

**IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION**

IN RE: RUSSELL CLIFFORD TATE, Debtor

**No. 2:11-bk-74591
Ch. 13**

ORDER

Before the Court is the *Objection to Confirmation of Plan, or, in the Alternative, Motion to Dismiss* filed by creditor Bluegrass Rentals, LLC [Bluegrass Rentals] on February 21, 2012. On July 5, 2012, the Court held a hearing on this matter. At the conclusion of the hearing, the Court took the matter under advisement. For the reasons stated below, the Court sustains Bluegrass Rentals' objection to confirmation. The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and this is a core proceeding under 28 U.S.C. § 157(b)(2)(L). This Order contains findings of fact and conclusions of law pursuant to Federal Rules of Bankruptcy 7052 and 9014.

On June 1, 2011, the debtor, an Arkansas resident, traveled to Oklahoma and entered into a *Lease/Purchase Agreement and Disclosure Statement* [Agreement] relating to a portable warehouse building [the building] with Affordable Buildings, LLC [Affordable Buildings], at its main office in Muldrow, Oklahoma. The debtor paid Affordable Buildings \$200.00 for a security deposit at the time the Agreement was executed, as well as the first monthly payment of \$317.29.¹ Affordable Buildings delivered the building to the debtor in Arkansas. Affordable Buildings subsequently assigned its claim to Bluegrass Rentals, also located in Oklahoma.

On October 10, 2011, the debtor filed a voluntary chapter 13 bankruptcy case. The debtor proposed in his chapter 13 plan to treat Bluegrass Rentals as a secured creditor and to pay Bluegrass Rentals \$3000.00 for the value of the building over the life of the plan rather than the full amount owed under the Agreement--approximately \$5800.00.

¹ The parties testified that prior to filing bankruptcy on October 10, 2011, the debtor made one additional monthly payment.

Bluegrass Rentals objects to its proposed treatment as a secured creditor under the debtor's plan and alleges that it is a lessor by assignment.

Bluegrass Rentals argues that Oklahoma law controls the interpretation of the Agreement, and the debtor argues that Arkansas law controls. When resolving a conflict of law dispute, a bankruptcy court should apply the forum state's choice of law rules unless the state law issue before the court has federal policy implications. *Bianco v. Erkins*, 243 F.3d 599, 601 (2d Cir. 2001); *see also Jump v. Goldenhersh*, 619 F.2d 11, 13 (8th Cir. 1980) (stating that the conflict of law rules of the forum state control which substantive law should apply). Thus, the Court will look to the Arkansas choice of law rules to determine whether Oklahoma or Arkansas law applies to the interpretation of the Agreement.

In contractual choice of law disputes, Arkansas courts apply the law of the state with the most significant relationship to the contract unless the contract contains an effective choice of law provision. *Scottsdale Ins. Co. v. Morrow Land Valley Co., LLC*, No. 11-905, 2012 WL 1950247, at *7, (Ark. May 31, 2012) (*citing Crisler v. Unum Ins. Co. of Am.*, 233 S.W.3d 658, 660 (Ark. 2006)). The following factors are relevant to the determination of which state has the most significant relationship to the contract at issue: the place the contract was made; the place the contract was negotiated; the place the contract was performed; the location of the subject matter of the contract; and the domicile, residence, nationality, place of incorporation, and place of business of the parties. *Crisler*, 233 S.W.3d at 660 (*citing* Restatement (Second) Conflict of Laws § 188 (1971)).

Because the Agreement between the debtor and Bluegrass Rentals does not contain a choice of law provision, the Court must determine which state has the most significant relationship to the Agreement, Arkansas or Oklahoma. *Id.* Arkansas relates to the Agreement because: (1) the debtor is a resident of Arkansas; (2) part of the performance of the Agreement took place in Arkansas because Affordable Buildings delivered the

building to the debtor in Arkansas; and (3) the subject matter of the Agreement (the building) is located in Arkansas. Oklahoma relates to the Agreement because: (1) the debtor initiated the Agreement by traveling to Affordable Buildings in Oklahoma;² (2) the parties negotiated the Agreement in Oklahoma; (3) the parties signed the Agreement in Oklahoma; (4) part of the performance of the Agreement took place in Oklahoma because the debtor paid his initial payments in Oklahoma and Affordable Buildings made modifications to the building in Oklahoma pursuant to the debtor's request; (5) Affordable Buildings' main office is in Oklahoma; and (6) Affordable Buildings assigned its interest to Bluegrass Rentals, an Oklahoma company.

The Court finds that both Arkansas and Oklahoma bear a relationship to the Agreement. However, because Arkansas courts place emphasis on “[t]he state where the parties initiate and conduct negotiations” when resolving choice of law disputes, the Court finds that Oklahoma has a more significant relationship to the Agreement than does Arkansas. *Heating & Air Specialists, Inc. v. Jones*, 180 F.3d 923, 929 (8th Cir. 1999) (citing *McMillen v. Winona Nat’l & Sav. Bank*, 648 S.W.2d 460, 462 (Ark. 1983)). Thus, the Court will apply Oklahoma law to determine if the Agreement is a lease or a security agreement.

Under Oklahoma's version of the Uniform Commercial Code [UCC], whether a transaction creates a lease or a security interest is determined by the facts of each case. Okla. Stat. Ann. tit 12A, § 1-203(a). A transaction creates a security interest if the debtor cannot unilaterally terminate the Agreement *and* one of the following four circumstances is present:

- (1) the original term of the lease is equal to or greater than the remaining economic life of the goods;

² The debtor testified that he initially visited an Affordable Buildings in Arkansas, but that his dissatisfaction with the Arkansas location's personnel and building selection resulted in him contacting Affordable Buildings in Oklahoma.

(2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;

(3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement; or

(4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

Okla. Stat. Ann. tit 12A, § 1-203(b) (emphasis added).

In the instant matter, the Court finds that Agreement does not create a security interest because paragraph 11 of the Agreement gives the debtor the unilateral right to “terminate [the] Agreement before the end of the lease term without penalty by notifying Lessor and paying the \$100.00 disposition fee.”³ Additionally, even if the Agreement had not given the debtor the unilateral right to terminate the agreement, the Agreement does not contain one of the other four circumstances required to create a security interest under § 1-203(b).

Specifically, the circumstance described in § 1-203(b)(1) is not present because the original term of the Agreement is not “equal to or greater than the remaining economic life of the goods.” Okla. Stat. Ann., tit 12A, § 1-203(b)(1). Paragraph 2(a) of the Agreement states the original term of the Agreement as “not less than five (5) months.” Neither party presented evidence regarding the normal life of a storage building but common sense dictates that a building of this type lasts significantly longer than five

³ Under Arkansas law, the Court’s analysis would be complete at this point. Arkansas, like Oklahoma, has adopted the UCC provision that distinguishes a lease from a security agreement. *See* Ark. Code Ann. § 4-1-203. However, unlike Oklahoma, Arkansas has found a single element of the applicable UCC provision to be dispositive-- if an agreement contains a provision giving the debtor the unilateral right to terminate the agreement, then that agreement is a lease. *See In re Copeland*, 238 B.R. 801 (Bankr. E.D. Ark. 1999).

months, making this subsection inapplicable to the Agreement.

The circumstance described in § 1-203(b)(2) is not present because the debtor is not “bound to renew the lease for the remaining economic life of the goods” nor is the debtor “bound to become the owner of the goods.” Okla. Stat. Ann., tit 12A § 1-203(b)(2). The Agreement contains no provision requiring the debtor to renew the lease, and, although the Agreement allows the debtor the option of purchasing the building, the debtor is not bound to do so and may terminate the Agreement without penalty after five months.

The circumstance described in § 1-203(b)(3) is not present because the Agreement does not contain a provision that allows the debtor to renew the lease. Finally, the circumstance described in § 1-203(b)(4) is not present because the debtor does not have “an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.” Okla. Stat. Ann., tit 12A § 1-203(b)(4). Under the Agreement, the debtor could exercise his option to purchase the building at any time. If the debtor exercised his option early in the lease term, he would be required to pay more than nominal additional consideration.⁴

In each of the four situations resulting in the creation of a security interest under § 1-203(b), the common thread is that the lessor retains no “meaningful residual interest” in the goods; in other words, the lessor cannot reasonably expect to receive anything of value at the end of the lease. *In re Cole*, 100 B.R. 561, 564 (Bankr. N.D. Okla. 1989). The “key factor distinguishing a lease from a security interest” is whether the lessor retains a meaningful residual interest. *Id.* Under the Agreement, the debtor was

⁴ The Agreement states in the “Purchase Option, Early Termination and Other Terms” section that “if [the debtor] make[s] all of the scheduled lease payments on time, [the debtor] may purchase the building by exercising [his] purchase option for \$100.00. [The debtor] may purchase the building at any time by paying the remaining balance of the original cash price, less fifty-five percent (55%) of the principal amount of all lease payments made (excluding taxes, fees and other charges), plus sales tax on the remaining principal amount and the purchase option fee of \$100.00.”

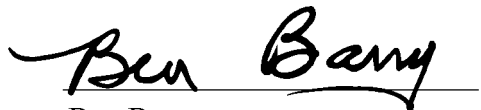
obligated to pay for the building for only five months. At any time after the initial five months, the debtor could terminate the lease and return the building to Affordable Buildings. Because of this provision, Affordable Buildings--and later its assignee, Bluegrass Rentals--could reasonably expect to receive something of value at the end of the lease, creating a meaningful residual interest.

Several provisions in the Agreement protect Affordable Buildings' residual interest. For instance, paragraph 7 of the Agreement provides that the debtor "shall maintain the Leased Property in good condition, reasonable wear and tear excepted." Paragraph 8 of the Agreement provides that the debtor "shall not permit the Leased Property to be altered for the construction of shelves, addition of equipment and accessories or the placing of signs thereon. . . ." Paragraph 8 further provides that the debtor "shall not permit the leased property to be tied to or otherwise affixed to any real estate in such a manner that the same cannot be removed without damage to the Leased Property, unless authorized in writing by the Lessor." Paragraph 15 of the Agreement provides that the "Leased Property shall be kept at the address indicated on the order form. It may not be moved from that address without the written consent of Lessor which shall not be unreasonably withheld. The Leased Property may only be moved by carriers authorized in writing by the Lessor." Paragraph 17 of the Agreement provides that "Lessor shall have the right to examine and inspect the Leased Property at all reasonable times."

The Court finds that these provisions, which are designed to preserve Affordable Buildings' residual interest in the building, are consistent with a lease. If the Agreement between the parties was a security agreement, the debtor would have the freedom to use the building as he wished, alter it without Affordable Buildings' written permission, and move it without notifying Affordable Buildings. Further, the debtor would not have granted Affordable Buildings the right to examine and inspect the building. *See Cole*, 100 B.R. at 565.

For the reasons stated above, the Court finds that the Agreement is a lease and orders the debtor to modify his chapter 13 plan to treat Affordable Buildings' assignee, Bluegrass Rentals, as a lessor within 21 days of the entry of this order.⁵

IT IS SO ORDERED.


Ben Barry
United States Bankruptcy Judge
Dated: 09/21/2012

cc: Donald A. Brady, Jr., attorney for debtor
R. Ray Fulmer, II, attorney for Bluegrass Rentals, LLC
Joyce Bradley Babin, chapter 13 trustee

⁵ On July 10, 2012, the Court issued an Order to Show Cause why it should not deny confirmation of the debtor's plan based upon the apparent applicability of 11 U.S.C. § 1325(a)'s "hanging paragraph" to Bluegrass Rentals' claim should the Court determine that the Agreement was a security agreement. A hearing was held on the Order to Show Cause on August 1, 2012, at which time the Court took the matter under advisement. Because the Court finds that the Agreement is a lease, the Court need not decide whether § 1325(a)'s "hanging paragraph" would have applied to Bluegrass Rentals' claim had the Court found that the Agreement was a security agreement.