

LENDER ALERT

Is Your Lease or Contract for Deed Now Really a Secured Transaction?

Lease and purchase transactions oftentimes bare so much resemblance to each other that it sometimes becomes difficult to easily distinguish. The law provides some guidance, for lack of an absolute bright-line rule, to set each apart. The UCC is a good starting point for the analysis, particularly as to personal property. Section 1.203 (Lease Distinguished from Security Interest) expressly states: "Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case." Factors to consider include whether the consideration to be paid is an obligation for the term of the lease and is not subject to termination by the lessee, and whether (1) the original term of the lease is equal to or greater than the remaining economic life of the goods; (2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods; (3) the lessee has an option to renew the lease for the remaining economic life of the goods for nominal or no additional consideration; or (4) the lessee has an option to become the owner of the goods for nominal or no additional consideration. A security interest is not created merely because: (1) the consideration is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into; (2) the lessee assumes risk of loss of the goods; (3) the lessee agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs; (4) the lessee has an option to renew the lease or to become the owner of the goods; (5) the lessee has an option to renew the lease (or own the goods) for a fixed rent (or price) that is equal to or greater than the reasonably predictable fair market rent (or value) for the goods at the time the option is to be performed.

The Texas Property Code also should be considered, and the following recent case details the impact of bankruptcy law in light of statutory amendments governing contracts for deed on real property (as opposed to typical mortgages or deeds of trust). In *In re Garza*, Case No. 11-32996-SGH-13 (Bankr. ND Tex. October 7, 2011), the bankruptcy court considered a lessor's motion to compel the Chapter 13 debtor to assume or reject her ostensible executory contract for deed. The contract required monthly installment payments in exchange for full use and enjoyment of the homestead property, and called for conveyance of full legal title upon completion of all payments. After several years of payments, the debtor eventually defaulted and filed for Chapter 13 protection. The lessor's motion, if successful, would have required the debtor to "promptly cure" the outstanding defaults or else lose the property. The bankruptcy court reviewed the Texas Property Code, particularly the amendments set forth at Tex. Prop. Code §§ 5.061-5.085. The court noted section 5.066 provides that (1) payment of 40% or more of the amount due (or the equivalent of 48 monthly payments under the contract) can prevent lessor (seller) from rescission or forfeiture and acceleration, (2) a default requires seller essentially to conduct a non-judicial foreclosure sale, and (3) the seller must disburse to purchaser any excess over the remaining debt due under the contract. Thus, the court concluded the Texas Property Code provides actual equitable title to any equity in the home, rather than just an equitable right to perform the contract. The result is that the lessor (now a lender) was not entitled to receive "prompt cure" of the default, but, rather, must allow the debtor to cure the default over the life of her Chapter 13 plan (typically 5 years).

Accordingly, if your lease or contract for deed walks and talks like a secured transaction, it might be a secured transaction. This is but a recent example of the interplay between bankruptcy and state law as they relate to defining a lease from a secured transaction. All relevant statutes and cases should be monitored regularly for their ever-changing impact. Upon formal retention with a written engagement letter, our firm regularly counsels secured creditors and their rights both in and outside of bankruptcy, including as to both corporate and individual bankruptcies within Chapter 7, 11, and 13. If you have any questions, please call our office at (214) 752-2222, or e-mail [Mark Castillo](mailto:Mark.Castillo@curtislaw.net) at mcastillo@curtislaw.net.

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