



1979

## Commercial Law–Usury–Lease Constructed as Installment Sale

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### Recommended Citation

Nelwyn Leone Davis, *Commercial Law–Usury–Lease Constructed as Installment Sale*, 2 U. ARK. LITTLE ROCK L. REV. 112 (1979).

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COMMERCIAL LAW—USURY—LEASE CONSTRUED AS INSTALLMENT SALE. *Bell v. Itek Leasing Corp.*, 262 Ark. 22, 555 S.W.2d 1 (1977).

In 1973 plaintiff Bell leased certain printing equipment from Itek Leasing Corporation. The contract was characterized as a lease, but it recited a "price" of \$12,670 for the equipment. The "down payment" was \$1498 and the "balance" was to be paid in sixty monthly installments of \$299 each.<sup>1</sup> The contract did not state what the payments represented, nor did it specify a rate of interest.

Bell brought suit seeking a declaratory judgment that the contract was not a lease but an installment sales contract that was void for usury. The lower court decided on the evidence that the contract was a true equipment lease and entered judgment for the defendant. The Arkansas Supreme Court reversed and held that the purported lease was a credit sales contract that was void for usury. *Bell v. Itek Leasing Corp.*, 262 Ark. 22, 555 S.W.2d 1 (1977).<sup>2</sup>

Before a court can determine whether a contract is usurious, it must decide if the contract is one to which the law of usury applies. A valid lease would not charge any interest and thus would not be subject to the usury laws. In Arkansas, however, installment sales contracts,<sup>3</sup> credit sales, and actual loans come within the scope of the usury laws. The payments on a lease are rent for the use of the property itself. The payments on an installment sales contract include not only the purchase price of the goods, but also interest, which is the charge for the extension of time for payment.<sup>4</sup> The

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1. In *Bell v. Itek Leasing Corp.*, 262 Ark. 22, 24, 555 S.W.2d 1, 2 (1977) the court implied that "price," "initial payment," and "balance" were odd words to use in a lease.

2. Petition for rehearing denied, 262 Ark. 26, 555 S.W.2d 3 (1977). Defendant raised three points, the most important one being the recent enactment of ARK. STAT. ANN. § 85-9-408 (Cum. Supp. 1977) which provides that a lessor may file a financing statement without creating a security interest in leased goods. The Arkansas Supreme Court dismissed this point by saying that (1) the provision was not in effect at the time of the contract and (2) usury is governed by the Arkansas Constitution and "is therefore for the courts rather than for the legislature" to decide. *Id.* at 26-A, 555 S.W.2d at 4. See also *Cooper v. Cherokee Village Dev. Co.*, 236 Ark. 37, 364 S.W.2d 158 (1963) for the proposition that the U.C.C. does not affect the Arkansas law on usury.

3. *Pacific Indus., Inc. v. Mountain Inn, Inc.*, 232 F. Supp. 801 (W.D. Ark. 1964). *But see* *Transportation Equip. Rentals, Inc. v. Ivie*, 96 Idaho 223, 526 P.2d 828 (1974) in which the court said "it has been established that to constitute usury there must be excessive interest or compensation on either a loan of money or forbearance or extension of time of payment on an existing debt." *Id.* at 224, 526 P.2d at 829. In some states installment sales contracts are not subject to the usury laws unless they are accompanied by chattel mortgages. 12 IDAHO L. REV. 115 (1975).

4. *Pacific Indus., Inc. v. Mountain Inn, Inc.*, 232 F. Supp. 801 (W.D. Ark. 1964) involved a cash sale price for furniture and equipment for \$151,604.25 as reflected in the conditional sales contract. The down payment of \$15,160.45 was credited against the cash sales price, resulting in a principal balance of \$136,444.19. A finance charge or time price

payments on a loan are for the use of the money borrowed. A loan may be one secured by personal property and have terms similar to an installment sales contract. When a court is faced with the task of deciding whether a contract is a lease, a credit sale or a secured loan, it must examine several factors which characterize the particular transaction.<sup>5</sup>

In a true lease the lessee never owns the property, and it is the intention of the parties that at the expiration of the lease term, the property will revert to the lessor.<sup>6</sup> Some of the following characteristics may enable a court to identify a true lease: (1) an express reservation of title in the lessor;<sup>7</sup> (2) an intent that the lessee acquire no equity in the property;<sup>8</sup> (3) an unambiguous agreement that a lease is intended;<sup>9</sup> and (4) a requirement that any option purchase price be a substantial amount.<sup>10</sup>

Several factors have been used to distinguish an installment or

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differential in the sum of \$33,429.01 was added. The court defined the finance charge as interest by saying that "the finance charge or time price differential is an amount exacted for the forbearance or extension of time for the payment of the principal balance, and is therefore interest as contemplated by the Arkansas Constitution and Statutes." *Id.* at 806.

5. *Transportation Equip. Rentals, Inc. v. Ivie*, 96 Idaho 223, 224, 526 P.2d 828, 829 (1974).

6. In *Sanders v. Commercial Credit Corp.*, 398 F.2d 988 (5th Cir. 1968) the court decided on the basis of the agreement that the contract was intended to be a lease because at the end of the 10 year lease term the chattel would return to the lessor unless the lessee exercised the option to continue the lease for another 10 year term by making an additional security deposit. The trustee in bankruptcy attempted to introduce an oral stipulation that a "bill of sale" would vest title in the lessee for a nominal amount, thus constituting a conditional sale. The court held that there was nothing in the agreement to merit such an interpretation.

7. *In re Atlanta Times, Inc.*, 259 F. Supp. 820 (N.D. Ga. 1966) held that an equipment lease expressly reserved title in the lessor when it stated that the lessee had no right, title or interest in the property except the right of use. The lessor always had the right to terminate the lease and to demand return of the property.

8. In the case of *In re Alpha Creamery Co.*, 4 UCC Rep. 794 (W.D. Mich. 1967) the court found that the lessee acquired no equity in the leased property because his payments were only for its rental and that if he wanted to buy the property it would cost him 32% of the list price. The court did not think 32% of list could be considered a "nominal" option purchase price within the meaning of "security interest" in U.C.C. § 1-201(37).

9. *In re Gresham*, 311 F. Supp. 974 (E.D. Va. 1970) held that the mere use of words such as "lease" or "rent" will not be construed to create a lease where in reality there is a conditional sale. In *Gresham*, however, the equipment was the subject of a lease which precluded title from passing to the lessee. The lease agreement expressly reserved title in the lessor and provided that at the end of the term the units would return to the lessor or they could be sold and the proceeds turned over to the lessor.

10. *In re Wheatland Elec. Prods. Co.*, 237 F. Supp. 820 (W.D. Pa. 1964) was decided on the basis of U.C.C. § 1-201(37) which provided in part that a lease is intended for security if the amount of money required to give the lessee ownership is nominal. The court held that 25% or more of the original price is not a nominal amount and ruled that "considerably more than completion of rental payments was required to give" the lessee ownership. *Id.* at 822.

credit sales contract from a lease. One crucial element is whether the lessee is to obtain an equity or property interest in the goods; that is, some ownership right in the property.<sup>11</sup> Another factor is whether the lessee can become the owner of the property at the end of the lease period<sup>12</sup> for no additional consideration or for a nominal amount.<sup>13</sup> Another aspect of a contract which may determine whether a lease is in fact an installment sales contract is the existence of a lease-ownership agreement<sup>14</sup> or an acceleration clause declaring all payments due on default.<sup>15</sup>

Many courts have considered the effect of section 1-201(37) of the Uniform Commercial Code in determining whether a transaction is a true lease. Section 1-201(37) is a definition of a security interest and states as follows:

“Security interest” means an interest in personal property or fixtures which secures payment or performance of an obligation. . . . Unless a lease . . . is intended as security, reservation of title thereunder is not a “security interest” . . . . Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.<sup>16</sup>

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11. See ARK. STAT. ANN. § 85-1-201(37) (Add. 1961).

12. J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE, § 22-3, at 762 (1972).

13. ARK. STAT. ANN. § 85-1-201(37) (Add. 1961). *Peco, Inc. v. Hartbauer Tool & Die Co.*, 262 Or. 573, 500 P.2d 708 (1972) recognized three alternative tests for determining if an option purchase price is nominal within the meaning of the U.C.C. The first test could be called the “economic compulsion” test. It considers whether the purchase of the equipment is the only sensible course open to the lessee. The second test involves a comparison of the option price with the value of the property at the time of exercising the option. The third test is a comparison of the option price with the original purchase price. *In re Herold Radio & Elecs. Corp.*, 218 F. Supp. 284 (S.D.N.Y. 1963) held that an option price of 10% of the original price is “nominal” within the Code definition.

14. *Capital Typewriter Co. v. Davidson (In re Shell)*, 390 F. Supp. 273 (E.D. Ark. 1975) held that a “lease-ownership” contract was a security agreement because the lessee intended to buy the typewriter and the lessor intended to sell it. The “lease” provided for 22 monthly rental payments of \$15 each followed by an option to purchase for an additional \$6.55, truly a nominal amount.

15. In *In re Transcontinental Indus., Inc.*, 3 UCC Rep. 235 (N.D. Ga. 1965) the court held that upon default the lessor had the right to repossess the equipment, sell it and hold the lessee liable for any deficiency in the proceeds. These actions are consistent with the effect of an acceleration clause which declares the total amount of the contract due at the time of default.

16. ARK. STAT. ANN. § 85-1-201(37) (Add. 1961).

Several courts have referred to section 1-201(37) when asked to determine whether a lease was in fact a financing arrangement.<sup>17</sup> If the lease creates a security interest in the property, the contract is the equivalent of a secured credit installment sale or a financing arrangement for the payment of the property.<sup>18</sup> When the lease is examined in the light of the Code definition of a security interest, the surrounding facts and circumstances are considered in determining whether the parties intended to create an interest in the leased property to secure its payment or whether they intended a true lease.<sup>19</sup> If the parties intend to create a security interest, they should file a financing statement in order to alert possible creditors that the property is serving as collateral for a secured credit sale or loan.<sup>20</sup>

Sometimes the filing of a financing statement under the U.C.C. convinces the court that a lease is actually a secured loan or a credit sale.<sup>21</sup> A 1972 amendment to the U.C.C., section 9-408, provides that a lessor *may* file a financing statement but its filing is not determinative of whether the lease is intended as security.<sup>22</sup> The official comments to section 9-408 indicate the rationale behind this amendment. It states that the lessor in a true lease may choose to file for safety should the lessee become insolvent.<sup>23</sup>

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17. *McGalliard v. Liberty Leasing Co.*, 534 P.2d 528 (Alaska 1975); *Transportation Equip. Rentals, Inc. v. Ivie*, 96 Idaho 223, 526 P.2d 828 (1974).

18. *In re Atlanta Times, Inc.*, 259 F. Supp. 820 (N.D. Ga. 1966); *Capital Typewriter Co. v. Davidson (In re Shell)*, 390 F. Supp. 273 (E.D. Ark. 1975).

19. *McKeeman v. Commercial Credit Equip. Corp.*, 320 F. Supp. 938 (D. Neb. 1970); *McGalliard v. Liberty Leasing Co.*, 534 P.2d 528 (Alaska 1975).

20. ARK. STAT. ANN. § 85-9-302(1) (Cum. Supp. 1977) provides in part that "a financing statement must be filed to perfect all security interests. . . ."

21. *General Elec. Credit Corp. v. Bankers Commercial Corp.*, 244 Ark. 984, 429 S.W.2d 60 (1968) (citing U.C.C. § 9-402, comment 2) said in dictum that "[a] financing statement, standing alone, does not create a security interest in the debtor's property. It merely serves notice that the named creditor may have a security interest." *Id.* at 986, 429 S.W.2d at 62. Filing the financing statement does not itself *create* the security interest in the property; the security interest is created by a security agreement between the parties to the installment sales contract or secured loan. ARK. STAT. ANN. § 85-9-203(2) (Cum. Supp. 1977). The purpose of filing the financing statement is to "perfect" the security interest that the secured party has in the property. ARK. STAT. ANN. § 85-9-302(1) (Cum. Supp. 1977). "Perfection" means to make the security interest enforceable according to its terms, not only between the parties, but also as against other creditors of the lessee. *See* ARK. STAT. ANN. § 85-9-301 (Cum. Supp. 1977).

22. ARK. STAT. ANN. § 85-9-408 (Cum. Supp. 1977) was adopted in 1973 and took effect Jan. 1, 1974.

23. *Rollins Communications, Inc. v. Georgia Inst. of Real Estate, Inc.*, 140 Ga. App. 448, 231 S.E.2d 397 (1976). ARK. STAT. ANN. § 85-9-408, comment 2 (Cum. Supp. 1977) states the reasoning of the drafters on the purpose of this amendment as follows: "If a lease is actually intended as security, this Article applies in full. But this question of intention is a

If the court determines from all the facts and circumstances surrounding the contract that the transaction is a secured financing arrangement or loan for the purchase of the property rather than a contract to lease the property, it must then determine the rate of interest charged to decide whether the contract is usurious. In Arkansas usury is defined in the state constitution as a rate of interest greater than ten percent per annum.<sup>24</sup> The Arkansas usury law has been applied to several types of contracts. Until 1952, usury applied only to a loan of money and the Arkansas Court did not apply it to a sale of merchandise.<sup>25</sup> After 1952, however, usury was applied to financed sales contracts<sup>26</sup> and to installment sales contracts.<sup>27</sup>

Installment sales contracts are the same as financed credit sales contracts and carry a rate of interest regardless of whether it is stated in the contract. The interest is the difference between the purchase price of the goods and the total of all the installment payments.<sup>28</sup> If usury is found in a contract for the sale of goods, the penalty is severe and absolute—the contract is void and the buyer gets the goods.<sup>29</sup>

Since 1970 at least three states have examined equipment

doubtful one, and the lessor may choose to file for safety even while contending that the lease is a true lease for which no filing is required.”

24. ARK. CONST. art. 19, § 13, which provides as follows:

“All contracts for a greater rate of interest than ten percent per annum shall be void, as to principal and interest, and the General Assembly shall prohibit the same by law; but when no rate of interest is agreed upon, the rate shall be six per centum per annum.”

See ARK. STAT. ANN. §§ 68-602 to 608 (1957 & Cum. Supp. 1977).

25. *Sloan v. Sears, Roebuck & Co.*, 228 Ark. 464, 468, 308 S.W.2d 802, 805 (1958).

26. *Hare v. General Contract Purchase Corp.*, 220 Ark. 601, 249 S.W.2d 973 (1952) held that credit sales financed by the seller would be subject to usury and issued a caveat that in the future usury would not be limited to transactions in which a loan of money was involved but would also apply to credit sales contracts.

27. *Pacific Indus., Inc. v. Mountain Inn, Inc.*, 232 F. Supp. 801 (W.D. Ark. 1964). See note 4 *supra*.

28. *McGalliard v. Liberty Leasing Co.*, 534 P.2d 528 (Alaska 1975).

29. *Universal C.I.T. Credit v. Hudgens*, 234 Ark. 1127, 356 S.W.2d (1962); *Sloan v. Sears, Roebuck & Co.*, 228 Ark. 464, 308 S.W.2d 802 (1958). There are very few defenses once usury has been found and for this reason usury will not be found if the opposite conclusion can reasonably be reached. *Briggs v. Steele*, 91 Ark. 458, 121 S.W. 754 (1909). The court in *Cagle v. Boyle Mortgage Co.*, 261 Ark. 437, 549 S.W.2d 474 (1977) held that a lack of intent to charge a usurious rate is no defense if the monthly statements show a computation of interest above the legal rate. See Note, 1 UALR L.J. 86 (1978). In a determination of usury the true nature of the agreement is examined in the light of the circumstances at the time of its making. *American Physicians Ins. Co. v. Hruska*, 244 Ark. 1176, 428 S.W.2d 622 (1968); *General Contract Corp. v. Duke*, 223 Ark. 938, 270 S.W.2d 918 (1954); *Tindall v. Sims*, 212 Ark. 860, 208 S.W.2d 173 (1948); *Home Bldg. & Sav. Ass'n v. Shotwell*, 183 Ark. 750, 38 S.W.2d 552 (1931).

leases in the light of their usury laws.<sup>30</sup> In deciding whether to apply their usury laws, these courts first had to decide whether the contract was a true lease, a loan, or a credit sale. If a true lease was found, usury did not apply;<sup>31</sup> but if the lease was found to have been in reality a financing arrangement or a secured installment sale, then usury did apply.<sup>32</sup>

In *Transportation Equipment Rentals v. Ivie*<sup>33</sup> the Idaho Supreme Court decided that the usury law did not apply because it found the contract in question was a true lease. The decision was based on the fact that title to the equipment did not pass to the lessee at the termination of the contract and therefore the agreement could not be characterized as a sale of the equipment. The dissent said that the contract was a hybrid, having characteristics of both a true lease and a financed sale, and should have been construed as a financing agreement subject to the usury law.<sup>34</sup>

In *McKeeman v. Commercial Credit Equipment Corp.*<sup>35</sup> a Nebraska farmer brought suit against a credit company for a declaratory judgment that an agreement involving farm equipment was a usurious loan transaction rather than a lease.<sup>36</sup> The plaintiff alleged that he had purchased some silos for \$42,000 and that the installment payments on the "lease" totaled \$58,000. The defendant denied that the plaintiff had purchased silos and contended that he had merely leased them. The court decided that since the lessee could purchase the silos at the end of the lease for only one dollar,<sup>37</sup> then by definition<sup>38</sup> this lease was one intended for security and thus was an installment sales contract. The following factors were considered by the court in reaching its decision: (1) all warranties had been assigned to the user; (2) the user could not sublease any units without the consent of the lessor nor could he encumber any of the

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30. Nebraska, Alaska, and Idaho. *McKeeman v. Commercial Credit Equip. Corp.*, 320 F. Supp. 938 (D. Neb. 1970); *McGalliard v. Liberty Leasing Co.*, 534 P.2d 528 (Alaska 1975); *Transportation Equip. Rentals, Inc. v. Ivie*, 96 Idaho 223, 526 P.2d 828 (1974).

31. *Transportation Equip. Rentals, Inc. v. Ivie*, 96 Idaho 223, 526 P.2d 828 (1974).

32. *McGalliard v. Liberty Leasing Co.*, 534 P.2d 528 (Alaska 1975).

33. 96 Idaho 223, 526 P.2d 828 (1974).

34. *Id.* at 223, 526 P.2d at 829.

35. 320 F. Supp. 938 (D. Neb. 1970).

36. *Id.* at 940, n.1. (citing NEB. REV. STAT. § 45-101, -105 (Reissue 1968)). Nebraska's legal rate of interest is 9% per year by statute. A finding of usury, however, does not make the contract void, it merely limits the recovery to the principal without interest.

37. *Id.* at 942.

38. U.C.C. § 1-201(37) definition of "security interest" provides in pertinent part as follows: "(b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security."

units;<sup>39</sup> (3) all expenses and taxes were to be paid by the user; (4) all risk of loss was assumed by the user; and (5) in the event of default the lessor could recover the full amount of the "rent" due and could repossess and resell the units.<sup>40</sup> The court said that since all the burdens of ownership were placed on the lessee, and since in a true lease the lessee never owns the property,<sup>41</sup> the only logical conclusion was that the contract was not a lease but was in fact a loan.<sup>41.1</sup> The rate of interest on the contract, determined from a comparison of the difference between the total payments and the original price, was found to be usurious.<sup>42</sup>

In an Alaska Supreme Court case, *McGalliard v. Liberty Leasing Co.*,<sup>43</sup> a leasing company brought suit against the owner of a gift shop to recover the balance of payments due under a purported lease of trade fixtures. The lessee had purchased the fixtures from a supplier for \$17,000. A leasing company with a close relationship to the supplier then secured a loan to the lessee by allegedly taking title from the supplier and making a "lease" which called for payments totaling \$24,000. The Alaska Supreme Court found that the contract was a third party loan cloaked in the form of a lease and thus was within the purview of the usury laws.<sup>44</sup> The court identified the following six factors as important to its determination that the transaction was a usurious loan: (1) the intention of the parties to create a loan or extension of credit; (2) a discussion by the parties of financing possibilities; (3) a close relationship between the supplier and the financier; (4) proof that it was the supplier's normal business practice to assign paper after the transaction was consummated; (5) relation between the price the vendor received for his paper and his cash selling price; and (6) computation of the excess (time-price) charges in a manner in which loan interest is usually computed.<sup>45</sup> The leasing company's president testified that the defendant had purchased the fixtures and that the leasing company had advanced "a line of credit."<sup>46</sup> The decision was also based on

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39. Factor (2) seems to weigh against the decision reached by the court, but since it is listed with the other factors, perhaps the court merely weighed it against all the other factors and did not rely on it to reach its decision.

40. *McKeeman v. Commercial Credit Equip. Corp.*, 320 F. Supp. 938, 947 (D. Neb. 1970).

41. *Id.*

41.1. *Id.*

42. *Id.* at 948.

43. 534 P.2d 528 (Alaska 1975).

44. *Id.*

45. *Id.* at 530.

46. *Id.* at 531.



an analysis of the lease under the provisions of the Alaska U.C.C. definition of "security interest"<sup>47</sup> and a comparison of the option purchase price with the original price.<sup>48</sup>

These three cases indicate that if the lessee owns the goods at the end of the lease term, the arrangement should be characterized as a purchase. The cases go one step further in holding that if the lessee has the option to purchase the goods for a small or nominal amount at the end of the lease term, it is a purchasing arrangement. All three cases are illustrative of the way that courts examine the surrounding facts and circumstances in order to find out what the parties intended when they made the agreements.

The reasoning of the Arkansas Supreme Court in the principal case, *Bell*, was based on the Uniform Commercial Code definition of security interest<sup>49</sup> and the cases of *McKeeman*, *McGalliard*, and *Burroughs Adding Machine Co. v. Bogdon*,<sup>50</sup> a pre-Code case. The court stated that the issue in *Bell* was whether a contract to lease was really an installment sales contract carrying such an excessive rate of interest as to be void for usury.<sup>51</sup>

The court held that the lease in *Bell* was an installment sales contract but did not discuss at length either the facts or the controlling rule of law because the court said "in this case both are beyond dispute."<sup>52</sup> The court pointed out that the "lease" stated a "price" for the equipment, a "down payment" and the "balance" in monthly payments.<sup>53</sup> These provisions were considered to be terms of a sales contract. The defendant did not explain how he had arrived at the amount of the monthly payments. The court concluded that the charges were actually remittances on a credit sales contract which provided an annual interest rate of 19.31%.<sup>54</sup> The court stated that its decision was based on five findings of fact which were either established by, or could be inferred from, the proof. First, defendant Itek Leasing was in reality a finance company which financed the sale of Itek products. Second, plaintiff lessee was to pay all taxes and insurance on the property. Third, the finance company would have the same remedies on default that would be available to a conditional seller or mortgagee; for example, the lessor could declare

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47. *Id.* at 531, n.12 (citing ALASKA STAT. § 45.05.020(37)).

48. *Id.* at 532.

49. ARK. STAT. ANN. § 85-1-201(37) (Add. 1961).

50. 9 F.2d 54 (8th Cir. 1925).

51. *Bell v. Itek Leasing Corp.*, 262 Ark. 22, 23, 555 S.W.2d 1, 2 (1977).

52. *Id.* at 24, 555 S.W.2d at 2.

53. *Id.*

54. *Id.*

all payments due on default and, not receiving payment, the lessor could repossess the property, sell it, and hold the lessee personally liable for any deficiency. Fourth, the lessee was to join the lessor in executing a financing statement pursuant to the U.C.C. for the protection of the interest of the lessor in the property. Last, Itek's witness testified that Itek, about thirty days prior to the expiration of the five year lease term, would have offered to Bell the option to purchase the equipment for ten percent of its original cost. These five findings plus the definition of "security interest" in section 1-201(37) formed the basis of the court's decision that the lease was a secured installment sales contract.<sup>55</sup>

The court cited both *McKeeman*<sup>56</sup> and *McGalliard*<sup>57</sup> but did not discuss them or their application to *Bell*; nor did it discuss the U.C.C. definition of a "lease intended for security." Furthermore, there are no facts in the opinion to support the finding that defendant Itek is a finance company. The court reached this conclusion from the facts that Itek does not manufacture any of the equipment it leases and that it has 1300 leases outstanding which represent an \$18,000,000 investment. From these two facts, the court said that "it is fair to infer that Itek Leasing Corporation finances the sale of Itek products."<sup>58</sup>

The court did not use *Bell* to set definitive guidelines for the interpretation of lease contracts in Arkansas. The case is uncertain as precedent because it does not provide workable guidelines upon which drafters of leases can rely. *Bell* is the first Arkansas case to hold that under certain circumstances an equipment lease can be subject to usury laws. The court could have rendered valuable service to the commercial leasing world by clearly stating the conditions under which a lease may be identified as a credit sales contract that is subject to the usury prohibition. In Arkansas the penalty for usury, cancellation of the contract and awarding the goods to the buyer,<sup>59</sup> is too harsh to leave open the question whether a lease agreement will be construed as an installment sales contract.

The impact of *Bell* is far-reaching in that it affects every lessor of equipment ranging from typewriters to automobiles. Possibly every contract which allows the lessee to purchase the goods at the end of the lease is an installment sales contract, even though the

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55. *Id.* at 26, 555 S.W.2d at 2.

56. *McKeeman v. Commercial Credit Equip. Corp.*, 320 F. Supp. 938 (D. Neb. 1970).

57. *McGalliard v. Liberty Leasing Co.*, 534 P.2d 528 (Alaska 1975).

58. *Bell v. Itek Leasing Corp.*, 262 Ark. 22, 24-25, 555 S.W.2d 1, 3 (1977).

59. *Universal C.I.T. Credit v. Hudgens*, 234 Ark. 1127, 356 S.W.2d 658 (1962); *Sloan v. Sears, Roebuck & Co.*, 228 Ark. 464, 308 S.W.2d 802 (1958).

parties did not intend to make a contract for sale at the beginning of the relationship. A large portion of the *Bell* opinion is devoted to the fact that Itek's witness testified that, thirty days before the completion of the lease, the lessee *would have* been offered the option to purchase the equipment for ten percent of its original cost. The court assumed that this agreement was part of the original contract, in spite of the fact there was no evidence that it was. If the parties had originally agreed to this, the court's conclusion that the lease was intended for security would have been reasonable.<sup>60</sup> It is not clear, however, that the option was part of the contract at the time of its making.

The five findings of fact which the court relied on in holding the transaction to be a sale, with the exception of the supposed option to purchase, are all characteristic of *either* a lease or a credit sale. The fact that Itek was not a manufacturer of goods which it leased would not seem to be material because many lessors do not manufacture the goods which they lease.<sup>61</sup> Manufacturers, on the other hand, do not always dispose of their goods directly to the user but very often wholesale them to distributors who resell them. The provisions in the lease relating to taxes, insurance, and risk of loss are a matter of contract between the parties and are commonly found in leases. The lessor could easily bear these costs himself and charge the lessee a higher rent to cover them. Acceleration clauses, such as that in the Itek lease, are common in leases of both real and personal property, and are drafted to allow the lessor to obtain one recovery at the time the lessee defaults. Without such a clause the lessor would have to sue each month to recover the rent due for that month. The finding relating to the U.C.C. filing of a financing statement is contrary to the Arkansas Statute<sup>62</sup> that clearly states a court should not presume that a lease is a conditional sales contract or a loan merely because a financing statement is filed. Last, the finding that the lessee would have been offered the property for ten percent of its original cost would be material only if this price had been substantially lower than the market value of the equipment at the time the lease was terminated. There is little evidence in the record as to the fair market value of the property, and it seems that the court did not have a basis for determining that the option purchase price was "nominal"<sup>63</sup> as required by the U.C.C. definition of

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60. ARK. STAT. ANN. § 85-1-201(37) (Add. 1961).

61. For example, Hertz and Avis do not manufacture the cars they lease.

62. ARK. STAT. ANN. § 85-9-408 (Cum. Supp. 1977).

63. *Bell v. Itek Leasing Corp.*, 262 Ark. 22, 26, 555 S.W.2d 1, 3 (1977).

“security interest.”

This decision broadens the application of stringent usury laws but fails to provide proper guidelines to drafters of lease agreements. In light of the court's five findings in *Bell*, only an incautious lawyer would unquestioningly assume that an “ordinary” leasing transaction was not subject to the usury laws.

[Note by Nelwyn Leone Davis]