IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

In Re:	)	
	)	Chapter 11
VIDEO UPDATE, Inc., et al.	)	
	)	Bankruptcy Case Nos. 00-3663
Debtors.	)	through 00-3683 (JHW)
______________________________	)	
GENERAL ELECTRIC CAPITAL	)	
CORPORATION,	)	
	)	C.A. No. 02-202-GMS
Appellant,	)	
	)	
v.	)	
	)	
VIDEO UPDATE, INC. et al.,	)	
	)	
Apelleee.	)	

MEMORANDUM AND ORDER

I. INTRODUCTION

On September 18, 2000, Video Update, Inc. ("Video Update") filed its petition for relief under Chapter 11 of the United States Bankruptcy Code. In December 2000, General Electric Capital Corporation ("GECC") moved for an order directing immediate payment of Video Update's post-petition lease obligations pursuant to 11 U.S.C. § 365(d)(10). In September 2001, Video Update cross-moved to designate the agreement as a security interest, or in the alternative, to reject the agreement and to establish the amount of administrative rent due to GECC. Judge Wizmur denied GECC's motion for immediate payment in its entirety on November 16, 2001.[1]

Presently before the court is GECC's appeal of the Bankrupcty Court's November 16, 2001 order. For the following reasons, the court will affirm the Bankruptcy Court's decision.

---

[1]Judge Wizmur is a United States Bankruptcy Judge for the District of New Jersey, sitting by designation.

II. STANDARD OF REVIEW

In reviewing a case on appeal, the Bankruptcy Court's factual determinations will not be set aside unless they are clearly erroneous. *See Mellon Bank, N.A. v. Metro Comm., Inc.*, 945 F.2d 635, 641 (3d Cir. 1991), *cert. denied*, 503 U.S. 937, (1992). Conversely, a Bankruptcy Court's conclusions of law are subject to plenary review. *See Metro Comm., Inc.*, 945 F.2d at 641. Mixed questions of law and fact are subject to a "mixed standard of review." *See id.* at 641-42. Under this "mixed standard of review," the appellate court accepts findings of "historical or narrative facts unless clearly erroneous, but exercise[s] plenary review of the trial court's choice and interpretation of legal precepts and its application of those precepts to historical facts." *Id.*

III. BACKGROUND

GECC is the successor in interest to CLG, Inc. ("CLG"). Video Update is a successor by acquisition of Moovies, Inc. ("Moovies"). On or about October 17, 1995, CLG entered into an "Equipment Lease Agreement" (the "Agreement") with Moovies. Under the Agreement, CLG provided financing which enabled Moovies to acquire point of sale computers and a variety of other "goods." Pursuant to the terms of the Agreement, Moovies paid all the taxes, and the "goods" were supplied "as is" with all risks borne by Moovies. Moovies was obligated to maintain, repair, or replace the equipment. It further paid all costs of insurance and bore all risk of loss. Each specific equipment financing transaction was embodied in a written "Supplement" which was governed by the Agreement.

For every Supplement, CLG was guaranteed a minimum rate of return on its initial investment. Typically, the initial term of each Supplement was thirty-six months with an additional mandatory three month supplemental termination period. The minimum payment terms were

calculated such that CLG would invariably recover the full cost of equipment financed, together with "soft costs," including shipping and installation and an implicit annual rate of return exceeding 8%.

Video Update maintains that CLG did not demonstrate the existence of any facilities or ability to repair used computer equipment. Moreover, CLG itself characterized the Agreement as a "line of credit" and each of the Supplements as "loans." Video Update further argues that CLG did not manufacture, distribute, or sell any of the equipment covered by the Supplements. Indeed, all of the equipment covered by the Supplements was selected and ordered by Moovies directly and specifically for use by Moovies. Video Update contends that CLG was not aware of what Moovies had selected until it received the invoices. On several occasions, Moovies purchased the equipment before contacting CLG to arrange for financing.

Several of the transactions covered by the Agreement were in the form of sale-leaseback arrangements. Under such arrangements, CLG purportedly purchased and leased back to Moovies "goods" already owned by Moovies. Video Update contends that the transactions often involved a variety of pre-existing equipment and included items with no meaningful resale or residual value. Much of the equipment was not specifically identified or identifiable. Indeed, some of the Supplements reflected the cost of prepaid maintenance contracts. Finally, Video Update contends that a substantial portion of the funds that CLG advanced were used to pay for things that cannot be leased, such as labor costs, installation costs, project management costs, and installed cabling.

With these facts in mind, the court will now turn to the issues raised on appeal.

IV. DISCUSSION

GECC appeals from the Bankruptcy Court's order on three grounds. First, it argues that the Bankruptcy Court erred in its application and analysis of the Uniform Commercial Code as adopted

by North Carolina. Second, it argues that the Bankruptcy Court's finding that CLG did not regularly engage in refurbishing, marketing, and selling the equipment returned from its customers was clearly erroneous. Finally, GECC argues that the Bankruptcy Court's finding that the equipment would remain with the "lessee" for the duration of the economic life of the equipment was clearly erroneous. The court will address each of these issues in turn.

A. Application of the Uniform Commercial Code

It is undisputed that, by its terms, the Agreement is governed by the laws of the state of North Carolina. The relevant provision of the Uniform Commercial Code, as enacted by North Carolina, provides:

> Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and
>
> (a) the original term of the lease is equal to or greater than the remaining economic life of the goods;
>
> (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,
>
> (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
>
> (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

N.C. GEN. STAT. § 25-1-201(37). GECC characterizes the four alphabetized factors as the "*per se*"

factors.

The Bankruptcy Court concluded that none of the *per se* factors were present.[2] It instead focused on the overall reality of the case, without giving special prominence or effect to any one detached term or condition. GECC now argues that the Bankruptcy Court determined that a security agreement existed based upon an incorrect weighing of factors. The court must disagree that the Bankruptcy Court erred.

GECC first argues that an "equity factor" should be viewed as the centerpiece for the court's analysis.[3] Applying the "equity factor," a true lease is indicated when the lessee receives no right, title, or interest in the disputed goods. *See Tolaram Fibers, Inc. v. Tandy Corp.*, 375 S.E.2d 673, 675 (N.C. Ct. App. 1989). GECC argues that the equity factor favors CLG because the debtors' purchase option was not sufficiently nominal to anticipate that the debtors would acquire title to the equipment.[4]

While the Bankruptcy Court did not explicitly address the "equity factor," the court concludes that this omission is not reversible error. It is clear that North Carolina law dictates that "the entire contract must be taken into consideration, without giving special prominence or effect to any one detached term or condition." *See L.C. Williams Oil Co. v. Nafco Capital Corp.*, 502

---

[2]On appeal, Video Update urges that, should the court wish to affirm on other grounds, it could find that some of the *per se* factors are in fact present. The court need not reach that issue, however, as it concludes that the Bankruptcy Court did not err in its analysis.

[3]Although GECC argues that the "equity factor" is the most important factor, it nevertheless concedes that, ultimately, it is the totality of the circumstances of each transaction that must be analyzed in order to determine whether a transaction is a lease or a financing arrangement. *See* Appellant's Reply Brief at 4.

[4]Under the terms of the Agreement, the debtors could purchase the equipment for its then-fair market value, not to exceed 20% of the original equipment cost.

S.E.2d 415, 418 (N.C. Ct. App. 1998). Thus, the "equity factor," is, as Video Update correctly points out, merely one factor among many in this analysis.

Second, GECC argues that the Bankruptcy Court erred in relying on factors that North Carolina has rejected as relevant in re-characterizing leases as secured transactions. Specifically, GECC argues that the "rejected factors" are the five provisions under subsection (b) of the North Carolina statute. Subsection (b) states that:

> A transaction does not create a security interest merely because it provides that:
>
> (i) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,
>
> (ii) The lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording or registration fees, or service or maintenance costs with respect to the goods,
>
> (iii) The lessee has an option to renew the lease or to become the owner of the goods,
>
> (iv) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonable predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or
>
> (v) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

N.C. GEN. STAT. § 25-1-201(37)(b).

GECC first takes exception with the Bankruptcy Court's conclusions that CLG's "documents showed recovered rates of 96% to 100% of the original purchase price" and that the lessee "bore the

risk of loss of the property." GECC contends that consideration of these factors is irrelevant.[5] The court must disagree with GECC's argument on this point. First, it is true that, pursuant to the North Carolina General Statute, this factor *alone* does not establish a secured transaction. However, in making its determination, the Bankruptcy Court did not consider this factor to the exclusion of all other factors. As directed by the North Carolina Court of Appeals, this was merely one of many pieces of evidence that ultimately factored into its analysis. *L.C. Williams*, 502 S.E.2d at 418.

Second, GECC argues that a transaction does not create a security interest merely because the lease is entered into as part of a sale-leaseback transaction. In support of this argument, GECC cites to North Carolina Statute § 2A-308(3) which provides that, "retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as the lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith." GECC offers no further analysis on this point. Indeed, GECC's conclusory statements fail to apply this authority in any way to the facts of the present case, or to the Bankruptcy Court's opinion. Finally, as the court stated above, to the extent that the Bankruptcy Court considered the sale-leaseback nature of the Agreement, it was but one of numerous factors that cumulatively led to the Bankruptcy Court's decision. Thus, on the record before it, the court finds no error.

In sum, GECC has failed to point to any authority which holds that the "rejected factors" may never be considered. Indeed, it has merely demonstrated that each alone does not conclusively

---

[5]GECC does not appear to take exception with the Bankruptcy Court's factual determination on this point. Indeed, GECC concedes that, "testimony may have indicated that the gross lease proceeds exceed the purchase price of the goods . . . ." *See* Appellant's Opening Brief at 18.

establish a financing arrangement. Thus, although any one of the facts the Bankruptcy Court considered may alone have been insufficient to establish a disguised financing arrangement, the totality of the circumstances approach requires the examination of all factors. The Bankruptcy Court made just such an examination in its opinion.

B. Disputed Findings of Fact

GECC also purports to take exception to three of the Bankruptcy Court's findings of fact.[6] However, because GECC has briefed only two of the disputed findings of fact, the court will not address the third issue.

1. Refurbishing, Marketing, and Selling

The Bankruptcy Court found that CLG did not customarily engage in the refurbishing, marketing, and selling of the equipment returned from its customers. As support for its contention otherwise, GECC argues that it presented the unrebutted trial testimony of Stephen Horne and Dale Griffith. GECC contends that this testimony indicated that CLG intended to retain title, and had the ability and resources to refurbish, remarket, and sell equipment. GECC further contends that, when CLG and Moovies first negotiated the lease, CLG had a "department" which was to remarket leased equipment which had been recovered. GECC does concede, however, that CLG's principle business operation was not refurbishing and remarketing equipment. It further concedes that CLG was primarily a finance company which provided monies to enable parties to obtain equipment.

In evaluating GECC's argument, the court notes that the Bankruptcy Court specifically credited GECC's testimony that CLG had the facilities to refurbish equipment. It merely concluded

---

[6]In actuality, GECC states that it is discussing the "three (3) more erroneous findings of fact," but as GECC has failed to point to more than three, the court will ignore the innuendo that the Bankruptcy Court's decision is rife with errors too numerous to discuss.

that GECC's customary business operation was as a finance company, and not as a refurbisher and remarketer of equipment. Thus, in light of GECC's above-mentioned concessions on these very points, the court cannot conclude that the Bankruptcy Court's finding of fact on this point was clearly erroneous.

2. Return of the Goods

The Bankruptcy Court determined that the proofs reflected the economic expectation of the parties that the equipment would not be returned to the "lessor," but would remain with the "lessee" for the duration of the economic life of the equipment. GECC now argues that this conclusion was clearly erroneous because the Bankruptcy Court failed to take into account the testimony of GECC's expert on this subject. The court must disagree.

In making its determination, the Bankruptcy Court credited several pieces of evidence. Specifically, it noted that "[i]n addition to the personal computers, file servers and telephone equipment, the equipment included software, much of which was either proprietary or would not be resaleable in the marketplace." It further concluded that, many of the goods at issue were "comprised of items that would have no fair market value at the end of the lease, such as labor costs, freight expenses, project management, reference manuals, installations costs, and 'miscellaneous' expenses." Additionally, the Bankruptcy Court recognized that the parties may have envisioned that the sale equipment would have had a continuing economic life in the possession of Moovies, beyond the minimum term of the transaction. Upon further review of the evidence, however, the Bankruptcy Court concluded that the parties could have also reasonably predicted that the equipment would substantially decrease in fair market value over the minimum term of the transaction. This fact, coupled with the finding that CLG did not customarily engage in refurbishing, marketing, and

selling returned equipment, led the Bankruptcy Court to its conclusion that the parties did not expect that the equipment would be returned to the "lessor."

It is undisputed that, pursuant to Federal Rule of Bankruptcy Procedure 8013, "[f]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses." In the present case, it is clear that Bankruptcy Court considered and weighed competing oral and documentary evidence in reaching the above two rulings. Thus, the court cannot find that these rulings were clearly erroneous.

V. CONCLUSION

For the foregoing reasons, IT IS HEREBY ORDERED that:

1. The November 16, 2001 decision of the Bankruptcy Court for the District of Delaware is AFFIRMED.

Dated: July 30, 2002

Gregory M. Sleet
UNITED STATES DISTRICT JUDGE