

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

IN the Matter of :
 :
 WILLIAM L. FRIEZE and : Case No. 91-2987-W H
 PEGGY C. FRIEZE, : Chapter 7
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 Debtors. :
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ORDER ON OBJECTION TO EXEMPTIONS

Trustee's Objection to Debtors' Claim of Exemptions came before the Court via telephonic hearing on February 13, 1992. Deborah L. Petersen represented the Debtors and Charles L. Smith represented himself as Trustee. At the conclusion of the hearing, the matter was taken under advisement upon a briefing deadline. Both Trustee and Debtors timely filed briefs and the matter is now fully submitted.

This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B). Upon review of the pleadings and arguments of counsel, findings and conclusions are now entered pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. On October 15, 1991 at 7:30 a.m., Debtors filed a voluntary Chapter 7 petition.
2. On Schedule D, Creditors Holding Secured Claims, Debtors listed a debt to Jim Hawk Truck Trailers in the amount of \$10,020.00. Debtors further stated that the debt was secured by a Lease purchase agreement with a 1984 Great Dane Trailer serving as collateral. The trailer was not listed on

Schedule B as personal property. It was listed on Schedule G-- Executory Contracts and Unexpired Leases, as a Lease Purchase Agreement for a "1984 Great Dane Reefer, Model 701 TZ-1 and Thermo-King Sentry Refrigeration Unit." The trailer was again listed in the Statement of Financial Affairs as property held for another person under a lease agreement.

3. On the night of the date of filing, Debtor was involved in a collision that damaged the trailer.

4. On November 15, 1991 the Debtors amended their bankruptcy schedules by amending Schedule C, Property Claimed as Exempt, to include a 1984 Great Dane Trailer valued as exempt at \$9,850.00 and a 1984 Great Dane Trailer valued as exempt at \$4,000.00. The exemptions were claimed pursuant to Iowa Code § 627.6(10) and (9)(b) respectively.

5. On December 19, 1991, Trustee filed an objection to the Debtors' claim of exemption in both and each of the truck trailers.

6. Debtors' Objection to Trustee's Objection to Debtors' Claim of Exemption filed December 27, 1991 clarifies that Debtors own and claim one 1984 Great Dane Trailer and claim it exempt under Iowa Code sections 627.6(10) (tool of the trade) and 627.6(9)(b) (motor vehicle).

7. A copy of the lease concerning the trailer was submitted by the parties. It is dated December 13, 1989.

9. The trailer was insured and the insurance company

paid \$12,000.00 for the loss of the trailer to Jim Hawk Finance, Ltd. After the application of the insurance proceeds to the remaining balance outstanding under the terms of the lease, there remained the sum of \$2,663.21 available, which has been turned over to the trustee.

9. The Trustee remains in possession of the sum of \$2,663.21 pending this Court's ruling on the Trustee's objection to claim of exemption. The Debtors have claimed these proceeds as exempt as proceeds of exempt property.

10. The parties have stipulated there is no factual dispute between the parties. The parties further stipulate that the only legal issue the Court must determine is whether the Debtors' interest under the equipment lease is exempt to them.

DISCUSSION

While framed in the context of an exemption dispute, at issue in this proceeding is the Debtors' interest in the insurance proceeds of the truck trailer, which they now claim as exempt. Was their interest a mere leasehold interest or did they have an equity interest in the trailer? Whether Debtors held an equity interest in the trailer depends on whether the agreement between Debtors and Jim Hawk Finance, Ltd. was a true lease or a lease intended as security. If the Debtors did have an equity interest in the trailer, then the

insurance proceeds of the trailer/reefer could be claimed as exempt by the Debtors as proceeds of a tool of the trade pursuant to Iowa Code § 627.6(10). See In re Meyer, No. 88-1699-CH (Bankr. S.D. Iowa May 31, 1989) (#97).

The question of whether a document is a true lease or a lease intended as security is a question of state law. The agreement provides that it is to be interpreted and enforced under the laws of the State of Minnesota. Minnesota has adopted the Uniform Commercial Code and therefore the terms of the Uniform Commercial Code govern interpretation of the agreement. The basic guideline for determining whether a lease is a true or a lease intended as security under the Uniform Commercial Code is set forth in U.C.C. § 1-201(37), the U.C.C. definition of security interest. ¹ Uniform Commercial Code § 1-201(37) provides in pertinent part:

Whether a lease is intended as security is to be determined by the facts of each case; however,

(a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and

(b) an agreement that upon compliance with the terms of the lease the lessee shall

¹ In 1989 Minnesota amended clause (37) of section 336.1-201. The amendment, however, does not govern this case because it does not apply to lease contracts entered into prior to January 1, 1990. Minn. Stat. Ann. § 336.1-201(37) (Supp. 1992). This lease contract became effective and is dated December 13, 1989. Amended clause (37) does, however, provide useful analogies for the matter at bar.

become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

U.C.C. § 1-201(37) (same as Minn. Stat. Ann. § 336.1-201(37) (1989)).

One of this court's most recent analyses of whether an agreement is a true lease or a lease intended as security may be found and is cited by the parties at In re Rose Way, Inc., No. 89-1273-CH (Bankr. S.D. Iowa Aug. 30, 1989) (#105), appeal dismissed, Civil No. 89-817-B (S.D. Iowa Mar. 12, 1991). Rose Way included an examination of whether the agreement contained a nominal purchase option, but focused on which party had the real interest in the disposition of the property. Rose Way, op. at 8. Other factors the court considered were:

1. whether the lessee is required to insure the items on behalf of the lessor in an amount equal to the total rental payments;
2. whether risk of loss or damage is on the lessee;
3. whether lessee is to pay for taxes, repairs, damage and maintenance;
4. whether there exist default provisions governing acceleration and resale of the item;
5. whether there exists a substantial nonrefundable deposit requirement;
6. whether the goods are to be selected from a third party by the lessee;
7. whether rental payments are a reasonable equivalent of the cost of the items plus interest;

8. whether the lease is to be discounted with a bank;
and
9. whether warranties generally found in a lease are
excluded by the agreement.

Rose Way, op. at 9 (citing In re Tucker, 34 B.R. 257, 261
(Bankr. W.D. Okla. 1983)). The list continued with factors
that may indicate the existence of a true lease:

- 1) whether the purchase option price approximates
the market value at the time of exercise of the
option;
- 2) whether rental charges indicate intention to
compensate lessor for loss of value over term of
lease due to normal aging and obsolescence;
- 3) whether rentals are not excessive and option
price is not too low; and
- 4) whether facts demonstrate lessee is acquiring no
equity in leased items during term of lease.

Id.

The agreement between Debtors and Jim Hawk Finance, Ltd.
is a lease intended as security. First, it is notable that
the written agreement does not contain an option to purchase,
nor does it contain a "residual guaranty clause;" however, the
written contract does not appear to contain the parties'
complete agreement. The most important factor in determining
that the agreement is a lease intended as security is the fact
that the insurance proceeds surplus after payment of the
remaining balance under the terms of the lease was paid to the
trustee as property of the estate. This fact indicates that

the Debtor/Lessee, not the Lessor, had the reversionary interest under the agreement.

The written agreement in substance appears to be a lease. While many of the burdens of ownership such as insurance, taxes, fees, repairs, and maintenance are placed on the lessee, both paragraphs 12 (loss or damage) and 18 (remedies) provide that lessor is entitled to any surplus upon disposition of the reefer. Moreover, paragraph 14 provides clearly for the return of the reefer upon expiration of the agreement. Thus, it appears that under the written agreement, which was clearly not followed, the agreement was a lease.

The turnover to the trustee as property of the estate of the reversionary interest indicates that the parties' agreement was in fact a lease intended as security. The lease and the lessees' obligations under the lease were not subject to termination by the Debtor-Lessee. The Debtors testified that they had discussed with the Lessor the fact that they would have the option to purchase the equipment at the end of the lease term. Finally, and most importantly, the insurance proceeds were paid to the trustee as property of the estate contrary to the written terms of the agreement. If these funds do not represent Debtors' equity in the equipment, Trustee fails to explain what they do represent.

The court already determined at hearing that the Debtors' interest in the reefer could be exempt as a tool of the trade.

Thus, the issue will not be addressed here. See In re Meyer, No. 88-1699-CH (Bankr. S.D. Iowa May 31, 1989) (#97).

ORDER

IT IS ACCORDINGLY ORDERED that trustee's objection to Debtors' claim of exemptions is OVERRULED.

Dated this 16th day of November, 1992.

RUSSELL J. HILL
U.S. Bankruptcy Judge