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November 21, 1990

John M. Sipple, Esq.
Premerger Notification Office - Room 303
Federal Trade Commission
Washington, D.C. 20580

Dear Mr. Sipple:

Pursuant to previous conversations with you and Mr. Richard Smith of the Premerger Notification Office of the Federal Trade Commission, we request an interpretation pursuant to Section 803.30 of the Rules, Regulations, Statements and Interpretations (the "Rules") under the Hart Scott-Rodino Antitrust Improvements Act of 1976 (the "Act") as to our client's obligations under such Act. It is our view that a termination of a certain Lease Agreement (the "Lease"), between our client, the lessor (the "Lessor"), and the lessees (the "Lessees"), whereby the Lessor transfers title to the property subject to the Lease back to the Lessees, does not obligate the parties to file a premerger notification under the Act.

Description of the Transaction:



The Lessor is a nominally capitalized, special purpose corporation organized under [REDACTED]. The sole shareholder of the Lessor is a [REDACTED]. The Lessor was incorporated specifically to participate in the financing



transaction of which the Lease is a part. Upon termination of the Lease, the Lessor will be dissolved.

The business of the Lessor is limited by the terms of a certain Credit Agreement (hereinafter defined) to the acquisition of certain improved real property (collectively, the "Property" or individually, a "Parcel of Property") and certain related Equipment (collectively, the "Equipment" or individually, a "Unit of Equipment") and the leasing under the Lease of such Property and Equipment to the Lessees. The Lessor conducts no other business and owns no assets other than the Property and Equipment.

The vast majority of the Property and Equipment under the Lease was owned by the Lessees prior to the commencement of the Lease, at which time title to such Property and Equipment was transferred to the Lessor by deeds and bills of sale, as the case may be, and simultaneously leased back to the Lessees. One Parcel of Property and its related Equipment was acquired by the Lessor from a third party at the request of a Lessee and then leased to such Lessee. This Parcel and its related Equipment has an Acquisition Cost (hereinafter defined) of approximately

 The other Property and Equipment has an aggregate Acquisition Cost of approximately  All of the Property and Equipment is essential to the business of the Lessees.

Sale/Leaseback

*Lease financing for Lessor
Acquisition by Lessee is beneficial ownership is deemed to have passed to the Lessee. Lessor holds title and a security interest only.*

Lessee pays all maintenance, repairs, insurance, taxes and bears entire risk of loss resulting from damage or other claims arising out of the lease.

The Lease is a "net" lease pursuant to which the Lessees are obligated to pay for all maintenance, repairs, insurance and taxes relating to the Property and Equipment. The Lessees bear the entire risk of damage, loss and destruction of the Property and Equipment. The Lessor is made whole for all of its costs and expenses incurred in connection with the Lease. The Lessees indemnify the Lessor and its affiliates for any losses, obligations, claims, damages, penalties, causes of action, suits, judgments, and costs and expenses relating to, or in any way arising out of, the Lease or the transactions contemplated thereby or arising out of the Lessor's acquisition of title to, or financing of, the Property and Equipment.

The Lessees selected all Property and Equipment to be acquired by the Lessor on the basis of their own judgment. The Lessor expressly disclaims any representations or warranties of any kind with respect to the Property and Equipment. The Lessees are required to insure all Property and Equipment on behalf of the Lessor for an amount equal to the total amount of debt incurred by the Lessor in financing such Property and Equipment (the "Acquisition Cost").

The term of the Lease ("Lease Term") with respect to each Parcel of Property and Unit of Equipment corresponds to the economic useful life of (i) the improvements upon such Parcel or (ii) such Unit, as the case may be. At the end of

*Lease term * for useful life of asset w/ renewal option.*

the Lease Term, each Lessee has the right, at its option, to renew the Lease for a renewal term at fair market rental value as set forth in the Lease.

The Lessor finances one hundred percent (100%) of the Acquisition Cost of the Property and Equipment through borrowings pursuant to a certain credit agreement (the "Credit Agreement") with a lender. The Lessor's source of repayment for such borrowings are the payments by the Lessees under the Lease. Pursuant to a certain Security Agreement (the "Security Agreement"), the Lessor's obligations to the lender are secured by an assignment of the Lessor's rights under the Lease, including rent and all other amounts due under the Lease, and by the granting of a security interest in the Lessor's bank accounts and its rights in the Equipment. With respect to the Lessor's rights in the Property, the Lessor granted a mortgage and security agreement to the lender. Financing statements are filed under Section 9-408 of the Uniform Commercial Code ("UCC") naming the Lessees, as debtor, and the Lessor, as secured party, in jurisdictions where the Equipment is located, contemplating characterization of the Lease as a lease intended as security under Section 1-201(37) of the UCC.

During the Lease Term, each Lessee is obligated to pay "Monthly Rent" in monthly installments, which consists of two components: the "Fixed Component" and the "Variable

Lessor's acquisition financed by lender who received a mortgage and security agreement in the leased property

Lease payments over least term equal acquisition cost plus lessor's financing cost and fees to the lessor and lender.

Component". The Fixed Component of Monthly Rent is a pre-determined amount which will result in the total amount of Fixed Components over the Lease Term equaling the Acquisition Cost of the Parcel or Unit. As the Fixed Components are paid, they are subtracted from the Acquisition Cost and the resulting figure is the amortized acquisition cost (the "Amortized Acquisition Cost"). The Variable Component includes the Lessor's monthly financing costs under the Credit Agreement and fees to the Lessor and the lender. The Lease provides that all amounts payable by the Lessees thereunder will be paid without setoff, diminution or counterclaim of any nature.

In addition, each Lessee is obligated to pay to the Lessor all amounts necessary to reimburse the Lessor for its obligations, costs and expenses that are not included in Monthly Rent incurred in connection with the transactions contemplated by the Lease and the Credit Agreement.

Lessee has power of disposition at certain times during lease term and to acquire the leased property for the cost or its fair market value.

At certain times during the Lease Term, each Lessee has the option, upon giving requisite notice to the Lessor, to terminate the lease of any Parcel of Property or Unit of Equipment by causing the Lessor to sell its interest in such Parcel or Unit to a third party (a "Sale at Lessee's Option"). Additionally, each Lessee has the option, at certain times during the Lease Term and upon giving requisite notice to the

Lessor, to purchase each Parcel or Unit for the greater of its Amortized Acquisition Cost or its fair market value.

The Lessor has the right, after notice to the affected Lessee, to terminate the lease of any or all Property or Equipment if for any reason the Lessor cannot arrange for financing from any lender for the acquisition and leasing of such Parcel or Unit (a "Lessor's Put"). In the case of a Lessor's Put, the affected Lessee is required, at the Lessee's option, either to purchase such Parcel or Unit for its Amortized Acquisition Cost or to arrange for the sale of such Parcel or Unit.

In addition to a Sale at Lessee's Option, the Lessees have the right to sell or otherwise dispose of Equipment upon payment of its Amortized Acquisition Cost, so long as such sale or disposal does not, in the aggregate, result in the sale or disposal in any calendar year of Equipment having an Amortized Acquisition Cost of more than 20% of the aggregate Amortized Acquisition Cost of all Equipment under the Lease during such calendar year.

If any Parcel of Property or Unit of Equipment is lost, stolen, destroyed, seized, confiscated, rendered unfit for use or damaged beyond repair, attached or taken by eminent domain or otherwise, then on the rent payment date following such event the affected Lessee is required to pay the Lessor the Amortized Acquisition Cost of such Parcel of

Property or Unit of Equipment. Any insurance proceeds in excess of the Amortized Acquisition Cost must be paid by the Lessor to such Lessee. The rent obligation with respect to such affected Parcel or Unit continues until the Lessor receives payment of Monthly Rent payable and any other amounts owing under the Lease, whereupon the lease of such Parcel or Unit terminates and the Lessor transfers title to the Parcel or Unit to the affected Lessee.

Default by Lessee can result in a form or as Lender by the Lessor

Upon an event of default under the Lease, the Lessor may, at its option, terminate the Lease and sell the Property and Equipment, or require the Lessees to pay as liquidated damages the Amortized Acquisition Cost of all Property and Equipment, and upon such payment, transfer title to the Lessees.

An event of default under the Lease is an event of default under the Credit Agreement, whereupon the lender may terminate the Credit Agreement and declare all obligations of the Lessor thereunder to be immediately due and payable and proceed to exercise the Lessor's rights under the Lease which were assigned to the lender pursuant to the Security Agreement.

Discussion:

We believe the termination of the above-described transaction is not subject to the Act because, upon entering into the Lease, the Lessor simply acquired title to the

Property and Equipment as collateral security. With respect to the Equipment, the Lease is a lease intended as security under Article 9 of the UCC, and with respect to the Property, the combination of the deeds transferring title to the Lessor and the Lease actually constitute an equitable mortgage under real property law. The Lessor merely holds title to facilitate the financing arrangement for the Lessees. Beneficial ownership of the Property and Equipment remained with the Lessees at the inception of the Lease and continues to remain with the Lessees during the Lease Term. Therefore, upon termination of the Lease and receipt of the requisite payment, the Lessor simply releases its security interest by transferring title back to the Lessees.

In connection with the instant transaction, title to the Property and Equipment was transferred from the Lessees to the Lessor by deeds and bills of sale, as the case may be, and the Lease designates the Lessor as owner of such Property and Equipment. However, the conditions and provisions in the Lease and the conduct of the parties, demonstrate that absent default by the Lessees or a Sale at Lessee's Option, the Lessees never relinquish their beneficial ownership of the Property and Equipment during the economic useful life of any Parcel of Property or Unit of Equipment and never intend to do so. The following features

of the Lease illustrate that the burdens and benefits of ownership remain with the Lessees:

(i) The Lessor has no equity investment in the Property and Equipment;

(ii) The Lessees have the benefits of ownership, including complete possession, use and control of the Property and Equipment. The Lessees may sublease such Property and Equipment under certain conditions and may make improvements to such Property and Equipment under certain conditions;

(iii) The Lessees, upon a Sale at Lessee's Option, a Lessor's Put or a sale in the case of an event of default, have the opportunity to recognize all appreciation in value of the Property and Equipment and the Lessees bear substantially all the risks of depreciation in value of such Property and Equipment;

(iv) There is no reasonable expectation that the Lessor will obtain possession of the Property and Equipment at the end of the Lease or upon early termination of the Lease. In every disposition of the Property and Equipment arising under the Lease (other than a sale to a third party upon default), the Lessor, upon receipt of the Amortized Acquisition Cost and all other amounts owing under the Lease, will transfer title

but Lessor appears to have benefit of gain in value of lessee addresses its right to acquire the leased assets during the lease term.

back to the Lessees or to a purchaser designated by the Lessees;

(v) The terms of payment make it clear that Monthly Rent is designed to pay the Lessor its costs incurred in financing the Property and Equipment; and

(vi) The Lessees have the burdens and risks of ownership, including keeping the Property and Equipment in good operating order, repair, condition and appearance, ensuring all legal and insurance requirements applicable to such Property and Equipment are met, paying all taxes, assessments and other charges, and assuming all risk of loss, damage, destruction and confiscation.

The above facts and the economic realities of the transaction indicate that pursuant to the Lease, the Lessor does not hold beneficial ownership of the Property and Equipment under Section 801.1(c)(1) of the Rules. Beneficial ownership of such Property and Equipment resides at all times in the Lessees. Upon termination of the Lease, the Lessor merely releases its security interest. The Act and the Rules, while not addressing the specific terms of the transaction described herein, rather clearly provide that the acquisition of a security interest or mortgage is not intended to be an "acquisition" subject to the Act. See

Section 7A(c)(2) of the Act and Section 801.1(c)(1) of the Rules.

With respect to the Equipment, we believe the rights, obligations and remedies of the Lessor and the Lessees under the Lease are governed, in part, by Article 9 of the UCC, since the Lease is a lease intended as security. UCC § 9-102. There are numerous cases which deal with whether an agreement is a lease intended as security. UCC Section 1-201(37) states that the determination whether a lease is a lease intended as security is to be made on a case by case basis. Courts have given consideration to many factors in making this determination, including, the intention of the parties. In In re Beker Industries Corp., the Court stated that an objective standard must be used to determine the intent of the parties at the time of contracting. 69 Bankr. 937, 939 (Bankr. S.D.N.Y. 1987). The Court in that case surveyed the law in this area and listed some of the factors in determining whether a lease is intended as security as follows:

- (i) whether the lessee is required to insure the items on behalf of the lessor in an amount equal to the total rental payments,
- (ii) if risk of loss or damage is on the lessee,
- (iii) if lessee is to pay for taxes, repairs, damage and maintenance,

- (iv) whether there exist default provisions governing acceleration and resale of the item,
- (v) whether goods are to be selected from a third party by the lessee,
- (vi) whether rental payments are a reasonable equivalent of the cost of the items plus interest,
- (vii) whether the lease is to be discounted with a bank,
- (viii) whether the terms of the lease create equity in the lessee with respect to the goods, and
- (ix) whether warranties generally found in a lease are excluded by the agreement.

Beker at 942-943. See also In re Tucker, 34 Bankr. 257, 261 (Bankr. W.D. Okla. 1983).

In the transaction at hand, all of the factors listed above that were considered by the Beker court in determining whether a lease is a lease intended as security are found in the Lease. A similar list of factors, the vast majority of which are present in the Lease, can be found in In re Catamount Dyers, Inc., 43 Bankr. 564, 567 (Bankr. D. Vt. 1984).

A number of courts have found the controlling factor in determining whether a lease is a lease intended as security to be the creation of "equity" in favor of the lessee. See Beker at 942. The United States Court of

Appeals for the Fifth Circuit in In re Tillary, 571 F.2d 1361 (5th Cir. 1978), in finding a lease to be a lease intended as security cited favorably the following passage from In re Royer's Bakery, Inc., 1 U.C.C. Rep. Serv. (Callaghan) 342, 345-346 (E.D.Pa. 1963):

" ... whenever it can be found that a lease agreement concerning personal property contains provisions the effect of which are to create in the lessee an equity or pecuniary interest in the leased property the parties are deemed as a matter of law to have intended the lease as security within the meaning of Sections 9-102 and 1-201(37) of the Uniform Commercial Code." Tillary at 1365.

Other courts have found this factor, which is clearly a feature of the Lease, to be paramount in finding a lease to be a lease intended as security. See, e.g., Hill v. Bentco Leasing, Inc., 708 S.W.2d 608, 609 (Ark. 1986); Credit Car Leasing Corp. v. DeCresenzo, 525 N.Y.S.2d 492, 495 (N.Y. Civ. Ct. 1988).

Lastly, with respect to the Property, we believe the deeds transferring title from the Lessees to the Lessor together with the Lease, when viewed in the context of the transaction, are actually "equitable mortgages", the real property equivalent of leases intended as security.

An equitable mortgage has been defined as a transaction which has the intent but not the form of a mortgage, and which a court will enforce in equity to the same extent as a mortgage. Mailloux v. Spuck, 449 N.Y.S.2d 69, 70 (1982). Any agreement in writing made by the owner of land, upon a valid consideration, by which an intention is clearly shown that the land is to be security for an obligation, creates an equitable mortgage upon that land. Boyarsky v. Froccaro, 479 N.Y.S.2d 606, 612 (1984). Thus, a deed absolute on its face if given for security is a mortgage by operation of law. Id. at 612. See also Baugham v. Slane, 49 N.Y.S.2d 869, 871 (1943).

All jurisdictions today permit an instrument taking the form of an absolute deed to be proved to have been intended by the parties to operate as security only. Some states have codified the case law proposition that a deed absolute on its face can be shown to be a mortgage. 3 R. R. Powell, The Law of Real Property § 447 (rev. ed. 1990).

It is a well-established rule that a conveyance though absolute on its face, is in fact a mortgage if it is given as collateral security for a debt and it is the true and actual intent of the parties that the property be held as security only. Curcic v. Sesti, 225 N.Y.S.2d 172, 175 (1962). The issue of whether a deed is intended as a valid transfer or a mortgage is one of intent and a court will

look at all surrounding circumstances. Id. Some of the facts which tend to establish the mortgage character of a transaction involving a conveyance by absolute deed are:

- (1) The right of the conveyer to recover the property upon payment of the indebtedness to the conveyee;
- (2) The retention of possession by the conveyer after the conveyance;
- (3) The continuance of the conveyer's payment of taxes and/or insurance premiums;
- (4) The continuance of debtor-creditor behavior between the conveyer and conveyee; and
- (5) Expressions by the parties consistent only with the mortgage intent.

This may be relevant to the question of whether benefit and ownership passed from the lessee to the lessor in a sale/leaseback arrangement. Query the relevance for a lease financing arrangement whereby the lessee acquires the property to be purchased.

3 Powell, supra p.16. See also Robar v. Ellingson, 301 N.W.2d 653, 660 (N.D. 1981); Wallace v. McCabe, 245 N.Y.S.2d 854, 856 (1964).

In the transaction at hand, all of the factors mentioned above to establish the existence of a mortgage are present. The Acquisition Cost or agreed indebtedness of the Property has been reduced by the amount of Fixed Components of rent paid. The Lessees remain in possession of the Property and pay all taxes, insurance premiums and other charges. The Lessor's role as landlord is purely passive with respect to the Property. Furthermore, it is the intent

of the Lessor and the Lessees that the Lessor receive absolute title from the Lessees solely as collateral security for the indebtedness. The Lessor is obligated to reconvey title to the Property back to the Lessees upon payment of Amortized Acquisition Cost in the termination scenarios described previously herein.

Conclusion:

We believe, based on the above discussion, that the Lease is actually a security device constituting a part of a financing arrangement. With respect to the Equipment, the Lease is a lease intended as security under Article 9 of the UCC. With respect to the Property, the deeds which transferred title to the Lessor when read together with the Lease and other documents constituting the financing arrangement create equitable mortgages. In each case, the Lessor has not acquired the beneficial ownership of the Property and Equipment, but merely a security interest. In light of the foregoing, we believe that the reconveyance of title is merely the release of a mortgage or security interest, which is not subject to the reporting and waiting periods under the Act. We note that under Section 7A(c)(2) of the Act an acquisition of a mortgage is exempt from the requirements of the Act. It would therefore be anomalous, and not in furtherance of the policies of the Act, that the release of a security interest should be subject thereto.

In addition, under Section 801.1(c)(1) of the Rules, it is clear that beneficial ownership of the Property and Equipment to date has been and continues to be "held" by the Lessees and that termination of the Lease and the related financing arrangements will not result in an "acquisition" for purposes of the Act.

We hereby request the Federal Trade Commission staff to render an interpretation as to the obligations of the Lessor and the Lessees under the Act. The termination of the Lease is currently scheduled for December 11, 1990.

Very truly yours,

Lessor - title, security interest.

Lessee - possession, risk of loss due to damage or use of the leased assets arising from lease.

Right to require sale to third party

Right to require for greater of Amortized Acq. Price OR FMV. (lessor has benefit of gain in value)

Lease payments tied to acquisition cost plus expenses and fees

Lease for useful economic life plus right of renewal.

1) With respect to property + equipment ~~formerly owned~~ ^{previously} owned by the lessee previously held title - based on facts presented it appears that beneficial ownership never passed to the lessor but continued to reside w/ the lessee. Thus, acquisition at hand is not of the leased assets but rather of a security interest in the leased assets - may be exempt under CCA)

2) With respect to property + equipment purchased from 3rd persons, ~~the~~ ^{if} we conclude the beneficial ownership passed to lessee then the lease has a ^{potentially} impermissible acquisition. Here, not reportable because less than \$5M.