

In the United States Bankruptcy Court  
for the  
Southern District of Georgia  
Brunswick Division

In the matter of:	)	
	)	Chapter 11 Cases
FIRST AMERICAN HEALTH	)	
CARE OF GEORGIA, INC.	)	Numbers <u>96-20188</u>
and its wholly owned subsidiaries	)	through <u>96-20218</u>
	)	
<i>Debtors</i>	)	
	)	
	)	
	)	
LEASE INVESTMENT	)	
CORPORATION	)	
	)	
<i>Movant</i>	)	
	)	
	)	
v.	)	
	)	
FIRST AMERICAN HEALTH	)	
CARE OF GEORGIA, INC.,	)	
	)	
<i>Respondent</i>	)	

**MEMORANDUM AND ORDER**  
**ON MOTION FOR RELIEF FROM STAY**

On June 26, 1996, this Court held a hearing on the Motion of Lease Investment Corporation ("LIC") for relief from stay. After consideration of the evidence adduced in support of that Motion, I make the following Findings of Fact and Conclusions of Law.

## FINDINGS OF FACT

Leave Investment Corporation is the lessor of an eight-passenger business jet aircraft leased by the debtor-in-possession ("Debtor") with a gross lease balance, exclusive of purchase option, of \$599,287.50 (Movant's Ex. "1" and "2" and Movant's proof of claim). The lease agreement relates to a Hawker HS125-1A/731, registration number N731BW, Serial Number 25075, including two Garrett TFE 731-3R1H engines (Movant's Ex. "2"). The lease is a closed-end, 60-month lease which obligates the Debtor to, *inter alia*, make monthly payments of \$22,830.00 plus sales tax on the twelfth day of each month. The lease ends, under the terms of the agreement, in May 1998. The lease is personally guaranteed by Mr. and Mrs. Robert J. Mills, principals of the Debtor.

The lease affords the Debtor a "first right of refusal" to purchase the aircraft for fair market value to be determined by, "an agreed licensed aircraft appraiser." Experts for both parties agree that the plane is currently worth around \$1 million, wholesale (Tr. p. 28, 67). Lease Investment Corporation paid \$1,050,000.00 for the aircraft in 1993 (Tr. p. 28).

The lease agreement also requires the Debtor to maintain and insure the aircraft at the Debtor's expense. Aircraft maintenance includes the repair of things which break as well as an extensive regimen of inspections, scheduled preventative maintenance, and equipment overhauls. Some of the maintenance must be done on a calendar basis; other

maintenance is scheduled according to the number of hours the plane has been flown.

The fixed costs which accrue for FAA-mandated, calendar-based maintenance should average in excess of \$4,300.00 per month. The accruing variable costs of maintenance which are based on the number of hours that the aircraft is operated will average approximately \$580.00 per flight hour (Tr. p. 25). By possessing and operating the subject aircraft, the Debtor consumes that portion of the value of the aircraft which is attributable to the most recent overhauls, inspections and preventative maintenance done on the aircraft (Tr. p. 27).

As part of its obligation to maintain the aircraft, the Debtor is required by the lease to keep in effect the "Maintenance Service Plan" ("MSP"). The MSP contract obligates Allied Signal Corporation to maintain the engines on the aircraft according to standards established by the engine's manufacturer, Garrett. The cost of the MSP contract is proportional to the amount of time that the Debtor flies the airplane, with a fixed monthly minimum. Allied Signal calculates the amount due each month based on the Debtor's report of aircraft usage. The Debtor's financial officer, Mr. Cansler, believes that the Debtor has been making payments to Allied Signal, but no witness for the Debtor could show that the appropriate amount has been paid, or that the Debtor has sent monthly operating reports to Allied Signal.

The initiation of an MSP contract on this aircraft costs approximately

\$300,000.00 to \$600,000.00, depending on the age and condition of the engines (Tr. p. 26, 83); therefore, maintenance, and more particularly, preservation of the MSP contract, has a profound impact on the value of the plane. Movant's witness testified that the plane would have a value of \$150,000.00 if the MSP contract were allowed to lapse and if the engines were run to a point where they would require rebuild or replacement (Tr. p. 27). Debtor's witness testified that the value of the airplane with run-out engines would be around \$900,000.00 with MSP intact (Tr. p. 73).

Debtor filed its Chapter 11 petition on February 21, 1996. Debtor has failed to make post-petition payments coming due LIC under the subject lease on March 12, April 12, May 12 and June 12, 1996.

Debtor introduced a written secondary purchase option in favor of Mr. James Bishop and signed by LIC (Ex. D-2). The purchase option provided that in the event First American complied with all of the terms of the lease, but failed to exercise its fair-market-value purchase option, Bishop could buy the plane for \$150,000.00.

LIC's witness, Mr. Bill Walker, was personally involved in the negotiation of both the lease between LIC and the Debtor, and the purchase option (Tr. p. 21). He testified that guarantor Robert J. Mills demanded the right to designate a secondary optionee. Mr. Mills did not take the option himself, or designate the Debtor as the optionee (Tr. p. 36-41; Tr. p. 43-44). The \$150,000.00 price of the option given to Bishop was based on

Walker's worst-case prediction of the value of the aircraft at the conclusion of the lease (Tr. p. 46).

LIC sent Bishop a letter, post-petition, terminating his secondary option based on First American's default in lease payments (Ex. P-4). In response, Bishop disclaimed any knowledge of, interest in, or right to the option (Ex. D-3).

### CONCLUSIONS OF LAW

Whether a contract is a lease contract or a purchase contract is a question of state law. In re Paz, 179 B.R. 743 (Bankr.S.D.Ga. 1995). At O.C.G.A. Section 11-1-201(37), the Georgia Code describes the characteristics which tend to distinguish a lease from a purchase contract.<sup>1</sup>

I hold the contract between Lease Investment Corporation and the Debtor to be a true lease, based on the following characteristics:

- 1) It is for a fixed term which is shorter than the economic life of the leased aircraft;
- 2) The lessee is not bound to renew the lease or become the owner of the property at the conclusion of the lease term;

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<sup>1</sup> Although the subject lease was created on May 13, 1993, before the effective date of amended O.C.G.A. § 11-1-201(37) and is not technically controlled by that statute, the statute largely codified pre-existing case law. Paz, supra.

- 3) The lease affords the lessee no renewal option;
- 4) The "purchase option" at the conclusion of the lease term is *not* one for nominal consideration. It requires the Debtor to pay the appraised fair market value of the aircraft at the time of the exercise of the option.

The existence of the "Bishop Option" does not turn this lease into a sale transaction. First, the Debtor is not the optionee. The existence of a secondary option agreement between LIC and Bishop does not change the terms or character of the lease agreement between the Debtor and LIC. Second, the Bishop Option is not one for nominal consideration and the only option held expressly by Debtor is a fair market value lease. On its face, \$150,000.00 is non-nominal. More important, the uncontradicted testimony of Bill Walker is that the figure was negotiated in 1993 based on Walker's worst-case prediction of the value of the aircraft at the conclusion of the lease (Tr. p. 46). Accordingly, the \$150,000.00 secondary option could, in fact, approximate fair market value.

Since I find the agreement at issue to be a true lease, it is an executory contract within the meaning of 11 U.S.C. Section 365. LIC, as a lessor, is entitled to the protections of 11 U.S.C. Sections 365(d)(10) and 363(e).

Section 365(d)(10) of the Bankruptcy Code provides that the trustee (or debtor-in-possession),

. . . . shall timely perform all of the obligations of the debtor . . . first arising from or after 60 days after the order for relief in a case under chapter 11 of this title under an unexpired lease of personal property . . . until such lease is assumed or rejected . . . .

Debtor has failed to do so, and may be unable to do so in the future without either the consent of the United States ("HCFA") or without violating the order under which the Debtor's operations continue to be funded by HCFA.<sup>2</sup>

The Bankruptcy Code does not specify the penalty to be imposed on the trustee/debtor-in-possession for failing to make Section 352(d)(10) payments. The obvious intent of Section 362(d)(10) is to limit the economic impact on lessors of the loss of rental income while the automatic stay deprives them of their leased assets. If a trustee/debtor-in-possession cannot or will not make Section 362(d)(10) payments, one logical consequence could be the loss of leased assets. I conclude that the failure to make Section 362(d)(10) payments may constitute "cause" for lifting the stay pursuant to 11 U.S.C. Section 362(d)(1).

A party opposing a motion for relief from stay has the burden of proving the movant is adequately protected. *See* 11 U.S.C. § 362(g)(2). Debtor has failed to prove that LIC's interest in the aircraft is adequately protected. Witnesses for both parties agreed that

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<sup>2</sup> HCFA is funding the Debtor on a cost reimbursement basis. HCFA has taken the position that it will only reimburse the Debtor for flight expenses equal to those of commercial airline flights. At a hearing on the Debtor's motion for authority to pay various creditors, including LIC, HCFA objected to the motion to the extent that it would have authorized payments to LIC and another aircraft lessor. To resolve the objection, the Debtor agreed not to pay the aircraft lessors without further consent from HCFA.

it is essential to the value of the plane that the Debtor continue to pay the MSP contract payments (Tr. p. 90). The amount due each month is a fixed minimum figure plus a variable figure which relates to the number of hours that the plane is flown (Tr. p. 78). Debtor has not shown that it has provided the MSP contractor, Allied Signal Corporation, with monthly reports. Debtor's chief financial officer testified that the Debtor is making payments to Allied Signal, but could not say precisely how much was being paid.

Debtor contends that a significant equity cushion protects LIC. However, it is clear that the equity cushion which exists if the MSP contract is in place could quickly disappear if the MSP contract were allowed to lapse, or if a cost-prohibitive airworthiness directive grounds the plan (Tr. p. 28). In order to provide adequate protection, Debtor must resume payment of the lease obligation, or "cause" to lift the stay will be established.

#### ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, the Debtor IS ORDERED to commence, effective August 1996, making the monthly lease payments and fulfill all Maintenance Service Plan obligations, pending a decision whether to assume the lease. In the event Debtor fails to do so and fails to cure any default within ten (10) days of the filing of an affidavit of non-compliance, the Court will, without further notice, enter an order lifting the stay.

Lamar W. Davis, Jr.  
United States Bankruptcy Judge

Dated at Savannah, Georgia

This \_\_\_\_ day of August, 1996.