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IN THE COURT OF APPEALS OF NORTH CAROLINA

No. COA22-564

Filed 18 April 2023

Davidson County, No. 18 CVS 1473

KCK RESOURCES, INC., a NORTH CAROLINA CORPORATION, Plaintiff,

v.

SCHWARZ PROPERTIES, L.L.C., a NORTH CAROLINA LIMITED LIABILITY COMPANY, Defendant.

Appeal by plaintiff from order entered 21 October 2021 by Judge Vance Bradford Long in Davidson County Superior Court. Heard in the Court of Appeals 25 January 2023.

J. Calvin Cunningham III, for the Plaintiff-Appellant.

Fox Rothschild, LLP, by Richard Coughlin, Kip David Nelson and W. Craig Turner, for the Defendant-Appellee.

DILLON, Judge.

Plaintiff KCK Resources, Inc. (“Plaintiff”) appeals from the trial court’s order granting a directed verdict to Defendant Schwarz Properties, LLC (“Defendant”). We affirm.

I. Background

Plaintiff is in the business of buying and reselling discarded fiberglass material. Prior to 2012, Plaintiff was also in the business of recycling the discarded fiberglass material.

When Plaintiff ceased the recycling portion of its business, it entered into discussions with various potential buyers interested in purchasing the equipment it used to run its recycling operation (the “equipment”).

Plaintiff entered into a “handshake” agreement with non-party Ferguson Fibers (“Ferguson”), wherein Ferguson purchased a “complete line of fiberglass cutting and opening equipment.” The agreement between the two parties was communicated through various letters. In these communications, Ferguson agreed to purchase the equipment for \$300,000, payable in installments over a three-year period. Upon tender of the final payment, Ferguson would become the “owner of the equipment free and clear of any debt or equity” and Plaintiff would deliver a bill of sale to Ferguson.

In 2012, Plaintiff delivered the equipment to Ferguson’s place of business, and Ferguson made several installment payments to Plaintiff. Ferguson, however, did not make any scheduled payments after its July 2012 payment, about three months after the equipment was delivered.

The next month, in August 2012, Ferguson filed for Chapter 11 bankruptcy. Ferguson did not list the equipment among its assets, and the equipment was not subject to the claims of its third-party creditors.

Upon Ferguson's default, Plaintiff did not remove or repossess the equipment. Instead, it began to contact other buyers. Plaintiff did not file a financing statement to cover the equipment.

During Plaintiff's business dealings with Ferguson, Plaintiff helped Ferguson acquire raw materials because Plaintiff "needed to keep [Ferguson] alive". During trial, the owner of Plaintiff company explained that he would utilize his contacts to obtain materials for Ferguson, and then bill Ferguson for the amount. He stated that he thought it would "be a nice moneymaker" for Ferguson. Plaintiff continued to do so until 2016, when he ceased due to Ferguson's failure to pay for the materials.

In December 2017, Ferguson moved its place of business, including the equipment, into a warehouse owned by Defendant. Ferguson's lease agreement with Defendant provided that in the event of default, Defendant would obtain a lien on any property left on the premises.

Shortly thereafter, Ferguson defaulted on its lease with Defendant. Defendant sought and obtained summary ejectment, as well as a writ of possession for the property, including the equipment.

Defendant gave public notice of its intent to sell the equipment to the highest bidder. Plaintiff offered Defendant \$10,000 along with \$1,000 per month in rent for up to three months if Defendant would give Plaintiff time to resell the equipment, with payment due after the sale. Another company made an offer of \$17,000, which Defendant accepted.

Plaintiff sued Defendant for conversion of the equipment. The case came on for trial. Defendant moved for a directed verdict both at the close of Plaintiff's evidence, and at the close of all the evidence. The trial court granted Defendant's renewed motion for a directed verdict, on the grounds that the transaction between Plaintiff and Ferguson was governed by the Uniform Commercial Code ("UCC"), that ownership of the equipment transferred to Ferguson upon delivery, and that Plaintiff did not have any claim to the equipment due to its failure to perfect its security interest by filing a financing statement. Plaintiff appeals.

II. Analysis

We review a trial court's grant of a directed verdict *de novo*. *Green v. Freeman*, 367 N.C. 136, 141, 749 S.E.2d 262, 267 (2013). In doing so, we consider whether the evidence, taken in the light most favorable to the non-moving party, is sufficient as a matter of law to be submitted to the jury. *Id.* at 140, 749 S.E.2d at 267.

At issue in this appeal is the nature of the transaction between Plaintiff and Ferguson. Plaintiff claims that the transaction was a lease-to-own agreement, or in the alternative, a bailment, in which case Plaintiff would retain title to the equipment, thus supporting its claim for conversion. However, Defendant claims the transaction was for the sale of goods, and that Plaintiff merely retained a security interest, which it failed to perfect.

A. Whether the transaction is a bailment

We note that Plaintiff failed to allege its bailment theory in its complaint or argue it during the trial. As a result, this argument was not preserved pursuant to Rule 10 of our Rules of Appellate Procedure. *See* N.C. R. App. P. Rule 10(a)(1) (“In order to preserve an issue for appellate review, a party must have presented to the trial court a timely request, objection, or motion, stating the specific grounds for the ruling the party desired the court to make if the specific grounds were not apparent from the context.”) Even if Plaintiff’s bailment argument was properly preserved, we conclude that it is meritless for the following reasons.

Ferguson’s obligation throughout the duration of the agreement was to tender payment to Plaintiff. Ferguson did not have an obligation to return the property to Plaintiff at the completion of the contract. Rather, the contract between Ferguson and Plaintiff contemplated that Ferguson would become the owner of the equipment upon completion of the installment payments. Because “the obligation to redeliver or deliver over the property at the termination of the bailment on demand is an essential part of every bailment contract,” Plaintiff’s argument is unconvincing. *Hanes v. Shapiro & Smith*, 168 N.C. 24, 31, 84 S.E. 33, 36 (1915).

We also disagree with Plaintiff’s argument that its agreement with Ferguson “changed over time” into a bailment after default occurred. During trial, evidence was admitted showing that Ferguson attempted to change the nature of the agreement after default. However, Plaintiff’s owner testified that the parties agreed “over a lunch, to leave it alone.” He also testified that Ferguson’s obligation continued

to be one of payment. “[Ferguson] never doubted that he owed me the money... [i]t was a matter of when and if he would ever pay it.” Because Plaintiff conceded Ferguson’s obligation to pay never changed, Plaintiff’s argument must fail.

B. Whether the transaction is a sale or lease

Next, we consider whether the transaction between Plaintiff and Ferguson was a lease, such that title in the equipment never passed to Ferguson.

Our Supreme Court has held in making this determination, “the courts ‘do not consider what description the parties have given to it, but what is its essential character.’” *Szabo Food Serv. v. Balentine’s, Inc.*, 285 N.C. 452, 461, 206 S.E.2d 242, 249 (1974).

In 1965, North Carolina adopted the Uniform Commercial Code to govern transactions for the sale of goods. *Fordham v. Eason*, 351 N.C. 151, 154, 521 S.E.2d 701, 703 (1999). While a lease agreement and a transaction for the sale of goods may appear similar in character, the law treats each distinctly. Thus, determining which law applies affects the rights afforded to each party in the event of default. For example, if the transaction here is determined to be a lease, then Plaintiff, as lessor, retains title to the equipment and may prevail in a suit for conversion against Defendant. Alternatively, if the transaction is one for the sale of goods, Plaintiff’s attempt to retain title to the equipment is *limited in effect to reservation of a security interest*. N.C. Gen. Stat. § 25-2-401(1) (2012). As a result, its failure to perfect the interest (by filing a financing statement or taking possession of the equipment) causes

Defendant's landlord's lien to have priority, thus defeating any claim for conversion. N.C. Gen. Stat. §§ 25-9-310(a) (2012) ("a financing statement must be filed to perfect all security interests..."); 25-9-313(a) ("a secured party may perfect a security interest in tangible negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral"); N.C. Gen. Stat. § 44A-2(e) (2012) (explaining that a landlord's lien does not have priority over a *perfected* security interest).

In *Szabo*, our Supreme Court explained how to determine whether a contract should be characterized as a lease or sale:

[o]ne of the principal tests for determining whether a contract is one of conditional sale or lease is whether the party is obligated at all events to pay the total purchase price of the property which is the subject of the contract. If the return of the property is either required or permitted, the instrument will be held to be a lease; if the so-called lessee is obligated to pay the purchase price, even though it be denominated rental, the contract will be held to be one of sale.

Szabo, 285 N.C. at 461-62, 206 S.E.2d at 249. We also note that the fact that purchase-money is denominated as "rent" and divided into installment payments does not render a transaction a bailment or lease. *Hamilton v. Highlands*, 144 N.C. 279, 284, 56 S.E. 929, 931 (1907).

A conditional sale is one in which the seller or "vendor" attempts to retain title to the equipment. N.C. Gen. Stat. § 105-306(c)(2) (2012). Under this type of sale, the purchaser of the property at issue, in this case, Ferguson, is "considered the owner of

the property if he has possession of or the right to use the property” regardless of a seller’s retention of title as security for the payment of the purchase price. *Id.* A conditional sale is considered a security agreement governed by the UCC and can often appear on its face as a lease-to-own transaction. *Szabo*, 285 N.C. at 461, 206 S.E.2d at 249.¹ This is because the lessor in a lease agreement retains title to the property, while in a conditional sale, the seller or “vendor” *purports* to retain title (albeit limited in effect).

Here, Plaintiff attempted to retain title to the equipment by agreeing to deliver a bill of sale only after Ferguson made the final scheduled payment. Further, Plaintiff’s inclusion of the equipment on its tax returns evinces its intention to retain title. Perhaps most convincing are communications between the two parties memorializing that Plaintiff “will continue to be the owner of the equipment” and “after the full payment [Ferguson] will be the owner of the equipment.” However, Plaintiff’s attempt to retain title is thwarted for the two reasons discussed below.

First, Ferguson’s obligation was to pay the purchase price. He was under no obligation to return the equipment at the expiration of a given term. Indeed, the parties did not contemplate that the agreement would be terminated by any event

¹ We note that Plaintiff included the equipment on its tax returns, and Ferguson omitted the equipment from its list of assets subject to bankruptcy proceedings. The parties likely did so given their mutual agreement that Plaintiff would retain title until the bill of sale was delivered upon complete payment of the purchase price. However, this was erroneous because conditional sales are treated differently for taxing purposes. Pursuant to N.C. Gen. Stat. § 105-306(c)(2), the party in possession of the property, in this case Ferguson, is considered the owner and is liable for paying taxes on the property.

other than full payment of the purchase price, at which point Plaintiff would deliver the bill of sale to Ferguson. Because the transaction here could not be completed except by complete payment, the transaction is a conditional sale instead of a lease. N.C. Gen. Stat 25-2A-103(1)(j) (2012) (explaining that a lease “means a transfer of the right to possession and use of goods *for a term* in return for consideration.”)

Second, the purchase price of the equipment indicates that the transaction was a sale instead of a lease. A purported lease is a conditional sale when the “lessee” can acquire the property for little or no additional consideration. N.C. Gen. Stat. § 25-1-203(b)(3) (2012). If this is the case, then the transaction is a disguised security agreement for the sale of goods. *Beau Rivage Plantation v. Melex USA, Inc.*, 112 N.C. App. 446, 450, 436 S.E.2d 152, 154 (1993); *see also L.C. Williams Oil Co. v. NAFCO Capital Corp.*, 130 N.C. App. 286, 290-91, 502 S.E.2d 415, 418 (1998). Thus, we must consider the “option price with the market value of the equipment at the time the option is exercised.” *Beau*, 112 N.C. App. at 450, 436 S.E.2d at 154.

Here, Ferguson was obligated to pay \$300,000 for the equipment, which is its estimated market value. No additional amount of payment was required to “purchase” the equipment. Instead, Plaintiff agreed to deliver a bill of sale as soon as Ferguson completed the final payment. Thus, the UCC and our case law instructs that this transaction was a conditional sale in which Plaintiff’s retention of title was limited in effect to a security interest in the equipment. N.C. Gen. Stat. § 25-1-203(b)(3); *L.C.*, 130 N.C. App. at 290-91, 502 S.E.2d at 418 (UCC applied where the

agreement in question expressly granted plaintiff the option to purchase equipment for one dollar); *see also Borg-Warner Acceptance Corp. v. Johnston*, 97 N.C. App. 575, 581, 389 S.E.2d 429, 433 (1990), *cert. denied*, 333 N.C. 254, 424 S.E.2d 918 (1993) (transaction governed by the UCC where a third-party was given the option to purchase equipment for either one dollar or “fair market value”).

III. Conclusion

Because the evidence conclusively established that Plaintiff merely retained a security interest in the equipment and that Plaintiff failed to perfect its security interest, we conclude the trial court did not err in granting Defendant a directed verdict, based on its conclusion that Defendant’s landlord’s lien on the equipment has priority over any security interest Plaintiff has in the equipment.

AFFIRMED.

Judges MURPHY and FLOOD concur.

Report per Rule 30(e).