

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 02-30286

MARK DAVID THOMAS
DEBORAH ANNETTE THOMAS
a/k/a DEBORAH ANNETTE CONNER

Debtors

MEMORANDUM ON OBJECTION TO PLAN

APPEARANCES: BOND, BOTES & LAWSON, P.C.
Cynthia T. Lawson, Esq.
5414 Clinton Highway
Knoxville, Tennessee 37912
Attorneys for Debtors

GWENDOLYN M. KERNEY, ESQ.
Post Office Box 228
Knoxville, Tennessee 37901
Chapter 13 Trustee

THOMAS PRIVETTE, JR., ESQ.
3214 Tazewell Pike
Suite 102
Knoxville, Tennessee 37918
Attorney for Rowland Electronics, Inc.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

On May 15, 2002, the court held a confirmation hearing on the March 4, 2002 Objection to Confirmation by Chapter 13 Trustee (Objection). Also before the court was the "Objection to Objection of Chapter 13 Trustee to Confirmation of Original Plan" (Rowland Objection) filed on March 12, 2002, by Rowland Electronics, Inc., d/b/a Rowland TV and Appliance (Rowland).¹ At issue is the true nature of a "Rental Purchase Agreement" and "Bill of Sale" executed between Rowland and the Debtors.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(L) (West 1993).

I

The Debtors' Chapter 13 Plan filed on January 22, 2002, originally proposed to pay Rowland in full outside the Plan under a prior "Rent to Own" arrangement. However, the "Modified Chapter 13 Plan Prior to Confirmation" (Amended Plan) filed on March 7, 2002, now offers Rowland only a 20% - 70% dividend as an unsecured creditor.

The Debtors' relationship with Rowland is evidenced by the above-referenced Bill of Sale and Rental Purchase Agreement. The Bill of Sale was executed on June 21, 2001, and according to its terms the Debtors "agree[d] to sell" Rowland the following items of personal property for \$1,325.00:

1. Three computers;

¹ The Chapter 13 Trustee argues that the Rowland Objection should be stricken as an untimely objection to confirmation. See E.D. Tenn. LBR 3015-3. The Rowland Objection, despite its lengthy caption, supports the Debtors' treatment of Rowland under the original plan and is in substance merely a response to the Chapter 13 Trustee's Objection. However, because the Debtors' amended Plan changes the treatment accorded Rowland under the original plan and appears to cure the Chapter 13 Trustee's Objection by treating Rowland as a nonpriority unsecured creditor, the court will deem Rowland's Objection as an objection to the Amended Plan.

2. One printer;
3. One scanner;
4. Three televisions;
5. Two VCR's; and
6. One stereo.

The Rental Purchase Agreement, dated October 25, 2001, provides for the Debtors' "lease" of a related list of items² for a bi-monthly rental term. The rent is set at \$166.66 per month or \$38.49 per week. The Agreement further provides that if the Debtors "choose to rent to own [they] must renew this lease" for 12.5 additional months at either \$188.74 per month or \$43.59 per week, for a purported total cost of approximately \$2,359.00. The Agreement also lists an illegible "Cash Price" for the property and provides an "Early Purchase Option."³

Four prior Rental Purchase Agreements between the parties, similar in content and form, were introduced into evidence at the confirmation hearing. Also at the hearing, the court heard the testimony of Debtor Deborah Annette Thomas and Janie Yoder, Rowland's Manager. These two witnesses were in agreement as to the material facts relating to the Rental Purchase Agreement and Bill of Sale.

In June 2001, the Debtors were in need of money. They contacted Rowland, which sent a representative to their home. Based on the representative's evaluation of the Debtors' personal

² The Lease Purchase Agreement, which makes no reference to any addendum, provides that the "rental property" consists of six computers and a printer/scanner. An "Addendum to Rental Purchase Agreement" attached to the Agreement inventories the rented items as at least four computers, a printer/scanner, three televisions, two VCR's, a stereo, a washing machine, a dryer, and a living room suite.

³ Under the "Early Purchase Option," the Debtors "may purchase the property any time before the last 90 days of this agreement by the payment of 55.00% of the remaining Total Cost calculated at that time."

property, Rowland "bought" the items listed in the Bill of Sale for \$1,000.00.⁴ The parties simultaneously executed a June 21, 2001 Rental Purchase Agreement whereby the Debtors purportedly leased a related list of items from Rowland.⁵

In October 2001, the Debtors again found themselves in need of money. They again contacted Rowland, who "paid" them an additional \$325.00. The Debtors then executed the October 25, 2001 Lease Purchase Agreement presently at issue, which includes a repackaging of the Debtors' June 2001 obligations.

II

Rowland argues that the present Rental Purchase Agreement is a legitimate lease arrangement. The Chapter 13 Trustee, however, objects that the Agreement is in fact a "predatory and usurious" unsecured loan⁶ that should be treated in the same manner as all other unsecured debts under the Debtors' Plan.

The Tennessee Rental-Purchase Agreement Act, designed to require "adequate cost disclosures," was passed following a legislative finding "that a significant number of consumers

⁴ The Bill of Sale contains a \$1,325.00 "purchase price." Inexplicably, however, only \$1,000.00 was initially "paid" to the Debtors.

⁵ The June 21, 2001 Rental Purchase Agreement lists six computers and a printer/scanner. Three of the computers are inventoried by Rowland as Unit # 14988. The same Unit Number appears on "Addendum #1" to the Bill of Sale. The other three computers are listed on the June 21, 2001 Agreement as Unit # 14994. This Unit Number cannot be cross-referenced to the Bill of Sale Addendums, and its contents are therefore unknown.

⁶ "Usury" is the collection of interest in excess of the maximum amounts authorized by law. TENN. CODE ANN. § 47-14-102(11) (2001). With exceptions not relevant herein, the maximum annual interest rate allowed on loans in Tennessee is 10%. See TENN. CODE ANN. § 47-14-103. The Chapter 13 Trustee alleges that, over the course of various "leases" with Rowland, the Debtors have been charged between 88% and 267% interest per annum.

have sought to acquire ownership of personal property through rental-purchase agreements.”

TENN. CODE ANN. § 47-18-602 (2001). The Act defines a “rental-purchase agreement” as:

an agreement for the use of personal property by a natural person primarily for personal, family, or household purposes, for an initial period of four (4) 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.

TENN. CODE ANN. § 47-18-603(7) (2001).

The October 25, 2001 Lease Purchase Agreement, on paper, resembles this statutory definition. According to Rowland, the Agreement is one for the use of personal property by natural persons, primarily for personal, family, or household purposes,⁷ for an initial period of less than four months, that automatically renews with each payment and permits the Debtors to eventually gain ownership of the property.⁸ Nonetheless, despite its caption and form, the court finds the Agreement in substance to be merely a thinly disguised loan.

Courts must “disregard the form of the transaction and look to the substance of the dealings between the parties.” *Lake Hiwassee Dev. Co., Inc. v. Pioneer Bank*, 535 S.W.2d 323, 325 (Tenn. 1976); *accord Halco Fin. Servs., Inc. v. Foster*, 770 S.W.2d 554, 556 (Tenn. Ct. App. 1989) (“[A]greements purporting to be leases will be examined closely to be certain that they are not being used as a cloak for usurious charges”) (citation omitted). “Regardless of what

⁷ The Debtors use their computer equipment in both a business and a personal capacity, although it is unclear which is the primary use.

⁸ The Chapter 13 Trustee contends that the Agreement is invalid because it allegedly fails to meet numerous disclosure requirements. *See generally* TENN. CODE ANN. § 47-18-604 (2001). However, such shortcomings do not affect the Agreement’s status as a “rental-purchase agreement” under Tennessee law. *See In re Osborne*, 170 B.R. 367, 369-70 n.2 (Bankr. M.D. Tenn. 1994). Instead, Rowland would only be subject to potential civil liability for the violations. *See id.*; TENN. CODE ANN. § 47-18-611 (2001).

anything may be called it remains what it is.” *Morton Pharms., Inc. v. McFarland*, 368 S.W.2d 756, 757 (Tenn. 1963) (citation omitted). “If executed and delivered in the course of a valid business transaction, [an agreement] is not considered a loan; but if it is made for the purpose of raising money, then the form will be disregarded and it will be treated as a loan.” *Lake Hiwassee*, 535 S.W.2d at 326.

In *Halco*, the defendant sold his furniture and tools to the plaintiff financial company. The parties also entered into a “master lease agreement” whereby the defendant would “lease” the items back to the defendant in exchange for 81 monthly payments. *Halco*, 770 S.W.2d at 555. The *Halco* court looked beyond the form of the “master lease agreement” and found that “[t]his transaction, in substance, is a loan, with its terms carefully tailored by the plaintiff to avoid the application of the usury statute.” *Id.* at 556.

The *Osborne* case, cited by Rowland, is readily distinguishable. At issue in *Osborne* was whether two contracts through which the debtor *acquired* a dryer and refrigerator were true rental-purchase leases or instead conditional sales agreements creating a security interest. *See Osborne*, 170 B.R. at 368. The facts of *Osborne* stand in sharp contrast to *Halco* and the present case, where the “lessees” offered property that they already owned as *de facto* collateral in order to raise money.

As noted, the Tennessee Rental-Purchase Agreement Act speaks to transactions through which a consumer seeks to “acquire ownership of personal property.” *See* TENN. CODE ANN. § 47-18-602 (emphasis added). The evidence clearly establishes that the Debtors “acquired”

nothing through their various Rental Purchase Agreements. None of the “rent to own” items originated with Rowland nor did any item ever physically leave the Debtors’ home. The subject transactions were, in truth, “pawn shop” type loans whereby the Debtors: (1) offered collateral; (2) received funds; and (3) incurred an obligation to either repay the debt or forfeit their pledged property. Rowland’s “rent to own” scheme, despite incorporating certain terms of the Tennessee Rental-Purchase Agreement Act, is merely a transparent game of semantics designed “to avoid the application of the usury statute.” *Halco*, 770 S.W.2d at 556. Such subterfuge has no place in a confirmable Chapter 13 plan.

The Objection to Confirmation by Chapter 13 Trustee will therefore be sustained and Rowland’s Objection will be overruled.⁹ The loan evidenced by the October 25, 2001 “Rental Purchase Agreement” is unsecured¹⁰ and must be treated in the same manner as the Debtors’ other

⁹ Although the Debtors’ March 7, 2002 Amended Plan appears to resolve the Chapter 13 Trustee’s Objection, the court has nonetheless chosen to deal with the issue before it in the context of that Objection. *See supra* n.1.

¹⁰ No security agreement was executed or filed nor does Rowland hold a purchase-money security interest. *See* TENN. CODE ANN. § 47-9-103(a)(2) (2001) (A “purchase-money obligation” is incurred by a consumer in order to “acquire rights in or the use of” collateral.) (emphasis added).

unsecured debts pursuant to 11 U.S.C.A. § 1322 (West 1993 & Supp. 2001). The Debtors' Amended Plan will accordingly be confirmed.

FILED: June 4, 2002

BY THE COURT

/s/

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 02-30286

MARK DAVID THOMAS
DEBORAH ANNETTE THOMAS
a/k/a DEBORAH ANNETTE CONNER

Debtors

ORDER

For the reasons stated in the Memorandum on Objection to Plan filed this date, the court directs the following:

1. The Objection to Confirmation by Chapter 13 Trustee filed March 4, 2002, by the Chapter 13 Trustee, Gwendolyn M. Kerney, is SUSTAINED.
2. The Objection to Objection of Chapter 13 Trustee to Confirmation of Original Plan filed March 12, 2002, by Rowland Electronics, Inc., d/b/a Rowland TV and Appliance, is OVERRULED.
3. The Debtors' "Modified Chapter 13 Plan Prior to Confirmation" filed March 7, 2002, will be confirmed. The Chapter 13 Trustee will submit appropriate confirmation documents within ten (10) days.

SO ORDERED.

ENTER: June 4, 2002

BY THE COURT

/s/

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE