SO ORDERED,

Judge Neil P. Olack
United States Bankruptcy Judge
Date Signed: March 10, 2017

The Order of the Court is set forth below. The docket reflects the date entered.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:

PIONEER HEALTH SERVICES, INC. ET AL., | **CASE NO. 16-01119-NPO**

JOINTLY ADMINISTERED

DEBTORS. | **CHAPTER 11**

MEMORANDUM OPINION AND ORDER ON JOINT MOTION OF MED ONE CAPITAL FUNDING, LLC AND FIRST GUARANTY BANK TO (1) COMPEL PAYMENT OF ADMINISTRATIVE CLAIM; AND (2) COMPEL PERFORMANCE OF UNEXPIRED LEASE OF PERSONAL PROPERTY

This matter came before the Court for hearing on February 10, 2017 (the "Med One Hearing"), on the Joint Motion of Med One Capital Funding, LLC and First Guaranty Bank to (1) Compel Payment of Administrative Claim; and (2) Compel Performance of Unexpired Lease of Personal Property (the "Motion to Compel") (Dkt. 1097) filed by Med One Capital Funding, LLC ("Med One") on behalf of itself and as servicer on behalf of certain interests of its assignee, Republic Bank, and First Guaranty Bank ("First Guaranty"), as successor to certain interests of Republic Bank; the Answer and Response to Joint Motion of Med One Capital Funding, LLC and First Guaranty Bank to (1) Compel Payment of Administrative Claim; and (2) Compel Performance of Unexpired Lease of Personal Property (the "Answer") (Dkt. 1207) filed by

Pioneer Health Services, Inc. ("Pioneer Health"); and the Objection to Joint Motion of Med One Capital Funding, LLC and First Guaranty Bank to (1) Compel Payment of Administrative Claim; and (2) Compel Performance of Unexpired Lease of Personal Property (the "Objection") (Dkt. 1226) filed by the Official Committee of Unsecured Creditors (the "Committee") in the above-referenced bankruptcy case (the "Bankruptcy Case"). At a status conference held on December 9, 2016, the Court set the Med One Hearing to address the limited legal question of whether certain agreements attached to the Motion to Compel constituted "true" leases and instructed the parties to file briefs in support of their respective legal positions. On February 2, 2017, the Committee and Pioneer Health filed the Supplemental Brief in Support of Objection to the Joint Motion of Med One Capital Funding, LLC and First Guaranty Bank to (1) Compel Payment of Administrative Claim; and (2) Compel Performance of Unexpired Lease of Personal Property and Request for Dismissal of Joint Motion (the "Committee Brief") (Dkt. 1656), and Med One and First Guaranty filed the Brief of Med One Capital Funding, LLC and First Guaranty in Support of Motion to (1) Compel Payment of Administrative Claim; and (2) Compel Performance of Unexpired Lease of Personal Property (the "Med One Brief") (Dkt. 1657). At the Med One Hearing, Derek A. Henderson represented Med One; Jeffrey R. Barber and Jordan Montgomery Lewis represented First Guaranty; Craig M. Geno represented Pioneer Health; Darryl Laddin represented the Committee; and Brian I. Swett represented Capital One, National Association.

Jurisdiction

This Court has jurisdiction over the parties to and the subject matter of the Bankruptcy Case pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C.

§ 157(b)(2)(A), (M), and (O). Notice of the Motion to Compel was proper under the circumstances.

Facts

1. Pioneer Health is the parent company of several hospitals and other healthcare facilities located in Mississippi, Tennessee, Georgia, Virginia, and North Carolina. (Mot. to Compel at 2).

2. On December 29, 2011, Pioneer Health entered into the McKesson Master Agreement, Contract No. MA124131219 (the "McKesson Agreement") (Dkt. 1097-1) and Order Forms, including Contracts Nos. 1-18XKQT and 1-18X8C9_PS1, with McKesson Technologies, Inc. ("McKesson") and its affiliates in anticipation of the purchase of software licenses, products, and services for its healthcare facilities. (*Id.* at 3). The contracts relevant to the Motion to Compel cover software licenses and hosting services that form part of the total package of computer hardware and software known as the "Paragon Hospital Information System"[1] (the "Software") (Dkt. 1097-2 at 2 & 6).

3. In order to finance the acquisition of the Software—at a total cost of approximately $8.5 million—Pioneer Health entered into three (3) agreements drafted by Med One. Two (2) of the agreements are entitled "CONDITIONAL SALES AGREEMENT." (Dkt. 1097-2). The third agreement consists of a letter signed by Pioneer Health, McKesson, and Med One, which Med One and First Guaranty generously refer to as the "Intercreditor Agreement." (Dkt. 1097-3).

[1] Although it is not relevant to the present issue, Pioneer Health apparently acquired the Software because of the Health Information Technology for Economic and Clinical Health Act, which creates incentive payments for hospitals that demonstrate "meaningful use" of certified electronic health record technology. 42 C.F.R. § 495.2; (McKesson Agr. at 96).

4. The first Conditional Sales Agreement (the "First Agreement") (Dkt. 1097-2) is dated January 25, 2012. At the top of the first page, Pioneer Health is identified as the "CUSTOMER," and McKesson, as the "VENDOR." Seven (7) of Pioneer Health's affiliated hospitals are listed as "CO-CUSTOMERS."[2] Under the heading "EQUIPMENT" is the following description: "McKesson - Paragon Hospital Information System - as described in quote #MA124131219." (*Id.* at 1). That number refers to the McKesson Agreement. Under the heading "TERMS AND CONDITIONS" appears seventeen (17) numbered paragraphs. The first numbered paragraph provides:

> 1.) For good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, Med One . . . hereby sells the equipment described above (the "Equipment") to [Pioneer Health] and [Pioneer Health] hereby purchases the Equipment and agrees to tender payment for the Equipment pursuant to the Installment Payments & Terms outlined above.

(First Agr. ¶ 1). A table entitled "INSTALLMENT PAYMENTS & TERMS" directly above the first numbered paragraph indicates that the term of the installment agreement is sixty (60) months, the total cost of the equipment is $6,031,525.00, the monthly payment for the first year is $75,000.00, and for the final four (4) years is $132,690.00, and the "Agreement Expiration Date" is January 27, 2012. (First Agr. at 1). At the bottom of the table appears this language: "Title to the Equipment will be transferred to [Pioneer Health] upon completion of all payments set forth above." (*Id.*).

The numbered paragraphs that appear below the heading TERMS AND CONDITIONS contain the following relevant provisions: "This Agreement is a net sale." (First Agr. ¶ 3).

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[2] The co-customers included: Pioneer Health Services of Early County, LLC, Pioneer Health Services of Patrick County, Inc., Pioneer Health Services of Newton County, LLC, Pioneer Health Services of Stokes County, Inc., Pioneer Health Services of Choctaw County, LLC, Pioneer Health Services of Monroe County, Inc. and Independent Healthcare Management, Inc. d/b/a Lackey Memorial Hospital and Convalescent Home. (First Agr. at 1).

"This Agreement is a fully net, non-cancelable sale that may not be terminated for any reason." (*Id.* ¶ 4). "Upon full completion of the payments set forth above, Med One . . . shall transfer title to [Pioneer Health] via bill of sale." (*Id.* ¶ 5). "[Pioneer Health] hereby grants to Med One . . . a security interest in and to the Equipment" and "authorizes Med One . . . to file UCC-1 Financing Statements." (*Id.*). "[Pioneer Health] shall be responsible for . . . the Equipment." (*Id.* ¶ 6). "[Pioneer Health] shall timely provide adequate and mutually acceptable insurance coverage for such Equipment." (*Id.* ¶ 7). "[Pioneer Health] represents that [it] has selected the equipment and purchases it as is." (*Id.* ¶ 9). "This Agreement is presented subject to review and approval of credit and financial information pertaining to [Pioneer Health]." (*Id.* ¶ 10).

5. Under the First Agreement, each transaction is initiated by the issuance of a "Purchase Order." (*Id.* ¶ 10).

6. Med One and First Guaranty assert that numbered paragraph 11 applies to the transaction at issue to the exclusion of numbered paragraphs 1-10. (Med One Br. at 4-5). Paragraph 11 is set forth in full below:

> 11.) In the event the Equipment includes software (which [Pioneer Health] agrees shall include all documentation, later versions, updates, upgrades, and modifications) (herein "Software"), the following shall apply: (i) [Pioneer Health] shall possess and use the Software in accordance with the terms and conditions of any license agreement ("License") entered into with the owner/vendor of such Software and shall not breach the License (at Med One's request, [Pioneer Health] shall provide a complete copy of the License to Med One); (ii) [Pioneer Health] agrees that Med One has an interest in the License and Software due to its payment of the price thereof and is an assignee or third-party beneficiary of the License, (iii) as due consideration for Med One's payment of the price of the License and Software and for providing the Software to [Pioneer Health] at a lease rate (as opposed to a debt rate), [Pioneer Health] agrees that Med One is leasing (and not financing) the Software to [Pioneer Health]; (iv) except for the original price paid by Med One, [Pioneer Health] shall, at its own expense, pay promptly when due all servicing fees, maintenance fees, update and upgrade costs, modification costs, and all other costs and expenses relating to the License and Software and maintain the License in effect during the term of this

> Agreement; and (v) the Software shall be deemed Equipment for all purposes under this Agreement.

(First Agr. ¶ 11).

7. Paragraph 13 of the First Agreement grants Med One certain rights with respect to software if Pioneer Health failed to make payments when scheduled or otherwise defaulted. In that event, "[Pioneer Health] shall immediately (i) delete from its systems all Software then installed, (ii) destroy all copies or duplicates of the Software which were not returned to Med One, and (iii) cease using the Software altogether." (*Id.* ¶ 13). Paragraph 14 contains similar provisions that allow Med One to declare any software license terminated in the event of Pioneer Health's default. (*Id.* ¶ 14).

8. The second Conditional Sales Agreement (the "Second Agreement") (Dkt. 1097-2), dated April 13, 2012, is nearly identical to the First Agreement but involves different software and payment terms. The description under the heading "EQUIPMENT" in the Second Agreement is, as follows:

> McKesson - Paragon Hospital Information System - as described in Contract #1-18XKQT
>
> McKesson - Paragon Hospital Information System - as described in Contract #1-18X8C9_PS4A
>
> McKesson - Software - as described in Contract #1-18X8C9_PS6
>
> McKesson - Paragon Interface Implementation Service – as described in Contract #1-18X8C9_PS6

Under the heading "INSTALLMENT PAYMENTS & TERMS" the term of the installment agreement is sixty (60) months, the total cost of the equipment is $2,413,667.55, the monthly payment for the first year is $25,000.00 and for the final four (4) years is $54,594.00. (Dkt.

1097-2 at 7). All numbered paragraphs under the heading "TERMS AND CONDITIONS" in the Second Agreement are identical to those in the First Agreement.[3]

9. Attached to the Agreements are Purchase Order Nos. 22998A and 22998B dated April 23, 2012. (Dkt. 1097-2 at 11-12).

10. A letter addressed to "Whom it may concern" sets forth a three (3)-way agreement between McKesson, Pioneer Health, and Med One, the so-called "Intercreditor Agreement" (Dkt. 1097-3), which the Court refers to as the "Letter Agreement." At the top of the first page appears this instruction: "Hospital Letterhead Please." In the subject line, the Letter Agreement purportedly relates to "Contract Supplements, 1-18X8C9_PS1, 1-18X8C9_PS6, 1-18X8C9_PS4A, 1-18XKQT to Master Agreements No. 124131219, dated December 29, 2011." It instructs McKesson to submit directly to Med One all invoices "[w]ith respect to Software, Equipment and Services fees due and payable." It acknowledges, however, that "nothing contained herein" alters Pioneer Health's financial obligations to McKesson. In that regard, if Med One fails to pay an invoice, Pioneer Health agrees to pay McKesson on written notice from McKesson. The second paragraph of the Letter Agreement describes the nature of the relationship between Pioneer Health and Med One, as follows:

> [Pioneer Health] acknowledges that it has entered into a financing arrangement with [Med One], i.e., the Loan Agreement, dated April 18, 2012 and that in connection with this Agreement, rights and obligations associated with the Software, Equipment and Services are transferred to [Med One] and [Med One] is undertaking to fund the obligations of [Pioneer Health] under the initial Agreement.

(Dkt. 1097-3 at 2). The Letter Agreement also grants Med One a self-help remedy in the event Pioneer Health fails to make loan payments:

[3] Together, the First Agreement and Second Agreement are sometimes referred together as the "Agreements."

> [Pioneer Health Services] acknowledges and agrees in the event of a default under the loan, (whether or not such rights are contemplated in the McKesson Agreement) [Med One] may notify McKesson of [Pioneer Health's] default and McKesson may terminate all equipment maintenance services and software maintenance services provided by McKesson.

(*Id.*).

11. At some point, Med One assigned the Agreements to Republic Bank but remained as the servicer. (Mot. to Compel ¶ 11). A UCC-1 Financing Statement (Dkt. 1097-4 at 2-4) listing Republic Bank as the secured party was filed on April 25, 2012. On May 26, 2015, First Guaranty became the successor in interest to the Second Agreement, and a UCC-1 Financing Statement Amendment (Dkt. 1097-4 at 5) was filed on July 20, 2015, indicating an assignment from Republic Bank.

12. On March 30, 2016, Pioneer Health commenced the Bankruptcy Case by filing a voluntary chapter 11 petition (Dkt. 1). On that same date, the following affiliates of Pioneer Health also filed voluntary chapter 11 petitions for relief: Pioneer Health Services of Patrick County, Inc. (Case No. 16-01120-NPO); Pioneer Health Services of Newton County, LLC (Case No. 16-01121-NPO); Pioneer Health Services of Stokes County, Inc. (Case No. 16-01122-NPO); Pioneer Health Services of Choctaw County, LLC, (Case No. 16-01123-NPO); and Pioneer Health Services of Monroe County, Inc. (Case No. 16-01125-NPO). Another affiliate of Pioneer Health, Pioneer Health Services of Early County, LLC (Case No. 16-01243-NPO) filed for bankruptcy relief under chapter 11 on April 8, 2016. The bankruptcy cases of these affiliates have been administratively consolidated into the lead Bankruptcy Case. (Dkt. 44 & 92).

13. On September 9, 2016, a hearing was held on a motion filed by McKesson (the "McKesson Hearing") to compel Pioneer Health to pay administrative expenses for healthcare technology services provided under the McKesson Agreement. (Dkt. 794). Med One and First

Guaranty filed a joint response (Dkt. 938), alleging that it would be inequitable for McKesson to be paid before they had an opportunity to file a similar motion. Based on the description provided by counsel for First Guaranty at the McKesson Hearing, the Court expressed some confusion about the nature of the transaction between Med One and Pioneer Health. The Court questioned, among other things, whether Med One actually could lease software to Pioneer Health that it did not own or possess. After concluding that McKesson's services were an actual, necessary expense of preserving the estate pursuant to 11 U.S.C. § 503(b)(1), the Court awarded McKesson a percentage of its administrative expense claim in an interim order. (Dkt. 1080). In doing so, the Court overruled the objection of Med One and First Guaranty but reserved their right to seek payment for any claim they may have against the estate. In that regard, the Court instructed Med One to file its own motion explaining in more concise and understandable terms its relationship to Pioneer Health.

14. On October 4, 2016, Med One and First Guaranty filed the Motion to Compel. In general, they assert that Med One agreed to pay McKesson approximately $8.5 million for Pioneer Health's acquisition of the Software, Pioneer Health transferred its interest in the Software to Med One "as a third party beneficiary," and Med One "leased" the Software back to Pioneer Health over a term of sixty (60) months. Based on their characterization of the transaction as a "lease" and their contention that Pioneer Health has failed to make monthly "lease" payments totaling $1,123,704.00 since the filing of the Bankruptcy Case as of October 4, 2016, they seek immediate payment of post-petition administrative expenses of all "lease" payments that became due after the sixtieth day post-petition, as well as the sum of $187,284.00 per month for Pioneer Health's continued use of the Software. (Mot. to Compel at ¶¶ 14, 22, & 25); *see* 11 U.S.C. § 365(d)(5), § 503(a).

15. On October 28, 2016, Pioneer Health filed the Answer, denying that Med One and First Guaranty are entitled to an administrative expense claim and characterizing Med One and First Guaranty as unsecured creditors of the estate. On November 2, 2016, the Committee filed the Objection, also denying that Med One and First Guaranty are entitled to any administrative expense claim or to any claim under 11 U.S.C. § 365(d) on the ground that the Agreements are loans, not leases. (Obj. at 2-3).

16. On February 2, 2017, the Committee Brief and Med One Brief were filed addressing the limited legal question of whether the Agreements are "true" leases as a matter of law.

Discussion

A. Legal Standard

Because the Committee and Pioneer Health seek denial of the Motion to Compel without the need for any discovery, the Objection and Answer are akin to a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure ("Rule 12(b)(6)"), as made applicable to adversary proceedings by Rule 7012 of the Federal Rules of Bankruptcy Procedure ("Rule 7012").[4] Under Rule 12(b)(6), a court considering a motion to dismiss "accepts all well-pleaded facts as true, viewing them in the light most favorable to the plaintiff. To survive a Rule 12(b)(6) motion to dismiss, the plaintiff must plead enough facts to state a claim to relief that is plausible

[4] The Motion to Compel is a contested matter under Rule 9014(c) of the Federal Rules of Bankruptcy Procedure ("Rule 9014"), as opposed to an adversary proceeding under Rule 7001 of the Federal Rules of Bankruptcy Procedure. Part VII of the Federal Rules of Bankruptcy Procedure contains the rules regarding motion practice in adversary proceedings and, except for the Part VII rules listed in Rule 9014(c), those rules do not apply in contested matters "unless the court directs otherwise." FED. R. BANKR. P. 9014(c). The list of rules in Rule 9014(c) does not specifically include Rule 7012, but the Court exercises its discretion to direct that it apply to the Motion to Compel. *See also* FED. R. BANKR. P. 9013 (requiring motions to state with particularity the grounds for the relief sought).

on its face." *See In re Katrina Canal Breaches*, 495 F.3d 191, 205 (5th Cir. 2007) (citations & internal quotation omitted). "Generally, in deciding a motion to dismiss for failure to state a claim, if matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment." *Id.* (citation omitted). Where exhibits, such as contracts, are referred to in the complaint and are central to the plaintiff's claim, a court "may consider the terms of the contracts in assessing the motions to dismiss." *Id.* (quotation omitted); *see also Collins v. Morgan Stanley Dean Witter*, 224 F.3d 496, 499 (5th Cir. 2000) (holding that a court may consider documents attached to a motion to dismiss, and not to the pleadings, if they are referred to in the plaintiff's complaint and "[i]n so attaching, the defendant merely assists the plaintiff in establishing the basis of the suit, and the court in making the elementary determination of whether a claim has been stated."). Here, Med One and First Guaranty attached copies of the Agreements, Purchase Orders, and Letter Agreement, as well as relevant excerpts from the voluminous McKesson Agreement, to the Motion to Compel. Because these documents are central to the claims of Med One and First Guaranty, the Court may consider them without converting the Motion to Compel into a summary judgment motion under Rule 7056 of the Federal Rules of Bankruptcy Procedure.

B. 11 U.S.C. § 365(d)

In a chapter 11 case, a debtor's obligations under an unexpired lease do not automatically become obligations of the bankruptcy estate. *In re Nat'l Gypsum Co.*, 208 F.3d 498, 504 (5th Cir. 2000). Section § 365 of the Bankruptcy Code authorizes a debtor, subject to the Court's approval, to assume or reject an unexpired lease at any time before the confirmation of the plan. 11 U.S.C. § 365(d)(2). For a commercial lease of personal property, however, the debtor has sixty (60) days to make that decision. Under 11 U.S.C. § 365(d)(5), a debtor must pay the

contract rate "first arising from or after 60 days after the order for relief . . . under an unexpired lease of personal property." *Id.* In order for the special provision in 11 U.S.C. § 365(d)(5) to apply, however, a lease must be a "true" lease of personal property. *Wells Fargo Equip. Fin., Inc. v. Circuit-Wise, Inc. (In re Circuit-Wise, Inc.)*, 277 B.R. 460, 462 (Bankr. D. Conn. 2002); 3 COLLIER ON BANKRUPTCY ¶ 365.02[3] (16th ed. 2016). The Committee and Pioneer Health contend that the transaction between Med One and Pioneer Health is a loan, whereas Med One and First Guaranty assert that it is a "true" lease for purposes of 11 U.S.C. § 365(d)(5). Their dispute raises a question of law. For the sake of brevity and clarity, the Court will refer only to Med One and the Committee as the disputing parties.

1. Choice of Law

In determining whether a particular transaction is a true lease or a loan, the Court turns to applicable state law. *See Butner v. United States*, 440 U.S. 48, 55 (1979) (holding that "property interests are created and defined by state law"). Med One applies the law of Utah to the entirety of the transaction, based on a choice-of-law provision in the Purchase Order. (Mot. to Compel at 6 n.6). The Committee applies the law of Pioneer Health's principal place of business (Mississippi) (Comm. Br. at 4-5 & n.2). Inasmuch as Utah and Mississippi both have adopted versions of the Uniform Commercial Code ("UCC") that define leases in the same way, the Court applies Utah law without deciding the proper choice of law.

2. True Leases?

It is well-accepted that courts must look to the substance of a transaction in analyzing its true nature, rather than the labels used by the parties. In many cases where a dispute over the true nature of a transaction arises, the document in question is labeled a "lease," and a court must decide whether that terminology is used to avoid the consequences of calling the transaction

what it really is. *In re Grubbs Constr. Co*., 319 B.R. 698, 709-12 (Bankr. M.D. Fla. 2005). Often, the choice confronted by a court is whether an agreement is a "true" lease or a secured transaction, although the choice could be between a "true" lease and some other form of transaction. *Id* at 710.

The labels used by Med One in the documents provide no pretense of a lease. The Agreements are entitled "CONDITIONAL SALES AGREEMENT," not leases. Internally, the Agreements are replete with sale language. (Agrs. ¶¶ 1, 3-5, 9, 14). They contain some lease language, but almost all of those references appear in paragraph 11, which pertains to software included in equipment. The only other references to a lease relate to Med One's remedies in the event of a default. (*Id*. ¶¶ 4, 14). As to the Letter Agreement, it states that "[Pioneer Health] acknowledges that it has entered into a *financing* arrangement with [Med One]" and later refers to their arrangement as a "loan." (Letter Agr. at 1). Thus, if the transaction is a "true" lease, Med One did not make that intent clear from the labels it chose. The Court, however, is required to ignore the labels and determine the parties' intent based on the structure of the Agreements. Still, the Court notes that this matter is unusual in that the documents purport to be conditional sales rather than true leases.

a. Committee

The Committee asserts that application of the bright-line test under § 1-203 of the UCC demonstrates that the Agreements are not leases. UTAH CODE ANN. § 70A-1a-203. Section 1-203 contains a two-prong test that, if satisfied, results in a finding that a purported lease is a disguised security agreement as a matter of law. Under this bright-line test, "a transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to

termination by the lessee." UTAH CODE ANN. § 70A-1a-203(2). Simply put, a lease creates a security interest if: (1) the lessee does not have the right to terminate the lease; and (2) one or more of the four "residual value" factors in the statute is found to exist. *Auto. Leasing Specialists, L.L.C. v. Little*, 392 B.R. 222, 231 (W.D. La. 2008) (construing substantively identical provision of Louisiana commercial law).[5] If the bright-line test is not satisfied, then the transaction in question does not create a security interest *per se*. 4 JAMES J. WHITE, ROBERT S. SUMMERS & ROBERT A. HILLMAN, UNIFORM COMMERCIAL CODE § 30:11 (6th ed. 2016). The burden of proof is on the party attempting to characterize the transaction in question as something other than what it purports to be. *In re Uni Imaging Holdings, LLC*, 423 B.R. 406, 414 (Bankr. N.D.N.Y. 2010; *In re Ecco Drilling Co., Ltd.*, 390 B.R. 221, 226 (Bankr. E.D. Tex. 2008); *In re QDS Components, Inc.*, 292 B.R. 313, 321-22 (Bankr. S.D. Ohio 2002).

The first prong of the bright-line test is whether Pioneer Health has the right to terminate the Agreements prior to the expiration of their terms. If so, then the transaction has a fundamental characteristic of a lease and is not deemed to have conclusively created a security interest. If, however, Pioneer Health does not have right to terminate the Agreements early, the satisfaction of any one of the four enumerated factors supports the finding that the Agreements are not leases as a matter of law. UTAH CODE ANN. § 70-1a-203(2).

First, Pioneer Health does not have a right to terminate the Agreements. "This Agreement is a fully net, non-cancelable sale that may not be terminated for any reason." (Agrs. ¶ 4). Second, Med One agreed to transfer title of the Software to Pioneer Health upon

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[5] The UCC has been uniformly adopted by most states, and, thus, decisions from other jurisdictions interpreting the same uniform statute are instructive. *See Duke Energy Royal, LLC v. Pillowtex Corp. (In re Pillowtex, Inc.)*, 349 F.3d 711, 718 n.8 (3d Cir. 2003); *WorldCom, Inc. v. Gen. Electric Global Asset Mgmt. Servs. (In re WorldCom, Inc.)*, 339 B.R. 56, 63-64 (Bankr. S.D.N.Y. 2006).

completion of the payments. In other words, Pioneer Health has the option of becoming the owner for no additional consideration upon compliance with the Agreements. "Upon full completion of the payments set forth above, Med One . . . shall transfer title to [Pioneer Health] via bill of sale." (*Id.* ¶ 5). Other common-law factors indicate that the Agreements are not leases. Pioneer Health was required to pay the costs of "operating the Equipment, maintenance and repairs" and to "provide adequate and mutually acceptable insurance coverage." (*Id.* ¶¶ 3 &7). Application of the bright-line test and consideration of other common-law factors show that the Agreements do not function as "true" leases as a matter of law.

b. Med One

Med One attempts to avoid the finding that the Agreements are not "true" leases by arguing that: (1) the Software is not a "good" within the meaning of the UCC and, thus, the bright-line test in § 1-203 does not apply and (2) numbered paragraphs 1-10 in the Agreements do not apply to the present transaction. Article 2 of the UCC, which pertains to sales, defines goods as "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale . . . .". UTAH CODE ANN. § 70A-2-105(1). Article 2A of the UCC, which pertains to leases, defines goods in a similar way except that it excludes "general intangibles" from the definition. UTAH CODE ANN. § 70A-2a-103(h).

(1.) Applicability of the UCC

In the Med One Brief, Med One cites *SAS Inst., Inc. v. World Programming Ltd.*, No. 5:10-25-FL, 2016 U.S. Dist. LEXIS 79230, 2016 WL 3435196 (E.D.N.C. June 17, 2016), for the proposition that the UCC does not apply to software license agreements "on the grounds that the software is predominantly like a service." (Med One Br. ¶ 32). Noting that "the applicability of the [UCC] to software is a question that has confounded courts," the *SAS* court concluded that

the UCC does not apply to software license agreements, as opposed to software purchase agreements. *SAS*, 2016 WL 3435196, at *3. Med One, however, contends that the Agreements are leases, not licenses, and, therefore, SAS is inapposite.

As to the broader argument made by Med One, the Court agrees that the UCC covers "transactions" in "goods" but does not cover "services." Here, the subject of the Agreements is remotely-hosted Software defined as "Equipment," rather than as a service or general intangible. Although the Software includes hosting services, those services do not predominate the transaction. *See Utah Local Gov't Trust v. Wheeler Mach. Co.*, 199 P.3d 949, 956 (Utah 2008). Contracts for the sale or lease of software often involve the provision of incidental support for services but the inclusion of those services does not automatically render the UCC inapplicable to the transaction. *Micro Data Base Sys., Inc. v. Dharma Sys., Inc.*, 148 F.3d 649, 654 (7th Cir. 1998). Indeed, the Agreements here contemplate the application of the UCC. "Med One . . . shall be entitled to all available . . . remedies provided in the applicable version of the Uniform Commercial Code." (Agrs. ¶ 8). Finally, if the Software is a service to which the UCC does not apply, the Court's inquiry would not end there. Instead, common law principles would apply in determining the economics of the transaction. Because § 1-203 of the UCC is based on those same principles, no different result would be reached under the facts here where the Agreements purport to be sales.

(2.) Versatility of the Agreements

Med One's second attempt to avoid application of the bright-line test is to carve out paragraphs 1 through 10 from the remaining numbered paragraphs of the Agreements. According to Med One, the Agreements are based on a one-size-fits-all form used for both the sale of equipment and the lease of software. As explained by Med One, different provisions of

the form apply depending on whether the transaction is a sale or lease. For physical equipment, paragraphs 1 through 10 apply to create financing arrangements, but for software, paragraphs 11 through 14 apply to create true leases. Because the subject matter of the Agreements is software, Med One contends that paragraph 11 applies to the exclusion of all prior numbered paragraphs. Med One points to the following language in paragraph 11: "Med One has an interest in the License and Software due to its payment of the price thereof and is an assignee or third-party beneficiary of the License." (Agrs. ¶ 11).

Under well-accepted rules of contract interpretation, the plain language of a contract generally governs its meaning and the intent of the contracting parties as a matter of law. *WebBank v. Am. Gen. Annuity Serv. Corp.*, 54 P.3d 1139, 1144 (Utah 2002). Moreover, each contractual provision must be considered "in relation to all of the others, with a view toward giving effect to all and ignoring none." *Id.* There is no language in the Agreements, however, that suggests the versatility urged by Med One. The introduction to the numbered paragraphs simply does not discern between sales and leases. In the Agreements, the Software is defined as "Equipment," and paragraph 11 applies only "[i]n the event the Equipment includes software." (Agrs. ¶ 11). It is nonsensical to read paragraph 11 as applying to the Software because it would require a finding that the Software includes software. Rather, it is clear that the parties intended paragraph 11 to apply to mass market software where, for example, a license agreement appears on the computer screen the first time the software is used, and the user accepts the license agreement by clicking on the "yes" icon button. This interpretation is consistent with the McKesson Agreement, which mentions the necessity of such third-party software, defined as "any software that is owned by a third party and sublicensed to [Pioneer Health]." (McKesson Agr. at 17).

At a status conference prior to the Med One Hearing, Med One urged the Court to delay consideration of the Motion to Compel until it had an opportunity to engage in full discovery, including the depositions of the Pioneer Health officers who signed the documents, to determine the intent of the parties. The Committee suggested that engaging in discovery would constitute a waste of resources until the Court decided whether the Agreements are leases as a matter of law. The Court agreed with the Committee given the absence of any dispute about which documents govern the transaction and the parol evidence rule.

Under the parol evidence rule, evidence of prior or contemporaneous agreements or statements is not admissible to supplement or contradict the terms of an integrated and unambiguous written contract.[6] *Tangren Family Trust v. Tangren*, 182 P.3d 326, 329 (Utah 2008). An "integration" is a writing or writings that constitute a final expression of the terms of an agreement. *Id.* at 328. No one disputes that the Agreements, Purchase Orders, and Letter Agreement are related documents from which the intent of the parties may be determined without violating the parol evidence rule. *Winegar v. Froerer Corp.*, 813 P.2d 104, 109 (Utah 1991). Med One, however, asks the Court to look beyond the four corners of those documents.

The Agreements on their face appear to be fully integrated, and the Purchase Orders contain a clear integration clause. (Purchase Order ¶ 5). Regardless, Med One does not point to any ambiguous provision in the Agreements, defined under Utah law as a "contractual term or provision . . . capable of more than one reasonable interpretation because of uncertain meaningful terms, missing terms or other deficiencies." *Daines v. Vincent*, 190 P.3d 1269, 1275 (Utah 2008) (quotation omitted). Paragraph 11 applies only "[i]n the event the Equipment

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[6] The parol evidence rule is viewed as substantive law, rather than a procedural rule of evidence, and, therefore, federal courts apply state law. *Jack H. Brown & Co. v. Toys "R" Us, Inc.*, 906 F.2d 169, 173 (5th Cir. 1990).

includes software." (Agrs. ¶ 11). Med One, however, seeks permission to introduce extrinsic evidence to create an ambiguity in Paragraph 11 as to whether the parties actually intended to state, "[i]n the event the Equipment is software." (*Id.*) (emphasis added). Med One argued that the Agreements were poorly drafted and, therefore, ambiguous. The parol evidence rule applies, however, even when the contract in question is poorly drafted. *McEwan v. Mountain Land Support Corp.*, 116 P.3d 955, 959 (Utah 2005) (in applying parol evidence rule, noting that contractual confusion does not make a contract ambiguous).

In the absence of a finding of ambiguity, the parties' intention must be determined solely from the language of the written documents. *Daines*, 190 P.3d at 1277. For that reason, the Court declined Med One's request to engage in discovery for the purpose of showing that the Agreements are something other than what they purport to be.

Even assuming Med One's construction of paragraph 11 of the Agreements is correct, the transaction lacks the most fundamental characteristic of a lease, which is the transfer of a lessor's right to use and possess the leased property. *See In re CNB Int'l, Inc.*, 307 B.R. 363, 369 (Bankr. W.D.N.Y. 2004) (holding that a purported lease was not a true lease but an executory contract because the alleged lessor held no right or interest in the software being leased); UTAH CODE ANN. § 70A-2a-103(1)(j) (defining a lease as "a transfer of the right to possession and use of goods for a term"). It is undisputed that at all times during this transaction, McKesson, not Med One, retained ownership of the Software. Med One asserts, however, that it acquired a possessory interest in the Software from McKesson by virtue of its right to terminate Pioneer Health's access to the Software in the event of a default. Pursuant to the Letter Agreement, each monthly payment by Pioneer Health to Med One ensured forbearance of Med One's right to

deactivate the Software. According to Med One, this right is similar to the one recognized by the U.S. Supreme Court in *Chicago Board of Trade v. Johnson*, 264 U.S. 1 (1924).

In *Johnson*, a bankruptcy trustee attempted to sell a debtor's membership in the Chicago Board of Trade. *Id*. at 6. A rule of the Chicago Board of Trade, however, precluded members from transferring their membership unless they had paid all assessments and had no outstanding claims held against them by other members. *Id*. The U.S. Supreme Court noted that this rule was the only right that the Chicago Board of Trade or its members had to compel the payment of obligations, that is, the right to prevent the transfer of a membership as long as any obligation remained unpaid. *Id.* at 11. Med One likens this right of the Chicago Board of Trade and its members to its right to terminate Pioneer Health's access to the Software.

The issue in *Johnson* was whether the debtor's membership was an asset of the bankruptcy estate subject to disposition by the trustee even though state law mandated that it was beyond the reach of creditor's claims. The U.S. Supreme Court resolved the conflict between federal bankruptcy law and state property law by holding that under bankruptcy law, control of the debtor's right to dispose of the membership passed to the trustee, but not the membership itself. Med One does not explain how *Johnson* supports a finding that it acquired a possessory interest in the Software sufficient for the Court to conclude that the transaction is a true lease.

Med One places too much emphasis on the Letter Agreement. Med One's right to disable the Software is not tantamount to the right to use and possess the Software, and the deactivation right granted Med One is just as analogous to the self-help remedies available to a secured party to repossess collateral on default as it is to a lessor. Although there is language in the Letter Agreement that "rights and obligations associated with the Software . . . are transferred to [Med One]," the remaining language makes it clear that the only right granted to Med One is

McKesson's right to deactivate the Software. To bolster its position, Med One refers to itself as a third party beneficiary of the McKesson Agreement, but there is no language in the Letter Agreement granting Med One such status, and the McKesson Agreement contains the following provision: "No Third Party Beneficiaries. Except as specifically set forth in an Order Form, nothing in this [McKesson Agreement] will confer any right, remedy, or obligation upon anyone other than [Pioneer Health] and McKesson." (McKesson Agr. at 12).

Conclusion

Med One is correct in pointing out that the purchase of specialized software, given the expense, is often financed through a lease. It just so happens that the documents used by Med One did not create a true lease as a matter of law. The decision to document a $8.5 million transaction using a form entitled "CONDITIONAL SALES AGREEMENT" and a letter addressed "To whom it may concern" was Med One's.

Having found that the Agreements are not "true" leases, the Court finds that the Motion to Compel should be denied. In reaching this conclusion, the Court does not address any other issues at this time, such as whether the Agreements constitute a secured or unsecured financing transaction.

IT IS, THEREFORE, ORDERED that the Motion to Compel is hereby denied.

##END OF OPINION##