

Renting-to-Own: Exploitation or Market Efficiency?

Eligio Pimentel*

Introduction

The social value of Rent-To-Own (RTO) contracts¹ can be evaluated by carefully navigating between the Scylla of free market economics and the Charybdis of governmental regulation. This course is best charted by striking a balance between the conflicting policy rationales of equality and market efficiency.² On the one hand, the United States has always taken great pride in its tradition of free market competition. Capitalism has relied on what Adam Smith once called "the invisible hand,"³ to ensure the efficient operation of its markets. These efficient markets have, in theory, allowed the U.S. to prosper and its people to flourish.

On the other hand, the idea that all people are entitled to be treated equally and fairly pervades American history. Although ec-

* B.S., Stanford University, 1988. J.D., University of Minnesota, 1995. I would like to thank David Ramp of the Legal Aid Society of Minneapolis for his many insights and help; any mistakes or omissions are strictly those of the author. I would also like to thank my wife, Ellen Efron Pimentel, for her comments, love and support.

1. A lease-purchase or "rent-to-own" (RTO) contract is a contract which allows a person to use a particular product, usually a consumer good, in exchange for an agreed upon number of payments during a "lease" period. See James P. Nehf, *Effective Regulation of Rent-to-Own Contracts*, 52 OHIO ST. L.J. 751, 751-57 (1991). At the end of the "lease" period, a person is typically given the option of obtaining title to the good for either nominal or no additional consideration. *Id.*

2. One of the major socioeconomic tradeoffs pervading social policy involves the tradeoff between equality and efficiency. See ARTHUR M. OKUN, *EQUALITY AND EFFICIENCY: THE BIG TRADEOFF* 1-5 (1975).

3. The economic "invisible hand" is a metaphor for how economic processes function in a capitalist society. Adam Smith coined the term in the following passage:

[E]very individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. . . . [H]e intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.

2 ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS*, 22-23 (Lloyd Reynolds & William Fellner eds., Irwin Paperback Classics in Economics 1963) (1776).

onomically disadvantaged American citizens have suffered inequities under the American system of free market capitalism, these wrongs have historically been ameliorated through either federal or state legislation.⁴ Consequently, the optimal level of governmental regulation necessary to reduce the negative impact of free market capitalism can best be determined by striking a balance between the competing rationales of equality and market efficiency.

Consumer advocates argue that RTO agreements are unfair to economically disadvantaged people for several reasons. First, RTO agreements, used mostly by the poor, are considered to be highly regressive, meaning they consume a larger percentage of disposable income than traditional credit arrangements typically used by more affluent consumers.⁵ Second, since RTO transactions are characterized as leases and not sales in most jurisdictions, standard consumer protection laws are usually inapplicable.⁶ Finally, consumer advocates believe that, notwithstanding efforts to disclose information to consumers, the RTO industry is simply exploiting uninformed and undereducated poor consumers.⁷

4. The New Deal reforms are typical of legislative attempts throughout U.S. history to enact laws that further the policy aim of ensuring the fair treatment of all Americans. Important and permanent legislation arising out of the New Deal reforms included the Securities and Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the National Housing Act, and the Tennessee Valley Authority. *THE MAKING OF THE NEW DEAL: THE INSIDERS SPEAK* 115 (Katie Louchheim ed., 1983). "In 1938 Congress passed the Fair Labor Standards Act which regulated wages and hours in industries producing goods for interstate commerce." *Id.* at 82.

5. See Lee M. Breslau, *A Study of Appliance Rental Practices: Appliance Rentals and Purchases by Low-Income Consumers*, 20 *CLEARINGHOUSE REV.* 1515, 1516-17 (1987). See also *Rent-To-Own: Providing Opportunities Or Gouging Consumers? Hearing Before the Committee on Banking, Finance and Urban Affairs*, 103rd Cong., 1st Sess. 121-22 (1993) [hereinafter *Hearings*] (testimony of William Leibovici, Maryland Assistant Attorney General) (stating that "[e]verybody seems to agree that the customers of rent-to-own centers are primarily low-income consumers . . . In addition to being low-income, a significant number of rent-to-own customers are seniors. In 1990, the American Association of Retired Persons (AARP) produced a Senior Consumer Alert in which it stated 'Older Persons are prime targets of these [rent-to-own] come-ons'").

6. The RTO industry has insisted that

[The industry] is exempt from usury limits and other consumer protection laws—most notably, the federal Truth in Lending Act, state retail installment sales acts, and the repossession provisions of Article 9 of the UCC—that govern the activities of most retailers and financiers of consumer goods under traditional credit arrangements.

Nehf, *supra* note 1, at 752. See also *infra* note 56 for examples of egregious behavior which can occur in the absence of meaningful regulation of RTO transactions.

7. A recent survey conducted by a RTO company (Rent-A-Center) found that 21% of those purchasing goods using a RTO contract had not graduated from high school, 64% of those purchasing RTO goods had not received schooling beyond high school, and only seven percent had graduated from college. See *Hearings, supra* note 5, at 536 (Cheskin and Masten, *Rent-A-Center Longitudinal Research Quarterly Report #4*, June 1991).

The RTO industry argues that it is simply filling a market need, not exploiting consumers. Without the RTO industry, poor people, and those with poor credit records, would have little to no purchasing power.⁸ The higher prices paid by RTO customers, the RTO industry argues, simply reflect the higher risks of extending credit to such consumers.⁹ Moreover, the industry points out that no one "forces" consumers to purchase under a RTO agreement. Consumers always have the option of either saving their money and purchasing goods later at regular retail prices or possibly purchasing goods by using a layaway plan.¹⁰ Finally, the RTO industry argues that the RTO transaction is a lease, not a sale, and is therefore not subject to the standard protections applicable to sales.¹¹

One of the primary problems associated with RTO agreements stems from their classification in most jurisdictions as a lease.¹²

Furthermore, RTO transactions disproportionately impact racial minorities. A recent report prepared for the Board of Directors of Thorn EMI PLC, the parent company of Rent-A-Center, found that approximately 38.6% of its RTO customers were Black and 10.9% of its RTO customers were Hispanic. CARL C. HOFFMAN & ROBERT L. LOVLER, RENT-A-CENTER FINAL REPORT 18 (1994). Data from the 1990 U.S. census indicates that Blacks constitute 12.1% of the total population, while Hispanics constitute nine percent of the total population. BUREAU OF THE CENSUS, U.S. DEPT OF COMMERCE, 1990 CENSUS OF POPULATION, GENERAL POPULATION CHARACTERISTICS, UNITED STATES 3 (1990). Thus, Blacks and Hispanics appear to be over-represented in RTO transactions.

8. See *infra* note 112.

9. The RTO industry maintains that its higher prices reflect increased risks:

Losses for the industry are substantial. Electronic equipment such as VCRs and stereos are often stolen. Upwards of 20% of all VCRs rented by RTO merchants are stolen by customers. Overall, 12% of a rental dealer's inventory can be expected to be stolen. Thus, the costs and risks are very significant in this business.

Hearings, supra note 5, at 240 (written testimony of the Rental Purchase Industry). But see Michael L. Walden, *The Economics of Rent-to-Own Contracts*, 24 J. CONSUMER AFF. 326, 335 (1990) (finding implicit interest rates in excess of 60% even when all risks are accounted for; the interest rate economic model accounts for maintenance and repair costs, depreciation costs, service costs, and opportunity costs).

10. See *infra* note 21.

11. *Hearings, supra* note 5 at 53 (statement of Bill Keese, Executive Director, Association Of Progressive Rental Organizations) ("Rental customers are never, never obligated to keep making payments. That's why the transaction is not a sale . . . we think that the rules applying to debtor/creditor relationships is inappropriate for what is fundamentally a rental transaction").

12. Professor Barkley Clark has put forth five factors useful in distinguishing a "true lease" from a "disguised security interest," or credit sale. First, "[i]s the lessee obligated contractually to pay the full purchase price?" Second, "[i]s there a purchase option and, if so is it nominal?" Third, "[i]s the lease term equivalent to the economic life of the goods?" Fourth, "[a]t the expiration of the initial lease term, can the lessee renew indefinitely or for a period extending through the economic life of the goods?" Fifth, "[d]oes the lessor retain any meaningful residual value in the goods?" BARKLEY CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 1.5 [4] (2d ed. 1988). If all of the above factors apply (with the exception of the first), the RTO consumer never is obligated to pay the full purchase

When classified as a lease, several consumer protection statutes do not apply.¹³ This lack of effective consumer protection laws has allowed the RTO industry to operate essentially unregulated.¹⁴ Virtually unchecked, the RTO industry has abused consumers with little fear of reprisal.¹⁵

This comment will discuss the effects upon consumers of using RTO agreements to purchase consumer goods. It will show that RTO agreements should be regulated in order to eliminate the abuses and unfairness experienced by RTO consumers. Section I of this comment provides an overview of the laws which are or arguably should be applicable to RTO agreements. Section II outlines the Minnesota approach to regulating RTO agreements and examines the current state and shortcomings of Minnesota law. Section III reviews the latest RTO federal legislation introduced in Congress. The section appraises the federal bills and discusses perceived shortcomings. Section IV analyzes the economic considerations at issue in RTO agreements and provides an analytical framework for making RTO regulatory policy decisions. Section V suggests which RTO reforms would be most beneficial to RTO consumers.

price since the contract is terminable at will. Therefore, applying these factors to a RTO transaction, it appears that a RTO contract is actually a disguised sale.

The difficulty in characterizing RTO transactions as leases rather than credit sales was dramatized during a recent state legislative session in Minnesota when "a legislator telephoned an RTO dealer from the floor and announced to all present that the dealer was 'renting' wedding rings." David L. Ramp, *Renting to Own in the United States*, 24 CLEARINGHOUSE REV. 797, 804-05 (1990). Obviously, one would hope the purchase of a wedding ring would be somewhat more permanent.

13. See Federal Truth in Lending Act, 15 U.S.C. §§ 1601-1667e (1991) (requiring meaningful disclosures regarding the cost of consumer credit to allow consumers to make knowledgeable decisions in the credit marketplace); Truth-in-Lending Simplification and Reform Act, Pub. L. No. 96-221, 1980 U.S. Code Cong. & Admin. News 94 Stat. 168 (1980) (improving upon the original TILA which had proven to be overly technical and burdensome to the courts having to hear TILA cases, to creditors attempting to comply with the intricacies of the statute, and even to consumers burdened with disclosures too lengthy and difficult to understand); Consumer Leasing Act, 15 U.S.C. § 1667 (1991) (assuring the meaningful disclosure of terms relating to consumer leases); Fair Debt Collection Practices Act, 15 U.S.C.A. § 1692 (prohibiting oppression, harassment or abuse in the course of repossession); Fair Credit Reporting Act, 15 U.S.C.A. § 1681 (reducing the creditor's ability to use the threat of making a negative credit report as leverage for obtaining payment); Uniform Commercial Code, Article 9 and 2A (providing commercial standards intended to facilitate the conduct of business and its effects on buyers, sellers, creditors, and debtors); Equal Credit Opportunity Act, 15 U.S.C.A. § 1691 (ensuring nondiscriminatory access to the credit markets).

14. Minnesota has addressed this problem by enacting legislation which classifies RTO transactions as consumer credit sales under its state retail installment statute and consumer credit code. See MINN. STAT. ANN. § 325F.84 (West 1990) and *Miller v. Colortyme, Inc.*, 518 N.W.2d 544 (Minn. 1994). See also *infra* section II of this article. Minnesota RTO legislation, in light of its favorable disclosure provisions, should serve as a model for other state RTO legislation.

15. See *supra* note 6.

I. *Regulating the Rent-to-Own Industry*

The pivotal issue with respect to RTO contracts is whether they should be characterized as a lease or a sale.¹⁶ When characterized as a consumer credit sale, various statutory protections apply.¹⁷ However, if the RTO transaction is characterized as a lease, most of these consumer protections can usually be avoided.¹⁸ The following discussion highlights existing law which does or should apply to RTO agreements.

16. The distinction between leases and security interests is one of the most frequently litigated issues under the Uniform Commercial Code. See J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* § 23-3 (3d ed. 1988). RTO agreements are similar to leases inasmuch as both are terminable contracts that do not vest ownership as of the time the agreement is entered into. However, since RTO agreements provide lessees the option to purchase, RTO's are also similar to a security interest. The lessee "owns" the property while payments are being made, and outright if the full contract amount is paid, subject to the lessor's right to repossess if the payments cease before the full contract amount is paid. In sum, the lessor has a security interest in the leased property which runs until the RTO obligation is satisfied. Moreover, if an agreement is classified as a lease, the UCC, state usury laws, and state retail installment sale laws will not apply. See National Consumer Law Center, *Consumer and Energy Law in 1994 and Beyond*, 28 CLEARINGHOUSE REV. 971, 972 (1995). Therefore, the distinction between a lease and a security interest is often hotly litigated, because the outcome of a case will frequently turn on the classification of the contract.

The problems associated with distinguishing a lease from a sale may be illustrated with a simple example. Suppose A enters into a leasing arrangement under which she leases a television with the option to cancel at any time. She leases the television, worth \$300 retail, for \$60 a month; A becomes the owner of the television upon making 12 monthly payments. The total price to A of the television under the leasing arrangement is \$720 (\$60 per month x 12 months). Since A will have paid the retail value of the television after 5 payments, there is increasing economic pressure, with each payment in excess of the fifth payment, to actually purchase the consumer good. Although the transaction is structured as a lease, in effect, it really is no more than a disguised sale. Therefore, because the transaction can be characterized as both a lease and a sale, this point is often one of contention in the course of RTO litigation.

17. See *supra* note 13.

18. It has been noted that "the common uses of leases are designed to avoid some other rule of law which produces an unfavorable result in a particular case." John D. Ayer, *Further Thoughts on Lease and Sale*, 1983 ARIZ. ST. L.J. 341, 344 (1983). In the context of RTO contracts, the RTO industry attempts to characterize their contracts as leases, since they are terminable by the consumer at will. Classifying RTO transactions as leases permits the industry to circumvent the protections available to consumers purchasing goods through consumer credit sale arrangements. Consumer credit sales, unlike leases, are generally subject to the UCC, the Truth in Lending Act, the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, state usury laws, and state retail installment sales statutes. See *supra* note 13.

A. Usury Laws

Usury statutes prohibit "excessive" finance charges.¹⁹ The purpose of usury limits is to guarantee a "fair" rate of interest.²⁰ Interest rate limitations attempt to prevent overreaching by creditors by requiring them to charge a "fair" and profitable rate of interest without gouging the consumer, who is typically in a weaker bargaining position. However, these "fair" rates are only available to those who qualify for credit.²¹ To the extent that interest rate limits exclude high-risk individuals from obtaining credit, usury laws can actually hurt the poorer segments of the population.²²

State interest rate limitations apply only to installment credit sales. When RTO agreements are classified as leases, usury law does not apply.²³ Since the inflated cost of goods purchased through RTO agreements is one of the principal concerns of con-

19. A usurious contract is one for a loan or forbearance of money with an unconscionable and exorbitant rate or amount of interest. BLACK'S LAW DICTIONARY 1545 (6th ed. 1990).

20. The Minnesota usury statute, for example, provides in relevant part that:

The interest for any legal indebtedness shall be at the rate of \$6 upon \$100 for a year, unless a different rate is contracted for in writing. No person shall directly or indirectly take or receive in money, goods, or things in action, or in any other way, any greater sum, or any greater value, for the loan or forbearance of money, goods, or things in action, than \$8 on \$100 for one year.

MINN. STAT. § 334.01(1) (1992).

21. A Minnesota consumer group, Aggressive Consumer Education and Support Strategies (ACESS), recently announced a plan that allows low income customers to qualify for credit at two retail stores. Under the plan, ACESS would help the Dayton's and Target department stores "screen low-income customers with bad credit or no credit for a program that would allow them to purchase merchandise with a credit card." Wayne Washington, *Rent-To-Own Firms Defend Need For Their Service*, MINNEAPOLIS STAR TRIB., Dec. 8, 1994, at 2B. This program makes "fair" interest rates available to low income consumers who otherwise would not have access to credit card financing, the most commonly used type of consumer credit today. *Id.*

22. State usury laws are primarily intended to protect individuals from unscrupulous money lenders and to ensure for them a "fair" interest rate. See Harold C. Nathan, *Economic Analysis of Usury Laws*, 10 J. BANK RES. 200, 201 (1980). However, if allowable interest rates are limited, creditors become less inclined to lend to high risk individuals. *Id.* at 202. Consequently, usury laws may have the effect of excluding high risk individuals from the credit markets. Since these high risk individuals are in many instances poor, the net effect of the usury laws may be to exclude the poorer segments of society from the credit markets. Therefore, usury laws may in some instances actually hurt, more than help, the poor.

23. In Minnesota, a violation of the usury law will be found only if four elements are established:

(1) a loan of money or forbearance of debt, (2) an agreement between the parties that the principal shall be repayable absolutely, (3) the exaction of a greater amount of interest or profit than is allowed by law, and (4) the presence of an intention to evade the law at the inception of the transaction.

Miller v. Colortyme, Inc., 518 N.W.2d 544, 549 (Minn. 1994) (citing *Citizen's Nat'l Bank of Willmar v. Taylor*, 368 N.W.2d 913, 918 (Minn. 1985)). Since RTO transac-

sumer advocates, their goal is to have RTO agreements characterized as disguised sales, and not leases.

B. Uniform Commercial Code

The Uniform Commercial Code (UCC) provides a uniform statutory framework applicable to commercial transactions.²⁴ However, because its purpose is to regulate commercial transactions,²⁵ it addresses few consumer law issues.²⁶ Nevertheless, the UCC offers RTO consumers several protections.

1. Secured Transactions—UCC Article 9

Article 9 of the UCC governs secured transactions and provides a number of protections to consumers whose transactions fall within its scope.²⁷ For example, a consumer has the right to cure a default by tendering the amount secured by the obligation.²⁸ If the default is not cured, various provisions are triggered to decide who keeps the collateral, who can sell the collateral, and who must pro-

tions do not involve the forbearance of debt or require the absolute repayment of principal, they are not subject to state usury laws.

24. See BARKLEY CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 1.05 [8] (2d ed. 1988).

25. The Uniform Commercial Code was originally adopted to facilitate commercial transactions. It attempted to provide a uniform framework within which common business transactions could be conducted. An excellent example of this is Article 2, which codifies the law of sales. Since the UCC was originally developed to facilitate commerce, little thought was originally given to its effects on consumers. The subsequent and/or concurrent development of a separate body of consumer law illustrates this latent shortcoming of the UCC as regards consumer protection issues. See Fred H. Miller, *Consumer Leases Under Uniform Commercial Code Article 2A*, 39 ALA. L. REV. 957, 959 (1988).

26. Traditionally, consumer law has served three functions:

- (1) [T]he *disclosure function* to provide consumers with essential information, (2) the *representation function* to act as the bargaining agent for the consumer by mandating substantive provisions consumers would otherwise be unable to obtain, and (3) the *bargaining function* to offer consumers a choice.

Scott J. Burnham, *The Regulation of Rent-to-Own Transactions*, 3 LOY. CONSUMER L. REP. 40, 41 (1991).

27. The main purpose of Article 9 is to bring consensual security interests in personal property and fixtures within its scope. See § 9-102 (1972). A security interest is "an interest in personal property . . . which secures payment or performance of an obligation." UCC § 1-201(37) (1990). The existence of a security interest supports the notion that RTO transactions are really no more than disguised credit sales. Article 9 also provides consumers protections in the areas of default, repossession, and redemption. See *infra* note 28 and 29. See also Nehf, *supra* note 1, at 787-804 (discussing the scope and limitations of Article 9 as it relates to RTO consumers).

28. See UCC § 9-506 (1972) (providing the debtor with a right of redemption).

vide notice of sale.²⁹ The critical issue in RTO transactions is whether they create a lease or a security interest. Because Article 9 applies only to transactions which create a security interest, consumer advocates prefer RTO transactions to be characterized as security interests so that Article 9 protections apply.

Under the 1990 revised UCC, the distinction between a security interest and a lease continues to turn on a fact-specific determination which focuses on the economics of the transaction, not the subjective intent of the parties to the transaction.³⁰ The comments to the UCC provide that "a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee . . . and if one of four additional [economic] tests is met."³¹ Significantly, whether or not a security interest is created depends on the economics of the transaction, and not the intent of the parties.³² Therefore, if the transaction is on its facts economically equivalent to a security interest, a court may deem the transaction to be a security interest even though it is couched in the language of a lease.

Although the 1990 version of the UCC purportedly clarifies the distinction between a lease and a security interest, § 9-102 actually confuses the issue once again. It provides that Article 9 will apply "to any transaction (regardless of form) which is intended to create a security interest in personal property."³³ This reliance on the intent of the parties is in direct conflict with the definition of a security interest in § 1-201(37). The drafters of the UCC fell short of their goal of deleting all references to the intent of the parties to a transaction³⁴ when they failed to amend § 9-102. Therefore, the exact circumstances under which a security interest is created remain ambiguous.

29. See UCC § 9-505(2) (1994) (requiring written notice before a dealer may retain repossessed consumer goods through a process of "strict foreclosure"); UCC § 9-504(2), (3) (1994) (requiring a dealer to give the consumer notice prior to selling repossessed goods, and requiring surplus proceeds to be credited to the consumer).

30. UCC § 1-201(37) (1990) (stating that "[w]hether a transaction creates a lease or security interest is determined by the facts of each case"). See R. HILLMAN, J. McDONALD & S. NICKLES, *COMMON LAW & EQUITY UNDER THE UNIFORM COMMERCIAL CODE* § 18.05 [3][a], S 18-22 (1991 Cum. Supp.) (stating that the "new definition [of § 1-201(37)] rejects the cases finding that a lease is intended as security even though the lessee has a free right to terminate the arrangement").

31. UCC § 1-201, Official Comment 37 (1994).

32. UCC § 1-201, Official Comment 37 (1994) ("All of these tests focus on economics, not the intent of the parties").

33. UCC § 9-102(1)(a) (1994).

34. See UCC § 1-201, Official Comment 37 (1994).

2. Leases—UCC Article 2A

Article 2A of the UCC applies to all leases of personal property, including RTO transactions.³⁵ Prior to Article 2A, Article 2, which deals with the sale of goods, was applied to leases by analogy.³⁶ Although RTO transactions fall within Article 2A's general definition of "lease" and "consumer lease," Article 2A is not a consumer protection statute and offers only limited help to RTO consumers.³⁷ In this regard, it is worth noting that Article 2A was adopted primarily in response to dissatisfaction among commercial lessors with inconsistent and unpredictable court decisions on product warranties and remedies for breach of a true lease agreement.³⁸

Product warranties are generally not, however, a concern to RTO consumers. The RTO transaction typically includes repairs for all consumer goods being leased.³⁹ Therefore, RTO consumers

35. UCC § 2A-201 (1994). As of August 1994, thirty-eight jurisdictions (Alabama, Alaska, Arizona, Arkansas, California, Colorado, Delaware, District of Columbia, Georgia, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Maine, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming) had enacted the 1990 version of Article 2A. 3A WILLIAM D. HAWKLAND, HAWKLAND & MILLER UCC SERIES, ARTICLE 2A: LEASES (1982 & Supp. 1994). Florida has enacted the 1987 version of Article 2A with non-uniform amendments, and South Dakota has adopted the 1987 version of Article 2A with some of the 1990 provisions. *Id.*

36. See *infra* note 38. See Official Comment for UCC § 2A-201 which states:

A court may apply this Article analogy to any transaction, regardless of form, that creates a lease of personal property other than goods, taking into account the expressed intentions of the parties to the transaction and any differences between a lease of goods and a lease of other property. *Such application has precedent as the provisions of the Article on Sales (Article 2) have been applied by analogy to leases of goods.*

(Emphasis added.)

37. Nehf, *supra* note 1, at 805. But see Fred H. Miller, *Consumer Leases Under Uniform Commercial Code Article 2A*, 39 ALA. L. REV. 957, 958-64 (1988) (stating that although the Uniform Commercial Code expressly recognizes little consumer law, Articles 2 and 2A contain more consumer protections than is at first apparent).

38. The lack of state to state uniformity in decisions relating to leasing is a result of the *ad hoc* methodology used by courts in their decisions. State courts have decided issues relating to leases by forcing the transaction into existing legal frameworks, such as Article 2 or contract law. These other areas of law, although analogous, do not address the complexities involved with leasing arrangements, such as issues of warranty, default, and ownership. See Amelia H. Boss, *The History of Article 2A: A Lesson For Practitioner And Scholar Alike*, 39 ALA. L. REV. 575, 578-79 (1988).

39. See David L. Ramp, *Renting To Own in the United States*, 24 CLEARINGHOUSE REV. 797 (1990). Notwithstanding promises by RTO stores to provide quick repairs of leased property as part of the RTO transaction, dealers frequently offer RTO consumers the option to purchase liability damage waivers for an additional charge. *Id.* at 803. These waivers are not insurance, but simply release the consumer from liability to the dealer. *Id.* The sale of liability waivers is extremely profitable, with about 70% of all RTO customers purchasing this waiver, generating an average of three percent of gross revenues for the RTO industry. *Id.*

generally need not be concerned about product warranty issues. Further, although remedies for default by either the lessee or lessor are provided for under Article 2A, as long as an agreement is not unconscionable the parties are free to contract as they please.⁴⁰ Therefore, any remedial benefit to RTO consumers relating to defaults under Article 2A can be eliminated if a lessor carefully drafts the RTO agreement in such a way that the rights of all parties in all events are specified in the agreement.

On the other hand, the forum selection clause limitations of § 2A-106 provide a nominal benefit to RTO consumers. This section attempts to limit potential abuses by making applicable the RTO law of the state in which the goods are originally leased or used.⁴¹ Thus, abuses may be curtailed by forcing a RTO dealer to use the RTO or lease-purchase law of the jurisdiction in which the consumer resides.

Finally, potentially the most important provision in Article 2A for RTO consumers is the unconscionability clause of § 2A-108.⁴² For RTO consumers, § 2A-108 differs from its Article 2 counterpart in two important respects. First, under § 2A-108 a RTO lessor can be held liable for damages arising from unconscionable inducement or collection activities.⁴³ Second, and perhaps of more importance

40. Article 2A "implies no restriction on the freedom to contract." UCC § 2A-503, Official Comment 1 (1994). A contract will be enforced by the court unless it is found to be unconscionable. See *infra* notes 42 and 129.

41. The forum selection provision of Article 2A provides that:

- (1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within 30 days thereafter or in which the goods are to be used, the choice is not enforceable.
- (2) If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, the choice is not enforceable.

UCC § 2A-106 (1994).

42. The unconscionability provision of Article 2A provides that:

- (1) If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
- (2) With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

UCC § 2A-108(1), (2) (1994). See also *infra* note 129.

43. Under UCC § 2A-108, a consumer may sue for affirmative damages if the collection activities of the lessor were unconscionable and resulted in damages to the lessee. See Nehf, *supra* note 1, at 812. In addition, an unconscionable inducement to contract can be the subject of damage awards. *Id.* In determining whether particu-

to low income consumers, § 2A-108 authorizes the recovery of attorneys' fees if a lessee prevails at trial.⁴⁴ Although § 2A-108, in an effort to curb abuses, also authorizes attorneys' fees for a lessor, given the judgment-proof nature of most low income RTO consumers this provision is unlikely to be of much use to RTO lessors.

C. Truth-in-Lending Laws

In 1968 Congress passed the Truth in Lending Act (TILA)⁴⁵ in an attempt to ensure that all consumers would benefit from meaningful disclosures when making consumer credit decisions.⁴⁶ When Congress passed the Truth-in-Lending Simplification and Reform Act (TILSRA) in 1980, it reaffirmed the TILA policy rationale that consumers benefit from such disclosures.⁴⁷ In addition to these federally mandated disclosures, every state has enacted some form of

lar conduct of the lessor was unconscionable, a fact specific inquiry will be necessary. See also *infra* note 129.

44. The authority to award attorneys fees stems from UCC § 2A-108(2), which allows courts to grant "appropriate relief." See also UCC § 2A-108(4)(a). See Nehf, *supra* note 1, at 813.

45. The TILA is part of a well established consumer protection framework.

[The Truth in Lending Act (TILA)] was enacted in 1968 as Title I of the Consumer Credit Protection Act. See Act of May 29, 1968, Pub. L. No. 90-321, 82 Stat. 146, 1968 U.S. CODE CONG. & ADMIN. NEWS 176. Subsequent titles amended to the original act include the Fair Credit Reporting Act (Title VI), the Equal Credit Opportunity Act (Title VII), the Fair Debt Collection Practices Act (Title VIII), and the Electronic Fund Transfer Act (Title IX). TILA is divided into five "chapters"—general provisions, credit transactions, credit advertising, credit billing, and consumer leases. Chapter 5 on consumer leases is also known as the Consumer Leasing Act.

Nehf, *supra* note 1, at 758 n.29. Proposed federal RTO legislation would add a new title, Title X, to the Consumer Credit Protection Act. See *infra* section III of this article.

46. Regulation Z, issued by the Board of Governors of the Federal Reserve System implements the Federal Truth in Lending Act, which is contained in Title I of the Consumer Credit Protection Act, 15 U.S.C.A. § 1601 *et seq.* (1982). TILA Regulations (Reg Z), 12 C.F.R. § 226.1(b) (1994). See also Jonathan M. Landers, *Some Reflections on Truth in Lending*, 1977 U. ILL. L. F. 669, 669-70 (1977) (discussing the rationale for passage of the Act); Ndiva Kofele-Kale, *The Impact of Truth-in-Lending Disclosures on Consumer Market Behavior: A Critique of the Critics of Truth-in-Lending*, 9 OKLA. CITY U. L. REV. 117, 120 (1984) (discussing the objectives and purpose of the Act).

47. See Truth-in-Lending Simplification and Reform Act of 1980, Pub. L. No. 96-221, 1980 U.S. CODE CONG. & ADMIN. NEWS 94 Stat. 168 (1980).

Congress passed the Truth-in-Lending Simplification and Reform Act to improve upon the original TILA which had proven to be overly technical and burdensome (1) to the courts having to hear TILA cases, (2) to creditors attempting to comply with the intricacies of the statute, and (3) even to consumers burdened with disclosures too lengthy and difficult to understand.

Rent-To-Own: Providing Opportunities Or Gouging Consumers? Hearing Before the Committee on Banking, Finance and Urban Affairs, 103rd Cong., 1st Sess. 555 (1993) [hereinafter *Opportunities Or Gouging?*] (Edward L. Winn, III, *Understand-*

retail installment sales (RIS) law that requires additional disclosures.⁴⁸

The Truth-in-Lending and RIS statutes require strict disclosures in consumer credit sales. A RTO contract governed by either the TILA, or a state RIS statute, would require a RTO dealer to disclose the contract price of the consumer good, to state the total RTO price, to disclose the associated finance charges, to state the applicable interest rate, and to subject the RTO transaction to state interest rate limitations.⁴⁹ Theoretically, full disclosure would allow consumers to shop around for the best price on merchandise⁵⁰ and ensure reasonable finance charges.⁵¹ However, since RTO transactions are not consumer credit sales, neither the TILA nor state RIS laws apply. Several court decisions support this position.⁵² Nevertheless, these disclosures would

ing the Rent-To-Own Industry, Association Of Progressive Rental Organizations, July 1991).

48. See, e.g., Consumer Credit Sales Act, MINN. STAT. ANN. §§ 325G.15(2), (5) and 325G.16 (1981) (defining "consumer credit sale" and "sale of goods" in § 325G.15, and setting out restrictions and rights relating to consumer credit sales in § 325G.16). See also Nehf, *supra* note 1, at 759.

49. See *supra* notes 45 and 48. See also KATHLEEN E. KEEST, USURY AND CONSUMER CREDIT REGULATION 88 (Cum. Supp. 1993).

50. See Robert L. Jordan and William D. Warren, *Disclosure of Finance Charges: A Rationale*, 64 MICH. L. REV. 1285, 1299 (1966). Cf. Nehf, *supra* note 1, at 842 n.356 (stating that "[f]ollowing the enactment of TILA in 1968, a consensus emerged that information overload had a deleterious effect on comprehension of disclosed information Confronted with too much information, the typical consumer response is to ignore disclosure entirely").

51. See *Opportunities Or Gouging?* *supra* note 47, at 122 (testimony of William Leibovici, Maryland Assistant Attorney General) (stating that in "order to make the best choice, those consumers, just like everybody else, have to have the best information possible so that they can compare their purchase and credit alternatives"). Cf. Nehf, *supra* note 1, at 781 n.132 (stating that "[t]here is conflicting evidence, however, on whether disclosure does, in fact, increase awareness of credit alternatives and facilitate credit shopping").

52. *In re Martin*, 64 B.R. 1 (Bankr. S.D. Ga. 1984) (rental or lease agreements with option to purchase which are terminable at will are not subject to disclosure requirements of the TILA); *Lemay v. Stroman's, Inc.*, 510 F. Supp. 921 (E.D. Ark. 1981) (terminable 78 week RTO agreement for a television set was neither a "consumer lease" nor a "credit sale" for purposes of the TILA); *Dodson v. Remco Enterprises, Inc.*, 504 F. Supp. 540 (E.D. Va. 1980) (terminable month-to-month RTO agreement for a TV set was not a "consumer lease" or a "credit sale" within the meaning of the TILA); *Stewart v. Remco Enterprises, Inc.*, 487 F. Supp. 361 (D. Neb. 1980) (terminable 78 week RTO agreement for a color TV set was neither a "consumer lease" nor a "credit sale" for purposes of the TILA); *Smith v. ABC Rental Systems of New Orleans, Inc.*, 491 F. Supp. 127 (E.D. La. 1978), *aff'd* 618 F.2d 397 (5th Cir. 1980) (per curiam) (week-to-week RTO agreement for a TV set was neither a "consumer lease" nor a "credit sale" for purposes of the TILA); *Remco Enterprises, Inc. v. Houston*, 677 P.2d 567, 9 Kan. App.2d 296 (1984) (television set rental or lease agreements with an option to purchase, which are terminable at will by the consumer, are not "credit sales" within the meaning of the TILA).

be an essential component in any effective RTO regulatory scheme.⁵³

D. Unfair Repossession Tactics

The Fair Debt Collection Practices Act (FDCPA)⁵⁴ is of no concern to the RTO industry since it does not apply to creditors who collect their own debts.⁵⁵ The Act allows RTO dealers who collect their own debts to use more persuasive means for obtaining "voluntary" payment; if no payment is forthcoming, the lessor can recover the goods herself. Numerous cases highlight questionable repossession tactics that the RTO industry has used.⁵⁶

In addition to the FDCPA, some state unfair trade practices statutes prohibit breaches of the peace and deceptive repossession efforts.⁵⁷ Moreover, the "owners" of goods that are subsequently repossessed may be deemed to have purchased them through a RIS plan, or the goods may be considered to be subject to a security interest, thereby triggering a variety of protections available under Article 9.⁵⁸ Finally, although they cannot be legally enforced, many RTO dealers include provisions in their agreements for their *in terrorem* effect. The language of these clauses, for example, may give RTO dealers permission to enter the customer's premises to repossess goods.⁵⁹ This type of illegal tactic should be closely regulated.

53. See *infra* part IV of this article.

54. The Fair Debt Collection Practices Act was enacted in 1978 to regulate the activities of debt collectors in order to prevent consumer debtors from being unfairly abused or harassed. See 15 U.S.C. §§ 1692-1693r (1988).

55. Under the Fair Debt Collection Practices Act, debt collectors include third party debt collection agencies and collection attorneys, but specifically excludes creditors attempting to collect their own debts or recover their own property. 15 U.S.C. § 1692a(6)(A) (1988). Therefore, absent remedial legislation, the Fair Debt Collection Practices Act will not apply to RTO dealers who collect their own debts and property.

56. See, e.g., *Kimble v. Universal TV Rental*, 65 Ohio Misc. 17, 417 N.E.2d 597 (1980) (RTO dealer breaks into home to repossess goods when customer not home); *Taylor v. Action Household Rentals*, 351 So.2d 865 (La. Ct. App. 1977) (RTO customer's door is kicked down in the course of repossessing a leased refrigerator); *State v. Action TV Rentals*, 297 Md. 531, 538; 467 A.2d 1000, 1003 (1983) (pressures exerted on a RTO customer ranged from "stupid to outrageous to criminal"); *Fassitt v. United TV Rentals*, 297 So.2d 283, 287 (La. Ct. App. 1974) (holding a RTO contract provision authorizing home entry unenforceable as against public policy); *Williams v. Matthews*, 248 Va. 277, 448 S.E.2d 625 (1994) (holding that a sheriff may not break and enter into a home, without the occupant's permission, for the purpose of seizing rent-to-own consumer goods).

57. See J. SHELDON & R. SABLE, *REPOSSESSIONS* § 2.4.3.1 (National Consumer Law Center, 2d ed. 1988).

58. See *supra* note 27.

59. *In terrorem* clauses are frequently included in contracts as a tool for coercion. For example:

E. Other Abuses

There are many other miscellaneous RTO industry abuses which "nickle and dime" consumers, resulting in exorbitant rental rates.⁶⁰ There are two areas in which regulation of particularly egregious acts is desperately needed.

First, RTO transactions are often subject to an assortment of miscellaneous fees or charges that result in significant price increases to consumers. These additional costs typically include "fees for contract processing, late payments, reinstatement of the contract after default, home collection of payments, delivery of the goods, termination of the contract, security deposits, and personal property insurance."⁶¹ These fees are easily abused, and often lack any reasonable justification.⁶²

Second, in some instances, used goods may be leased to RTO consumers as if they were new. Several problems result from this practice. For example, if a consumer decides to exercise her option to own the leased goods, she may actually end up paying the price of a new consumer good for a used consumer good. Many RTO dealers require the same weekly or monthly payment for leased goods whether or not the goods being leased are new or used. Clearly, used goods should be cheaper to lease or own than new goods.

In addition, if a RTO consumer wishes to reinstate her RTO agreement after a default,⁶³ there is no guarantee that the property returned to the customer will be the same as that previously leased.

Many of the instalment [sic] contracts now in use contain "in terrorem" clauses. These are provisions in the contract which authorize the seller to use force in repossessing the merchandise and relieve him of any liability to the seller when force is resorted to, or which require the assignment of wages even though such an assignment is not enforceable by law . . . Even when clauses of this type have no legal effect, the buyer is frequently ignorant of that fact; and the seller by threatening to invoke their terms may be able to coerce the buyer into surrendering some of his legal rights. In fact, there can be no other purpose in inserting any such clauses which have no legal effect.

Opportunities Or Gouging?, *supra* note 47, at 177-78 (Charles Mindel, *Retail Installment Selling*, Research Report No. 6, Maryland Legislative Council Research Division). See also Scott J. Burnham, *The Regulation of Rent-to-Own Transactions*, 3 LOY. CONSUMER L. REP. 40 (1991).

60. See Nehf, *supra* note 1, at 824-36.

61. *Id.* at 824.

62. The principal problem with RTO contract fees involves the difficulty of predicting the impact of these fees on the final price of the good being acquired. "While the industry argues that these extra fees are most often assessed to recover costs incurred by the consumer's conduct, analysis of these several additional fees reveals that many of them are not justified." *Opportunities Or Gouging?*, *supra* note 47, at 121 (statement of David L. Ramp, Staff Attorney for Mid-Minnesota Legal Assistance, Inc.). See also Nehf, *supra* note 1, at 824-36.

63. All RTO statutes except Massachusetts mandate reinstatement rights. See Nehf, *supra* note 1, at 837 n.341.

When exercising the right to reinstate a RTO contract, the dealer could substitute used goods for the new goods previously leased. This raises questions regarding what rental price should be paid when substitute goods are provided.

Finally, there are questions as to what, if any, product warranty will apply to used goods if the ownership option is exercised early in the RTO contract. For example, suppose a person enters into a RTO agreement and receives a used product on which the manufacturer's warranty has expired. If the RTO consumer purchases the product, what product warranties are available? In this instance, absent a collateral warranty agreement with the RTO dealer,⁶⁴ the consumer would not be able to complain to either the manufacturer or the RTO dealer.

II. *The Minnesota Approach to Regulating Rent-to-Own Transactions*

Minnesota is one of thirty-four states that have adopted RTO legislation.⁶⁵ Although there are some shortcomings in the Minnesota statute, it nevertheless is a model for any future RTO legislation.⁶⁶ The following sections outline the law in Minnesota and discuss its perceived shortcomings.

64. See *Opportunities Or Gouging?*, *supra* note 47, at 366 (Edwin L. Winn, III, *Profits from Pay-Outs, Your Paid-Up Customer is Your Best Prospect*, Progressive Rentals) ("Most dealers offer to pass along any unexpired manufacturer's warranties when the customer obtains ownership. . . . Some dealers additionally offer their own in-store warranties").

65. See ALA. CODE §§ 8-25-1 to -6 (1990); ARK. CODE ANN. §§ 4-92-101 to -107 (1990); COLO. REV. STAT. §§ 5-10-101 to -1001 (1990); 1991 CONN. GEN. STAT. §§ 42-240 to -253 (1995); DEL. CODE ANN. tit. 6, §§ 7601 to 7616 (1991); FLA. STAT. ANN. §§ 559.9231 to .9241 (West 1990); GA. CODE ANN. §§ 10-1-680 to -689 (1991); IDAHO CODE §§ 28-36-101 to -111 (1993); ILL. REV. STAT. ch. 121 1/2, paras. 1801-1805 (1989); IND. CODE §§ 24-7-1-1 to -9-7 (1990); IOWA CODE §§ 537.3601 to .3624 (1989); KAN. STAT. ANN. §§ 50-681 to -692 (1994); KY. REV. STAT. ANN. §§ 367.976 to 367.985; LA. REV. STAT. ANN. §§ 3351-3362 (West 1995); MD. CODE ANN., COMM. LAW §§ 12-1101 to -1112 (1990); ME. REV. STAT. ANN. tit. 9-A, §§ 11-101 to 11-121 (West 1993); MASS. ANN. LAWS ch. 93, §§ 90-94 (Law Co-op. 1991); MICH. COMP. LAWS ANN. §§ 445.951 to .970 (West 1989); MINN. STAT. §§ 325F.84 to 325F.98 (1991); MO. REV. STAT. §§ 407.660 to .665 (1990); NEB. REV. STAT. §§ 69-2101 to -2115 (1989); NEV. REV. STAT. §§ 597.010 to 598.2808 (1993); N.Y. PERS. PROP. LAW §§ 500-507 (McKinney 1991); N.D. CENT. CODE §§ 47-15.1-01 to -08 (1994); OHIO REV. CODE ANN. §§ 1351.01-1351.09 (1990); OKLA. STAT. tit. 59, §§ 1950-1957 (1990); R.I. GEN. LAWS §§ 6-44-1 to -10 (1990); S.C. CODE ANN. §§ 37-2-701 to -714 (1991); S.D. CODIFIED LAWS ANN. §§ 54-6A-1 to -10; TENN. CODE ANN. §§ 47-18-601 to -614 (1990); TEX. BUS. & COM. CODE ANN. §§ 35.71 to .74 (1991); UTAH CODE ANN. §§ 15-8-1 to -12 (1993); VA. CODE ANN. §§ 59.1-207.17 to .27 (1991); WASH. REV. CODE §§ 63.19.010 to .901 (1992).

66. See *supra* note 14.

A. The Law in Minnesota

The Consumer Credit Sales Act (CCSA) regulates consumer credit sales in Minnesota, providing restrictions regarding the sale of goods.⁶⁷ Specifically, it requires affirmative disclosures.⁶⁸ In 1981, the Act was amended to include terminable leases.⁶⁹

In addition, Minnesota passed the Rental Purchase Agreement Act (RPAA), which specifically addresses concerns relating to RTO contracts.⁷⁰ The RPAA provides a number of protections for consumers. It requires specific disclosures in the RTO agreement,⁷¹ in advertising,⁷² and on in-store merchandise tags;⁷³ im-

67. MINN. STAT. ANN. §§ 325G.15 to .16 (1981). The Consumer Credit Sales Act defines "consumer credit sale":

[A] sale of goods or services in which

- (a) credit is granted by a seller who regularly engages as a seller in credit transactions of the same kind;
- (b) the buyer is a natural person; and
- (c) the goods or services are purchased primarily for a personal, family or household purpose, and not for commercial, agricultural, or business purpose.

Id. § 325G.15(2). The Act then proceeds to define a "sale of goods" as one which includes, without limitation, any agreement in the form of a bailment or lease of goods if the bailee or lessee agrees to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the goods involved and it is agreed that the bailee or lessee will become, or for no other or a nominal consideration has the option to become, the owner of the goods upon full compliance with his obligations under the agreement.

Id. § 325G.15(5). The restrictions placed on consumer credit sales are set out in MINN. STAT. ANN. § 325G.16.

68. *See, e.g.*, MINN. STAT. ANN. § 325G.16(5) (1981) (requiring leases relating to consumer credit sales to specify "whether the goods which are the subject of the sale are new or used").

69. Consumer Credit Sales Act, MINN. STAT. ANN. § 325G.15(5) and § 325G.16(4)-(5) (1981).

70. The Rental Purchase Agreement Act (RPAA) was adopted by Minnesota in 1990, and was intended to ameliorate many of the problems experienced by rent-to-own consumers. *See* MINN. STAT. ANN. § 325F.84 to .97 (1990). Moreover, a review of the legislative history shows that the RPAA was not intended to repeal the Consumer Credit Sales Act (CCSA). *See* MINN. STAT. ANN. § 325G.15 to .16 (1981). *See* *Miller v. Colortyme, Inc.*, 518 N.W.2d 544, 550 (Minn. 1994). Therefore, the RPAA provides rent-to-own consumers with a set of remedies that are coextensive with those provided by CCSA.

71. The RPAA requires the following disclosures: the total dollar amount of payments necessary to acquire ownership; the total number, amount, and timing of payments and other charges necessary for ownership; the difference between the price paid and the cash price of the good; any initial or advance payments required; a statement indicating that ownership will not vest until all payments are made; a statement that the total of all payments include no additional charges, i.e., late fees; a statement that the lessee is liable for damages to the good; a statement that the lessee need not purchase a waiver of liability damage from the lessor; a description of the good including model number and indicating whether the good is new or old; a statement indicating the terms under which the good can be purchased early and the formula for computing the price; the cash price of merchandise; and, a statement setting out the lessee's rights with respect to reinstatement rights, default notice,

poses restrictions and protections in the event of default;⁷⁴ provides for reinstatement rights to consumers;⁷⁵ prohibits certain waiver provisions in RTO agreements and limits delivery charges, security deposits and collection fees;⁷⁶ authorizes the commissioner of com-

and consumer warranties. Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.86 (1990).

72. The RPAA places limitations on advertising. The RPAA prohibits false advertising: "An advertisement for a rental-purchase agreement shall not state or imply that a specific item is available at specific amounts or terms unless the lessor usually and customarily offers or will offer that item at those amounts or terms." Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.88 (1990). Moreover, the RTO advertisement is required to disclose the following information: that the transaction is a RTO transaction; the number of payments to acquire ownership; and, that the lessor will not own the property until the terms of the RTO agreement are satisfied. *Id.* All displayed items are required to legibly indicate the cash price, the amount of the lease payment, and the total of lease payments required for ownership of the good. *Id.* The numerous disclosures required reflect the legislative belief that the best means to protect a consumer is to inform him or her of the consequences of any action he or she may take, e.g., purchasing a television with a RTO contract containing highly unfavorable terms.

73. RPAA form requirements generally require that the disclosures provided be clear and conspicuous. Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.88(2) (1990).

74. The RPAA provides various protections to the consumer in the event of default. Conditions for enforceability, authorization or procedures for requesting surrender of property, time-frame before legal recourse is available to the lessor, ability of lessee to voluntarily surrender property, effect of curing default, and the extent of default notice required are all addressed in this statutory section. Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.89 (1990). These conditions ensure that the consumer is provided minimum protections in these areas. Importantly, the default notice must include the name, address, and telephone number of the lessor, a brief identification of the transaction, the lessee's right to cure, the amount of payment and when it must be made to cure default, a statement of the lessee's reinstatement rights, and a request to voluntarily surrender the property if payment is not made. *Id.* These requirements increase the possibility that the lessee will be aware of his or her rights upon purchase or default.

75. Under the RPAA, the lessee must satisfy two requirements before he or she may reinstate the RTO agreement under its original terms. First, a lessee may reinstate the original RTO agreement if the lessee surrenders the property to the lessor within seven days of a lessor's request to surrender the property. Second, if the lessee has paid less than 60% of the total payments necessary for ownership, he or she has 60 days to reinstate, otherwise, if the lessee has paid more than 60%, the lessee will have not less than 180 days to reinstate. Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.90 (1990).

76. The RPAA prohibits certain practices in the RTO industry. A RTO contract may not contain a provision requiring a confession or judgment, or a provision authorizing a lessor to breach the peace during repossession, or a waiver of a defense, counterclaim, or right against the lessor. MINN. STAT. ANN. § 325F.91(1) (1990). Additionally, a RTO contract may not require the payment of a late charge, unless payment is delinquent for more than two business days, and even then only in an amount not exceeding the greater of five percent of the delinquent lease payment or three dollars. *Id.* A RTO contract may not purport to provide a lessor with the authority to charge a penalty for early termination of the RTO agreement. *Id.* Finally, the RPAA limits the extent to which delivery charges and collection fees can be assessed, and prohibits the charging of a security deposit. *Id.* § 325F.91(3) (1990).

merce to adopt rules governing cash price limits;⁷⁷ prohibits identified abusive debt collection practices;⁷⁸ and, provides for enforcement both by the Attorney General and through a private right of action.⁷⁹ Notwithstanding the protections afforded con-

77. The RPAA gives the Minnesota commissioner of commerce the authority to adopt rules governing cash price limits for RTO agreements. Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.91(2) (1990). Cash price limits may be adopted to prevent the RTO industry from avoiding usury law limits. If the lessor inflates the cash price of an item held out for purchase under a RTO agreement, the usury limits may be avoided, since the difference between the total paid under the RTO agreement and the inflated cash price may be less than the amount allowed under state usury laws.

The principal constraint on the arbitrary increase of cash prices is the loss of potential cash customers, which can be a powerful constraint on businesses competing in a market for cash sales. In low-income areas, where cash customers for furniture and appliances are likely to be few, the potential loss in cash sales resulting from increased cash prices will probably be minimal. For RTO dealers, who rarely even offer items for cash, there is virtually no limit, short of the doctrine of unconscionability, on the level of stated cash prices. These merchants can offer goods at zero percent interest, bury the entire cost of credit in the cash price, and lose little or no business.

Nehf, *supra* note 1, at 782-83. In an attempt to curb these abuses, Minnesota's RPAA requires the Commissioner of Commerce to regulate the cash price of RTO goods.

78. The RPAA provides specific limitations on how a lessor may communicate with a lessee. See MINN. STAT. ANN. § 325F.92 (1990). In determining the location of a lessee, a lessor communicating with third parties must identify itself and state that it is confirming or correcting location information concerning the lessee. *Id.* § 325F.92(1) (1990). The lessor must not communicate with anyone more than once unless requested or unless the lessor reasonably believes the previous answer was in error or incomplete. *Id.* The lessor must not communicate by postcard, not use any language in any communications indicating that the communication relates to the recovery or repossession of property and not communicate with any person other than the lessee's attorney once the lessor is aware that lessee is represented by counsel. *Id.* A lessor may not communicate with any person other than the lessee, the lessee's attorney, or the lessor's attorney, except as is reasonably necessary to acquire location information concerning the lessee. *Id.* § 325F.92(3) (1990). If the lessee notifies the lessor that the lessee wishes the lessor to cease communicating with the lessee, the lessor will cease communications, except as needed to inform the lessee that legal remedies will be invoked. *Id.* § 325F.92(4) (1990).

The RPAA also limits the time and place during which the lessor may communicate with the lessee. *Id.* § 325F.92(2) (1990). The lessor may not communicate with the lessee at work or at any unusual time or place. *Id.* It is presumed that the convenient time for communicating with the lessee is after 8:00 a.m. and before 9:00 p.m. *Id.* In addition, the lessor is prohibited from harassing, oppressing, or abusing any person in connection with a rental-purchase agreement by using violence or threat of violence, by using obscene, profane, or abusive language, or by using the telephone to annoy, abuse or harass a person. *Id.* § 325F.92(5) (1990).

79. The RPAA provides for penalties and remedies. Lessors can be arrested and prosecuted by the Attorney General for violations of the RPAA. MINN. STAT. ANN. § 325F.97(1) (1990). Additionally, a lessee can bring a private right of action against a lessor and seek damages for violation of the RPAA. *Id.* Several provisions limit the reach of this statute. First, lessees may not offset a lessor's potential liability against the amount due under the RTO agreement. *Id.* § 325F.97(3) (1990). Second, a lessor is provided with a means for correcting errors arising before the filing of an

sumers in RTO transactions under the RPAA, the Minnesota Supreme Court recently decided that the RPAA does not, on its face, establish an exclusive system for regulating RTO contracts.⁸⁰

The court in *Miller v. Colortyme* held that RTO agreements are consumer credit sales for all purposes and that RTO contracts are entitled to all of the state consumer law protections available to ordinary credit sales.⁸¹ The court reasoned that consumers who enter into RTO transactions are entitled to the same protections afforded to consumers who purchase goods through ordinary installment sale transactions, even though they incur neither a debt nor an obligation to repay the principal amount.⁸² The court relied on the CCSA definition of "sale of good" to conclude that RTO transactions are covered by that law.⁸³ One of the most important consequences of this decision is that courts in Minnesota must now treat RTO transactions as subject to the interest rate limitations set out in the Minnesota usury statute.⁸⁴ Although this result provides consumer protection from usurious interest rates, it does so by relying on a poorly drafted statute.⁸⁵ RTO consumer law would benefit from an amendment to the CCSA clarifying its language.

action for damages and within 60 days of discovering the error. *Id.* § 325F.97(4) (1990). Finally, the lessor's liability is limited to actual damages if the lessor can show by a preponderance of the evidence that the violation was the result of a "bona fide error." *Id.* § 325F.97(5) (1990).

80. *Miller v. Colortyme*, 518 N.W.2d 544, 550 (Minn. 1994). In *Miller v. Colortyme*, appellants Delilah Miller and Craig Stenzel entered into RTO contracts for the purchase of goods. Appellant Miller purchased a used washer and dryer. The stated cash price was \$800.75. Under the terms of the RTO contract, Miller could acquire ownership "by making 16 monthly payments of \$84.40, for a total of \$1,350.40, or by making 69 weekly payments of \$21.10, for a total of \$1,455.90." *Id.* at 546. Appellant Stenzel entered into a similar transaction. Appellants subsequently filed a lawsuit claiming violations of Minnesota's Consumer Credit Sales Act and Rental Purchase Agreements Act. *Id.* The Minnesota Supreme Court found the RTO contracts to be within the Minnesota Consumer Credit Sales Act, and, therefore, subject to state usury law limitations. *Id.* at 548.

81. *Miller v. Colortyme, Inc.*, 518 N.W.2d 544, 548 (Minn. 1994) ("We hold that rent-to-own transactions are credit sales within the meaning of MINN. STAT. § 325G.15 subd. 2 because buyers of goods are not required to make full payment upon acquiring possession but are allowed to pay for goods sold over time.").

82. *Id.* at 549.

83. *Id.* at 547-51.

84. *Id.* at 548. See General Usury Statute, MINN. STAT. ANN. § 334.01 (1992).

85. Although the CCSA defines "sale of goods" to include a lease of goods, as is the case with a RTO transaction, the CCSA also defines a "consumer credit sale" as a transaction in which "credit is granted." Since no credit is granted in a RTO transaction in the traditional legal sense, an interpretive ambiguity is created; this ambiguity is the result of poor legislative drafting. The Minnesota Supreme Court decided the issue by looking to the legislative intent behind the statute and found that RTO transactions were intended to be included within the scope of the CCSA. The Court reasoned that by including terminable leases within the meaning of "sales" in the CCSA, the legislature made it clear that it intended for these leases to receive the

B. Shortcomings in the Minnesota Approach

Minnesota law governing RTO transactions is comprehensive and, with one minor exception, a model for other states' RTO legislation.⁸⁶ The area of concern relates to the definition of "cash price" in the RPAA. The RPAA defines "cash price" as "an amount equal to the equivalent fair market value for goods offered under a consumer credit sale."⁸⁷ The "cash price" problem arises when RTO dealers try to circumvent usury laws by inflating the cash price of merchandise. In so doing, dealers make the price paid under a RTO contract appear more reasonable and thereby avoid usury rate limitations. However, even if price controls are theoretically desirable,⁸⁸ determining an appropriate cash price is a difficult task, especially when used goods are sometimes leased.⁸⁹

In Minnesota, the Commissioner of Commerce has the authority to "adopt rules governing cash price limits for rental-purchase agreements."⁹⁰ Although this approach is useful, it introduces inefficiencies into the market which result in increased costs to consumers. These market inefficiencies are primarily the result of bureaucratic inertia. Implementing a cash-price regulation is not only an expensive and time consuming endeavor, but it could also lead to instances where the adopted fair market price is not an accurate reflection of the current market. For example, if the price of the good has decreased in the general market, the true market price may not be reflected in the higher price already adopted by the Commissioner. Moreover, there is always the risk that increased costs related to statutory compliance may be passed on to consumers in the form of higher fees or finance charges. Finally, "cash price" itself is of marginal relevance to RTO consumers who are frequently not allowed to purchase the item under these terms.⁹¹

same protections afforded to ordinary credit sales. *Miller v. Colortyme, Inc.*, 518 N.W.2d 544, 547-50 (Minn. 1994).

86. See *supra* note 14.

87. MINN. STAT. ANN. § 325F.84(3) (1990).

88. See W. David Slawson, *Price Controls for a Peacetime Economy*, 84 HARV. L. REV. 1090 (1971) (discussing the theoretical desirability of having price controls as a means of controlling inflation).

89. While the price of fungible goods like corn and gasoline can conceivably be set by government, it is difficult to imagine an effective means for determining and monitoring the retail and/or wholesale price for every type of television, refrigerator, and stereo on the market. See Nehf, *supra* note 1, at 823.

90. Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.91(2) (1994) (the "Commissioner of Commerce shall adopt rules governing cash price limits for rental-purchase agreements").

91. See *Miller v. Colortyme*, 504 N.W.2d 258, 261 n.3 (Minn.App. 1993) (stating that "although the 'cash price' or market value is listed on the contract, it is meaningless since customers have no option to purchase the item under those terms").

Treating the "cash price" of a good as equivalent to its fair market value is a useful approach, it may not, however, be the most effective approach because of bureaucratic inefficiencies.

III. Federal Legislation

Attempts by Congress to enact legislation regulating RTO transactions have been unsuccessful. In 1983, Senator Paula Hawkins (R.FL) introduced S. 1152, a bill adopting a Federal Reserve Board proposal for regulating rental-purchase transactions under the Consumer Leasing Act.⁹² This bill passed the Senate in amended form as part of S. 2851, but subsequently died in the House of Representatives.⁹³ In 1984, Congressman Doug Barnard, Jr. (D.GA) introduced H.R. 2322, Congressman Bruce A. Morrison (D.CT) introduced H.R. 2370, and Senators Slade Gorton (R.WA) and Paula Hawkins (R.FL) introduced S. 1908.⁹⁴ The Morrison bill attempted to characterize RTO transactions as credit sales, while the remaining bills followed the 1993 Federal Reserve Board proposal.⁹⁵ All three bills died in Congress with no hearings ever held.⁹⁶ In 1992, Congressman Larry LaRocco (D.ID) introduced H.R. 4497.⁹⁷ This bill died after hearings were held before the House Subcommittee on Consumer Affairs and Coinage in June of 1992.⁹⁸

Two recent bills⁹⁹ pending in Congress appear to effectively address some of the consumer concerns relating to RTO transactions. The bills provide simple yet essential protections for RTO consumers. Although the present political climate makes enactment of federal RTO legislation unlikely,¹⁰⁰ the bills offer insights into

92. EDWARD L. WINN, III, RENTAL-PURCHASE LEGAL INDEX 17-18 (1993).

93. *Id.* at 18.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 18-19.

98. *Id.*

99. The Rent-to-Own Reform Act of 1993, H.R. 3136, 103rd Cong., 1st Sess. (1993) [hereinafter *H.R. 3136*] and The Rent-to-Own Consumer Credit Protection Act of 1993, S.1566, 103rd Cong., 1st Sess. (1993) [hereinafter *S.1566*]. A third bill, The Rental-Purchase Reform Act of 1993, H.R. 2803, 103rd Cong., 1st Sess. (July 29, 1993) [hereinafter *H.R. 2803*], was introduced by Congressman LaRocco in July, 1993. Since this bill is simply a reintroduction of a bill previously found unworkable (H.R. 4497), its potential merits and suggested approach will not be discussed.

100. The political climate after the Republicans took over Congress in the 1994 election was one in which smaller government and less regulation was the order of the day. For example, Bob Tillman, an executive vice president of a home-improvement retailer in North Carolina, recently stated that "[t]he average American consumer feels like maybe Republicans will do a better job of managing smaller government, which to them means fewer taxes and less government regulation in their lives." *U.S. Midterm Elections: Business Leaders Cheer Big Republican Win, A Wall Street Journal Europe Roundup*, WALL ST. J. EUR., Nov. 10, 1994, at 6. Repub-

possible approaches for dealing with the problems associated with RTO transactions.

The first bill, entitled the Rent-to-Own Reform Act of 1993, was submitted to the House by Representative Henry Gonzalez (D.TX).¹⁰¹ The Act would amend the Consumer Credit Protection Act (CCPA) and designate Title X of the CCPA as the Rent-to-Own Protection Act. The Act would make applicable to RTO transactions state interest rate limitations,¹⁰² limit fees and other charges, require full disclosure,¹⁰³ and, most importantly, make the following federal laws applicable to RTO transactions: The Truth in Lending Act (TILA); the Equal Credit Opportunity Act (ECOA); The Fair Debt Collection Practices Act (FDCPA); and the Fair Credit Reporting Act (FCRPA).¹⁰⁴ Violation of the Act would constitute an unfair

licans are perceived to be supporters of smaller government and less government regulation. *Id.* Consequently, additional consumer protection legislation is unlikely to be received favorably by the newly elected Republican Congress. See also National Consumer Law Center, *Consumer and Energy Law in 1994 and Beyond*, 28 CLEARINGHOUSE REV. 971, 972 (1995) (maintaining that "attempts at [federal] legislation are not anticipated at any time in the foreseeable future").

101. H.R. 3136, *supra* note 99.

102. The Federal Act provides RTO consumers with several limitations regarding fees, charges, guarantees, and warranties. See H.R. 3136, *supra* note 99, at § 1004 (Entitled "Application of State laws regarding fees, charges, guarantees, and warranties to rent-to-own transactions"). Section 1004(a) of the Act makes the usury laws of the state in which the seller is located applicable to RTO transactions. Section 1004(b) authorizes a termination fee if the consumer is given the right to terminate the RTO contract at any time, and a recovery fee in those cases where the good is not voluntarily recovered, although the recovery fees must be reasonable in relation to the cash price of the good. The termination fee is limited to five percent of the cash price under the contract and must be disclosed in the contract; the recovery fee is only required to be disclosed in the contract. Section 1004(c) makes state consumer credit sale or retail installment sale laws relating to guarantees and warranties applicable to RTO transactions.

103. The Federal Act requires RTO sellers to disclose certain information to RTO consumers. See H.R. 3136, *supra* note 99, at § 1006 (Entitled "Disclosures"). Specifically, under § 1006(a), the Act requires that, at the time of contracting, the seller disclose the cash price of the item, an itemization of services provided and the cash price of each service, the annual percentage rate of interest as calculated under the Truth in Lending Act, the weekly, monthly or incremental payment applicable under the RTO contract and the number of payments, "the total of payments required to be paid to acquire ownership" as determined under the Truth in Lending Act, and a statement indicating whether the good being acquired is new or used. Note that these disclosures are useful only to the extent the consumer has a meaningful choice. A disclosure of cash price and effective interest rate is meaningless to a consumer who is unable to shop elsewhere, or to a consumer who must purchase the good because it is essential to normal everyday existence, e.g., a refrigerator.

104. The Act makes the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, and the Fair Credit Reporting Act applicable to RTO transactions. See H.R. 3136, *supra* note 99, at § 1005 (Entitled "Application of Federal laws to rent-to-own transactions").

and deceptive act or practice in violation of the Federal Trade Commission Act,¹⁰⁵ and subject sellers to potential civil liability.¹⁰⁶

The second bill, entitled the Rent-To-Own Consumer Credit Protection Act of 1993, was submitted by Senator Howard Metzenbaum (D.OH).¹⁰⁷ This Act would also amend the Consumer Credit Protection Act by adding a RTO protection Act at Title X. The protections outlined in this bill are essentially the same as those provided under the bill submitted by Representative Gonzalez.

The most important aspect of this bill is its application of tested consumer protection statutes to RTO transactions, such as the FDCPA and the TILA. Application of the TILA disclosure requirements to RTO transactions assures that consumers using RTO arrangements obtain sufficient information to make informed decisions. Application of the FDCPA to RTO transactions ensures that minimum levels of professional courtesy are maintained between the RTO dealer and the consumer during repossession.¹⁰⁸ Although excessive governmental involvement in commercial markets can affect market efficiency when the costs of regulation exceed any perceived benefit from regulation, to the extent that governmental involvement is limited to broad regulatory arenas which have proven effective in the consumer credit context, market inefficiencies should be limited.

105. A RTO seller is prohibited from using or threatening to use criminal prosecution unless the seller can show by clear and convincing evidence that the consumer intends to perpetrate a fraud on the seller. See H.R. 3136, *supra* note 99, at § 1007(a). The seller may not "use threats or coercion to collect or attempt to collect any amounts" due from the consumer, engage in conduct that oppresses, harasses, or abuses any person in connection with collecting amounts due, unreasonably disclose information to third parties regarding amounts due by the consumer, "make any fraudulent, deceptive or misleading representation to obtain information about the consumer or to collect amounts owed by the consumer," use any unconscionable collection means, advertise as free services for which the seller actually charges a fee, or use a cash price other than the one specifically defined within the Act. *Id.*

Under § 1007(b), enforcement of this Act is delegated to the Federal Trade Commission (FTC). *Id.* The FTC is required to issue regulations implementing the Act. Violations of this statute are deemed to be an unfair or deceptive act or practice in commerce in violation of the Federal Trade Commission Act. *Id.*

106. The Act provides two tiers of damages. The first tier provides a method for determining damages in instances where the RTO seller fails to properly provide the disclosures required under § 1006. See H.R. 3136, *supra* note 99. Damages against the seller are limited to the sum of the actual damages sustained by the consumer as a result of the failure, \$250 for each failure, and all costs of the action and reasonable attorneys fees. *Id.* at § 1008(a). Damages sustained, other than under § 1006, are limited to the sum of the actual damages sustained by the consumer, \$2,500 for each violation, and all costs and reasonable attorneys' fees. *Id.* at § 1008(b). In addition, the Act provides a two year statute of limitations for bringing actions under this Act. *Id.* at § 1008(c).

107. See S.1566, *supra* note 99.

108. See *supra* note 56 and accompanying text.

Although the recent proposals may be useful to consumers, in an effort to minimize market inefficiencies, any RTO federal laws should be limited to broad consumer protections that guarantee a minimum degree of protection to all consumers from the predatory tactics of many RTO dealers.¹⁰⁹ Excessive governmental regulation of RTO transactions could increase the cost of doing business and potentially reduce the number of RTO dealers.¹¹⁰ Consequently, the net effect could be to limit the access of some people to the consumer goods they desire.

IV. *Should We Regulate the RTO Market?: An Economic Analysis*

An economic evaluation of the current status of the RTO industry requires a two-part inquiry. First, are current RTO industry practices unfair to poor consumers? Second, if RTO industry practices are unfair to poor consumers, should the RTO industry be regulated to ameliorate this unfairness? These questions can be resolved by considering whether there is currently a reasonable opportunity for effective bargaining between the parties to a RTO transaction, and by asking whether there is a reasonably competitive RTO market.¹¹¹

A. Are RTO Transactions Unfair?

While both the RTO industry and consumer advocate groups arguably agree that consumers pay more money under a RTO contract for consumer goods than if the goods were purchased at a re-

109. *Id.*

110. The effect of extensive federal governmental regulations on the RTO industry, as well as on consumers, has been described as follows:

[O]ver two-thirds of the rent-to-own industry involves small "Mom and Pop" operations. Expansive changes in the legal requirements for this industry could impose compliance obligations that many such businesses could not easily meet. As a result, many such businesses could be forced to leave the market. These departures ultimately might harm rent-to-own consumers who rely on those businesses in their neighborhoods and would be left with a less competitive industry.

Opportunities Or Gouging?, *supra* note 47, at 39 (statement of David Medine, Associate Director for Credit Practices, Federal Trade Commission). Therefore, a careful balancing of policy objectives is necessary in order to provide the optimal solution for consumers and the RTO industry. Here, subjecting the RTO industry to existing federal disclosure and consumer protection laws would be no more onerous a requirement than that imposed on other small businesses who sell rather than lease goods. Since there is little evidence that these federal requirements have adversely impacted small businesses, it is unlikely that they will adversely impact the RTO industry.

111. See generally Lary Lawrence, *Toward a More Efficient and Just Economy: An Argument for Limited Enforcement of Consumer Promises*, 48 OHIO ST. L.J. 815 (1987).

tail price, they sharply disagree as to the underlying fairness of the transaction.¹¹² Key aspects of the RTO transaction, such as usurious interest rates, inadequate disclosures, and oppressive collection practices, are clearly unfair. Thus, we are left asking: To what extent are RTO contracts unfair?

Purchasing consumer goods through a RTO arrangement is clearly more expensive than purchasing the same merchandise from a retail outlet with traditional financing.¹¹³ The high cost of RTO goods is generally due to exorbitant effective interest rates accompanying such transactions, often ranging between 100 and 150

112. "We are the people who . . . trust [consumers] with our merchandise—even when we know they have come to see us nine times out of ten because no one else will trust them with enough credit." Nehf, *supra* note 1, at 752 n.8 (citing Waters, *We Are the People Who do Good*, RTO NETWORK NEWS, Jan. 1990, at 3). Cf. David L. Ramp, *Renting to Own in the United States*, 24 CLEARINGHOUSE REV. 797, 805 (1990) (maintaining that the "RTO industry has greatly benefited from a decade of deregulation . . . The people who have been adversely affected by RTO laws are predominately low-income and, frequently, minority consumers . . . RTO customers frequently lose the benefit of all consumer protection statutes"). See also Lee A. Sheppard, *Are Rent-To-Own Contracts Leases or Sales?*, 64 TAX NOTES 989, 992 (1994) (stating that "[o]nly an economically irrational consumer without access to credit would enter a rent-to-own contract with a present intention to own the appliance").

113. The following provides an example of the higher prices a consumer pays in a RTO transaction:

Cost of Purchasing Identical 19-inch Color Televisions
Through Selected Rental Purchase Agreements*

#	Weekly (78 wk.)	Total Cost	Monthly (18 mo.)	Total Cost
1.	\$15.00	\$1,170	\$54.00	\$972
2.	\$11.25	\$ 878	\$40.00	\$720
3.	\$15.55	\$1,213	\$54.20	\$976
4.	\$15.00	\$1,170	\$49.00	\$882
5.	\$14.00	\$1,092	\$46.00	\$828

* Stores located in metropolitan Atlanta, GA.

Imputed Annual Percentage Rates for Television Purchased
Through Selected Rental Purchase Agreements*

#	Total Cost (Weekly)	APR Est ^a (Percent)	Total Cost (Monthly)	APR Est ^a (Percent)
1.	\$1,170	187	\$972	149
2.	\$ 878	137	\$720	100
3.	\$1,213	193	\$976	150
4.	\$1,170	187	\$882	133
5.	\$1,092	175	\$828	122

*Retail value of \$ 362.

^aImputed APR.

Roger M. Swagler and Paula Wheeler, *Rental-Purchase Agreements: A Preliminary Investigation of Consumer Attitudes and Behaviors*, 23 J. CONSUMER AFF. 144, 146-47 (1989).

percent.¹¹⁴ Since interest rates in credit transactions have historically been limited to assure the "fair" treatment of consumers,¹¹⁵ it seems only reasonable that these limitations now be extended to RTO agreements, which are in substance no different from other consumer credit sales. However, there are countervailing arguments for why higher interest rates are reasonable.

Consumers who enter into RTO transactions have usually been denied credit by other businesses.¹¹⁶ They typically resort to the RTO arrangement in a final effort to obtain the merchandise they desire. The rationale, therefore, becomes: if these consumers constitute a large credit risk, how can the interest rate they are charged be considered unreasonable?¹¹⁷ The answer, in part, depends on whether the credit markets are reasonably competitive.

If the credit markets are reasonably competitive, then competition among RTO dealers would force interest rates down to a level which would truly reflect the inherent risk involved in the transaction. However, the RTO credit markets are not reasonably competitive. Since most low income consumers generally lack the resources to shop far and wide for the best bargain on a particular product, the fact that RTO stores are typically located long distances from each other cuts against a reasonably competitive RTO credit market.¹¹⁸ RTO stores do not compete for common customers, but rather serve a localized clientele. Therefore no competitive incentive exists to reduce the effective RTO interest charges and, absent

114. *Id.* See also *supra* note 9.

115. Usury laws have a long history:

The first recorded usury laws date to 2400 B.C. in India. In the West, interest rates were controlled through a number of legal devices during the Roman Republic. The Old Testament injunctions against profiting on loans to one's "brother" had a considerable influence on religious law and European civil law at least through the Reformation. Massachusetts and many other North American colonies followed English law in limiting interest payments to a fixed annual percentage of the loan. Noah Webster, a crusading libertarian as well as a lexicographer, led an energetic but unsuccessful campaign against state interest rate controls in post-revolutionary America. As recently as 1971, every state but two (Massachusetts, which repealed its usury law in 1867, and New Hampshire) imposed one form or another of interest rate limit on consumer loans.

Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG. 201, 202 (1986). Thus, the desire to provide "fair" treatment to consumers has a long history and affords a rationale for providing RTO consumers with adequate protections.

116. See *supra* note 112.

117. But see Walden *supra* note 9.

118. See Eric Schnapper, Comment, *Consumer Legislation and the Poor*, 76 YALE L.J. 745, 752 (1967) (arguing that low income consumers are pressured into purchasing goods in their community and are kept from shopping in other neighborhoods by "the inconvenience of a time-consuming trip to a more affluent area").

regulation, RTO consumers will be charged unfairly high interest rates.

One could argue that the existence of a vast credit card market makes regulating interest rates on RTO transactions unnecessary.¹¹⁹ If a consumer can buy merchandise using a credit card, why would he purchase through a RTO agreement?¹²⁰ In theory, the competition between the credit card industry and the RTO industry should drive interest rates to an equilibrium level that reflects the inherent risk associated with extending credit to particular individuals. However, the flaw in this argument is that many consumers are unable to obtain more favorable financing using credit cards.¹²¹ Because of this, the credit card market cannot exert leverage on the RTO credit market to assure that a fair interest rate is charged.¹²²

Inadequate disclosures to RTO consumers are also inequitable. An agreement is not fair if no reasonable opportunity exists for effective bargaining between the seller or lessor and the consumer.¹²³ Since RTO transactions are substantively indistinguishable from consumer credit sales, they should be subject to TILA disclosure requirements as well as to federal truth-in-lending laws to prevent practices which undermine effective bargaining between parties.¹²⁴

Finally, there is no sound reason to exclude RTO transactions from either the federal limitations on repossessions under the Fair Debt Collection Practices Act (FDCPA), or reporting requirements under the Fair Credit Reporting Act (FCRA).¹²⁵ Both consumer advocates and the RTO industry generally agree that egregious repossession tactics are unfair to consumers and should be avoided.

119. From 1970 to 1986, for families earning less than \$10,000 per year, the percentage of families holding a credit card increased from 17% to 42%. See Glenn B. Canner, *Changes in Consumer Holding and Use of Credit Cards, 1970-1986*, 10 J. RETAIL BANKING 13, 14 (1988).

120. See *supra* note 112.

121. In 1984, only about sixty-nine million Americans held bank credit cards. See DeMuth, *supra* note 115, at 208. In 1990, there were about 250 million people in the United States. See BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, 1990 CENSUS OF POPULATION, GENERAL POPULATION CHARACTERISTICS, UNITED STATES 3 (1990). Thus, a significant portion of the U.S. population does not have access to credit cards. A large portion of these people are undoubtedly poor consumers.

122. But see *supra* note 21.

123. See Lawrence, *supra* note 111, at 815.

124. *Id.* at 816-17 (arguing that consumers are unable to make rational consumer purchases—"the adeptness of salesmanship and advertising combined with the limited information and analytical skills possessed by a vast majority of the consuming public causes most consumer purchases to be irrational").

125. See Fair Credit Reporting Act, 15 U.S.C.A. §§ 1681t (West 1982), and Fair Debt Collection Practices Act, 15 U.S.C.A. §§ 1692-16920 (West 1982).

However, the FDCPA and the FCRA will apply to RTO contracts only if either RTO transactions are characterized as credit sales or if they are made subject explicitly to these federal statutes.¹²⁶ Although all states prohibit collection practices which breach the peace,¹²⁷ applying the FDCPA to RTO transactions would assure a uniform minimum level of protection and consumer fairness. Application of the FCRA to RTO transactions would also protect consumers from RTO dealers who may wrongfully report delinquent payments to credit agencies, thereby further impairing the credit record of someone who probably already has a marginal credit record. Finally, subjecting RTO transactions to the FCRA could help some consumers improve their credit record by making accessible to other creditors their record of timely payments on RTO goods.

B. Should RTO Transactions be Regulated?

In determining whether RTO transactions should be regulated, two issues should be considered. First, should freedom of contract override any issues of fairness in a transaction? Second, will the regulation of RTO contracts interfere with the efficient operation of the credit markets because the costs of such regulation exceed the perceived benefits?

1. *Regulating RTO Transactions Arguably Undermines Contract Law*

Freedom of contract is one of the most basic tenets of American contract law.¹²⁸ Contracts are rarely invalidated unless the court finds some combination of substantive and procedural uncon-

126. The FDCPA requires that a creditor "offers or extends credit creating a debt." See 15 U.S.C.A. § 1692a. RTO dealers do not extend credit since RTO contracts require prepayment for every period of expected use. Similarly, the FCRA applies only to credit transactions. See 15 U.S.C.A. § 1681-1681a. Therefore, the FDCPA and the FCRA will apply to RTO transactions only if they are made explicitly applicable through legislation.

127. Nehf, *supra* note 1, at 788-89 (stating that "[b]reaches of the peace and unfair or deceptive collection efforts of RTO dealers are prohibited under local law in every jurisdiction. . .").

128. Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 315 (1975) (*quoting* Printing and Numerical Registering Co. v. Sampson, L.R. 19 Eq. 462, 465 (1875): "[I]f there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice"). See also Craig Horowitz, Comment, *Reviving The Law of Substantive Unconscionability: Applying The Implied Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts*, 33 UCLA L. REV. 940 (1986).

scionability.¹²⁹ Under this standard, it is unclear whether RTO agreements would be considered unconscionable. Since consumers are not "forced" to purchase goods,¹³⁰ it is difficult to argue that entering into a RTO transaction involves a lack of meaningful choice.¹³¹ Therefore, the procedural requirement for unconscionability will not likely be satisfied. However, a RTO contract may be found unconscionable in jurisdictions where substantive unconscionability is sufficient to invalidate such agreements. In a minority of jurisdictions, courts have held that contracts are substantively unconscionable based on excessive price alone.¹³² These courts would likely invalidate RTO contracts as unconscionable. Nevertheless, in a majority of jurisdictions, the doctrine of unconscionability is unlikely to offer RTO consumers relief since these courts require

129. See *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965) stating that "[u]nconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties [procedural unconscionability] together with contract terms which are unreasonably favorable to the other party [substantive unconscionability]". Courts have looked to a variety of factors in applying the doctrine of unconscionability:

These factors include: (1) The use of printed form or boilerplate contracts drawn skillfully by the party in the strongest economic position, which establish industry wide standards offered on a take it or leave it basis to the party in a weaker economic position . . . ; (2) a significant cost-price disparity or excessive price; (3) a denial of basic rights and remedies to a buyer of consumer goods . . . ; (4) the inclusion of penalty clauses; (5) the circumstances surrounding the execution of the contract, including its commercial setting, its purpose and actual effect . . . ; (6) the hiding of clauses which are disadvantageous to one party in a mass of fine print trivia or in places which are inconspicuous to the party signing the contract . . . ; (7) phrasing clauses in language that is incomprehensible to a layman or that divert his attention from the problems raised by them or the rights given up through them; (8) an overall imbalance in the obligations and rights imposed by the bargain; (9) exploitation of the underprivileged, unsophisticated, uneducated and the illiterate . . . ; and (10) inequality of bargaining or economic power.

Wille v. Southwestern Bell Telephone Company, 549 P.2d 903, 906-07 (Kan. 1976). (citations omitted). These factors permit one to recognize unconscionability in a contract by looking at the totality of circumstances surrounding the contract. Weighing these factors, it becomes evident that RTO contracts should be deemed unconscionable in many instances.

130. See *supra* INTRODUCTION of this article.

131. For a critical view of the freedom of contract theory in an unconscionability case, see *Lefkowitz v. ITM, Inc.*, 52 Misc.2d 39, 54, 275 N.Y.S.2d 303, 321 (S. Ct. 1966) ("Let the buyer beware is a poor business philosophy for a social order allegedly based upon man's respect for his fellow man. Let the seller beware, too! A free enterprise system not founded upon personal morality will ultimately lose freedom.").

132. See *Horowitz, supra* note 128, at 947 (stating that all court decisions in which contracts have been invalidated on substantive grounds alone have involved "flagrantly excessive purchase prices in consumer credit contracts").

both substantive and procedural unconscionability to invalidate contracts.¹³³

2. *The Benefits of Regulation Outweigh the Costs*

The regulation of RTO transactions will not adversely affect the efficient operation of the RTO credit market. Market efficiency has been interpreted in two ways: wealth maximization and allocative efficiency.¹³⁴ A legal rule maximizes wealth when it facilitates the most efficient utilization of resources. However, wealth maximization is possible only when a consumer is aware of her preferences. RTO consumers cannot make fully rational purchasing decisions without sufficient disclosures.¹³⁵ In the absence of meaningful disclosure, a RTO consumer is unable to accurately ascertain her preferences. The consumer's inability to accurately ascertain preferences prevents efficient resource utilization, causing a market failure. Inadequate disclosures to RTO consumers ultimately leads to a market failure that is best remedied by some type of regulatory scheme.

Rent-to-own agreements are not allocatively efficient and should, therefore, be regulated. An exchange is allocatively efficient when one party cannot be made better off without making the other party worse off.¹³⁶ RTO transactions are not efficient because consumers lack sufficient disclosure to determine rationally whether or not they would be better off from any given exchange. Consumers do not know whether purchasing merchandise through a RTO arrangement is in their best economic interests when they do not have sufficient information to make a rational choice.¹³⁷ Therefore, allocative efficiency will not be possible in the absence of some regulatory controls.

133. *Id.* at 942 n.14 (stating "[s]ince 1971, no court has declared a contract unconscionable solely on substantive unconscionability grounds").

134. See Lewis A. Kornhauser, *A Guide to the Perplexed Claims of Efficiency in the Law*, 8 HOFSTRA L. REV. 591, 592 (1980). See also R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 4.7 at 10 (2d ed. 1977) (defining economic efficiency as the exploitation of "economic resources in such a way that 'value'—human satisfaction as measured by aggregate consumer willingness to pay for goods and services—is maximized") (emphasis in original). Cf. Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509, 512 (1980) ("Economists as well as proponents of the economic analysis of law employ at least four efficiency-related notions, including: (1) Productive efficiency, (2) Pareto optimality, (3) Pareto superiority, and (4) Kaldor-Hicks efficiency . . . Posner's wealth maximization would increase the total to at least five").

135. See *supra* notes 50 and 51.

136. Kornhauser, *supra* note 134, at 593 (stating that the allocative efficiency rationale is also called "Pareto optimality").

137. See *supra* note 135.

V. Suggested Reforms: Adopting the Minnesota Approach to RTO Contracts

The RTO industry has historically treated its consumers in an abusive and unfair manner,¹³⁸ and eluded consumer protection statutes by insisting that RTO transactions are leases and not sales. Fortunately, some jurisdictions are abandoning this position.

The Rental Purchase Agreement Act (RPAA)¹³⁹ adopted in Minnesota should, with a few minor modifications, serve as a model for other states adopting RTO legislation. The RPAA requires significant disclosures and sets controls in place to limit the cash price of goods purchased under a RTO contract.¹⁴⁰ However, the RPAA can be strengthened and clarified with two additional provisions.

First, the RPAA should explicitly define RTO transactions as consumer credit sales. This would ensure that all consumer protection statutes that apply to consumer credit sales would also apply to RTO transactions. By explicitly defining RTO transactions as consumer credit sales, statutory ambiguity is eliminated and the RPAA becomes a stand-alone statute. Consequently, the exercise in statutory interpretation performed by the Minnesota Supreme Court in *Miller v. Colortyme*¹⁴¹ becomes unnecessary.

Second, the cash price limit for RTO transactions should not be set by a bureaucracy. In Minnesota, the Commissioner of Commerce has authority to "adopt rules governing cash price limits for rental-purchase agreements."¹⁴² A more market efficient way of setting cash price would be to require that the cash price be no more than the average retail price for similar new or used goods in the community, with the RTO dealer responsible, subject to penalties, for ensuring that this requirement is met. A RTO dealer should be permitted to offer as a complete defense to a claim under this statute proof of a good faith attempt to comply with the provision.

This additional cash price statutory provision should award plaintiffs suing under the statute and prevailing at trial with significant damages as well as attorneys' fees. Since damage awards based on excessive variations between cash price and average retail

138. See *supra* note 56.

139. The Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.84-.97 (West Supp. 1995).

140. See *supra* notes 70 to 79.

141. *Miller v. Colortyme, Inc.*, 518 N.W.2d 544 (Minn. 1994). The Minnesota Supreme Court held that the RPAA did not repeal the Consumer Credit Sales Act. *Id.* at 551. Instead, the two statutes provide cumulative protection for consumers. *Id.*

142. Rental Purchase Agreement Act, MINN. STAT. ANN. § 325F.91, subd. 2 (West Supp. 1995).

price in the community are unlikely to serve as a sufficient deterrent to violation of the statute, damages should be set at a constant and predetermined amount, for example, \$500 per violation. This provision would ensure that RTO dealers abide by the statute, or risk costly lawsuits by RTO consumers. Allowing RTO dealers to police themselves under the shadow of a costly lawsuit should be more economically efficient than relying on an inefficient and expensive bureaucracy to promulgate RTO cash price regulations.

These additional changes to the Minnesota RPAA should strengthen and clarify the statute. The revised RPAA suggests a means for reforming other state consumer credit protection statutes to include similar protections for RTO consumers. RTO reform legislation is essential to protect consumers from abusive RTO practices. The Minnesota RPAA, combined with the suggested amendments above, should considerably improve the plight of RTO consumers.

Conclusion

The RTO industry has abused its consumers for many years. Regulation would stem these abuses. From an economics-based standpoint, market inefficiencies in the RTO industry could be eliminated by using regulations to assure wealth maximization and allocative efficiency. Consumers will be treated fairly only when they are provided with sufficient information to make rational purchasing decisions.

Renting-to-own: exploitation or market efficiency? The answer will depend in large part on the effectiveness of the regulatory scheme selected, which in turn will depend on how the competing policy objectives of equality and efficiency are ultimately balanced. What is clear is that RTO consumers will be subject to exploitation in the absence of regulations providing meaningful disclosures and protections.