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## COMMERCIAL CODE

### *Leases: Provide Regulations Relating to Leases of Goods*

**CODE SECTIONS:** O.C.G.A. §§ 11-1-105, -201(37) (amended), 11-2A-101 to -532 (new), 11-9-113 (amended)  
**BILL NUMBER:** HB 395  
**ACT NUMBER:** 412  
**SUMMARY:** The Act amends Georgia's Commercial Code to add a new Article 2A, designed to uniformly and comprehensively address the legal issues raised by leasing transactions in goods. This addition to Georgia's Commercial Code follows Article 2A of the Uniform Commercial Code as amended in 1990.  
**EFFECTIVE DATE:** July 1, 1993

### *History*

Article 2A of the Uniform Commercial Code (UCC) was approved in 1987 by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI), and represents the first new Article to be added to the UCC since its promulgation.<sup>1</sup> The Article was amended to provide certain policy changes and clarifications in 1990.<sup>2</sup>

Prior to enactment of Article 2A, Georgia law relating to the lease of personal property was a hybrid of the law of bailment, contract, UCC Article 2 (Sales of Goods), UCC Article 9 (Secured Transactions),<sup>3</sup> together with common law principles concerning personal property and real estate leases.<sup>4</sup> However, the application of concepts tailored to sales and secured transactions at times provides an improper fit for leases,<sup>5</sup> and concepts appropriate to realty may be inappropriate for

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1. Frederick H. Miller, *Analysis of New UCC Article 2A*, in ALI-ABA COURSE OF STUDY: THE EMERGED AND EMERGING NEW UNIFORM COMMERCIAL CODE 159 (A.L.I. 1992).

2. *Id.*

3. Interview with Rep. John Hammond, House District No. 32 (Apr. 21, 1993) [hereinafter Hammond Interview]. Rep. Hammond, Secretary of the House Committee on Judiciary, was one of the sponsors of the bill. *Id.* Rep. Hammond also participated in the UCC Sub-committee of the Business Law Section of the State Bar of Georgia in its modification of the model UCC Article 2A for submission to the General Assembly as HB 395. *Id.*

4. U.C.C. art. 2A, *Foreword* (1987).

5. *Id.* For instance, the remedy structures for a lease and for a secured transaction are quite different due to the differences in the relative equity in the

personal property.<sup>6</sup> Furthermore, prior to enactment of Article 2A, this hybrid mix of leasing law was not codified as a whole and was difficult to find.<sup>7</sup> This uncertainty was bad for business, the most vocal business lobbies being banks, automobile leasing companies and equipment leasing companies.<sup>8</sup>

Incorporation of Article 2A into the UCC resolves three significant issues with respect to personal property leases: the difference between a lease and a security interest disguised as a lease,<sup>9</sup> whether the lessor is considered to have made warranties to the lessee,<sup>10</sup> and what remedies are available to the lessor upon the lessee's default.<sup>11</sup>

### HB 395

The Act amends Georgia's Commercial Code<sup>12</sup> to enact a new Article 2A relating to leases of personal property.<sup>13</sup> The Act also amends three other sections of title 11 in order to conform those sections to Article 2A's codification of personal property lease law.<sup>14</sup> Article 2A is intended to define the relationship between the lessor, the lessee, and any lenders involved in the transaction.<sup>15</sup>

goods: in a secured transaction the debtor may have an equity in the goods, which is not so in the case of a true lease. Miller, *supra* note 1. Although the remedies of a seller and a lessor may be analogous, the remedies are different in that the lessor has an additional right to get the goods back. *Id.*

6. U.C.C. art. 2A, *Foreword* (1987).

7. Hammond Interview, *supra* note 3.

8. *Id.*

9. U.C.C. § 2A-101 cmt. (1987). The need for a bright line between a "true" lease and a lease which has characteristics of a security interest which is subject to Article 9 of the UCC is particularly highlighted in the requirements for filing a financing statement. Miller, *supra* note 1. There is no filing requirement for a lease. *Id.* However, security interests subject to Article 9 of the UCC have filing requirements which must be met to perfect the secured party's interest in the goods. *Id.* Thus, if a lease is found to be a disguised security interest, the lessor's failure to file a financing statement to perfect his security interest may result in a loss of the lessor's security interest in the goods. *Id.*

10. U.C.C. § 2A-101 cmt. (1987).

11. *Id.* One commentator explains that

[T]he Article 9 remedy structure is quite different from that for a true lease because the debtor may have an equity in the goods in a secured transaction. If instead a true lease is involved, . . . the lessee has no equity to protect and thus the lessor's remedies can more closely approximate those of a seller, with in addition a right to get the goods back.

Miller, *supra* note 1.

12. O.C.G.A. tit. 11.

13. O.C.G.A. tit. 11, art. 2A (Supp. 1993).

14. See O.C.G.A. §§ 11-1-105, -201(37), 11-9-113 (Supp. 1993).

15. Telephone Interview with Rep. John Hammond, House District No. 32 (Apr. 16, 1993) [hereinafter Hammond Telephone Interview].

With minor exceptions, the Act adopts verbatim the UCC's Article 2A regarding leasing of personal property.<sup>16</sup> The minor changes to the model Article 2A embodied in the Act were merely to conform Article 2A to existing Georgia variations in UCC Articles 2 and 9.<sup>17</sup> Examples of the Georgia variations are those involving lien priorities and privity for product liability purposes.<sup>18</sup>

Part 1 of Article 2A contains the scope and relevant definitions of the Article.<sup>19</sup> Part 2 deals with lease formation and warranties.<sup>20</sup> Part 3 details the obligations of the parties to the lease in relation to third parties.<sup>21</sup> Part 4 addresses the performance of a lease contract.<sup>22</sup> Part 5 outlines the default and remedy structure of a lease.<sup>23</sup>

The Act amends Code section 11-1-105 relating to territorial application of the UCC and the parties' power to choose applicable law.<sup>24</sup> That section provides that parties may choose to apply the law of another jurisdiction to a transaction subject to the UCC "when [the] transaction bears a reasonable relation to [the chosen] state or nation."<sup>25</sup>

Article 2A's choice of law provisions, however, govern transactions involving leases of personal property where such choice of law provisions are relevant.<sup>26</sup> For example, the applicable provisions of Article 2A provide that where goods covered by a certificate of title are involved in the leasing transaction, the law of the jurisdiction issuing the certificate of title governs issues of compliance with the title statutes until surrender of title or until the goods have been dislocated from that jurisdiction for four months.<sup>27</sup> The power of the parties to choose applicable law is limited in the case of a consumer lease.<sup>28</sup>

The Act amends Code section 11-1-201(37) which defines "security interest" as it is used throughout the UCC.<sup>29</sup> The changes deleted the relatively cursory guidelines for delineation between a secured transaction and a lease and added the following guidelines to the definition of "security interest":

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16. *Id.*

17. Hammond Interview, *supra* note 3.

18. *Id.*

19. O.C.G.A. §§ 11-2A-101 to -109 (Supp. 1993).

20. *Id.* §§ 11-2A-201 to -221 (Supp. 1993).

21. *Id.* §§ 11-2A-301 to -311 (Supp. 1993).

22. *Id.* §§ 11-2A-401 to -407 (Supp. 1993).

23. *Id.* §§ 11-2A-501 to -532 (Supp. 1993).

24. *Id.* § 11-1-105 (Supp. 1993).

25. *Id.* § 11-1-105(1) (Supp. 1993).

26. *Id.* § 11-1-105(2) (Supp. 1993).

27. *Id.* § 11-2A-105 (Supp. 1993).

28. *Id.* § 11-2A-106 (Supp. 1993).

29. *Id.* § 11-1-201(37) (Supp. 1993).

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.

A transaction does not create a security interest merely because it provides that

- (a) 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,
- (b) 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,
- (c) The lessee has an option to renew the lease or to become the owner of the goods,
- (d) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably 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
- (e) 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.

For purposes of this subsection (37):

(x) Additional consideration is not nominal if (i) when the option to renew the lease is granted to the lessee the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed, or (ii) when the option to become the owner of the goods is granted to the lessee the price is stated to be the fair market value of the goods determined at the time the option is to be performed. Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised;

(y) "Reasonably predictable" and "remaining economic life of the goods" are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and

(z) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.<sup>30</sup>

The amendment to the definition of "security interest" addresses the problems relating to the difference between a lease and a security interest disguised as a lease<sup>31</sup> by giving more guidance regarding the line of demarcation between the two.<sup>32</sup> The amended definition eliminates testing of intent to determine whether a transaction creates a lease or a security interest.<sup>33</sup> Under the old definition, whether only nominal consideration was paid by a lessee in exercising an option to buy the goods at the end of the lease period became important to determine whether a transaction created a lease or a security interest.<sup>34</sup> The revised Code section 11-1-201(37) provides a safe harbor for consideration paid at fair market value when exercising such an option.<sup>35</sup>

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30. *Id.*

31. *See supra* notes 6, 9 and accompanying text.

32. Hammond Interview, *supra* note 3.

33. *See* Miller, *supra* note 1.

34. *Id.*

35. O.C.G.A. § 11-1-201(37)(x)(ii) (Supp. 1993). "When the option to become the

The Act amends Code section 11-9-113 which relates to security interests arising under Article 2.<sup>36</sup> The amendment adds corresponding applicability of Article 9 to the new Article 2A.<sup>37</sup>

There were two changes made to HB 395 in the substitute offered by the House Committee on Judiciary.<sup>38</sup> The first change was a minor clarification in the preamble to the Act.<sup>39</sup> The second change concerned the effective date of the Act.

The initial version of HB 395 provided for the effective date of the Act to be July 1, 1993.<sup>40</sup> The substitute bill from the House Committee on Judiciary, however, provided for effect of the Act to be in part dependent on the timing of a transaction.<sup>41</sup> The later provision passed and reads as follows:

This Act shall become effective on July 1, 1993, for all lease contracts that are first made or that first become effective between the parties on or after that date. This Act shall not apply to any lease first made or that first became effective between the parties before July 1, 1993, or to any extension, amendment, modification, renewal, or supplement of or to any such lease contract, unless the parties thereto specifically agree in writing that such lease contract, as extended, amended, modified, renewed, or supplemented, shall be governed by this Act.<sup>42</sup>

This change in effective date was necessary due to the "default" nature of UCC provisions: where a lease is silent on an issue, Article 2A governs.<sup>43</sup> Article 2A's default provisions relating to express and implied warranties, in particular, could have proven significant to

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owner of the goods is granted to the lessee [at] . . . the *fair market value* of the goods," the consideration is not nominal (emphasis added). *Id.* However, consideration at a price below fair market value does not necessarily transform the lease into a secured transaction. *See Miller, supra* note 1.

36. O.C.G.A. § 11-9-113 (Supp. 1993).

37. *Id.*

38. *Compare* HB 395, as introduced, 1993 Ga. Gen. Assem., *with* HB 395 (HCS), 1993 Ga. Gen. Assem.

39. The preamble amendment essentially rearranged words. The preamble to the original bill described the purpose of the Act in pertinent part, ". . . to provide for priority subject to subordination; to provide for performance of a lease contract which is repudiated, substituted, and excused. . . ." HB 395, as introduced, 1993 Ga. Gen. Assem. The House substitute clarified that portion of the preamble, as follows: ". . . to provide that priority is subject to subordination; to provide for repudiated, substituted, and excused performance of a lease contract. . . ." HB 395 (HCS), 1993 Ga. Gen. Assem.

40. HB 395, as introduced, 1993 Ga. Gen. Assem.

41. HB 395 (HCS), 1993 Ga. Gen. Assem.

42. *Id.*

43. Hammond Interview, *supra* note 3.

existing leases.<sup>44</sup> For instance, application of the Act to prior transactions where the parties did not intend for the UCC warranties to apply yet did not contractually address the issue, would have had the effect of incorporating the UCC warranties into the lease agreement.<sup>45</sup>

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44. *Id.*

45. *Id.*