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U.S. BANKRUPTCY COURT
DIST OF SOUTH CAROLINA

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:

Arthur Woodfield and Saundra Woodfield,

Debtor.

C/A No. 94-76315

JUDGMENT

Chapter 13

The "rent-to-own" Agreements between the Debtors and Rent-A-Center are security agreements. The objection to the confirmation of the Chapter 13 Plan of Reorganization filed by Rent-A-Center is overruled.

John E. Waites

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
April 25, 1995.

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UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE: C/A No. 94-76315

Arthur Woodfield and Saundra Woodfield, **ORDER**

Debtor. Chapter 13

THIS MATTER comes before the Court upon the Debtor's continued Chapter 13 Confirmation hearing. The sole objection to the confirmation of the Plan was filed by Rent-A-Center based upon two "rent-to-own" agreements ("Agreements") between Rent-A-Center and the Debtors. The Debtors' Chapter 13 Plan proposes to treat Rent-A-Center as a secured creditor to be paid $54.00 per month plus 8.5% interest. Rent-A-Center takes the position that the "rent-to-own" agreements are not security agreements, but are leases that must be assumed or rejected by the Debtors pursuant to 11 U.S.C. § 365. Based upon the evidence presented including the Agreements, the Court makes the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. The Debtors entered into two rental-purchase or "Rent-to-Own" Agreements with Rent-A-Center pre-petition. The first Agreement, entered into on June 11, 1994, was for the purchase of a ring in which the Debtor agreed to pay $16.99 per week. The Debtors have paid a total of $271.96 on this Agreement and continue to owe $417.58. The second Agreement, which was entered into on December 9, 1994 was for a 25 inch television, a VCR, and a stereo system in which the Debtors agreed to pay $27.99 per week. The Debtors have only paid $31.99 on the second Agreement and remain indebted in the

amount of $2,767.01. The last payment made by the Debtors on both Agreements was on December 9, 1994.

2. The initial term of the Agreements was one week. Rent for the initial term, and for each renewal term, was to be paid in advance. At the end of the initial term, the Debtors could renew the Agreements for an additional term by paying rent for an additional term in advance.

3. The Agreements could be terminated at any time by the Debtors by returning the property to Rent-A-Center.

4. Rent-A-Center at all times retained ownership of the property pursuant to the Agreements. Ownership of the property would be transferred to the Debtors after receipt of all payments due under the Agreements.

5. The Agreements contained an early purchase option in which the Debtors could elect to purchase the property any time after the first rental payment by paying 55% of the difference between the total of payments and the total amount of rent the Debtors had paid on the account.[1]

6. The early purchase option has not been exercised by the Debtors. If the early purchase option had been exercised by the Debtors at the time of the filing of the bankruptcy petition, the Debtors would have been able to purchase the ring for $229.63 (55% of $417.50) and the T.V., V.C.R. and Stereo for $1,521.86 (55% of $2767.01).

7. The Debtors filed a joint Chapter 13 petition on December 22, 1994. The Debtors'

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[1]There was no evidence presented as to the current value of the subject property.

Chapter 13 Plan attempts to treat the claim of Rent-A-Center as a secured claim. Rent-A-Center filed an objection to the confirmation of the Chapter 13 Plan.

CONCLUSIONS OF LAW

The determination of property rights in the assets of a bankrupt's estate is generally a matter of state law. Butner v. United States, 440 U.S. 48, 54, 99 S.Ct. 914, 917-18, 59 L.Ed.2d 136 (1979). South Carolina Code §36-1-201(37)[2] sets forth the standards for determining whether an agreement is a lease or a security agreement. A security interest is defined by South Carolina law as "an interest in personal property or fixtures which secures payment or performance of an obligation... Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security." Section 36-1-201(37).

Section 37-2-701(6) defines a consumer rental-purchase agreement as an agreement for the use of personal property by an individual primarily for personal, family, or household purposes, for an initial period of four months or less (whether or not there is any obligation beyond the initial period) that is automatically renewable with each payment and that permits the consumer to become the owner of the property. The term does not include a consumer credit sale as defined in § 37-2-104, or a consumer loan as defined in § 37-3-104, or a refinancing or

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[2]Further reference to the South Carolina Code of Laws, Annotated, shall be by section number only.

consolidation thereof, or a consumer lease as defined in § 37-2-106. South Carolina law further provides that the lessor must disclose certain items in a consumer rental-purchase agreement[3] and must provide that "at any time after the lessee has made the first periodic payment, the lessee may: (1) return the rented property to the lessor, (2) continue making periodic payments or renewals as provided for in the agreement for the remaining term of the agreement, or (3) purchase the property by tendering fifty-five percent of the difference between the total of scheduled payments and the total amount paid on the account." § 37-2-713. The Agreements

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[3] § 37-2-702(1) states that:

(1) In a consumer rental-purchase agreement, the lessor shall disclose the following items, as applicable:

(a) The total of scheduled payments.

(b) The number, amounts, and timing of all payments including taxes paid to or through the lessor necessary to acquire ownership of the property.

(c) A statement that the lessee will not own the property until the lessee has made the number of payments and the total of scheduled payments necessary to acquire ownership of the property.

(d) A statement that the total of payments does not include other charges, such as late payment charges, and that the consumer should see the contract for an explanation of these charges.

(e) If applicable, a statement that the lessee is responsible for the fair market value of the property if and as of the time it is lost, stolen, damaged, or destroyed.

(f) A statement indicating whether the property is new or used, provided, it is not a violation of this section to indicate that the property is used if it is actually new.

(g) A statement that at any time after the first periodic payment is made, the lessee may acquire ownership of the property by tendering fifty-five percent of the difference between the total of scheduled payments and the total amount paid on the account.

(h) The administrator of the Department of Consumer Affairs may promulgate regulations setting requirements for the order and conspicuousness of the disclosures set forth in subitems (a) through (h) of this section. These regulations may allow these disclosures to be made in accordance with model forms prepared by the administrator.

appear to comply with these sections of the South Carolina statutes. However, such compliance is not determinative of the issue of whether these documents constitute security agreements or leases.

Regardless of the label the parties put on an agreement, the determination of the nature of the agreement should be made on the facts of each case. The parties characterization of the agreement is not controlling, the court should instead apply an objective standard to the facts of each case to determine "the true relationship and economic realities created by the agreement." Compliance Marine, Inc. v. Campbell (In re Merritt Dredging Co.), 839 F.2d 203 (4th Cir. 2/12/88). In Merritt Dredging, the Fourth Circuit found that the parties to a barge charter agreement intended for the agreement to be a security agreement, in that the agreement allowed the charterer to purchase the barge for no additional consideration after twelve monthly "rental" payments, even though there was no obligation on the charterer to renew the three-month "lease".

In its findings, the Fourth Circuit held:

> Whether a putative lease actually represents a security agreement depends primarily upon the intent of the parties. S.C. Code Ann. § 36-1-201(37). The intent of the parties must be measured by the application of an objective standard to the facts of each case. 1 G. Gilmore, Security Interests in Personal Property §11.2 at 338 (1965). The parties' characterization of the charter party as a lease is not controlling, e.g., Percival Construction Co. v. Miller & Miller Auctioneers, Inc., 532 F.2d 166, 171 (10th Cir.1976), and we accordingly look to "the true relationships and economic realities created by the agreement" to determine the interests conveyed by it. Sight & Sound of Ohio, Inc. v. Wright, 36 B.R. 885, 889 (S.D. Ohio 1983).

Merritt Dredging, Id. at 208, 209.

In applying the "economic realties" test propounded by the Fourth Circuit in the Merritt Dredging opinion, this Court in the decision of In re Barnhill, No. 92-73678, slip op. (Bankr.

D.S.C. 12/23/92), held that "the main factor to be considered in determining whether an agreement is a security agreement or a true lease is whether the debtor has acquired sufficient equity in the property by making payments under the agreements so that at the end of the contractual terms it can reasonably be anticipated that the debtor will exercise the option to pay the nominal consideration necessary to purchase the property." If a debtor can become the owner of the property for a nominal consideration, then the agreement is probably a security agreement and not a lease. Other factors this Court has considered to make this determination include the following:

1. Whether the lessee may terminate the agreement without paying a sum certain or further obligation. In re Frady, 141 B.R. 600 (Bankr. W.D.N.C. 1991); In re Huffman, 63 B.R. 737 (Bankr. N. D. Ga. 1986); In re Pledger Roy Wood, 7 B.R. 543 (Bankr. N. D. Ga. 1980); In re Barnhill, 92-73678 (Bankr. D.S.C. 12/23/92).

2. Whether the lessee is obligated to maintain and repair the property. In re Moreggia & Sons, Inc., 852 F. 2d 1179 (9th Cir. 1988); In re Puckett, 60 B.R. 223 (Bankr. M.D. Tenn. 1986), aff'd 838 F. 2d 471 (6th Cir. 1988); In re Brookside Drug Store, Inc., 3 B.R. 120 (Bankr. D. Conn. 1980); In re Simpson Creek Development, 90-03836 (Bankr. D.S.C. 8/5/92); In re Barnhill, supra.

3. The total amount of the payments under the agreement as compared to the value of the property. In re W.B. Easton Construction, Co., 89-02817 (Bankr. D.S.C. 1/19/90); In re Puckett, supra; In re Powers, 43 B.R. 112 (Bankr. E.D. Mo. 1984); In re Barnhill, supra; In re Arthur, 93-72205 (Bankr. D.S.C. 9/17/93).

4. Whether the property has a useful life in excess of the economic value to the lessor. In re Puckett, supra; In re Celeryvale Transport, Inc., 44 B.R. 1007, 1014 (Bankr. E.D. Tenn. 1984); In re Barnhill, supra; In re Arthur, supra.

5. Whether the debtor acquires any equity in the property by making payments under the agreement. In re W.B. Easton Construction, Co., supra; In re Powers, supra; In re Barnhill, supra; In re Arthur, supra.

6. Whether the agreement requires the lessee to be responsible for the payment of any taxes, insurance, maintenance, repairs and other charges normally associated with ownership. In re W.B. Easton Construction, Co., supra; In re Johnson, 94-71254 (Bankr. D.S.C.

9/14/94); In re Simpson Creek Development, 90-03836 (Bankr. D.S.C. 8/5/92); Compliance Marine, Inc. v. Campbell (In re Merritt Dredging Co.), supra; In re Johnson, 94-71254 (Bankr. D.S.C. 9/14/94); In re Barnhill, supra; In re Arthur, supra.

7. Whether the lessor is in the business of leasing such equipment. In re Simpson Creek Development, supra; In re Teel, 9 B.R. 85 (Bankr. N.D. Tx 1980); In re Barnhill, supra.

8. Whether the lessor assumes the risk of any loss. In re Simpson Creek Development, Supra; In re Brower, 104 B.R. 226 (Bankr. D. N.D. 1988); In re Teel, supra; In re Barnhill, supra.

9. The sophistication of the parties. In re Arthur, supra.

Rent-A-Center has stipulated that the facts and issues in this case are significantly the same as discussed in Barnhill and Arthur[4]. As in Barnhill, the clear and unambiguous Agreements within specifically provide that the Debtors will have acquired sufficient equity in the property by making payments under the Agreements so that at the end of the contractual terms it can reasonably be anticipated that the debtor will exercise the option to pay the nominal consideration necessary to purchase the property. This is true even in regards to the second Agreement involving the T.V., V.C.R. and Stereo, of which the Court is especially concerned. Under that Agreement, the Debtors have only made one payment of $31.99 and must pay $2,767.01 before the ownership of the property vests in the Debtors. However, as this Court interprets Barnhill, the test to be applied is whether the Debtors will have acquired enough equity in the property by the end of the term wherein it can be reasonably anticipated that a debtor will make the final payment to gain ownership. In the within proceeding, because there is no final balloon payment and the Debtors could become the owners of the property by simply making the

[4] This Court notes that the appeal of the In re Arthur decision is currently pending in the United States District Court for the District of South Carolina, C/A No. 4:93-3251-2.

final weekly payment, it can be reasonably anticipated that the Debtors will make that payment. Additionally, the Agreements also provide that the Debtors may chose the early purchase option and purchase the property by making a payment of 55% of the difference between the total of payments and the total amount of the rent that has been paid, concluding that the Debtors acquire more equity in the property with each payment. Even though the Debtors have only paid $31.99 on the second Agreement out of a total of $2,799.00, the Debtors can elect to purchase the property for $1,521.86 thereby effectively creating $1,277.14 in equity by making the one payment.

Additionally, similar to the findings in Barnhill, the Debtors have the option to terminate the Agreements without paying a sum certain or further obligation. Rent-A-Center is obligated to maintain and repair the property in good working order; however, the Debtors remain liable for any damage in excess of normal "wear and tear".

Rent-A-Center does not dispute the presence of sufficient factors to meet the "economic realities" test propounded by Merritt Dredging and Barnhill, but has asked the Court to adopt the Seventh Circuit's position in Keith Alan Powers v. Royce, Inc., d/b/a Royce Rentals (In re Powers), 983 F.2d 88 (7th Cir. 1993). In Powers, the Seventh Circuit following Matter of Marhoefer Packing Co., Inc., 674 F.2d 1139 (1982), held "that an agreement... that included two options to purchase the equipment in question was a true lease and that where a lessee has the right to terminate the lease before the option arises to purchase the property for no additional or nominal consideration, the lease is a true lease and cannot be a conditional sale". The Seventh Circuit based its ruling upon the fact that under the agreement, the lessee was under no obligation to make the installment payments that would ultimately allow the lessee to exercise the right to

purchase the property. "This feature of the contract lead this Court to conclude that clause (b) of UCC § 1-201(37) did not apply. Marhoefer, 674 F.2d at 1143. In other words, because the lessee could terminate the lease at any time, the presence of an option to acquire the goods for a nominal price did not convert the leases into installment sales." Powers, Id at 91. The Seventh Circuit recognized that for lessees who are renting furniture with the intention of eventually owning the property, the agreements function as secured installment sales as long as all of the payments were made. The Seventh Circuit noted however, that

> [U]nlike buyers in standard installment sales...hybrid "rental-buyers" are not obligated to make payments, and they can change their minds and return their furniture at any time. This flexibility is not worthless, and in return [the creditor] earns the benefits of a lease when some of its renter-buyers become insolvent.

Powers, Id at 91. While the reasoning of the Powers decision is appealing, this Court feels that in this instance, the precedent established in this Districit in Barnhill and Arthur in interpreting Merritt Dredging should be followed.

In the Merritt Dredging decision the Fourth Circuit reiterated that

> The obligation of a "lessee" to pay the full purchase price need not be express; a security agreement may be indicated where it can reasonably be anticipated that an option to purchase will be exercised. Sight & Sound, 36 B.R. at 889; 839 F.2d 203; In re Peacock, 6 B.R. at 925-26. Because its payments were all credited toward the purchase price, [the debtor] acquired substantial "equity" in the [property], which would be lost if it failed to exercise its purchase option. See In re Joe Necessary and Son, Inc., 475 F. Supp. at 614 & n. 8. The pressures to purchase indicate that the parties intended the charter party as a conditional sale.

Merritt Dredging, Id. at 209, 210.

Under the creditor's argument, pursuant to 11 U.S.C. § 365, in order to keep the property, the Debtors would have to assume the Agreements. If the Agreements are assumed, the arrears

would then have to be brought current. If the leases are rejected, the creditor would recover its property. However, by finding that these Agreements are security agreements, a creditor would still receive the value of its collateral (as set by the Plan or a valuation order of the Court) through the Chapter 13 Plan. In the within proceeding, the Debtors propose that Rent-A-Center's claim be paid in full with 8.5 % interest.

Based upon the objective "intent of the parties" test propounded by Merritt Dredging, finding that these are security agreements and allowing the Debtor to retain possession while continuing to make payments to the creditor would result in the situation most closely contemplated by the original intent of the parties.

"[R]egardless of the terms of a written agreement a court sitting in equity may look to the practices, objectives, relationship, and intention of the parties in determining the true meaning of a document. In re Simpson Creek Development, Inc." In re Arthur, supra. Based upon the presence of sufficient factors to meet the Merritt Dredging "economic realities" test and the precedent set by this Court in Barnhill and Arthur, this Court must conclude that the Agreements are security agreements and not true leases.

CONCLUSION

Based upon the stipulation by Counsel for Rent-A-Center that the facts within are identical to the facts in Barnhill and Arthur, this Court follows the precedent set by this line of cases and finds that the "rent-to-own" Agreements are security agreements and not leases. For the reasons stated within, it is therefore,

ORDERED, that the objection to the confirmation of the Chapter 13 Plan of Reorganization filed by Rent-A-Center is overruled.

AND IT IS SO ORDERED.

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
April 25, 1995.