




# *the* VISIBLE HAND *of* GOVERNMENT

## *Fixing prices in the rental industry*

**S**tate governments continue to intrude into the rental-purchase marketplace by mandating the unrealistic requirement of setting prices for rental merchandise. The state of Maine is the latest to do so with an amendment to its rental-purchase statute last fall that limits the cash prices that rental dealers may charge for any item in the store. The Maine Legislature previously limited the total rental-purchase price to twice the cash price when the state enacted its rental-purchase statute in 1992. In the original law, the Legislature decreed that cash prices had to be “reasonably related to the fair market value of the property.”  BY EDWINN III

# *But that was not enough.*

Today, Maine rental dealers must set cash prices according to the following formulas:

- Appliances: 1.75 times the cost of the unit\*
- Electronics with a cost of less than \$150: 1.75 times the cost of the unit\*
- Electronics with a cost of more than \$150: 2 times the cost of the unit\*
- Furniture and jewelry: 2.5 times the cost of the unit\*
- Other rental property: 2 times the cost of the unit\*

\* Includes freight charges, net of volume rebates, discounts or other incentives

Why the Maine Legislature thinks that it can price computers better than willing buyers and willing sellers is a mystery. Unfortunately, it is not a new mystery. A number of other state legislatures also have wrestled with pricing in the rental industry.

The very first rental-purchase statute in Michigan limited the total rental-purchase price to 2.2 times the rental dealer's cash price. The cash price itself was not fixed in the statute. At the time, the decision of whether to allow the Legislature in Michigan to fix the rental-purchase price was a hotly debated section in the bill.

In 1984, a number of Michigan rental dealers still were not disclosing the total rental-purchase price in their rental agreements. These dealers would provide the weekly or monthly rental rate and the total number of payments required for ownership, but they would not do the multiplication for the customer. Since then, eight other states—Connecticut, Hawaii, Iowa, Maine, New York, Ohio, Pennsylvania and West Virginia—have determined that the total rental-purchase price should be set by statute. All of these states limit the total rental-purchase price to twice the cash price except West Virginia, which limits the total rental-purchase price to 2.4 times the “retail value.”

## *Shouldering the burden of proving “retail value”*

Until 1993, no state had tried to go beyond limiting the total rental-purchase price by statute. That year, however, West Virginia passed its comprehensive rental-purchase statute in which the Legislature gave the state attorney general the authority and obligation to fix the retail value of products offered in rental stores.

The Legislature equated “retail value” with “fair market value.” The attorney general promulgated a rule in 1994 that offered several choices for setting retail value, most of which impose a considerable administrative burden on rental dealers. For example, rental dealers can document actual sales of goods “of substantially similar features” in the same market area as the rental store. The rental dealers then have the burden to prove that their “retail values” are correct.

The rule also provides “[t]he proof may come from only one retailer, but the goods must be sold to more than one buyer.” So, West Virginia rental dealers would have to get records of actual sales from retailers in the market to justify the rental dealers’ retail values. That consumer retail sales are not generally matters of public record or that retailers might not willingly furnish such information to rental dealers seems not to have occurred to the attorney general.

Alternatively, the attorney general rule set formulas for fixing “retail values,” using a markup over the dealer cost as follows. These percentages have remained since they came into effect:

- Kitchen and major appliances: 56 percent\*
- Electronics: 56 percent\*
- Furniture: 67 percent\*
- Jewelry: 82 percent\*
- Other: 67 percent\*

\* Dealer cost includes freight, but excludes rebates, discounts, incentives or other value received from the manufacturer and the supplier must not be a person related to the dealer.

The next state to limit cash prices was California in 1995. The California Legislature acknowledged the relevance of the marketplace to the establishment of cash prices, but, once again, imposed a harsh administrative burden on rental dealers to prove their cash prices were in line with other cash prices in the relevant market.

California rental dealers can set prices in accordance with market prices, but they have the burden of proving what cash prices are available in the market by collecting ads and other pricing materials and holding them for three years. This cash price information must be collected every 90 days in order to be considered valid.

An alternative approach requires that rental dealers use a statutory formula based on a dealer's cost to fix cash prices. The formula in California is twice the dealer cost, including freight. Using this safe-harbor formula presumably works for California rental dealers, but one may fairly ask whether the cash prices for some items, especially low-end electronics, bear any relation to the real cash prices for which these items are being bought and sold in California markets.

In 1997, Hawaii followed the lead of California and determined that rental dealers should either have to prove their cash prices are real ones by exhaustive record-keeping requirements or adopt the two-times-dealer-cost formula for setting cash prices.

## *The nebulous “fair market value”*

Conversely, since 1985, Georgia does not require a cash price disclosure at all, but instead requires rental dealers to disclose the “estimated fair market value of the leased property.” This imposes an indirect limit on pricing, because rental dealers must keep themselves aware of pricing in the marketplace or run the risk of

pricing goods too high and violating the statute.

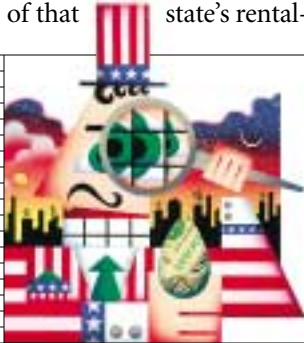
The fair market value of an item can only be finally determined after the fact by a judge or a jury who listens to evidence about the market and then decides if the price charged or disclosed was, in fact, the fair market value of the property.


In states that require the disclosure of a cash price defined as the price at which a willing dealer would sell the property to a willing buyer, the dealer can have the highest price in town without violating the law. In Georgia, however, a dealer with an estimated fair-market-value price higher than other merchants in town might be in violation of that state's rental-purchase statute.

tion. That argument held firm in a few states, but today it is a required disclosure in more than 40 states.

If most rental dealers are opposed philosophically to having the government set cash prices for them, it may behoove dealers to recognize that these efforts almost certainly have the unintended result of stifling competition—at least among retailers who would like to offer a rental program in their stores.

Electronics and furniture retailers who depend on cash sales will be loath to set up rental counters because they are competing on price for much of their merchandise. Since a merchant cannot have two different cash prices for the same merchandise in the same store, a low



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The argument for having the government set cash prices is that there are few actual cash sales of new merchandise in rental stores, so there is no market pressure on rental dealers as sellers to set cash prices realistically. Moreover, in the states where the total rental-purchase price that may be charged is tied to the cash price, there may be pressure on the rental dealer to raise cash prices to artificially high levels in order to get the desired number of turns on units.

### *The RTO "monopoly"?*

Fundamental to the notion of free market economics is that the market—the interplay between willing sellers and willing buyers—is the best means of establishing prices. The only times that the government can legitimately get involved in the pricing decision is when there are natural monopolies—utilities, for example, or during emergencies when necessities have become scarce with too few sellers and there is great demand and the risk of price gouging by merchants.

No one has argued that either of these situations exist in the rental-purchase industry. In fact, the 2000 Federal Trade Commission study noted that, "There do not appear to be any significant barriers to entry that would prevent new firms from entering the rent-to-own industry... A new entrant would need little more than a storefront, a delivery truck and an inventory of household merchandise."

### *Unintended competition barrier*

Early on, rental dealers argued that cash prices were an irrelevant disclosure in a rental-purchase transac-

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tion. That argument held firm in a few states, but today it is a required disclosure in more than 40 states. Fortunately, the setting of cash prices in rental stores does not appear to be a trend. There are few states left without rental-purchase legislation today. Cash price limits could appear in New Jersey, Wisconsin and North Carolina, in theory, but it may be that legislators in those states understand that fixing cash prices almost never has the intended result. If the prices are set too low, rental dealers will leave the market and consumers will have fewer choices. If the price is so low that rental dealers cannot run businesses profitably, there will be no rental-purchase choices for consumers. If the prices are set too high, then the price fixing has no effect at all.

It's like the guys who were sitting around one night debating the greatest invention of all time. Some were for the wheel; others were for fire; still others were for money. One old-timer then offered up the Thermos bottle. Amid all the laughter, someone in the group asked the old guy why the Thermos bottle was such a great invention. "Well," he replied, "It keeps the coffee hot in the wintertime and it keeps the tea cold in the summertime." To which the group responded, "What is so great about that?" The old man said, "But how does it know?"

Legislators do not know where to set cash prices for the many products offered daily to the American consuming public. Happily, most know their limits and leave such matters to Adam Smith's "Invisible Hand." The few efforts at price fixing in the rental-purchase industry have not had the desired result and in each case have probably been counterproductive to consumer advocate goals. ■

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