ORS 79.2040(3)
11 USC § 1129(b) (2)

In re Bear Cat Logging. Inc., Case No. 693-60940-aerll

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Between June of 1987 and April of 1988, the creditor provided financing for the debtor's purchase of logging equipment and took security interests in the equipment to secure payment of all obligations of the debtor to the creditor of every kind now existing and hereafter arising. In December of 1988, the debtor and the creditor entered an agreement for the lease of certain equipment to the debtor. In April of 1990, the parties entered another secured agreement which contained a similar but more expansive future advance clause. The debtor defaulted on its lease obligation. The creditor filed a proof of claim asserting a secured claim arising from the lease default.

In ruling on the debtor's objection to the proof of claim, the court determined that the portion of the claim arising from the lease default is secured. The court addressed the requirement that a future advance will fall within the scope of a security agreement only if it is of the "same class" as the primary obligation and determined that the obligations under the lease were within the scope of the future advance clauses of the security agreements because the underlying purpose of the lease and the other transactions was to procure logging equipment and vehicles and the obligations were therefore in the same class. Even if the lease obligations were not in the same class as the other transaction, the court determined that it would still be within the scope of the April 1990 security agreement because the lease obligation was in existence at the time of that agreement and the language of that agreement applied to all obligations whether or not the obligation was related to any other obligation by class or kind.

The court rejected the creditor's assertion that the claim arising from the lease should include a residual value because the lease did not provide for the payment of such value. Relying on 11 U.S.C. § 1129(b) (2), the court also determined that it is appropriate to apply an 8% discount factor to establish the present value of the lease deficiency in determining the allowed amount of the claim.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

IN RE	)	
	)	
BEAR CAT LOGGING, INC.,	)	Case No. 693-60940-aerll
	)	
	)	MEMORANDUM OPINION
Debtor-in-possession.	)	

This matter comes before the court upon the objection of the debtor-in-possession (debtor) to the claim of U. S. Bancorp Leasing and Financial Inc. (Bancorp).

Bancorp filed a timely proof of claim asserting both a secured claim and an unsecured claim. Later, Bancorp was permitted to amend its claim to classify the entire claim as secured in the total amount of $655,960.20.

The debtor has objected to this claim. The debtor concedes that a portion of the claim is secured but contends that the amount of the claim relating to a lease deficiency is unsecured. Further, the debtor and Bancorp dispute the proper amount of the lease deficiency. A hearing was held on the debtor's objection at which time the parties indicated they wished to submit briefs and a briefing schedule was established.

BACKGROUND

The facts are largely undisputed.

Beginning in June, 1987 the debtor and Bancorp entered into a number of transactions in which Bancorp provided financing to permit the debtor to acquire heavy logging equipment and vehicles.[1] The first three were secured loans. Each transaction was evidenced by a promissory note and a security agreement. The amount of each note was different, but otherwise the language of the promissory notes was nearly identical. The security agreements were the same pre-printed form; only the dates and the description of the collateral differed. In the first (June 25, 1987) and third security agreements (May 27, 1988) the collateral was described in a referenced "Attachment A". In the second (April 4, 1988) the collateral was described in paragraph 1. of the agreement.

The relevant language of each security agreement reads as follows:

> 1. Bear Cat Logging, Inc. . . .(hereinafter called "Borrower") hereby grants to Bancorp Leasing and Financial Corp. (hereinafter called "Secured Party", its successors and assigns, a security interest in the following property and any and all additions, attachments, and accessions thereto (hereinafter called the "Collateral"):

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[1]Both parties agree that the first three transactions were loans secured by logging equipment and vehicles. Bancorp maintains that the first three transactions were loans secured by logging equipment and vehicles that were acquired with the loan proceeds. U.S. Bancorp's Memorandum of Law, p.1, line 22 - 24. The debtor states that the first loan was a loan to the debtor for the purpose of redeeming the stock of certain shareholders. Debtor's Reply Brief, p. 1, line 22 - 23. This dispute is immaterial because the debtor concedes that the first, second and third loans are secured.

* * * [description of collateral] * * *

> 2. The security interest granted hereby is to secure payment and performance of the liabilities and obligations of Borrower to Secured Party of every kind and description, direct or indirect, absolute or contingent, due or to become due, now existing or hereafter arising including but not limited to all future advances of Secured Party to or on behalf of Borrower and also including liabilities of Borrower to Secured Party resulting from guarantees given by Borrower to Secured Party, plus extensions and renewals of all the foregoing (all hereinafter called "obligations"); . . .

On December 19, 1988 Bancorp (as lessor) and debtor (as lessee) entered into a "Lease Agreement" (the lease) for the lease of certain equipment to the debtor. It is the unpaid rents and other damages which have accrued under this agreement which Bancorp asserts are secured and which the debtor contends are unsecured. The lease contains a schedule 001 and 002 each referring to different leased equipment.

On the same day that the parties executed the lease agreement, the debtor also executed another security agreement covering two pieces of equipment not described in the lease agreement or in the previously executed security agreements. Except for the amount and the collateral acquired, the December 19, 1988 security agreement is identical to the other security agreements. The December 19, 1988 security agreement does not specifically refer to the lease. Bancorp perfected this security agreement by filing a financing statement on December 21, 1988.

Finally, on April 9, 1990 the parties entered into another secured transaction evidenced by a promissory note and security

agreement. This security agreement was in a slightly different form and contained the following language:

> 1.0 Bear Cat Logging, Inc. . . . hereby grants to U.S. Bancorp Leasing & Financial (herein after called "Secured Party"), its successors and assigns, a security interest in the following property, any and all additions, attachments, and accessions thereto now owned and hereafter acquired:
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> * * *
>
> [description of collateral]
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> * * *
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> 2.0 OBLIGATIONS; FUTURE ADVANCES.
>
> 2.1 The security interest granted hereby is to secure payment and performance of all liabilities and obligations of Debtor to Secured Party of every kind and description, direct or indirect, absolute or contingent, due or to become due, now existing and hereafter arising including without limitation, obligations and liabilities of Debtor to Secured Party as guarantor, surety, endorser or otherwise; . . .
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> 2.2 Obligations shall include any amounts paid or liabilities incurred by Secured Party for: (a) taxes, liens, levies or insurance on repairs to or maintenance of the collateral (b) taking possession of disposing of, maintaining or preserving the Collateral on default (c) reasonable attorneys' fees at trial or on any appeal (d) interest on any such amounts at the highest rate provided in any note executed pursuant to this Agreement, not to exceed any maximum imposed by law for the calculation of such interest;
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> 2.3 It is the true, clear and express intention of Debtor that the security interest granted hereby shall secure payment and performance of all Obligations of Debtor, whether now existing or hereinafter incurred, including Obligations incurred by future advances made by Secured Party or by any assignee of Secured Party, or otherwise, whether or not any <u>Obligation is related to any other Obligation by class or kind and whether or not any Obligation was contemplated by the parties at the time of Debtor's granting this security interest. . . .</u>(emphasis added)

The debtor defaulted on the lease when there were 33 payments remaining under Lease Schedule 001 and 31 payments remaining under Lease Schedule 002. Bancorp repossessed the leased equipment in March, 1992 and later sold it. The sale proceeds were $83,693.62

on lease schedule 001 and $49,993.62 on lease schedule 002. The amount of the claim in question is that amount claimed by Bancorp to be owed after application of the sale proceeds to the amounts owing pursuant to the lease.

The debtor argues that Bancorp's remaining claim under the lease is not secured. In addition, the parties disagree as to how the remaining amount owing under the lease should be calculated. The debtor maintains that a present discount factor should be applied. Bancorp contends that reducing its claim by a present discount factor is improper, further, it maintains that it is entitled to collect, as part of its claim, a "residual value" for the equipment which was leased.

ISSUES

This court must decide whether or not that portion of Bancorp's claim resulting from the lease is secured or unsecured. In addition, the court must decide the proper amount of that portion of Bancorp's claim.

DISCUSSION

Secured v. Unsecured Claim

The question of whether or not that portion of Bancorp's claim resulting from the lease (the lease deficiency claim) is secured must be decided in accordance with Oregon law. The debtor argues that the lease deficiency claim cannot be secured under the "future advances" clauses of the first three loan transactions because they are not of the "same class" as the primary obligations.

Future advance clauses are valid in Oregon. Future advances refers to "money lent after a security interest has attached and

secured by the original security agreement." Black's Law Dictionary 5th Ed. 609 (1979). O.R.S. 79.2040(3) provides that:

> Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment as defined in O.R.S. 79.1050(1)(k).

The leading Oregon case on future advances is Community Bank v. Jones, 278 Or. 647, 566 P.2d 470 (1977). In that case the Oregon Supreme Court held that for a future advance to fall within the future advances clause of a particular security;

> . . . no matter how the clause is drafted, the future advances, to be covered, must be of the same class as the primary obligation . . . and so related to it that the consent of the debtor to its inclusion may be inferred. 566 P.2d at 482.

In Community Bank the plaintiff bank filed suit to enforce its security interest covering the automobile inventory of the defendant, Robert L. Jones, an automotive wholesaler. Community Bank had first begun financing Jones on October 28, 1970 through an "Inventory Loan and Security Agreement." A financing statement was filed on October 30, 1970. A second security agreement was executed on April 19, 1972 and filed on April 27, 1972. Roy Ell began financing Jones in 1970 or 1971. Ell and Jones entered into a general security agreement on October 14, 1971, amended on December 15, 1971. A financing statement was filed October 18, 1971. George Vassil began financing cars for Jones in 1972. He took trust receipts as security, but entered into no written security agreements.

Almost immediately after entering into the agreements with the Bank, Jones began issuing potential overdrafts, which the Bank

honored. (A potential overdraft is a check drawn against uncollected funds.) By 1972, the potential overdrafts had become a regular occurrence and averaged $50,000 per day.

In December, 1973 (because of the gas shortage) the Jones operation collapsed. Jones couldn't move his inventory of big cars. On December 17, 1973 the Bank refused to pay checks drawn on Jones' account. It entered into one final flooring arrangement with Jones, but rather than disbursing any money to Jones, credited the entire amount to Jones' frozen bank account.

Between December 17 and 21, 1973 Jones conveyed nearly all of his inventory to Vassil and (through a third party) to pay off Ell. A dispute ensued among Ell, Vassil and the Bank as to who had priority in the funds in Jones' bank account and the proceeds from the inventory.

The court found that the bank's security agreement covered ". . .loans evidenced by notes, interest, all expenses incurred by the secured party to audit and service debtor's account and to preserve, collect, protect his interest in or realize on the collateral, including counsel fees and legal expenses, taxes and insurance premiums." 566 P.2d at 481.

The Oregon Supreme Court held:

> But, finding no reference to overdrafts in this section, we conclude that the obligations secured by the agreement include neither the overdrafts nor the costs and attorney fees pertaining thereto. 566 P.2d at 482.

The court observed that regarding the overdrafts:

> Although this transaction appears in form to conform to the security agreement, we find its substance to be different in kind and not related to the purpose intended by the parties when they entered into the October 28

> security agreement. To hold otherwise would be to allow a creditor secured as to one line of financing to retroactively secure a second separate indebtedness (not included in the loan section of the security agreement), and to step ahead of others holding perfected security interests in the same property. To permit such a belated reordering of priorities would do little to lend stability to commercial transactions. 566 P.2d at 482.

Other cases which have held that subsequent transactions are not covered by an appropriate "future advances" clause are as follows: H. Meyer Dairy Company v. Midwestern Food Stores, Inc., (In re Midwestern Food Stores, Inc.), 21 B.R. 944, (Bankr. S.D. Ohio 1982) where the debtor granted to the creditor a security interest in furniture, fixtures, equipment and inventory to secure an open account sale of dairy products by plaintiff, creditor to the debtor. There were also several leases under which the debtor, as lessee, rented various stores from the creditor. The court held that the rental obligation under the various leases was not secured by the "future advances" clause in the security agreement since the rent obligation constitutes an entirely different subject matter than that dealt with by the security agreement.

In National Acceptance Company of America v. Blackford, 408 F.2d 20 (5th Cir. 1969), the creditor entered into a three year factoring agreement with the debtor. The debtor gave the creditor ". . .a factor's lien on [its] materials, goods in process and finished goods intended for sale for all loans and advances to be made. . .and for all indebtedness and liabilities of every kind of Borrower to Lender hereinafter owing:. . ." 405 F.2d at 21. Subsequently, the debtor entered into a separate five year lease agreement with the creditor for rental of certain machinery and

equipment. The court held that the equipment lease was not covered by the "future advances" clause of the security agreement as there was an absence of nexus between the lease indebtedness and the factor's lien agreement.

In Lansdowne v. Security Bank of Coos County, (In re Smith and West Construction, Inc.), 28 B.R. 682 (Bankr. D. Or. 1983), Judge Luckey reached a different result. There, the bank and the debtor had entered into a security agreement covering a pickup truck, securing a promissory note. Subsequently, the debtor executed two more notes and two more security agreements covering additional collateral. The security agreements contained "future advances" clauses. After the first note was paid, the bank retained its lien on the pickup. The court decided that the lien asserted by the bank in the pickup truck was valid because the loans all appeared to be, ". . .of a business or commercial nature. Nothing offered by either party indicates that the subsequent additional obligations were not of the same class as the initial indebtedness." 28 B.R. at 683, 684.

Here, there were a total of six transactions between Bancorp and the debtor. At least four of the transactions were entered into to provide financing for the debtor to purchase logging equipment and vehicles. The debtor argues that the lease is not in the "same class" as these transactions since a lease is different than a loan. Pursuant to the terms of the lease, the debtor

acquired only the use and possession of the equipment leased and was not purchasing anything.[2]

Bancorp contends that all of the advances including the lease were for the purpose of enabling the debtor to acquire heavy logging equipment and vehicles to be used in the debtor's business operations. The court agrees with this characterization.

Although the debtor would not acquire any equity in the equipment leased (unless the debtor chose to exercise certain options provided in the lease) the equipment leased is heavy logging equipment. The "collateral" described in the five security agreements is also heavy logging equipment and vehicles.

It is, therefore, apparent that the lease obligation should be considered in the "same class" as the other transactions since the underlying purpose of the transactions was to procure heavy logging equipment and vehicles for use in the debtor's business operations.

In the alternative, even if this court were to decide that the lease obligation is not in the "same class" as the other transactions, it is clear that the parties meant to include this

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[2]The Lease Agreement, paragraph 7 provides: This is a non-cancellable contract of lease only and nothing herein or in any other document executed in conjunction wherewith shall be construed as conveying or granting to Lessee any option to acquire any right, title or interest, legal or equitable, in or to the Property, other than use and possession, subject to and upon full compliance with the provisions hereof. Lessee shall affix and maintain, at its expense, in a prominent and visible location, all ownership notices supplied by Lessor. Lessee shall permit Lessor to mark the Property in a manner sufficient to identify the Property as Lessor's Property. Lessee shall secure from each person not a party hereto who might acquire an interest, lien, or other claim in the Property, a waiver thereof.

obligation when they entered into the April 9, 1990 transaction. There, the parties expressly provided:

> 2.3 It is the true, clear and express intention of Debtor that the security interest granted hereby shall secure payment and performance of all Obligations of Debtor, whether now existing or hereinafter incurred, including Obligations incurred by future advances made by Secured Party or by any assignee of Secured Party, or otherwise, whether or not any Obligation is related to any other Obligation by class or kind and whether or not any Obligation was contemplated by the parties at the time of Debtor's granting this security interest. . . .(emphasis added).

The lease agreement was in existence at the time this security agreement was entered into. It is clear from the language quoted above that the parties intended to include all existing obligations of the debtor to Bancorp, including the lease agreement.

Amount of Claim

Both of the parties have submitted calculations as to the lease deficiency claim. The parties are in agreement as to all of the amounts submitted except as to the additional charge, by Bancorp of a "residual value" and the reduction by the debtor to present value using a discount factor.

Residual Value

Bancorp maintains that it is entitled to a residual value equal to 10% of the total agreed value on lease schedule 001 and 20% of the total agreed value of the property described in lease schedule 002. The debtor maintains that there is no provision for "residual values" provided for in the lease.

This court has examined the lease and notes that in schedule 001 the total agreed value is shown at $281,000 and in lease schedule 002 a total agreed value of $260,000 is provided. This

court agrees, however, with the debtor that there is no provision in the lease for the payment of any "residual value" by the debtor.

Discount Factor

Bancorp objects to the use, by debtor, in its calculations, of an 8% discount factor to establish the present value of the lease deficiency. Bancorp argues that there is no reason to believe that the debtor will pay Bancorp a lump sum to satisfy this claim therefore, a present value discount should not be part of the calculations.

Bancorp's argument overlooks the provisions of 11 U.S.C. § 1129(b)(2) which requires that Bancorp be paid the present value of its allowed secured claim in order for the debtor to obtain confirmation of a Chapter 11 plan. Accordingly, it is appropriate to use a discount factor to reduce the lease deficiency to a present value. If the debtor proposes a Chapter 11 plan requiring that the lease deficiency be paid over time, such payments must include an appropriate interest factor. The failure to use a discount factor, such as suggested by the debtor, would give Bancorp a windfall.

Accordingly, the court accepts the calculations of the amount owing on the lease deficiency as set forth in debtor's Brief on Objections to Proof of Claim of U. S. Bancorp, page 8.

CONCLUSION

Based upon the rationale set forth above, this court concludes that the entire claim of Bancorp is an allowed secured claim. This court also concludes that the lease deficiency portion of Bancorp's claim should be allowed in the amount of $188,971.62 as of the date

of the filing of the petition herein, March 9, 1993. This opinion shall constitute the court's findings of fact and conclusions of law; they shall not be separately stated.

ALBERT E. RADCLIFFE
Bankruptcy Judge