

December 3, 1987

Preston G. Gaddis II, Esq.
Crowe and Dunlevy
Attorneys and Counselors at Law
1800 Mid-America Tower
20 North Broadway
Oklahoma City, OK 73102

Dear Mr. Gaddis:

By your letter of November 17, 1987, you request our opinion as to whether a lease intended for security is affected by a clause which permits early termination in the event of the lessee's unavailability of funds.

Incident thereto, you request our review of a proposed "State and Municipal Aircraft Lease/Purchase Agreement" under the terms of which Citicorp North America, Inc., will lease aircraft to certain state and municipal entities as lessees. (Since you have not raised the issue as to whether a differing standard may be applicable to state and municipal lessees under 49 U.S.C. 1401(b)(2), I have not discussed it. As will be seen, the result would probably be the same.)

In advising the FAA Aircraft Registry with respect to who is the owner for registration purposes, this office has been guided by the principle that a lease which, upon compliance with its terms, results in the lessee becoming or having the option of becoming the owner for no additional consideration or nominal consideration, is one intended for security. 49 U.S.C. 1301(19) and U.C.C. Section 1-201(37)(b).

As you know, we have historically applied the "ten percent rule" to determine nominal value. Also, we are of the opinion that a lease which otherwise may be intended for security should not be viewed as such when the lessee has the option at its will to terminate before making all rental payments and where such termination will not result in the lessee becoming the owner for nominal value. (A "walk away" clause.) For support of this position, see Matter of Marhoefer Packing Co., Inc., 674 F.2d 1139 (1982).

That this lease is intended as one for security is uncontroverted. The lessee does not simply have an option to purchase, but will receive all "rights, title and interest" to the leased property "Upon payment by Lessee of the final Rental Payment...." The lessee grants the lessor "a first and priority security interest" in the aircraft.

Further, the parties agree that the lease "may be filed as a financing statement evidencing such security interest." See Section 13, Title: Security Agreement of the lease.

Section 10. Nonappropriation of Funds of the lease provides that if no funds or insufficient funds are appropriated and budgeted incident to the lease, lessee may terminate the lease, make appropriate rental payments, and return the aircraft.

Significantly, Section 10 also provides that if the lease is terminated, the lessee is constrained from acquiring similar equipment.

Based on the above discussion of the terms of the lease, it does not appear that Section 10 is intended as a lessee "walk away" clause. Rather, it is sensible recognition that availability of funds is subject to periodic appropriation processes and that governmental procurement authorities may only obligate funds for budgeted and approved projects.

It is clear the power to terminate lease with impunity is beyond the control of lessee. The lease may be terminated only because of unavailability of funds and with adverse consequences to the lessee (constraints on reprourement).

Based on the foregoing discussion, I am of the opinion that the proposed State and Municipal Aircraft Lease/Purchase Agreement is in the nature of a security agreement and that the various lessees thereto (assuming they are otherwise eligible) may be deemed to be the owners of the aircraft for purposes of aircraft registration.

Sincerely,

Original signed by:
Joseph R. Standell
Joseph R. Standell
Aeronautical Center Counsel

cc:
AGC-7
AGC-200
AAC-250

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