UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF KENTUCKY

In re:

SAUNDRA M. WILLIAMS Case No. 07-30414

Debtor Chapter 13

ORDER

THIS CORE PROCEEDING[1] comes before the Court on the Motion to Alter or Amend Confirmation, filed by Fairway Leasing LLC d/b/a Aaron's Sales and Lease ("Aaron's"), on grounds that the Order Confirming the Chapter 13 Plan for Saundra Williams, the debtor in this case ("Debtor"), erroneously treated three rent-to-own contracts entered between the Debtor and Aaron's as installment sales contracts rather than executory contracts in contravention of 11 U.S.C. § 365. Aaron's argues that the contracts at issue are executory contracts that must be either assumed or rejected. In her Objection to Fairway Leasing's Motion to Alter or Amend the Order of Confirmation, the Debtor argues that the three contracts were not truly executory, despite each being labeled as a "Lease Agreement," and, accordingly, the provisions of 11 U.S.C. § 365 requiring either assumption or rejection are inapplicable. The parties, through their attorneys, stipulated that they had entered into the three contracts at issue and rested on the pleadings, and the Court took the matter under submission on June 8, 2007. This Court finds that the contracts at issue here are executory contracts which the Debtor must either assume or

[1]28 U.S.C. § 157(b)(2)(A) & (B).

reject. Accordingly, Aaron's Motion to Alter or Amend Confirmation is GRANTED.

FACTS

The Debtor filed a Chapter 13 bankruptcy petition and plan on February 9, 2007. In her Chapter 13 plan, the Debtor characterized as a Secured Claim Not Subject to Valuation Under § 506, *inter alia*, an allowed secured claim in the amount of $3,080 to Aaron's covering the three separate contracts with Aaron's. These three contracts covered the following household goods: a contract for a washer and dryer, entered on January 25, 2006; a contract for a Dell personal computer and fifteen-inch monitor, entered on February 10, 2006; and a contract for a bedroom suite, including a headboard, night stand, and dresser with a mirror, entered on March 7, 2006.

The material provisions of the contracts are as follows: each contract contains identical language, except for portions describing the property covered. Under each contract, the Debtor must pay a specified fee for the use of the property for an "Initial Lease Term" of one month. This fee is itemized and includes amounts attributable for rent, a "Service Plus Fee," and tax. For seventeen months thereafter, the Debtor may choose to renew the agreement for another one-month term by making another payment identical in amount to the fee due for the first month. If the Debtor makes each of eighteen payments due under the contract on time, she will own the property outright. The Debtor, however, may also terminate the agreement without penalty at any time by returning or surrendering the property to Aaron's, provided any delinquent payments are paid. Additionally, each contract specifies a "Total Cost to Own," calculated by multiplying the amount of the equal monthly fees by eighteen—the "Total Number of Payments to Own." At any time prior to the completion of eighteen months, the Debtor may pay the Total Cost to Own,

less any monthly payments already made, and obtain title to the property with no penalty. Under these contracts, Aaron's is required to repair or replace any property damaged as a result of normal wear-and-tear, as well as any property damaged by fire, flood, windstorm, or other "Act of God." The Debtor is responsible for the property if it is stolen or otherwise "lost or destroyed."

On March 29, 2007, this Court entered an order confirming the Debtor's sixty month, 100% plan. Under the plan as confirmed, Aaron's has a $1,750 secured claim with the remaining outstanding debt under the contracts as an unsecured nonpriority claim.

On April 6, 2007, Aaron's filed a Motion to Alter or Amend Confirmation on grounds that the plan could not properly be confirmed under 11 U.S.C. § 1325(a)(1) and (3) because the three contracts are executory contracts under 11 U.S.C. §§ 365 and 506 that must either be assumed or rejected. On April 30, 2007, the Debtor filed an Objection to Fairway Leasing's Motion to Alter or Amend the Order of Confirmation on grounds that the three contracts, though self-described leases that bear some resemblance to leases, are actually installment sales contracts, and their treatment in the plan does not, therefore, run afoul of 11 U.S.C. § 1325.

Each of the three contracts at issue were identical, except that each covered a different product and had different dollar amounts. The contracts entered between the Debtor and Aaron's are attached to Aaron's Reply to Objection to Motion to Amend Order of Confirmation to Provide for Assumption/Rejection of Executory Contracts with Fairway Leasing as Exhibit A.

CONCLUSIONS OF LAW

Under 11 U.S.C. § 365, the debtor, with the Court's approval, may either assume or reject

any executory contract or unexpired lease to which the debtor is a party. 11 U.S.C. § 365(a). Although the Bankruptcy Code provides no explicit definition for an executory contract, "the legislative history to § 365 indicates that Congress intended the term to mean a contract on which performance is due to some extent on both sides." *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 522 n.6, 104 S.Ct. 1188, 1194 n.6, 79 L.Ed.2d 482 (1984) (quotations omitted). The outstanding duties on both sides of the contract must be "so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." *Terrell v. Albaugh (In re Terrell)*, 892 F.2d 469, 471 n.2 (6th Cir. 1989) (quoting Countryman, *Executory Contracts in Bankruptcy: Part 1*, 57 Minn. L. Rev. 439, 460 (1973)). Both federal and state law inform the courts as to whether a particular contract is executory.

> Although whether a given contract is executory under the Bankruptcy Act is an issue of federal law . . . , the question of the legal consequences of one party's failure to perform its remaining obligations under a contract is an issue of state contract law. While the principles of contract law do not differ greatly from one jurisdiction to another, to the extent that they do, a bankruptcy court should determine whether one of the parties' failure to perform its remaining obligations would give rise to a "material breach" excusing performance by other party under the contract law applicable to the contract.

Baldrian v. Perry (In re Cochise College Park, Inc.), 703 F.2d 1339, 1348 n.4 (9th Cir. 1983) (cited with approval in *Terrell*, 892 F.2d at 471-72).

Under Kentucky law, a contract for the conveyance of personal property is executory if title is to pass "at some time in the future upon the performance of certain additional acts of the seller. . . . It would seem the true test is as to the intention of the parties." *Lam v. White*, 264 S.W. 1113, 1115 (Ky. 1924); *see also Trinity Temple Charities v. City of Louisville*, 188 S.W.2d 91, 94 (Ky. 1945) ("The purpose, rather than the name given to a contract by the parties, controls."). This Court must consider the totality of the circumstances in determining the intent

of the parties and whether the contracts at issue were actually executory.

This Court finds it significant that the contracts at issue specifically stated the circumstances under which an ownership interest, rather than a mere leasehold interest, would pass from Aaron's to the Debtor. Each contract contained the following provision on the first page:

> Ownership: I will not own nor obtain any equity interest in the Leased Property until I have either made the Total No. of Payments to Own and paid the Total Cost to Own or exercised my early purchase option.

The parties' intent that further performance was required under the contracts before the Debtor would have any ownership interest in the pieces of property at issue is evidenced by this provision.

Moreover, the Debtor and Aaron's both have numerous additional outstanding obligations. The Debtor must make payments in order to renew her lease of the property for a new monthly term, and Aaron's must perform maintenance on the property to keep it in regular working order. Although the Debtor retains the right to purchase the property for a pre-determined amount so long as she continues her payments under the contract, she may terminate the contract at any time without penalty, provided she is not delinquent on any rental payments. Furthermore, Aaron's bears the risk of loss for damage to the property caused by normal wear and tear, fire, flood, windstorm, "or other Act of God." The Debtor bears the risk of loss if the property is lost, stolen, or destroyed by anything other than the aforementioned causes. The risk of loss from all causes would shift to the Debtor only if/when the Debtor paid the pre-determined outstanding purchase price for the property, effectively terminating the rental portion of the rental-purchase agreement and extinguishing Aaron's ownership interest altogether.

Additionally, in the event the Debtor moves within fifteen miles of the Aaron's location from which the property was acquired, Aaron's must relocate and set up the leased property in the Debtor's new residence at no additional charge. The Debtor rightly emphasizes that a contract is not executory when the only outstanding obligation is the payment of money, but the foregoing description constitutes significantly more obligations on both sides of the agreement.

Furthermore, the contracts comply with the Kentucky statutory provisions governing rental-purchase agreements, which are "sufficiently executory to fall within [11 U.S.C. §] 365." *In re Knowles*, 253 B.R. 412, 416 (Bankr. E.D. Ky. 2000); *see also In re Stellman*, 237 B.R. 759, 764 n.15 (Bankr. D. Idaho 1999); *In re Trusty*, 189 B.R. 977, 980-81 (Bankr. N.D. Ala. 1995). The term "rental-purchase agreement" is defined in KRS 367.976 as follows:

> (7) "Rental-purchase agreement" means 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. The term rental-purchase agreement shall not be construed to be, nor be governed by, any of the following:
>
> . . .
>
> (f) A security interest as defined in KRS 355.1-201(37) . . . .

The contracts not only fall within the definition in KRS 367.976 but also comply with the other statutory directives governing rental-purchase agreements. *See* KRS 367.977 (required disclosures in a rental-purchase agreement); KRS 367.979 (prohibited provisions in a rental-purchase agreement); KRS 367.980 (required provisions in a rental-purchase agreement). Although the contracts' compliance with the directives of KRS 367.979 and .980 does not prove that the contracts in question are rental-purchase agreements under KRS 367.976, it does support

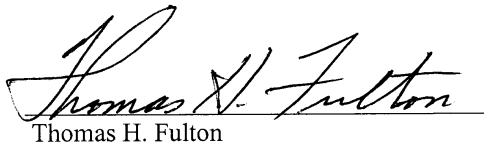
Aaron's claim that the parties intended to enter such agreements, especially when the language of certain provisions in the contracts mirrors that in the governing statutes.

The Debtor relies on *South Carolina Rentals, Inc. v. Arthur*, 187 B.R. 502 (D.S.C. 1995), in support of her argument that the agreements at issue are disguised installment sales contracts rather than true leases. *South Carolina Rentals v. Arthur* held that rental-purchase agreements are to be treated as disguised installment sales contracts, reasoning that the terms of the agreements in question create a "significant economic compulsion for the putative lessee to continue making payments," effectively rendering illusory the option not to continue making payments to the full purchase price. *S.C. Rentals, Inc. v. Arthur*, 187 B.R. at 505; *see also In re Merritt Dredging Co.*, 839 F.2d 203, 209-10 (4th Cir. 1988); *In re Burton*, 128 B.R. 807, 814-15 (Bankr. N.D. Ala. 1989). The state statute at issue in *South Carolina Rentals* and other states following that approach are distinguishable from Kentucky's statute governing rental-purchase agreements in that KRS 367.976(7)(f) displaces rental-purchase agreements from the purview of Kentucky's analogue to the Uniform Commercial Code, KRS 355.1-201 *et seq*. *See In re Knowles*, 253 B.R. at 415; *see also In re Stellman*, 237 B.R. 759, 762 (Bankr. D. Idaho 1999); *In re Osborne*, 170 B.R. 367, 369 (Bankr. M.D. Tenn. 1994) ("If this Court applied Judge Lundin's analysis in [*Consumer Lease Network, Inc. v. Puckett (In re Puckett)*, 60 B.R. 223 (Bankr. M.D. Tenn. 1986)] to the facts of this case, the court would reach the same conclusion. . . . However, in response to the 1986 *Puckett* decision, the Tennessee legislature in 1987 . . . passed the Tennessee Rental-Purchase Agreement Act . . . , which specifically exempted a 'rental-purchase agreement' from being construed as a conditional sale creating a security interest.").

Accordingly, this Court finds that, considering the totality of the circumstances

surrounding the rental-purchase agreements entered into between the Debtor and Aaron's, the three contracts in question are sufficiently executory under 11 U.S.C. § 365 such that they must either be assumed or rejected.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that Aaron's Motion to Alter or Amend Confirmation is hereby GRANTED.



Thomas H. Fulton
United States Bankruptcy Judge

Dated: June 25, 2007