, 18, Bankr. L. Rep. (CCH) P 71846, 4 U.C.C. Rep. Serv. 2d 210 (6th Cir. 1987).

73. APB, 259 B.R. at 818.
74. APB, 259 B.R. at 819-20.
75. APB, 259 B.R. at 820-21.
76. APB, 259 B.R. at 821.
77. APB, 259 B.R. at 821.
78. APB, 259 B.R. at 821.
79. APB, 259 B.R. at 821-22.
80. APB, 259 B.R. at 822.
81. APB, 259 B.R. at 822.
82. APB, 259 B.R. at 823.
83. APB, 259 B.R. at 823.
84. APB, 259 B.R. at 823-24.
85. See Naples, A Review and Analysis of the New Article 2A, 93 Com. L.J. 342, 349 (1988)
86. APB, 259 B.R. at 824.
87. APB, 259 B.R. at 824.
88. In re Integrated Health Services, Inc., 260 B.R. 71, 37 Bankr. Ct. Dec. (CRR) 154, 46 U.C.C. Rep. Serv. 2d 33 (Bankr. D. Del. 2001).
89. Integrated Health, 260 B.R. at 73.
90. Integrated Health, 260 B.R. at 73-74.
91. See In re PCH Associates, 804 F.2d 193, 200, Bankr. L. Rep. (CCH) P 71517 (2d Cir. 1986).
92. Integrated Health, 260 B.R. at 75.
93. Integrated Health, 260 B.R. at 75.
94. Compare *Westship, Inc. v. Trident Shipworks, Inc.*, 247 B.R. 856 862 n.7 (M.D. Fla. 2000) (collecting cases which apply federal law on one hand and state law on the other to lease v. security interest conflicts).
95. Integrated Health, 260 B.R. at 75.
96. Integrated Health, 260 B.R. at 76, citing *In re Continental Airlines, Inc.*, 932 F.2d 282, 294, 21 Bankr. Ct. Dec. (CRR) 1111, 24 Collier Bankr. Cas. 2d (MB) 1878, Bankr. L. Rep. (CCH) P 74018 (3d Cir. 1991).
97. Integrated Health, 260 B.R. at 76.
98. Integrated Health, 260 B.R. at 76.
99. Integrated Health, 260 B.R. at 76.
100. "A contract that does not contain a purchase option will be considered a lease as a matter of law, not a purchase agreement." *Legends Gym*, 383 F. Supp. 2d at 914.
101. Integrated Health, 260 B.R. at 76.
102. Integrated Health, 260 B.R. at 76. If the useful life of the property exceeds the stated term of the deal, the arrangement is a true lease. See *Marhoefer*, 674 F.2d at 1145. See also *Shores*, 332 B.R. at 39.
103. Integrated Health, 260 B.R. at 76-77.
104. Integrated Health, 260 B.R. at 77.
105. Integrated Health, 260 B.R. at 77.
106. Integrated Health, 260 B.R. at 77.

107. Integrated Health, 260 B.R. at 77.
108. Integrated Health, 260 B.R. at 77-78.
109. Grubbs, 319 B.R. 698.
110. Grubbs, 319 B.R. at 703.
111. Grubbs, 319 B.R. at 703-04.
112. Grubbs, 319 B.R. at 704-05.
113. Grubbs, 319 B.R. at 705-06.
114. Grubbs, 319 B.R. at 706.
115. Grubbs, 319 B.R. at 706-07.
116. Grubbs, 319 B.R. at 707.
117. Grubbs, 319 B.R. at 707-08. The court also noted well that, under the terms of the TRAC lease, the debtor had to return the asset to the bank, which then had to sell it for the best price, and credit the sale proceeds to the borrower's balloon payment. To be certain, there was no expectation that the bank would keep the asset. If there was a surplus from the disposal, Grubbs would get it. But if not (arguably the more likely scenario, in the authors' judgment), then the debtor had to pay the deficiency to Banc One. Grubbs, 319 B.R. at 707-08. One might call this a "win-win"—for the bank!
118. Grubbs, 319 B.R. at 708. A few other findings by the court bear mentioning. In the event of a casualty loss, the debtor was required to make the bank whole. In case of a default, Grubbs had to pay all amounts due to Banc One, including collection costs. In short, the court characterized this as "in substance simply a fixed balloon payment" assuring the bank that it would recover all of its principal, no matter what. Grubbs, 319 B.R. at 708-09.
119. Grubbs, 319 B.R. at 709.
120. See ante notes 24 through 37, inclusive.
121. Grubbs, 319 B.R. at 712.
122. Grubbs, 319 B.R. at 712 (quotation omitted).
123. Grubbs, 319 B.R. at 714 (citations omitted).
124. Grubbs, 319 B.R. at 714. See U.C.C. § 1-201(37)(2).
125. Grubbs, 319 B.R. at 714 (citations omitted). *Grubbs* borrows an interesting analogy for the per se test, likening it to a pinball safely rolling past four holes marked "security agreement," but remarking that merely evading that foursome of trapdoors does not yet qualify the arrangement to be a lease just yet. Grubbs, 319 B.R. at 715 (quotations omitted).
126. Grubbs, 319 B.R. at 715.
127. Grubbs, 319 B.R. at 715.
128. Grubbs, 319 B.R. at 715. See also U.C.C. § 1-201(37).
129. Grubbs, 319 B.R. at 716 (capitalization in the original). See also Barnes, Distinguishing Sales and Leases: A Primer on the Scope and Purpose of UCC Article 2A, 25 U. Mem. L. Rev. 873, 885 (1995) ("Where a person is left with no real economic choice, the price of taking the action [exercising the purchase option] must be nominal").
130. Grubbs, 319 B.R. at 715-16. Accord *WorldCom*, 339 B.R. at 68. Bankruptcy Judge Gonzalez of New York's Southern District comprehensively lists the several aliases for the Economic Realities Test and their respective sources, including the "no sensible alternative" and the sharp-tongued "no lessee in its right mind" tests. *World Com*, 339 B.R. at 66 n. 7.
131. Grubbs, 319 B.R. at 717 (citation omitted). Without question, this axiom prevails: "Foresight not hindsight controls." White and Summers, Uniform Commercial

Code § 30-3 (4th ed.), at 9. Accord *In re Zaleha*, 159 B.R. 581, 586, 23 U.C.C. Rep. Serv. 2d 1035 (Bankr. D. Idaho 1993) (“[T]he date of the transaction... determine[s] the adequacy of the option price”). See also Huddleson, *Old Wine in New Bottles: UCC Article 2A Leases*, 39 Ala. L. Rev. 615, 633 (1988) (“Transactions are not true leases where the parties anticipate, at the outset of the transaction, that the option will be irresistible”).

132. *Grubbs*, 319 B.R. at 717-18, citing *Lykes*, 196 B.R. at 582.

133. The better reasoned view is that the term “nominal” is relative, not absolute, given that the demise of the old fashioned “absolutely nominal” consideration of \$1 has compelled courts to devise new yardsticks to measure what is truly nominal or not in the context of the “true lease” conflicts. *WorldCom*, 339 B.R. at 66 n. 6.

134. *Grubbs*, 319 B.R. at 718-19 (citations omitted).

135. *Grubbs*, 319 B.R. at 719 (citations omitted).

136. *Grubbs*, 319 B.R. at 719 (citations omitted).

137. *Grubbs*, 319 B.R. at 719-20.

138. *Grubbs*, 319 B.R. at 720.

139. *Grubbs*, 319 B.R. at 720.

140. *Grubbs*, 319 B.R. at 720-21, 724.

141. *United Airlines, Inc. v. HSBC Bank USA, N.A.*, 416 F.3d 609, 45 Bankr. Ct. Dec. (CRR) 1, Bankr. L. Rep. (CCH) P 80322 (7th Cir. 2005), cert. denied, 547 U.S. 1003, 126 S. Ct. 1465, 164 L. Ed. 2d 247 (2006) (“*United I*”).

142. *United I*, 416 F.3d at 610.

143. *United I*, 416 F.3d at 610.

144. *United I*, 416 F.3d at 610, citing 11 U.S.C.A. § 365, § 506(a), and § 1129(b)(2)(A). Noting there are other ways the Bankruptcy Code treats leases differently from security interests, the court did not address them because “they don’t matter to today’s dispute.” *United I*, 416 F.3d at 610.

145. *United I*, 416 F.3d at 610-11. As we will see later in this article, the Los Angeles transaction spawned *United II*, while the Denver deal gave birth to *In re United Air Lines, Inc.*, 453 F.3d 463, 46 Bankr. Ct. Dec. (CRR) 199, 56 Collier Bankr. Cas. 2d (MB) 540, Bankr. L. Rep. (CCH) P 80652 (7th Cir. 2006) (“*United III*”).

146. *United I*, 416 F.3d at 611.

147. *United I*, 416 F.3d at 611.

148. *United I*, 416 F.3d at 611 (citations omitted).

149. *United I*, 416 F.3d at 611 (citations omitted).

150. See also *United Air Lines, Inc. v. HSBC Bank USA*, 322 B.R. 347, 53 Collier Bankr. Cas. 2d (MB) 2025 (N.D. Ill. 2005), aff’d, 453 F.3d 463, 46 Bankr. Ct. Dec. (CRR) 199, 56 Collier Bankr. Cas. 2d (MB) 540, Bankr. L. Rep. (CCH) P 80652 (7th Cir. 2006) (deciding under Colorado law that transaction between debtor and the City of Denver was a true lease).

151. *United I*, 416 F.3d at 611.

152. For a fuller explanation of the CSCDA, see *HSBC Bank USA v. United Air Lines, Inc.*, 317 B.R. 335, 338, 43 Bankr. Ct. Dec. (CRR) 264 (N.D. Ill. 2004), rev’d and remanded on other grounds, 416 F.3d 609, 45 Bankr. Ct. Dec. (CRR) 1, Bankr. L. Rep. (CCH) P 80322 (7th Cir. 2005), cert. denied, 547 U.S. 1003, 126 S. Ct. 1465, 164 L. Ed. 2d 247 (2006) (Darrah, J.).

153. *United I*, 416 F.3d at 611.

154. *United I*, 416 F.3d at 611.

155. United I, 416 F.3d at 611. Note the “rent” was to be paid to HSBC BankUSA as the indenture trustee for the CSCDA, hence the former’s role as the defendant in this action.

156. A “hell or high water” clause, as the melodramatic name implies, is a contractual provision that declares that all of the lessee’s obligations to the lessor are absolute and unconditional. As concisely stated by one set of noted commentators, “[e]ssentially, [the lessee] agrees to pay ‘come hell or high water.’” Dusch & Frohman, *Financing Payment Obligations for Services: Are ‘Hell or High Water’ and ‘Waiver of Defenses’ Clauses Enforceable in Contracts for Future Services?* 63 *The Secured Lender* 44, 46 (July/August 2007). The lessee in such a deal is expressly forbidden from raising any defense to nonpayment, including, but not limited to, abatement, reduction, set-off, deduction or counterclaim. Simply put, the lessee waives all defenses and has no option but to remit full payment without fail. Courts have found “hell or high water” clauses essential to the leasing industry, and thereby enforceable. See generally *Colorado Interstate Corp. v. CIT Group/Equipment Financing, Inc.*, 993 F.2d 743, 748 (10th Cir. 1993); *Philadelphia Sav. Fund Soc. v. Deseret Management Corp.*, 632 F. Supp. 129, 136 (E.D. Pa. 1985); *Brookridge Funding Corp. v. Northwestern Human Services*, 175 F. Supp. 2d 355, 363, 46 U.C.C. Rep. Serv. 2d 1150 (D. Conn. 2001); *Rhythm & Hues, Inc. v. Terminal Marketing Co., Inc.*, 2004 WL 941908 (S.D. N.Y. 2004), report and recommendation adopted, 2006 WL 800959 (S.D. N.Y. 2006) (Gorenstein, M.J.), analyzed at Sabino, *Come ‘Hell or High Water,’ The Lessee Must Pay*, 23 *LJN’s Equipment Leasing Newsl.* 3 (September, 2004) (a “hell or high water” clause is not oppressive, but rather a legitimate tool whereby a cautious lessor protects itself when it has reservations about the stability of its lessee). For a fine example of an actual text of a “hell or high water” proviso, and a worthy analysis of some of its ancillary issues, see Gross & Livingston, *Is Your (Non-True) Lease a Sale?* 26 *LJN’s Equipment Leasing Newsl.* 1, 2 (July 2007), discussing *Key Equipment Finance Inc. v. Pioneer Transp., Ltd.*, 472 F. Supp. 2d 1131 (W.D. Wis. 2007).

157. United I, 416 F.3d at 611-12.

158. United I, 416 F.3d at 612.

159. United I, 416 F.3d at 612, citing *PCH*, 804 F.2d at 198-200; *Pillowtex*, 349 F.3d at 716; *In re Moreggia & Sons, Inc.*, 852 F.2d 1179, 1182-84, 18 *Bankr. Ct. Dec. (CRR)* 206, 19 *Collier Bankr. Cas.* 2d (MB) 949, *Bankr. L. Rep. (CCH)* P 72417 (9th Cir. 1988) (9th Cir. 1988); *In re Pacific Exp., Inc.*, 780 F.2d 1482, 1486-87, 14 *Bankr. Ct. Dec. (CRR)* 69, *Bankr. L. Rep. (CCH)* P 70954, 42 U.C.C. Rep. Serv. 1414 (9th Cir. 1986), See also, e.g., *Continental*, 932 F.2d 282 (same under 11 U.S.C.A. § 1110, another esoteric part of the Code dealing with leases for aircraft).

160. United I, 416 F.3d at 612.

161. United I, 416 F.3d at 612, citing *Reves v. Ernst & Young*, 494 U.S. 56, 71, 110 S. Ct. 945, 108 L. Ed. 2d 47, *Blue Sky L. Rep. (CCH)* P 73213, *Fed. Sec. L. Rep. (CCH)* P 94939 (1990); *Bryant v. Yellen*, 447 U.S. 352, 370-71, 100 S. Ct. 2232, 65 L. Ed. 2d 184, 14 *Env’t. Rep. Cas. (BNA)* 1609, 10 *Envtl. L. Rep.* 20482 (1980).

162. United I, 416 F.3d at 612.

163. United I, 416 F.3d at 613.

164. United I, 416 F.3d at 613, citing *Boston and Maine Corp. v. Chicago Pacific Corp.*, 785 F.2d 562, 14 *Bankr. Ct. Dec. (CRR)* 475, 14 *Collier Bankr. Cas.* 2d (MB) 715, *Bankr. L. Rep. (CCH)* P 71076 (7th Cir. 1986).

165. United I, 416 F.3d at 613.

166. United I, 416 F.3d at 613.

167. United I, 416 F.3d at 613, citing *Helvering v. F. & R. Lazarus & Co.*, 1939-2 C.B. 208, 308 U.S. 252, 60 S. Ct. 209, 84 L. Ed. 226, 39-2 U.S. Tax Cas. (CCH) P 9793, 23 A.F.T.R. (P-H) P 778 (1939). See also, e.g., *Frank Lyon Co. v. U. S.*, 1978-1 C.B. 46, 435 U.S. 561, 98 S. Ct. 1291, 55 L. Ed. 2d 550, 78-1 U.S. Tax Cas. (CCH) P 9370, 41 A.F.T.R.2d 78-1142 (1978).

168. United I, 416 F.3d at 613.

169. United I, 416 F.3d at 613-14.

170. United I, 416 F.3d at 614.

171. United I, 416 F.3d at 614, citing S. Rep. No. 989, 95th Cong., 2d Sess. 17, 64 (1978), reprinted in 1978 U.S.C.C. A.N. 5787, 5850.

172. United I, 416 F.3d at 614.

173. United I, 416 F.3d at 614, citing *American Hosp. Ass'n v. N.L.R.B.*, 499 U.S. 606, 615-16, 111 S. Ct. 1539, 113 L. Ed. 2d 675, 137 L.R.R.M. (BNA) 2001, 118 Lab. Cas. (CCH) P 10646 (1991).

174. United I, 416 F.3d at 614.

175. United I, 416 F.3d at 614, citing *Cherokee Nation of Oklahoma v. Leavitt*, 543 U.S. 631, 125 S. Ct. 1172, 161 L. Ed. 2d 66 (2005).

176. United I, 416 F.3d at 614.

177. United I, 416 F.3d at 614.

178. United I, 416 F.3d at 615, citing *Butner*, 440 U.S. 48. The *United I* court also cited *Butner's* legion of progeny, to wit: *Raleigh v. Illinois Dept. of Revenue*, 2000-2 C.B. 109, 530 U.S. 15, 20, 120 S. Ct. 1951, 147 L. Ed. 2d 13, 36 Bankr. Ct. Dec. (CRR) 39, 43 Collier Bankr. Cas. 2d (MB) 869, Bankr. L. Rep. (CCH) P 78182, 2000-1 U.S. Tax Cas. (CCH) P 50498 (2000); *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544-45, 114 S. Ct. 1757, 128 L. Ed. 2d 556, 25 Bankr. Ct. Dec. (CRR) 1051, 30 Collier Bankr. Cas. 2d (MB) 345, Bankr. L. Rep. (CCH) P 75885 (1994); *Nobelman v. American Sav. Bank*, 508 U.S. 324, 329-30, 113 S. Ct. 2106, 124 L. Ed. 2d 228, 24 Bankr. Ct. Dec. (CRR) 479, 28 Collier Bankr. Cas. 2d (MB) 977, Bankr. L. Rep. (CCH) P 75253A (1993); *Barnhill v. Johnson*, 503 U.S. 393, 398, 112 S. Ct. 1386, 118 L. Ed. 2d 39, 22 Bankr. Ct. Dec. (CRR) 1218, 26 Collier Bankr. Cas. 2d (MB) 323, Bankr. L. Rep. (CCH) P 74501, 17 U.C.C. Rep. Serv. 2d 1 (1992).

179. United I, 416 F.3d at 615.

180. United I, 416 F.3d at 614, citing *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755, 21 Bankr. Ct. Dec. (CRR) 342, 24 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) P 73746A, 70 A.F.T.R.2d 92-5639 (1991).

181. United I, 416 F.3d at 615. See *In re Schoonover*, 331 F.3d 575, 577, Bankr. L. Rep. (CCH) P 78862 (7th Cir. 2003).

182. United I, 416 F.3d at 616.

183. United I, 416 F.3d at 614. Parenthetically, the Seventh Circuit noted that California also adopted this functional approach to distinguish true leases versus secured credit for real property transactions as well. United I, 416 F.3d at 616. See *Burr v. Capital Reserve Corp.*, 71 Cal. 2d 983, 80 Cal. Rptr. 345, 458 P.2d 185 (1969), and *Beeler v. American Trust Co.*, 24 Cal. 2d 1, 147 P.2d 583 (1944). *Beeler* arose from the sale and leaseback of real property, and relied not only on the fact that the landlord was a financial institution but also on the fact that the rent was equal to the sum needed to pay off a loan, and the lessee would become an owner after some years. (This is a mirror of the UCC's per se rule: If the lessee has an option to acquire ownership at the end of the term for no or a nominal payment, then the transaction must be treated as secured credit.) The yearly rent was substantially less than the going rate for similar property but exactly equal to the amount needed to amortize the amount of money borrowed. California's

Supreme Court held in *Beeler* that form had to yield to substance. *Burr* concerned a lease of personal property, but yielded an identical result; form must be disregarded to arrive at the substance of a purported lease. To be certain, the Seventh Circuit recalled that California had applied this rule of decision in numerous other cases. United I, 416 F.3d at 616, citing *Lovelady v. Bryson Escrow, Inc.*, 27 Cal. App. 4th 25, 32 Cal. Rptr. 2d 371, 24 U.C.C. Rep. Serv. 2d 270 (2d Dist. 1994), as modified on denial of reh'g, (Aug. 24, 1994); *Rider v. City of San Diego*, 18 Cal. 4th 1035, 77 Cal. Rptr. 2d 189, 959 P.2d 347 (1998); *Dean v. Kuchel*, 35 Cal. 2d 444, 218 P.2d 521 (1950); *City of Desert Hot Springs v. County of Riverside*, 91 Cal. App. 3d 441, 154 Cal. Rptr. 297 (4th Dist. 1979).

184. United I, 416 F.3d at 617.

185. United I, 416 F.3d at 617.

186. United I, 416 F.3d at 617.

187. United I, 416 F.3d at 617 (citations omitted). The CSCDA's last gasp was to argue that United failed to contest the lease within 60 days of its execution, a device purely of California state law. The agency's cross-appeal on this point was dismissed as surplusage. "State procedures do not matter in bankruptcy. State law defines property rights, but federal law prescribes the hoops through which the litigants must jump." The Seventh Circuit rejected any notion that a state could impose any law that modified the operation of a Bankruptcy Code statute. United I, 416 F.3d at 617-18, citing *Brown v. Felsen*, 442 U.S. 127, 99 S. Ct. 2205, 60 L. Ed. 2d 767, 5 Bankr. Ct. Dec. (CRR) 226, 20 C.B.C. 273, 1 Collier Bankr. Cas. 2d (MB) 34, Bankr. L. Rep. (CCH) P 67122 (1979). Such a concept is antithetical to the exclusivity of federal bankruptcy jurisdiction. And this is entirely set apart from the potentially preclusive effect of issues litigated to a resolution in state court prior to the onset of bankruptcy proceedings. United I, 416 F.3d at 618, citing, *inter alia*, *Grogan*, 498 U.S. at 284-85 n. 11; *Brown*, 442 U.S. at 139; *Kelly v. Robinson*, 479 U.S. 36, 47-49, 107 S. Ct. 353, 93 L. Ed. 2d 216, 14 Bankr. Ct. Dec. (CRR) 1383, 14 Bankr. Ct. Dec. (CRR) 1384, 15 Collier Bankr. Cas. 2d (MB) 890, Bankr. L. Rep. (CCH) P 71475 (1986). In sum, said Circuit Judge Easterbrook, "states may not compel potential debtors in bankruptcy to use state tribunals before repairing to federal court." United I, 416 F.3d at 617.

188. United I, 416 F.3d at 618.

189. *In re JII Liquidating, Inc.*, 341 B.R. 256, 46 Bankr. Ct. Dec. (CRR) 131 (Bankr. N.D. Ill. 2006).

190. JII, 341 B.R. at 260. See also JII, 341 B.R. at 263-66 for an exhaustive discussion of the standards for summary judgment, as well as a sharp criticism of the putative lessor's deficiencies in its submission seeking to both deflect and obtain such relief.

191. JII, 341 B.R. at 261.

192. JII, 341 B.R. at 261.

193. JII, 341 B.R. at 262-63.

194. JII, 341 B.R. at 266; JII, 341 B.R. at 264 ("Summary judgment is particularly appropriate in cases involving the interpretation of contractual documents").

195. See 11 U.S.C.A. § 365.

196. JII, 341 B.R. at 267, citing United I, 416 F.3d at 610.

197. JII, 341 B.R. at 267.

198. JII, 341 B.R. at 267, citing United I, 416 F.3d at 610.

199. JII, 341 B.R. at 267, citing Official Comment to U.C.C. § 1-201(37).

200. JII, 341 B.R. at 267, quoting White and Summers, Uniform Commercial Code § 30-3 (4th ed.).

201. JII, 341 B.R. at 267. See also *In re Powers*, 983 F.2d 88, 90, Bankr. L. Rep. (CCH) P 75066, 19 U.C.C. Rep. Serv. 2d 689 (7th Cir. 1993) (state law clearly governs the creation, nature, and extent of a security interest).

202. JII, 341 B.R. at 268. See U.C.C. § 1-201(37).

203. JII, 341 B.R. at 268.

204. JII, 341 B.R. at 268. But compare *In re Lerch*, 147 B.R. 455, 460, 20 U.C.C. Rep. Serv. 2d 260 (Bankr. C.D. Ill. 1992) (satisfying the two-prong per se test not enough; a further analysis of the economics of the transaction is needed to establish that the agreement is a security interest).

205. JII, 341 B.R. at 268-69. The *Mason* court went on to catalogue those attributes to be analyzed. JII, 341 B.R. at 269.

206. JII, 341 B.R. at 269.

207. JII, 341 B.R. at 269. See *In re Lunan Family Restaurants*, 194 B.R. 429, 450-51 (Bankr. N.D. Ill. 1996). It is well settled that the party seeking to characterize an arrangement is not what it purports to be, i.e., claiming a document labeled a "lease" is really a disguised security interest, bears the burden of proof. *WorldCom*, 339 B.R. at 62 (citing cases); *Parker*, 363 B.R. at 773 (party seeking to overturn characterization of an arrangement bears burden of proof); see also *In re Zaleha*, 159 B.R. 581, 586, 23 U.C.C. Rep. Serv. 2d 1035 (Bankr. D. Idaho 1993).

208. JII, 341 B.R. at 269.

209. JII, 341 B.R. at 269.

210. JII, 341 B.R. at 269-70.

211. JII, 341 B.R. at 270, citing *United I*, 416 F.3d at 612.

212. JII, 341 B.R. at 270.

213. JII, 341 B.R. at 270.

214. JII, 341 B.R. at 270. "[T]he practical inability of the lessee to return the leased goods due to the cost and difficulty of removal is evidence that a security interest was created." *WorldCom*, 339 B.R. at 74, citing *Pillowtex*, 349 F.3d at 723.

215. JII, 341 B.R. at 270. To be sure, the court reminds that it is not the inclusion of a mere purchase option, with nothing else, that make an agreement a secured transaction, it is the additional term of the purchases for a nominal consideration or no consideration at all the debunks the deal as a lease. JII, 341 B.R. at 270.

216. JII, 341 B.R. at 271.

217. JII, 341 B.R. at 272. Notably, the *Mason* court was more than fair on this point. Bankruptcy Judge Squires made an exhaustive analysis of whether or not the one dollar purchase option here was truly nominal. No "bright line" test exists for deciding what is nominal, said the court. JII, 341 B.R. at 271. At varying times, courts had sought to define "nominal" as \$1, \$10, or \$100. JII, 341 B.R. at 271 (citations omitted). Other jurists expanded the concept to calculating the option as a percentage of the value of the "leased" property or the total of the lease "rent" payments, with some courts declaring that any option price that constitutes over 25% of the total price can never be classified as nominal. JII, 341 B.R. at 271. (citations omitted). Indeed, there is a wide disparity over what the option sum is compared to: the total "rent" paid, the original cost, the fair market value of the end of the term of the agreement or the anticipated value of the property at the option exercise date, as projected by the parties at the time the transaction is first entered into. JII, 341 B.R. at 271. As stated above, the *Mason* court simply found it would have been foolhardy for the debtor not to exercise a one dollar option to pay for assets worth nearly \$6 million. Yet this could reflect that court's inclination towards an "economic realities" test, which Bankruptcy Judge Squires paraphrased as when the only sensible alternative is to exercise the option in view of all the circumstances. JII, 341

B.R. at 271-72 (citations omitted). Given the unquestioned nominality of the one dollar option here, some might criticize Judge Squires' elaboration as mere dicta. We disagree; the *Mason* court, by necessity, explicated why "nominal" is not such a facile concept, and in doing so, provides valuable guidance for future determinations of what is truly "nominal" in cases yet to come.

218. JII, 341 B.R. at 272. Yet again showing both open-mindedness and comprehensive analysis, Bankruptcy Judge Squires still parenthetically noted "other signposts indicating that the [a]greement is a disguised sale," among them: the alleged "rent" was over \$7.2 million, while the property's original cost was below \$6 million, a substantial difference (possibly indicative of an interest component in the deal); and the debtor had to pay for all maintenance, service, repairs, insurance, and taxes, what Judge Squires called "firm indicia of ownership" and certainly not a true lease. In counterpoise, the equipment had a fair market value at the agreement's termination of over \$4 million, suggesting the assets' useful life exceeded the "lease" term, a countervailing sign that this deal might have been a true lease. JII, 341 B.R. at 273. With the ultimate result unchanged and turning on different points, some might call this dicta. Once more, we call it meaningful instruction.

219. JII, 341 B.R. at 273, quoting White and Summers, Uniform Commercial Code § 30-3(b)(1) (4th ed.), cited by Parker, 363 B.R. 769, 773 (Bankr. D.S.C. 2006) (determination whether an agreement is a true lease or a disguised security interest is made at the time the parties sign the agreement).

220. JII, 341 B.R. at 273.

221. In re United Air Lines, Inc., 447 F.3d 504, 46 Bankr. Ct. Dec. (CRR) 125, 56 Collier Bankr. Cas. 2d (MB) 139, Bankr. L. Rep. (CCH) P 80513 (7th Cir. 2006) ("*United II*").

222. United II, 447 F.3d at 505.

223. United II, 447 F.3d at 505. Parenthetically, the court noted that United's plan of reorganization had been confirmed some three months before this decision, and as part thereof, the debtor had conditionally assumed the supposed lease. However, since this tribunal's decision would determine if the transaction was in fact a loan, that presumption would be overturned, and the claim would then be deemed a prepetition debt. Thus the point was far from moot. United II, 447 F.3d at 505 n.1.

224. United II, 447 F.3d at 505, citing 11 U.S.C.A. §§ 365, 506(a), and 1129(b)(2)(A), respectively.

225. United II, 447 F.3d at 506. See also U.S. Bank Nat. Ass'n v. United Air Lines, Inc., 331 B.R. 765 (N.D. Ill. 2005), judgment rev'd and remanded on other grounds, 447 F.3d 504, 46 Bankr. Ct. Dec. (CRR) 125, 56 Collier Bankr. Cas. 2d (MB) 139, Bankr. L. Rep. (CCH) P 80513 (7th Cir. 2006) (Darrah, J.) (United's arrangement at Los Angeles International Airport).

226. As cogently explained by Magistrate Judge Gorenstein, an indenture trustee fills a largely administrative role in transactions such as these. The indenture trustee's job is to handle money, safeguard the original lease documents in its vault, and so forth. In contradistinction, the indenture trustee has no obligation to examine the leases it is holding, nor look beyond the representations and warranties made by the lessor. Rhythm & Hues, 2004 WL 941908 (Gorenstein, M.J.), analyzed at Sabino, Come 'Hell or High Water,' The Lessee Must Pay, 23 LJN's Equipment Leasing Newsl. 3 (September, 2004).

227. United II, 447 F.3d at 506. At the time of the decision, over \$59 million in "balloon" payments on the books were outstanding. United II, 447 F.3d at 506.

228. United II, 447 F.3d at 506.

229. United II, 447 F.3d at 506, citing United I, 416 F.3d 609; PCH, 804 F.2d at 198-200; Pillowtex, 349 F.3d at 716; Moreggia, 852 F.2d at 1182-84; Pacific Exp., 780 F.2d at 1486-87.

230. United II, 447 F.3d at 506.

231. United II, 447 F.3d at 506-07.

232. United II, 447 F.3d at 507, citing United I, 416 F.3d at 615.

233. United II, 447 F.3d at 507, citing United I, 416 F.3d at 615-16.

234. United II, 447 F.3d at 507.

235. United II, 447 F.3d at 507. As postulated by the court, did United have to pay the full rent even if the property became unusable? United II, 447 F.3d at 507.

236. United II, 447 F.3d at 507, citing United I, 416 F.3d at 617.

237. United II, 447 F.3d at 508.

238. United II, 447 F.3d at 508, citing various California state law cases. The *United II* court also noted the similarity with *United I*, where it found the debtor's "rent" in San Francisco was not based upon the property's market value, but rather the sums the airline borrowed to develop its facilities at that city's airport. United II, 447 F.3d at 508, citing United I, 416 F.3d at 617.

239. United II, 447 F.3d at 508.

240. United II, 447 F.3d at 508, citing United I, 416 F.3d at 617.

241. United II, 447 F.3d at 508.

242. United II, 447 F.3d at 508, citing United I, 416 F.3d at 617.

243. United II, 447 F.3d at 508-09.

244. United II, 447 F.3d at 509, citing United I, 416 F.3d at 617.

245. United II, 447 F.3d at 509.

246. United II, 447 F.3d at 509.

247. United II, 447 F.3d at 509.

248. United II, 447 F.3d at 509, citing United I, 416 F.3d at 617 (same).

249. United II, 447 F.3d at 509. The tribunal further rejected the RAIC's argument that the reversionary interest held by the City of Los Angeles saved this point. While the City was the underlying owner, the lease at issue was between United and the agency, not the municipality. Since the court had already ruled the RAIC and the City were separate legal entities under their local law, this lack of identity effectively negated the contention that a reversionary interest existed. United II, 447 F.3d at 509.

250. United II, 447 F.3d at 509-10.

251. United III, 453 F.3d 463.

252. As related to us in United I, 416 F.3d 609, the airline had also contested its so-called lease at New York City's John F. Kennedy International Airport. Alas, this grouping would never become a quartet, as we now learn the tribunal disposed of the JFK dispute via an unpublished order. United III, 453 F.3d at 467 n. 2. And now we understand why *United IV* is a sequel that shall never be written.

253. Circuit Judge Easterbrook was on the panel, with Circuit Judge Bauer completing the triumvirate.

254. United III, 453 F.3d at 464-65.

255. United III, 453 F.3d at 465. Denver was and still is one of United's more critical, if not the most important, hub in the legacy airline's route system. DIA is United's second largest hub, and the top hub for its subsidiary Ted. United controls approximately 57% of all passengers aircraft at the airport, with approximately 77 out of

DIA's 138 gates. See Denver International Airport — Wikipedia, at http://en.wikipedia.org/wiki/Denver_International_Airport.

256. United III, 453 F.3d at 465.

257. United III, 453 F.3d at 465. The appellate court was careful to note that, as it was issuing this decision on July 6, 2006, United had already exited bankruptcy on February 1. However, the confirmed Chapter 11 plan has provisionally treated the Denver deal as a lease, but had a contingency if the court ruled the transaction was a disguised security interest. "Accordingly," said the Seventh Circuit, "we have a live, justiciable controversy before us." United III, 453 F.3d at 465 n. 1.

258. United III, 453 F.3d at 465, citing, inter alia, 11 U.S.C.A. § 365 and *United I*.

259. United III, 453 F.3d at 465.

260. United III, 453 F.3d at 465.

261. United III, 453 F.3d at 465-66.

262. United III, 453 F.3d at 466.

263. United III, 453 F.3d at 466.

264. United III, 453 F.3d at 466.

265. United III, 453 F.3d at 466.

266. United III, 453 F.3d at 466-67.

267. United III, 453 F.3d at 467. Indeed, the tribunal acknowledged its jurisprudence on this subject "is now a trilogy."

268. United III, 453 F.3d at 467.

269. United III, 453 F.3d at 467 (citations omitted).

270. United III, 453 F.3d at 467.

271. United III, 453 F.3d at 467, citing, inter alia, *Butner*, 440 U.S. 48.

272. United III, 453 F.3d at 467. The panel then devoted a substantial discussion to determining if it confronted a question of law or fact or an admixture of both, a determination necessary to ascertain the appropriate standard of appellate review. While highly enlightening on that discrete issue, for this Article's purposes suffice to say the cross-summary judgment motions below mandated this as a question of law. Hence, the de novo review standard customary in federal courts on summary judgment proceedings was appropriate, and therefore would be applied. United III, 453 F.3d at 467-68. See also *In re Kmart Corp.*, 434 F.3d 536, 541, 45 Bankr. Ct. Dec. (CRR) 223, 55 Collier Bankr. Cas. 2d (MB) 829, Bankr. L. Rep. (CCH) P 80435 (7th Cir. 2006) (while state law may provide substance, federal law provides the standard of appellate review).

273. United III, 453 F.3d at 468, citing *Univex Intern., Inc. v. Orix Credit Alliance, Inc.*, 914 P.2d 1355, 1357, 29 U.C.C. Rep. Serv. 2d 734 (Colo. 1996), and *Homier v. Faricy Truck & Equipment Co.*, 784 P.2d 798, 801, 10 U.C.C. Rep. Serv. 2d 118 (Colo. Ct. App. 1988).

274. United III, 453 F.3d at 468.

275. United III, 453 F.3d at 468-69 (citations omitted). The Seventh Circuit referred to "two helpful examples" from the Colorado state courts exemplifying this rule in action. United III, 453 F.3d at 469. In *Campbell Printing Press & Mfg. Co. v. Marsh*, 20 Colo. 22, 36 P. 799 (1894), the Colorado Supreme Court would not let the defendant sever the contract for the purchase of a printing press and a paper folder, because the press was useless without the folder. Since the folder was never delivered, the plaintiff was allowed to rescind the entire contract. As the *United III* court concluded, "[b]ottom line, because the plaintiffs would not have entered the contract if they could not obtain the press and the folder jointly, the contract could not be severed." United III, 453 F.3d at 469 (citations omitted). In *Homier*, 784 P.2d 798, the second and more recent

example, again the defendant's plea to sever was denied, because the contract was for a dump truck and an attached "dump body." Notwithstanding an explicit allocation for the latter component (which by the way did not work, and thus the ensuing litigation), "the purchase of the truck with a dump body was one integrated deal." There was no indication that the parties intended to transact in completely independent parts instead of a single, functioning dump truck, and therefore severing the contract was precluded. United III, 453 F.3d at 469 (citations omitted).

276. United III, 453 F.3d at 470.

277. United III, 453 F.3d at 470.

278. United III, 453 F.3d at 470.

279. United III, 453 F.3d at 470.

280. United III, 453 F.3d at 470.

281. United III, 453 F.3d at 470.

282. United III, 453 F.3d at 470 (emphasis in the original).

283. United III, 453 F.3d at 470-71. Almost as an aside, the panel rejected United's other argument, based upon a preexisting local ordinance that purportedly required the municipality to segregate leaseholds and bond deals into two. The older local law was usurped, said the court, by another Denver ordinance, specifically adopted at the time of the DIA deal, which contemplated the very type of unified documentation for a lease/bond deal as found in the instant case. And even if there was an inconsistency between the two municipal provisos, the one subsequently enacted specifically negated its precedents. Thus, United's statutory argument failed. United III, 453 F.3d at 471.

284. United III, 453 F.3d at 471.

285. United III, 453 F.3d at 471.

286. United III, 453 F.3d at 471. Once more in the interests of thoroughness, the panel noted that this resolution rendered moot the secondary issue of whether or not this transaction was a "stealth financing arrangement." United III, 453 F.3d at 471.

287. United III, 453 F.3d at 471-72.

288. United III, 453 F.3d at 472.