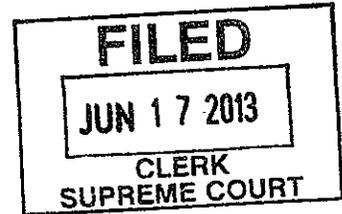


COMMONWEALTH OF KENTUCKY
SUPREME COURT OF KENTUCKY
CASE NO. 2012-SC-000249-D
AND 2010-CA-2332



ON APPEAL FROM
THE COURT OF APPEALS OF KENTUCKY and from
THE FRANKLIN CIRCUIT COURT

DELPHI AUTOMOTIVE SYSTEMS, LLC

APPELLANT

V.

CAPITAL COMMUNITY ECONOMIC/
INDUSTRIAL DEVELOPMENT CORPORATION, INC.

APPELLEE

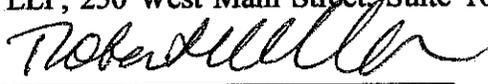
BRIEF FOR APPELLEE

Robert W. Kellerman
Sarah J. Bishop
STOLL KEENON OGDEN PLLC
201 West Main Street
P.O. Box 5130
Frankfort, KY 40602
Phone: (502) 875-6220

Counsel for Appellee

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of this Brief was served on this the 17th of June, 2013, by placing same, postage prepaid, in the United States mail addressed to the following: Hon. Thomas Dawson Wingate, Circuit Judge, Franklin Circuit Court, Judicial Building, 669 Chamberlin Avenue, Frankfort, Kentucky 40601, Samuel Givens, Jr., Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601, Virginia Hamilton Snell, Esq., Wyatt, Tarrant & Combs, LLP, 500 West Jefferson Street, Suite 2800, Louisville, KY 40202, and Daniel E. Hitchcock, Esq., Wyatt, Tarrant & Combs, LLP, 250 West Main Street, Suite 1600, Lexington, Kentucky 40507.


Counsel for Appellee

STATEMENT CONCERNING ORAL ARGUMENT

The Appellee believes that oral argument would serve to underscore the applicability of the governmental exemption for economic development leases from KRS Chapter 355.9, concerning secured transactions.

COUNTERSTATEMENT OF POINTS AND AUTHORITIES

INTRODUCTION..... 1

COUNTERSTATEMENT OF THE CASE..... 2

KRS 154.50-301 to 154.50-346 2

KRS 154.50-310 (4)..... 2

KRS 150.50-310 (2)..... 2

CR 59.05 6

KRS 355.9- 109(4)(q), 7

STANDARD OF REVIEW 7

Lewis v. B & R Corporation, 56 S.W.3d 432, 436 (Ky. App. 2001)
(quoting *Scifres v. Kraft*, 916 S.W.2d 779, 781 (Ky App.1996)) 7

ARGUMENT 7

Fischer v. Fischer, 348 S.W.3d 582, 595 (Ky. 2011)..... 7

Perry v. Williamson, 824 S.W.2d 869 (Ky. 1992)..... 8

Commonwealth Transp. Cabinet Dep't of Highways v. Taub,
766 S.W.2d 49 (Ky. 1988)..... 8

KRS 355.9-109(4)(q) 8

**I. The Court of Appeals Properly Determined that CCEIDA's
Transaction With Certified Tool was Not Subject to Article 9 of the UCC** 8

KRS 355.9-109(4) 8, 11

KRS 355.9-109(4)(q) 8, 10, 11, 12, 15, 17

KRS 355.9-104(5)..... 8

MPM Fin. Group, Inc. v. Morton, 289 S.W.3d 193, 197 (Ky. 2009) 9

<i>MP Star Financial v. Cleveland State University</i> , 837 N.E.2d 758 (Ohio, 2005).....	9
4 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE §30-12 (6th ed.) (2010).....	10
KRS Chapter 154.50	10
9A FREDERICK H. MILLER & NEIL B. COHEN, HAWKLAND UNIFORM COMMERCIAL CODE SERIES §9-109 (Westlaw 2010)	10
KRS 355.9-109(3)(4)	11
<i>Farmers & Merchants Nat’l Bank v. Fairview State Bank</i> , 766 P. 2d 330 (Okla., 1988)	11
<i>Bowlen v. Federal Deposit Ins. Corp.</i> , 815 P. 2d 1013 (Colo. App., 1991)	11
<i>Peoples Bank and Trust Company v. Applewhite</i> , 152 B.R. 119 (Bankr.N.D.Miss, 1992).....	11
<i>JP Morgan Chase Bank, N.A. v. Longmeyer</i> , 275 S.W.3d 697, 702 n.11 (Ky. 2009)	12
<i>Floyd County Bd. of Educ. v. Ratliff</i> , 955 S.W.2d 921, 925 (Ky. 1997)	12
KRS 355.9-102.....	12
<u>II. KRS 355.9-109(3) Also Provides a Proper Exemption for CCEIDA</u>	13
KRS 355.9-109(3).....	13, 14
KRS 154.50-343.....	14
KRS 355.9-109(3)(b)	14, 15
KRS Chapter 154.50	14, 15
<u>III. The Trial Court Correctly Awarded Summary Judgment to CCEIDA on Public Policy Grounds.</u>	15
KRS 355.9-109(4)(q)	15, 17
<i>In Re: City of Moran</i> , 713 P.2d 451 (Kan. 1986).....	15, 19, 20, 21, 22, 23

<i>Floyd County Bd. Of Educ. v. Ratliff</i> , 955 S.W.2d 921, 925 (Ky. 1997)	16
KRS 446.080	16
KRS 446.080(1)	16
KRS 355.9-109.....	16, 17
<i>JP Morgan Chase Bank, N.A. v. Longmeyer</i> , 275 S.W.3d 697, 702 n.11 (Ky. 2009)	17
KRS 154.50-301 to 154.50-346	17
<i>Light v. City of Louisville</i> , 248 S.W.3d 559, 563 (Ky. 2008)	17
KRS Chapter 355.9	18
<i>Delphi, Ford Motor Credit Co. v. Webb-Elkhorn Coal Corp.</i> , 775 S.W.2d 945 (Ky. App. 1989)	18
KRS 355.9-109(3)(b)	21
KRS 154.50-320(1)(b)	21
KRS 154.50-343.....	22
<i>In Re: Petroleum Products, Inc.</i> , 72 B.R. 739 (U.S.B.C., Kansas, 1987)	23
KRS 154.50-340.....	23

IV. The Court of Appeals Erroneously Found that The Lease Agreement was Not a True Lease

<i>Fischer v. Fischer</i> , 348 S.W.3d 582 (Ky. 2011)	24
<i>Cantrell Supply, Inc. v. Liberty Mut. Ins. Co.</i> , 94 S.W.3d 381, 384 (Ky.App.2002)	24
<i>In re Yost</i> , 54 B.R. 818, 820 (W.D. Ky. 1985).....	24, 27, 28, 29
KRS 355.1-203 (1).....	25
KRS 355.1-203(3).....	25

KRS 355.1-203 (2).....	26
KRS 154.50-343.....	28
<i>Diaz v. Goodwin Brothers Leasing, Inc.</i> , 511 S.W.2d 680 (Ky. 1974)	28
KRS 355-1-302(1).....	29
<u>V. Certified Tool Had No Ownership Interest in the Equipment to Transfer</u>	30
KRS 154.50-343.....	30
KRS Chapter 154.50	30,33
<u>CONCLUSION</u>	33

INTRODUCTION

Within the first sentence of the first page of its brief, Appellant Delphi Automotive Systems, LLC alleges in bold type that Appellee, Capital Community Economic/Industrial Development Corporation, Inc., a/k/a Capital Community Economic/Industrial Development Authority holds an unperfected security interest in certain property. Yet no court to consider the matter has found that Appellee's interest is unperfected. In fact, the issue is more properly described as whether Appellee, as a government entity, was required in 2001 to file a financing statement to document its lessor's interest under an equipment lease made pursuant to state economic development authority statutes, in order to cause the lease to be superior to a blanket security interest that was subsequently granted seven years later by debtor in debtor's property to Delphi.

COUNTERSTATEMENT OF THE CASE

The instant controversy stems from the lease of a large item of industrial equipment- a Komatsu industrial press- by Certified Tool & Manufacturing of Kentucky, Inc. ("Certified Tool") from Appellee, Capital Community Economic/Industrial Development Corporation, Inc., a/k/a Capital Community Economic/Industrial Development Authority ("CCEIDA"). The factual and procedural history behind that lease and the ensuing controversy between Appellant, Delphi Automotive Systems, LLC ("Delphi") is as follows:

CCEIDA is a Kentucky quasi-governmental non-profit corporation established under Kentucky's economic development statutes. Its principal place of business is located in Frankfort, Kentucky. CCEIDA is a joint city/county effort for industrial development in Frankfort and Franklin County, Kentucky. It is established under what is now codified as KRS 154.50-301 to 154.50-346. CCEIDA is recognized as a "governmental unit" pursuant to KRS 154.50-310 (4) which includes the combination of any city acting jointly with any county. These statutes are part of Kentucky's governmental scheme for economic development, and permit the acquisition of equipment, such as the Komatsu Press, with public funds for the purpose of industrial development.¹

The dispute between Delphi Automotive and CCEIDA concerns which entity is entitled to priority interest in liquidation proceeds realized from the sale of the Komatsu Press previously leased to Certified Tool beginning in 2001.

CCEIDA purchased the Komatsu Press as a result of funds made available through a Community Development Block Grant made by the Commonwealth of Kentucky Department for Local Government to Franklin County, Kentucky pursuant to the federal Housing and Community Development Act of 1974. The grant is evidenced by a Grant Agreement between

¹ See KRS 150.50-310 (2) which expressly includes "equipment."

Franklin County, Kentucky and the Commonwealth of Kentucky Department for Local Government which is dated May 9, 2001. ROA 225-246². These funds were designated for the specific purpose of increasing employment through the expansion of the Certified Tool factory in Franklin County, Kentucky.

Franklin County enacted an Ordinance (Ordinance 5, Amendment 4) accepting the grant funds on or about May 4, 2001. ROA 247. The Ordinance acknowledges receipt of the grant funds from the Department of Local Government in the amount of \$335,000.00 for "CDBG-Certified Tool." The Ordinance further authorizes the expenditure of \$320,000.00 of said amount specifically for equipment. *Id.* The equipment referred to in the Ordinance is the Komatsu Press. ROA 223.

CCEIDA's Lease Agreement with Certified Tool is dated April 16, 2001, and is specifically entitled a "Lease Agreement." ROA 209. In pertinent part, it provides:

- That it is a lease: CCEIDA is identified as the "lessor" and Certified Tool is identified as the "lessee." The equipment at issue is identified as the "leased property."
- No mention of a security agreement. In paragraph 16B, Certified Tool represented and warranted to CCEIDA that it had authority to "hold property under the 'lease'." In paragraph 16 C, Certified Tool warranted that the "Lease" is a legal, binding obligation of Lessee, enforceable against Lessee in accordance with its terms.
- That the equipment "is, and at all times during the term hereof shall remain, the sole and exclusive property of Lessor (CCEIDA). Lessee shall have no right, title or interest in the Equipment except as set forth in the lease."
- Certified Tool is prohibited from assigning or transferring the equipment or any interest in the lease or the equipment.

² Citations to "ROA" refer to the Record on Appeal.

- Any attempt to encumber the Equipment is a default under the lease.

ROA 209-217.

As set forth above, it was the express intent of both Certified Tool and CCEIDA to create a Lease Agreement. This is established not only by the above-cited language, but also by the fact that a plaque was affixed to the press from the time of delivery through its eventual sale at liquidation which declared that the press was, "Property of Franklin County Development Authority." ROA 223-224. Certified Tool complied with the terms of the lease for a significant period of time, but ultimately defaulted on the lease. CCEIDA was therefore entitled to take possession of the press. As a result of the default, the Komatsu Press was liquidated at the direction of CCEIDA, its owner. ROA 6. The proceeds of that sale were approximately \$185,370.00, and that sum is currently being held by the Franklin Circuit Court Clerk pursuant to the trial court's October 28, 2009 Order. ROA 83-84.

In February, 2008, Certified Tool granted to Working Capital Solutions, Inc. ("WCS") a security interest in, "Seller's now owned and hereafter acquired personal property and fixtures..." ROA 143. The Komatsu Press was not specifically identified in that security agreement. WCS filed financing statements with the Kentucky Secretary of State and the Illinois Secretary of State on February 26, 2008. ROA 158-161. Certified Tool defaulted on its obligations to WCS in June 2009, at which time \$324,253.98 was owed to WCS. ROA 112.

In May 2008, Certified Tool received a loan of up to \$250,000 to be paid on an as-needed basis from Delphi, and executed a promissory note evidencing that arrangement. ROA 127-128. That line of credit was later extended at the request of Certified Tool to \$275,000 in June 2008, and Certified Tool and Delphi executed a First Amended Promissory Note. ROA 127-128. In conjunction with this transaction, Certified Tool executed a blanket security interest of assets in favor of Delphi effective June 17, 2008. ROA 129-135. Notably, this instrument pledges to

Delphi, “all of the Debtor’s now owned or hereinafter acquired property” as security for its loan. ROA 129 (emphasis added). Again, the Komatsu press was not specifically identified in this security interest. Certified Tool, as a lessee, was of course not the owner of the Komatsu press at the time this security agreement was entered into and could not have pledged any interest in the press. Title was vested in CCEIDA.

As a result of the security interest granted to it, Delphi filed financing statements with the Kentucky Secretary of State and the Illinois Secretary of State on June 16, 2008³. ROA 136-142. Later, on or about December 11, 2008, Delphi and WCS entered into a Purchase and Sale Agreement pursuant to which Delphi purchased WCS’ interest in the Factoring Agreement and related documents between WCS and Certified Tool. ROA 162-166.⁴

On or about August 27, 2009, Delphi filed its Complaint in the Franklin Circuit Court, seeking a declaratory judgment finding that Delphi’s lien on the proceeds from the sale of the Komatsu press is superior to any interest CCEIDA may have. ROA 8. As part of its Complaint, Delphi noted that the amount due to it from Certified Tool as of August 10, 2009 was \$207,518.81. ROA 4.

Both CCEIDA and Delphi moved the trial court for summary judgment. ROA 191 and ROA 105, respectively. CCEIDA argued that its agreement with Certified Tool was indeed a true lease agreement; that even if the agreement was deemed a security agreement, CCEIDA was not required to file a financing statement to establish priority; and that Certified Tool never transferred any interest in the equipment to either WCS or Delphi because it had no authority to make such transfer. ROA 191-208. CCEIDA also argued that the Lease Agreement was entered into pursuant to Kentucky’s economic development statutes and thus exempt from Article 9

³ While the financing statements were filed on June 16, 2008. The Security Agreement has an effective date of June 17, 2008. ROA 129.

⁴ The copy of the Purchase and Sale Agreement filed in the record by Delphi as Exhibit F to its Motion for Summary Judgment appears to be unsigned by Delphi. ROA 166.

filing requirements, and that the UCC governmental filing exception exempts CCEIDA from filing a financing statements otherwise required by Article 9. ROA 269- 285.

Delphi, on the other hand, argued that the Lease Agreement should be construed as a Security Agreement and requiring the filing of financing statement for CCEIDA to perfect its interest in the property pursuant to UCC Article 9. Delphi asserted that it (and WCS, whose interest it purchased), having filed a financing statement, had an interest superior to that of CCEIDA. ROA 105-125. Delphi further argued in response to CCEIDA's supplemental memorandum that Kentucky's economic development statutes have no effect on the interpretation of the Lease Agreement, and that the UCC does not exempt CCEIDA from perfecting its security interest by filing as set forth in Article 9. ROA 286-301.

The trial court issued its Order on October 11, 2010 granting CCEIDA's Motion for Summary Judgment and Denying Delphi's Motion for Summary Judgment. ROA 305-318. The trial court ultimately found that the lease agreement was not a true lease, but instead created a security interest. However, the court based its finding in favor of CCEIDA on public policy, specifically finding that, "the purpose of Kentucky's economic development statutes would be thwarted; the confidence of bondholders in government bonds would be severely undermined," if the Court found that CCEIDA's interest was inferior to that of Delphi. ROA 315-316. Delphi filed a Motion to Alter, Amend, or Vacate this Order on October 22, 2010.⁵ ROA 319. The trial court denied that motion on November 23, 2010. ROA 373. Delphi appealed to the Court of Appeals on or about December 20, 2010.

Delphi presented the Court of Appeals with arguments nearly identical to those made before the trial court. Specifically, Delphi again argued that the lease between CCEIDA and Certified Tool was actually a security agreement; that CCEIDA was not exempt from Article 9

⁵ The Certificate of Service on Delphi's Motion to Alter, Amend or Vacate is dated October 20, 2010, putting it within the ten day time frame set forth in CR 59.05.

of the UCC; and that public policy actually favored a ruling in favor of Delphi. The Court of Appeals was not persuaded by Delphi's arguments, and found in favor of CCEIDA, albeit for reasons different from the Circuit Court. In its March 23, 2013 Opinion, the Court of Appeals determined that although the lease between CCEIDA and Delphi created a security agreement under ordinary lending circumstances between private parties, the industrial development equipment lease by CCEIDA, as a governmental entity, was exempt from Article 9 of the UCC. Based on the legislative history underlying KRS 355.9- 109(4)(q), the court reasoned that the General Assembly intended to include transfers of both assets and debt in its exemption for transfers by a governmental entity. Delphi moved for, and was granted, discretionary review by this Court.

STANDARD OF REVIEW

The proper standard of review on appeal of an award of summary judgment is, "whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law." *Lewis v. B & R Corporation*, 56 S.W.3d 432, 436 (Ky. App. 2001) (quoting *Scifres v. Kraft*, 916 S.W.2d 779, 781 (Ky App.1996)). Because the summary judgment in this action involves only legal conclusions, an appellate court typically reviews the trial court's determination *de novo*. *Id.*

ARGUMENT

Although CCEIDA agrees with the Court of Appeals' ultimate determination in its favor, and the sound legal reasoning upon which that decision was made, CCEIDA disagrees with the Court of Appeals' finding that the lease at issue was not a true lease. Despite Delphi's assertion to the contrary, it was not necessary for CCEIDA to file a cross-appeal in order to make arguments contrary to the Court of Appeals' reasoning. See *Fischer v. Fischer*, 348 S.W.3d 582,

595 (Ky. 2011)(“...the requirement of a cross-motion for discretionary review should only kick in when the Court of Appeals’ judgment—its *result*—somehow wrongs the appellee in this Court, even if only in part.”) (emphasis in original). The Court of Appeals’ judgment was in favor of CCEIDA. The fact that the entirety of its reasoning differed from that of CCEIDA did not require CCEIDA to file a cross-motion for discretionary review.

Delphi’s reliance on *Perry v. Williamson*, 824 S.W.2d 869 (Ky. 1992) for its suggestion to the contrary is misplaced, as that case relied on *Commonwealth Transp. Cabinet Dep’t of Highways v. Taub*, 766 S.W.2d 49 (Ky. 1988). *Taub* was effectively overruled by *Fischer*.⁶ Since *Fischer* accurately describes the law in Kentucky, and does not require the filing of a cross-motion for discretionary review in order for a prevailing party to assert alternate theories upon which affirming the lower Court is appropriate, CCEIDA will, after its discussion of the Court of Appeals’ correct ruling on the proper interpretation of KRS 355.9-109(4)(q), discuss why the trial court’s opinion could be affirmed for other reasons as well.

I. The Court of Appeals Properly Determined that CCEIDA’s Transaction With Certified Tool was Not Subject to Article 9 of the UCC.

KRS 355.9-109(4) explicitly states that, “This article does not apply to... [a] public finance transaction or a transfer by a government or governmental unit.” KRS 355.9-109(4)(q); also see prior KRS 355.9-104 (5). Because Article 9 of Kentucky’s Commercial Code does not apply to public finance transactions or transfers by a governmental unit, which CCEIDA clearly is, CCEIDA was not required to comply with those provisions of Article 9 which require a security interest to be perfected by filing. The Court of Appeals, after a thorough analysis of Kentucky law and the intent of the General Assembly in enacting this exception, agreed.

⁶ In fact, Shepard’s citations identify *Perry v. Williamson*, which is cited with confidence by Appellant as controlling authority, as being “overruled.”

Delphi argues that the Court of Appeals erroneously considered legislative intent in its analysis of the applicability of UCC Article 9 to the transaction between CCEIDA and Certified Tool. In fact, it is well settled that, "...the cardinal rule of statutory construction is that the intention of the legislature should be ascertained and given effect." *MPM Fin. Group, Inc. v. Morton*, 289 S.W.3d 193, 197 (Ky. 2009). Since CCEIDA and Delphi presented the Court of Appeals with a legitimate dispute regarding the interpretation of KRS 355.9-109(4)(q)'s statutory exception, it was necessary and proper for the court to ascertain and give effect to the intent of the General Assembly. *Id.* at 198.

The Court of Appeals' analysis focused on the meaning of the word 'transfer' as used in KRS 355.9-109(4)(q). In particular, the Court of Appeals recognized that prior to 2001, legislation was in place to exempt governmental issuers of assets and revenues from compliance with Article 9, then subsequent legislation was enacted on an emergency basis to continue the exemption in 2002. Opinion pp.10-11. CCEIDA continues to believe that the plain meaning of the word "transfer" within KRS 355.9-109(4)(q) necessarily includes transfers of assets and debt by a governmental unit. However, as the Court of Appeals rightly noted, the word is not defined within the statutes, nor is there any controlling case law clearly on point. This, combined with the opposing interpretations offered by CCEIDA and Delphi, rendered consideration of legislative intent proper. Upon its examination of the legislative history and commentary surrounding the enactment of KRS 355.9-109(4)(q) sometime prior to July 1, 2002, as well as subsequent legislation, the Court of Appeals found that the statute exempts governmental issuers of assets and revenues from the perfection and filing requirements of Article 9.

The recognition of the plain meaning of "transfer" by a governmental unit as being exempt from Article 9 is set forth in *MP Star Financial v. Cleveland State University*, 837 N.E.2d 758 (Ohio, 2005). *MP Star Financial* is also cited by White and Summers, 4 Uniform

Commercial Code, which discusses several examples where state law provides priority in certain instances over Article 9 liens. 4 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE §30-12 (6th ed.) (2010). Article 9 must be reconciled to local variations in the law, necessarily including Kentucky's economic development statutes in this case. Using the rationale of *MP Star Financial*, the lease at issue here is a transfer by a governmental unit, and therefore exempt from the requirements of Article 9.

Another treatise on the subject, Miller and Cohen, *Hawkland Uniform Commercial Code Series*⁷, explains that: "The justification for the exclusion of the governmental transfer in original Sec. 9-104 (e) is that such assignments are generally governed by special provisions of state or federal law" – just as leases by local economic development authorities are governed by KRS Chapter 154.50 in the instant case. 9A FREDERICK H. MILLER & NEIL B. COHEN, HAWKLAND UNIFORM COMMERCIAL CODE SERIES §9-109:3 (Westlaw 2010). *Hawkland* also recognizes the validity of the retention by some jurisdictions of the governmental unit exemption as a "nonuniform" provision. Consistent with this premise, the Court of Appeals correctly recognized Kentucky's retention of the governmental unit exemption at pages 10 and 11 of its Opinion.

Thus with respect to this case, *Hawkland* is important for three reasons. It recognizes the validity of state public policy exceptions, it validates states' "governmental unit" Article 9 exemption, and it expressly recognizes the plain meaning of the word "transfer", whether or not for a debt. *Hawkland* confirms CCEIDA's position on every aspect of the governmental unit exemption.

⁷ Nor is Delphi's citation to *Hawkland* compelling, as Delphi focuses on only half of a single footnote which clearly recognizes that governmental transfers are generally governed by special provisions of federal or state law. 9A FREDERICK H. MILLER & NEIL B. COHEN, HAWKLAND UNIFORM COMMERCIAL CODE SERIES §9-109:10 n.3. (Westlaw 2010).

Delphi criticizes the court's reliance on legislative intent, and suggests that rather than focusing on what the General Assembly intended in enacting KRS 355.9-109(4)(q), the court instead should have relied upon the cases it has cited from other jurisdictions which favor Delphi's interpretation.⁸ Delphi ignores that KRS 355.9-109 (3) and (4) actually recognize the existence of state specific exceptions to the application of Article 9. Since state specific exemptions exist, the rule of law in other states and jurisdictions with respect to the applicability of Article 9 is of limited merit.

A number of these out-of-state cases, originally cited by Delphi, but also relied upon by the trial court, in addition to not being binding precedent, remain factually distinguishable from the instant matter. See *Farmers & Merchants Nat'l Bank v. Fairview State Bank*, 766 P. 2d 330 (Okla., 1988); *Bowlen v. Federal Deposit Ins. Corp.*, 815 P. 2d 1013 (Colo. App., 1991); and *Peoples Bank and Trust Company v. Applewhite*, 152 B.R. 119 (Bankr.N.D.Miss, 1992), ROA 314. In *Farmers & Merchants Nat'l Bank, supra*, an Oklahoma case involving a controversy arising from a dispute as to proceeds from a crops subsidy, the government entity was neither a lessor, creditor or debtor, rendering any comparison to the instant case, where a government entity is a lessor, illogical and baseless. The Colorado case of *Bowlen v. Federal Deposit Ins. Corp.* is similarly distinguishable because it involved a private transaction that was assumed by the Federal Deposit Insurance Corporation (FDIC) following the failure of a bank. Again, while a government entity asserted a claim, the claim arose from a private lending transaction, thus there was no underlying transaction between a government entity and private entity, as there is here. Finally, *Peoples Bank and Trust Company v. Applewhite*, a bankruptcy case from the Northern District of Mississippi, involved unique factors which favored the finding of a security

⁸ It is interesting that while Delphi criticizes the Court of Appeals' reliance on legislative intent in interpreting KRS 355.9-109, Delphi's brief simultaneously argues on p. 16 that the Court of Appeals "ignores the key 'intent' of the statute." Delphi's position is inconsistent - alternately arguing both sides of the "legislative intent" issue as it suits it.

interest, namely the existence of a lease option which included real estate and had a specification of each principal and interest payment. CCEIDA asserts that none of these opinions have any applicability to the present circumstances, and Delphi's reliance upon them was misplaced. They further ignore the importance of state-specific exemptions.

As has been argued at length by Delphi in its brief, it is indeed improper for a court to, "depart from the plain language of the statute by reading into it exceptions, limitations, or conditions which conflict with a clearly expressed legislative intent." *JP Morgan Chase Bank, N.A. v. Longmeyer*, 275 S.W.3d 697, 702 n.11 (Ky. 2009). Here, Delphi essentially argues in favor of additional language being read into KRS 355.9-109(4)(q) that would alter the statutory language of the exception and restrict the application of subsection (4)(q) to situations where the government was a debtor (Essentially changing "This article does not apply to... [a] public finance transaction or a transfer by a government or governmental unit" to "This article does not apply to... [a] public finance transaction involving a government debtor or a transfer by a government debtor or governmental unit debtor.").

Regardless of what Delphi would like the exception to say, it is bound by the plain language of the statute, which in this case is more expansive than Delphi would prefer. *Floyd County Bd. of Educ. v. Ratliff*, 955 S.W.2d 921, 925 (Ky. 1997). The plain language of the statute applies to all transfers by a governmental unit, including the transfer of a leasehold interest in an asset, which is what occurred in the present action.

Delphi does not dispute that CCEIDA is a governmental unit as defined in KRS 355.9-102. In its capacity as a joint city/county industrial development entity, CCEIDA was the recipient of a grant from the Commonwealth of Kentucky Department For Local Government from which Certified Tool ultimately benefitted. This grant was awarded by Kentucky's Department for Local Government directly to Franklin County, Kentucky, which in turn

approved the expenditure of the funds for the Komatsu Press. As noted above, the arrangement between CCEIDA and Certified Tool was ultimately approved and ratified by ordinance of the Franklin County Fiscal Court, which noted that that the budget amendments contained therein were for government purposes, and accepted the funds from the grant while authorizing purchase of the Komatsu Press. ROA 247.

It is obvious, then, that the transaction at issue in this appeal, was effectuated only because CCEIDA, a governmental unit itself, was given the governmental authority and government funds by the Commonwealth of Kentucky and Franklin County Fiscal Court to do so. At its heart, the lease transaction between CCEIDA and Certified Tool was indeed, a "transfer by a government or governmental unit." and therefore CCEIDA was not required to file a financing statement to perfect any secured interest it had in the equipment.

Delphi's brief alleges over and over again that CCEIDA had an unperfected security interest in the press. In fact, CCEIDA's interest was superior without the filing of a financing statement because it was exempt from the filing requirements pursuant to KRS 355.9-109(4)(q). Consequently, Delphi's Article 9 analysis pertaining to the perfection of security interests simply does not apply.

The Court of Appeals' Opinion affirming the trial court's award of summary judgment in favor of CCEIDA was well reasoned and proper, and should be affirmed by this Court.

II. KRS 355.9-109(3) Also Provides a Proper Exemption for CCEIDA

KRS 355.9-109(3) provides that a transaction is exempt from the provisions of Article 9 where another statute or governing law addresses the transaction. Specifically, it states that:

This article does not apply to the extent that:

- (a) A statute, regulation, or treaty of the United States preempts this article;

(b) Another statute of this Commonwealth expressly governs the creation, perfection, priority, or enforcement of a security interest created by this Commonwealth or a governmental unit of this Commonwealth;

(c) A statute of another state, a foreign country, or a governmental unit of another state or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the state, country, or governmental unit; or

(d) The rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under KRS 355.5-114.

KRS 355.9-109(3).

Delphi alleges that CCEIDA has failed to identify another statute governing the transaction at issue. This allegation is simply wrong. As CCEIDA pointed out in its brief to the Court of Appeals, Kentucky's economic development statutes do not authorize a seller to finance a transaction by taking a security interest in the equipment that has been sold in order to secure a loan to the purchaser, but instead only permit the "lease" of such equipment by an industrial development authority. KRS 154.50-343 provides that the title to all property acquired by the authority shall vest in the authority. CCEIDA could not have entered into a secured lending transaction with Certified Tool, as it only had the statutory authority to enter into a lease. A lease arrangement by a governmental entity as lessor under state industrial development statutes is required to be a true lease and therefore is exempt from the filing requirements of Article 9 of the UCC as a matter of law.

KRS 355.9-109(3)(b) provides that Article 9 does not apply if there is another statute of the Commonwealth governing the creation or perfection of the security interest. Here, the relevant statutory scheme is KRS Chapter 154.50, which does not give industrial development authorities the power to finance transactions in a manner that would trigger the UCC. Delphi's brief suggests that KRS Chapter 154.50 cannot come within the exception provided for by KRS 355.9-109(3) because

the Kentucky Local Industrial Development Act does not contain perfection requirements. See Appellant's Brief, p. 18. But the exception set forth in KRS 355.9-109(3)(b) provides an exemption not only where perfection of security interests is addressed, but where, "[a]nother statute of this Commonwealth expressly governs the creation, perfection, priority, or enforcement of a security interest created by this Commonwealth or a governmental unit of this Commonwealth."

Even if CCEIDA wished to create a security agreement with Certified Tool, it had no statutory authority to do so. KRS Chapter 154.50 effectively governs the creation of such security interests by groups such as CCEIDA by failing to authorize them. As such, the exception to UCC filing requirements set forth in KRS 355.9-109(3)(b) applies here, and CCEIDA was not required to file a financing statement in order to document its ownership interest in the Komatsu Press. Likewise, by operation of the statutory exemption, Delphi in attempting to take a security interest from Certified Tool, was necessarily subject to CCEIDA's ownership interest under KRS Chapter 154.50.

III. The Trial Court Correctly Awarded Summary Judgment to CCEIDA on Public Policy Grounds.

Because the Court of Appeals found that CCEIDA was exempt from Article 9's filing requirements pursuant to KRS 355.9-109(4)(q), it did not address whether the trial court correctly awarded summary judgment to CCEIDA on public policy grounds. Although the Court of Appeals' reasoning was correct in affirming the Circuit Court based on the statutory exemption, it also could have affirmed for public policy reasons.

The trial court, relying in part on *In Re: City of Moran*, 713 P.2d 451 (Kan. 1986), discussed below, ultimately held that:

[T]he Lease Agreement in the instant case is exempt from the requirements of Article 9. Were we to hold otherwise, the purpose of Kentucky's economic development statutes would be thwarted; the confidence of bondholders in government bonds would be

severely undermined. As such, CCEIDA did not need to file a financing statement to perfect its interest in the Komatsu Press, and its prior-acquired interest in the machine is superior to that of Delphi Automotive.

Opinion and Order, October 11, 2010, at p. 11-12, ROA 315-316.

The Circuit Court correctly determined that the purpose of Kentucky's economic development statutes is, "to develop the economic prosperity of the state by providing greater employment opportunities and developing industry." Opinion and Order, at 11; ROA 315. Had the court sided with Delphi and ignored CCEIDA's interest in accordance with those statutes, it would have effectively eliminated their effect and import on economic development in Kentucky. While Delphi has argued that legislative intent is irrelevant in the instant matter, Kentucky law proves the contrary. It would have been error for the court to have interpreted Kentucky's economic development statutes so as to minimize their impact, because a reviewing court, "must interpret the statute according to the plain meaning of the act and in accordance with the legislative intent." *Floyd County Bd. Of Educ. v. Ratliff*, 955 S.W.2d 921, 925 (Ky. 1997). KRS 446.080 similarly requires that, "All statutes of this state shall be liberally construed with a view to promote their objects and carry out the intent of the legislature." KRS 446.080 (1). In this instance, to disregard CCEIDA's prior leasehold interest in the Komatsu Press would be akin to disregarding the legislative intent of Kentucky's economic development statutes. Such disregard is contrary to well-settled law.

Delphi has suggested that the trial court wrongfully read an additional, public policy-based, exception to UCC Article 9 beyond those set forth in KRS 355.9-109. The court did not infer or create an additional statutory exception, but instead properly recognized the legislative intent behind Kentucky's economic development statutes and the chilling effect that would be had on that legislative scheme if CCEIDA's publicly funded lessor's interest went unrecognized despite the fact that it was seven years prior in time to Delphi's blanket security interest. As

noted above, Delphi cites *JP Morgan Chase Bank, N.A. v. Longmeyer*, 275 S.W.3d 697, 702 n.11 (Ky. 2009) for the proposition that, “It is therefore improper for a court to depart from the plain language of the statute by reading into it exceptions, limitations, or conditions which conflict with a clearly expressed legislative intent...” CCEIDA agrees that legislative intent is a compelling factor in the interpretation and application of a statute. Indeed, it is CCEIDA who favors an analysis of legislative intent in the examination of KRS 355.9-109(4)(q). However, the legislative intent behind the UCC and exceptions thereto is no more important than the intent behind Kentucky’s economic development statutes, the intent of which Delphi seems content to ignore. The UCC simply does not preempt all other state laws, and it is appropriate that Kentucky’s economic development statutes, and the intent behind those statutes, be given equal consideration.

The trial court was correct to weigh the general exceptions to UCC Article 9, a uniform law adopted by many states, as set forth in KRS 355.9-109 against the plain language of Kentucky’s economic development statutes, which make specific authorizations in favor of transactions such as those between CCEIDA and Certified Tool. See KRS 154.50-301 to 154.50-346. In Kentucky, it is well-settled that:

It is incumbent upon courts to resolve the conflict between the two statutes so as to give effect to both. In harmonizing the conflict between two statutes that relate to the same subject, Kentucky follows the rule of statutory construction that the more specific statute controls over the more general statute

Light v. City of Louisville, 248 S.W.3d 559, 563 (Ky. 2008)(citations omitted).

At the summary judgment stage, the trial court properly gave weight to the economic development statutes that expressly govern the transaction in issue by specifically authorizing lease transactions such as the one between CCEIDA and Certified Tool. The trial court’s correct

analysis is in contrast to KRS Chapter 355.9 which merely sets forth general exceptions to the Article 9 requirements.

Also cited by Delphi, *Ford Motor Credit Co. v. Webb-Elkhorn Coal Corp.*, 775 S.W.2d 945 (Ky. App. 1989) states that it is not the role of the court to infer public policy that is contrary to legislative intent. Of course, here, each of the courts that have reviewed the matter have found in favor of CCEIDA, either for reasons of public policy or legislative intent. Further, in *Ford Motor*, the Court of Appeals remanded to the circuit court for further development of the record to assist in the determination of whether a true lease had been created. *Id.* at 947. Specifically, the court noted that, “we have no authority to alter the public policy clearly expressed by the General Assembly.” *Id.* at 946. In the instant case, the policy defining the UCC is not the only public policy at issue, and Kentucky’s economic development statutes must be considered. In the same way that the Franklin Circuit Court refused to ignore the legislative intent of the UCC, the Court of Appeals did not (and could not) ignore the legislative intent of Kentucky’s economic development statutes, despite Delphi’s urging.

The Circuit Court properly considered the UCC and indeed based a number of its findings on its interpretation of the plain language of the statutes contained therein.⁹ The court then properly weighed those considerations against the public policy at the heart of Kentucky’s economic development statutes and found that it was necessary to find in CCEIDA’s favor because to rule otherwise would necessarily pose a threat to the structure and practical functioning of government-funded economic development efforts pursuant to Kentucky statutes.

Delphi boldly suggests that public policy actually favors a finding that CCEIDA’s status as a governmental lessor under Kentucky’s economic development statutory scheme should be ignored, because the trial court’s ruling will increase the risk and uncertainty for loan issuers and

⁹ As discussed elsewhere herein, CCEIDA disputes the trial court’s application of certain provisions of the UCC.

could lead to rising interest rates and lenders refusing to loan to borrowers. Appellant's Brief at p. 24. The parade of horribles predicted by Delphi is specious at best, and disingenuous at worst. Delphi's argument fails to recognize the narrow scope of the trial court's ruling, which simply ruled that under the facts of this case, and under the statutes in existence in 2001 when the equipment lease to Certified Tool was executed, public policy dictates a finding of priority in favor of CCEIDA. The trial court properly recognized that the legislative intent behind Kentucky's economic development statutes represents public policy which favors transactions designed to stimulate local economies and develop jobs.

Delphi's apocalyptic predictions further ignore a more desirable and likely result of upholding the trial court's ruling on public policy grounds - that private lenders should actually perform at least rudimentary due diligence in determining whether a particular item is leased or owned and whether the debtor is contractually prohibited from granting a security interest therein, as it was in the present case. Indeed, lenders would be well served by investigating what collateral they are actually accepting in exchange for their loan, rather than accepting blanket security agreements and hoping for the best.¹⁰ In this case, Delphi's better remedy might be against Certified Tool based on possible misrepresentation of ownership of the Komatsu Press.

The Kansas Supreme Court dealt with a case factually similar to this one in *In Re: City of Moran*, 713 P.2d 451 (Kan. 1986). That case, though not binding precedent, is persuasive authority relied upon by the Circuit Court¹¹ in reaching its ultimate decision that CCEIDA's interest in the Komatsu press is superior to Delphi's interest. In *City of Moran*, as here, the city purchased industrial equipment with industrial development funds and then leased the equipment

¹⁰ Had Delphi even visited the Certified Tool factory and inspected its collateral, it would have seen the plaque that identified the Komatsu press as property of CCEIDA.

¹¹ Delphi suggests that the Court of Appeals also relied upon *City of Moran*. While the Court of Appeals certainly would have been justified in relying upon *City of Moran's* persuasive logic, CCEIDA can find no such reliance in the Court of Appeals Opinion.

to the Farmers Cooperative Association, all pursuant to Kansas' Economic Development Revenue Bond Act. Also similar to the present action, a creditor of the Association was alleging that the lease transaction was in fact a secured transaction and that the City of Moran had an unperfected security interest. It is these factual similarities that justify the trial court's reliance upon *In Re: City of Moran*.

The Kansas Supreme Court, recognizing that the Kansas economic development statutes at issue created a unique scenario rather than a typical commercial lease situation, ruled that it was unnecessary for the city to have filed a financing statement because the lease from the City to the Association was not subject to the filing requirements of the Uniform Commercial Code. Specifically, the Kansas Court reasoned:

Even though a transaction falls within the general scope of K.S.A. 84-9-102 of the UCC, it still may be excluded from Article 9 as a matter of public policy by the legislature. K.S.A. 84-9-104 includes a list of express exclusions from Article 9. It does not specifically exclude the type of transaction involved in the present case. It is therefore necessary to look at the industrial revenue bond statutes, K.S.A. 12-1740 *et seq.*, to determine whether the legislature intended that such transactions should be excluded.

Id. at 456.

The court went on to reason that the Kansas industrial bond revenue statutes authorized the city to enter into leases or lease-purchase agreements for industrial facilities and equipment, and that the Kansas legislature (like Kentucky's) did not specifically require perfection by filing for leases or lease-purchase agreements where the facility is actually owned by the governmental entity and leased to a private enterprise. Thus, the City of Moran, having leased the equipment to the Association pursuant to Kansas' industrial revenue bond statutes, was not subject to the requirements of Article 9.

The instant facts are nearly identical, and the same argument was made by CCEIDA to the trial court in its Motion for Summary Judgment. The trial court rightly found that Kentucky's

economic development statutes, like Kansas' industrial revenue bond statutes, provide for transactions such as those between CCEIDA and Certified Tool in order to provide stability and promote prosperity in local economies. Statutes such as these make it apparent that the legislature favors and encourages arrangements like the lease agreement between CCEIDA and Certified Tool, and this policy was properly recognized by the court.

Delphi argues, as it did before both the Court of Appeals and the Circuit Court, that reliance upon *City of Moran* is improper because the UCC states that exceptions created by other statutes apply only where, "another statute of this Commonwealth expressly governs the creation, perfection, priority, or enforcement of a security interest..." KRS 355.9-109(3)(b). This precise argument was presented to the Circuit Court in Delphi's Response to CCEIDA's Supplemental Memorandum and in its Motion to Alter, Amend, or Vacate. ROA 290-291, ROA 326-327. The trial court rejected Delphi's arguments on both occasions. The trial court recognized a public policy exception based on the intent of Kentucky's economic development statutes, precisely the same way that the Kansas Supreme Court decided *City of Moran*.

Delphi also contends that there were significant differences between the Kansas Economic Development Bond Act and Kentucky's economic development statutes, specifically that the Kansas act only permitted the city to enter into lease agreements, not security agreements, whereas Kentucky's Act permitted CCEIDA to enter into either. Again, Delphi is wrong. Delphi erroneously asserts beginning on page 21 of its brief that the *City of Moran* is distinguishable from the present case because the Kansas Economic Development statute mandated that the City enter into a lease agreement because it had no statutory authority to enter into a secured transaction which would be governed by UCC Article 9. Delphi also erroneously asserts that KRS 154.50-320(1)(b) permits an authority to enter into a secured transaction because the statute grants the power to "lease, sell or convey" industrial equipment.

The fundamental flaw with Delphi's logic is that it considers the sale or conveyance of property as being synonymous with the financing of such a sale by a seller as a secured, seller-financed, transaction. The sale of an item and the seller financing of an item are two separate and different transactions. The sale or conveyance of an item can occur upon the payment of the purchase price in full, with no seller-financing. Such a sale is authorized by Kentucky statute as a "sale." Kentucky's economic development statutes, however, do not authorize a seller like CCEIDA to finance a transaction by taking a security interest in the equipment that has been sold, because ownership and title would necessarily be transferred to the purchaser before the seller could then obtain a security interest in the sold item. Indeed, as noted above, KRS 154.50-343, provides that the title to all property acquired by the authority shall vest in the authority. The statutory scheme only permits the "lease" of such equipment by an industrial development authority. This statute comports naturally with numerical paragraph six of the Lease, which states that title to the Komatsu Press shall remain with CCEIDA.

In the sense that Kentucky statutes do not permit seller financing by industrial development authorities, they are substantively identical to the Kansas statutory scheme. Delphi admits that the Kansas statute authorizes a lease only and because of that the *City of Moran* was held not to be a secured creditor because a contrary ruling would effectively mean that the City exceeded its powers. Appellant's Brief at p. 21. This same logic, accepted by Delphi, is dispositive of the present dispute.

As in *City of Moran*, the agreement in the present action should be construed to be a lease because CCEIDA is not authorized by Kentucky statutes to enter into a secured transaction as a creditor. Accordingly *City of Moran* is analogous, is directly on point and presented persuasive logic for the trial court, and ultimately this Court, to follow in affirming the decision below.

A Federal Bankruptcy Court sitting in Kansas also endorsed the logic of the *City of Moran* Opinion. See *In Re: Petroleum Products, Inc.*, 72 B.R. 739 (U.S.B.C., Kansas, 1987). The *Petroleum Products* court stated that the industrial development statutes of Kansas were intended to be excluded from Article 9 of the UCC as a matter of public policy. *Id.* at 745. The court recognized that application of the UCC would dictate a different result, however, it recognized that the Kansas courts had held that industrial revenue bond lease purchase agreements fall outside the scope of the UCC.¹²

The Circuit Court quoted and relied upon *In re City of Moran* because the facts are nearly identical and the proper reasoning compels a finding of priority in favor of CCEIDA. The Court of Appeals did not address the trial court's reasoning on this issue because it affirmed on other grounds.

In addressing public policy, the Kansas Supreme Court noted that to find that the city was required to comply with UCC Article 9, "would certainly discourage bondholders who would be dependent upon the city or the county to protect their interest by filing a financing statement." *City of Moran, supra* at 457. The Circuit Court adopted similar reasoning in an effort to effectuate the intent of Kentucky's General Assembly, and its ruling should be upheld.¹³

The Circuit Court correctly recognized that the public policy behind Kentucky's economic development statutes is the promotion of local economies and creation of jobs, financed by government funds and ultimately, government bondholders. To find that CCEIDA was subject to the perfection requirements set forth in Article 9 of the UCC under the narrow facts of the instant case would necessarily thwart the intention of Kentucky's economic

¹² *In Re Petroleum Products* has been criticized on other grounds, but not on the logic of its analysis of Kansas law.

¹³ The present action involves a Community Development Block Grant. Although the trial court in the present action cites bonds and the interests of bond holders in its decision, the logic is sound even though bonds are not involved. The development authority is authorized to issue revenue bonds for the purpose of acquiring property for lease or sale to the private sector (See KRS 154.50-340) and the funds utilized for the purchase of the Komatsu Press could have easily been derived from bonds.

development statutory scheme and the public policy that led to its creation. As such, if the Court reaches consideration of the trial court's Order should regarding public policy, that ruling should be affirmed.

IV. The Court of Appeals Erroneously Found that The Lease Agreement was Not a True Lease

The Court of Appeals agreed with trial court's determination that the Lease Agreement between CCEIDA and Certified Tool constituted a security interest rather than a true lease. This finding was erroneous as a matter of law. As noted above, because this determination by the Court of Appeals did not affect the outcome of the case, or otherwise harm CCEIDA, CCEIDA was not required to file a cross-motion for discretionary review in order to argue the erroneous nature of this finding to this Court. See *Fischer v. Fischer*, 348 S.W.3d 582 (Ky. 2011)(... "Where a party is in no way aggrieved by any judgment below, there is no basis to complain – or appeal;" ". . . [I]f a judgment has been affirmed, there is obviously no logical reason for the prevailing party to appeal, regardless of the ground or grounds upon which affirmance occurs.").

In construing the agreement between CCEIDA and Certified Tool, it was the obligation of the both the trial court and the Court of Appeals to effectuate the intent of the parties, as Kentucky courts have determined that, "[t]he primary object in construing a contract or compromise settlement agreement is to effectuate the intentions of the parties." *Cantrell Supply, Inc. v. Liberty Mut. Ins. Co.*, 94 S.W.3d 381, 384 (Ky.App.2002). There is no evidence in the record that CCEIDA and Certified Tool intended to create anything other than a true lease.

CCEIDA acknowledges that the title of the Lease Agreement may not in itself be determinative. *In re Yost*, 54 B.R. 818, 820 (W.D. Ky. 1985) (" When determining the character of an agreement, the use of the term "lease" or "security agreement" is not controlling. Whether an agreement is a true lease or a security agreement is instead determined by the objective intent

of the parties at the contract's formation.”). Kentucky’s General Assembly has further enacted legislation stating that, “Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.” KRS 355.1-203 (1).¹⁴ Kentucky’s enactment of the UCC goes on to provide additional guidance regarding the distinction between a lease agreement and a security interest, with KRS 355.1-203(3) providing that:

A transaction in the form of a lease does *not* create a security interest merely because:

- (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;
- (c) The lessee agrees to pay, with respect to the goods, taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;
- (d) The lessee has an option to renew the lease or to become the owner of the goods;
- (e) 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
- (f) 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.

KRS 355.1-203 (3).

These factors make it apparent that the simple fact that a lessee bears much of the risk and/or loss under the terms of a lease agreement does not divest the agreement of its status as a lease. The fact that Certified Tool was responsible for maintenance of the press and could

¹⁴ Former KRS 355.201.

ultimately become the owner of the press is not sufficient to deem the Lease Agreement a security interest, despite Delphi's suggestion to the contrary.

The statute goes on to describe factors which would cause a lease agreement to create a security interest, specifically where the consideration paid by lessee is an obligation for the term of the lease and not subject to termination by the lessee, among other factors. See KRS 355.1-203 (2).

Although the factors set forth in the relevant statutes do not universally favor the finding of a true lease in the instant matter, there are a number of facts which would warrant finding that the Lease Agreement is indeed a lease. First, the economic life of the goods clearly exceeds the term of the lease is demonstrated by the fact that the Komatsu Press was sold for nearly \$200,000 even though the lease was scheduled to expire in 2008. The press obviously still had significant economic value despite the scheduled expiration of the lease in 2008. Next, Certified Tool was not bound to become an owner of the goods under the terms of the lease agreement. It would become an owner only if all conditions set forth in the agreement were met. Since the transfer of any interest in the press to a third party is a default under the terms of the Lease Agreement, even if the security interest granted to WCS or Delphi was valid¹⁵ the transfer itself was a default which terminated the lease and extinguished any interest that Certified Tool or its assignees had in the press. Certified Tool was not bound to become the owner of the press, and indeed it never possessed any ownership interest in the press.

With respect to the third factor, there was plainly no option to renew the lease, and Delphi has never argued otherwise. The plain language of the Lease Agreement makes it apparent that there was no renewal contemplated. Finally, there was no option for Certified Tool

¹⁵ As noted elsewhere herein, it is the position of CCEIDA that the blanket security interest granted to Delphi, which did not specifically identify the Komatsu press, was not of a legitimate grant of security interest in the press in part because Certified Tool had no authority to grant such an interest.

to become the owner of the goods following completion of the lease term. Instead, Certified Tool would automatically become the owner of the goods following compliance with the terms of the lease.

In re Yost, supra, also set forth a number of factors to assist in the determination of whether a purported lease is indeed a true lease. The trial court never examined these factors, declaring that there was no need to delve into such an inquiry because the Lease Agreement clearly was a security agreement. The Court of Appeals similarly never examined the *Yost* factors. Even an analysis based purely on the factors listed in the relevant statute could result in a finding that the Lease Agreement in question creates a true lease. At worst, an analysis under the statutory factors creates some question as to whether the Agreement is a true lease, warranting consideration of the factors set forth in *In re Yost, supra*, as well as the language of the Kentucky economic development statutes.

The factors identified in *In re Yost* include whether: (1) there is an option to purchase for a nominal sum at the end of the lease term; (2) whether the lease grants lessees an equity or property interest; (3) the lessor's business is that of a financing agency; (4) the lessee is responsible for paying taxes associated with ownership of the property; (5) the lessee is responsible for comprehensive insurance; (6) the lessee is required to maintain the equipment; (7) the agreement places the risk of loss on the lessee; (8) the agreement permits the lessor to accelerate the rent due upon default; (9) the lessee is required to pay a substantial security deposit; (10) a financing statement is executed; (11) there are default provisions inordinately favorable to lessor; (12) the lease provides for liquidated damages; (13) a lease provision disclaims warranties; and (14) the aggregate rentals approximate the value of the property leased. *In re Yost*, 54. B.R. 818, 820-821 (W.D. Ky. 1985).

Delphi has consistently argued that the *Yost* decision compels a finding that the Lease Agreement at issue is in fact a security agreement. However, the *Yost* court ultimately determined that the agreement at issue was a true lease even though many factors on the list provided by the Court therein weighed in favor of considering it a security agreement. *Id.* at 821. The bankruptcy court ruled that the, “lessor’s unequivocal retention of control and ownership over the equipment, and the absence of any purchase option...” were determinative of the issue and rendered the challenged agreement a true lease. *Id.* If this same reasoning had been applied by the Court of Appeals, the Lease Agreement should have been determined to be a true lease, because the Komatsu Press was at all times, and remained, the property of CCEIDA, and was plainly marked as such, for the entire duration of the lease. In fact, Kentucky’s economic development statutes compelled that title to all property acquired by the authority vest in the authority. KRS 154.50-343. The equipment would become the property of Certified Tool only in the event that all lease payments were timely made and all provisions of the lease agreement for its entire term were complied with. Certified Tool received no equity interest in the equipment during the term of the lease.

The *Yost* court relied on *Diaz v. Goodwin Brothers Leasing, Inc.*, 511 S.W.2d 680 (Ky. 1974) in making its decision. *See Yost, supra* at 821. In *Goodwin*, the Kentucky Court of Appeals, then Kentucky’s highest court, again found that the agreement challenged therein was a lease rather than a security agreement, in part because the equipment leased remained the property of the lessor during the duration of the lease. *Diaz v. Goodwin Brothers Leasing, Inc.*, 511 S.W.2d 680, 682 (Ky. 1974). Again, the reasoning applied in that case would compel the finding of a true lease here, where the ownership of the press remained with CCEIDA throughout the term of the lease and was transferred to Certified Tool only if and when all terms of the lease were complied with for the entire term of the lease. Further, because Certified Tool defaulted

under the lease, the Komatsu press never became the property of Certified Tool, nor did Certified Tool ever have the authority to pledge the press to WCS, Delphu, or any other creditor, as is discussed in detail elsewhere herein.

The Court of Appeals appears to have never even considered *Yost* or *Goodwin*, finding instead that the UCC statutory language rendered the Lease Agreement a security interest. This was error. Had the court considered these cases, it would likely have realized that because the ownership of the press remained at all times with CCEIDA, the Lease Agreement was indeed a true lease.

Under the instant facts many of the factors set forth in the applicable statutes and case law favor the determination that the agreement between CCEIDA and Certified Tool was a true lease, contrary to the findings below, which were erroneous. It was similarly erroneous for the Court of Appeals to fail to consider and apply the relevant caselaw, which may have changed its ruling that the Lease Agreement created a security interest.

Even if the lease document would otherwise be construed under the Uniform Commercial Code to constitute a secured transaction, Certified Tool and CCEIDA plainly and unequivocally expressed their intention that the relationship would be that of a lessor and lessee. By doing so they varied the effect of the provisions of the UCC by agreement pursuant to KRS 355-1-302(1). To hold otherwise would violate established precedent and KRS 355.1-302(1) as to giving effect to the intentions of the parties.

Although CCEIDA believes that the Court of Appeals' ultimate holding in favor of CCEIDA on other grounds should be affirmed, CCEIDA believes that the Court of Appeals' determination that the Lease Agreement created a security interest was erroneous.

V. Certified Tool Had No Ownership Interest in the Equipment to Transfer

As with the argument above, CCEIDA disputes the Court of Appeals' determination that a security interest was created by its Lease Agreement with Certified Tool. However, this Court could affirm the judgment in favor of CCEIDA based simply in the fact that Certified Tool's transfer to WCS or Delphi did not include the Komatsu press that was the subject of the Lease Agreement.

Pursuant to KRS 154.50-343, CCEIDA was, as a matter of law, the sole owner of the Komatsu Press at all times relevant to this litigation and therefore the law of the Commonwealth deemed the press to be the property of CCEIDA and therefore any subsequent attempt to transfer an interest in the press by Certified Tool was void. ROA 204. ROA 369-370.

In its Motion for Summary Judgment, CCEIDA argued that no interest in the Komatsu Press could have been transferred to WCS or Delphi under the plan language of the Lease Agreement, and further that no transfer was made because Certified Tool had no ownership interest to transfer. This reasoning remains applicable despite the fact that the Court of Appeals improperly found that the Lease Agreement created a security interest.

Subchapter 50 of KRS Chapter 154, pertaining to Industrial Development, expressly gives local authorities such as CCEIDA the authority to acquire and lease property for industrial development purposes. As CCEIDA has noted multiple times above, KRS 154.50-343 expressly states that **"title to all property acquired by the authority shall vest in the authority"** (emphasis added). The lease document is consistent with this premise, and specifically states that, "The Equipment is, and at all times during the term hereof shall remain, the sole and exclusive property of the Lessor. Lessee shall have no right, title, or interest in the Equipment except as set forth in this Lease." ROA 210. The Lease Agreement also provided that the press

was to be marked as the property of CCEIDA, which it was, bearing a plaque noting that it was the property of the Franklin County Development Authority. ROA 223-224.

Even if Certified Tool attempted to assign its interest in the press to Delphi in the blanket security agreement, Certified Tool had absolutely no ownership or equity interest to assign. Although Certified Tool could have become the owner of the equipment at the termination of the lease, provided all the terms and conditions therein were complied with, Certified Tool ultimately defaulted under the terms of the lease and therefore never acquired any assignable interest in the property.

The lease agreement expressly forbade Certified Tool's assignment of any interest it may have had in the property. Paragraph 21 of the lease deals with assignment, and states that:

A. Without Lessor's prior written consent, Lessee shall not (1) assign, transfer, pledge or hypothecate this Lease, the Equipment or any interest therein, or (2) sublet or lend the Equipment to be used by anyone other than Lessee or Lessee's employees. Consent to any one of the foregoing acts applies only in the given instance and is not a consent to any subsequent like acts by Lessee or any other person,

B. Lessee's interest herein may not be assigned or transferred by operation of law.

ROA 215.

It is clear from the plain language of the Lease Agreement that even if Certified Tool had any assignable interest in the Komatsu press - which it did not - Certified Tool had no authority to assign or transfer such interest, and therefore any attempt to assign the interest to WCS or Delphi was meaningless.

Further problematic to Delphi's position is the generic blanket language of its security agreement with Certified Tool, which in no way identifies the Komatsu Press. The Security Agreement between Certified Tool and Plaintiff does not specifically list the Komatsu Press as part of the collateral, but instead states that the collateral shall include all owned or later-acquired

assets, including all machinery and equipment owned by Certified Tool. The Factoring and Security Agreement entered into between Certified Tool and WCS contains a similar provision, declaring collateral to include all of Certified Tool's owned and thereafter acquired personal property and fixtures, but again does not identify the Komatsu press specifically. There is no indication in the record that Delphi was ever even aware that a Komatsu Press existed until shortly prior to this litigation. Had Delphi performed even a cursory degree of due diligence it would have discovered the Lease Agreement, and presumably also the plaque on the press that stated that it was the property of CCEIDA. ROA 223-224. For this reason, Delphi's position that it has a priority interest in property in which Certified Tool had no assignable ownership or equity interest, and which was not specifically identified in the security agreements between Certified Tool and Delphi or WCS should never have been accepted by the courts below, which never specifically ruled on the issue of Certified Tool's authority to assign an interest in the press. Another flaw in Delphi's position is that neither of its financing statements on file in Illinois or Kentucky, nor those filed by Working Capital Solutions specifically mentions the Komatsu Press. Again, there is no evidence in these statements or in the record that Delphi even knew of the existence of the Komatsu Press when the financing statements were filed. Delphi simply asserted an interest in the press after Certified Tool's default in an attempt to take advantage of the blanket security interest in "all assets." Delphi effectively asked the Circuit Court to determine that: (1) Certified Tool had an assignable interest despite the plainly conflicting language in the Lease Agreement; (2) Certified Tool had the authority to assign any interest in the press to an outside party despite the plain language in the Lease Agreement to the contrary; (3) Certified Tool intended to assign its non-assignable interest in the press to either Delphi or WCS, despite the fact that this piece of equipment, owned by CCEIDA, was never named in any security agreement or financing statement; and (4) Delphi has a perfected security

interest in the press, despite the fact that there is no evidence that Certified Tool ever had the ability, authority, or intent to assign its interest and Delphi never knew of the existence of the press. There was no justification for the courts below to disregard KRS Chapter 154.50 and to declare that the Lease Agreement in fact created a security interest.

CONCLUSION

The primary flaw with Delphi's position is that it wants the courts to consider Article 9 (KRS Chapter 355.9) in a vacuum, ignoring that the lease in issue was created pursuant to Kentucky's economic development statutes. The CCEIDA/ Certified Tool lease was not a UCC transaction. It was not a sales transaction covered under Article 2 or an Article 2A lease transaction. It was not an Article 3 negotiable instrument transaction, nor was it an Article 9 secured transaction. As even Delphi acknowledges in its Brief, the transaction was a lease pursuant to the statutory authority granted to local economic development authorities in KRS Chapter 154, Subchapter 50. As an exception to Article 9, the state specific statutes control.

The Court of Appeals' determination, and the trial court's determination- though based on different reasoning- that CCEIDA is entitled to judgment as a matter of law, should be affirmed.

Respectfully submitted,

STOLL KEENON OGDEN PLLC



Robert W. Kellerman
Sarah Jackson Bishop
201 West Main Street
P.O. Box 5130
Frankfort, KY 40601
Telephone: (502) 875-6220
Facsimile: (502) 875-6235

Counsel for Appellee