



of lawsuits and legislation

WITH UNFAVORABLE DECISIONS IN NEW JERSEY AND WISCONSIN, MARCH WAS HARSH FOR THE RENT-TO-OWN INDUSTRY

It was T.S. Eliot who declared April as the cruelest month. Cruelty came early to the rent-to-own industry this year as March saw the New Jersey Supreme Court and then the governor of Wisconsin lay waste to the industry in those two states. It was all bad RTO news in March, but in February the U.S. Supreme Court once again championed the fundamental fairness and utility of mandatory consumer arbitration as a means of resolving disputes. This article reviews all three events and their likely impact on the rental business.

BY ED WINN III

NEW JERSEY: Perez v. Rent-A-Center

NEW JERSEY SUPREME COURT, MARCH 15, 2006

SOME BACKGROUND ON RTO IN NEW JERSEY

The rent-to-own industry has had a long, antagonistic history in New Jersey. Even before RTO came on the scene in the state, New Jersey courts were leading the way in the development of such pro-consumer doctrines as unconscionability and products liability. Some of the first cases ever decided against businesses using these new-at-the-time legal doctrines were in New Jersey courts, a fact to which New Jersey jurists point with pride.

The first RTO case to find its way into a New Jersey state court was *Green v. Continental Rentals Inc.* in 1994. The trial court judge concluded that traditional rent-to-own agreements were retail installment contracts under state and federal law because courts must look beyond the form of a transaction and get to the substance of it—the “economic verity of the transaction” in the judge’s words. The RTO agreements were also “unconscionable” according to the judge in *Green*. Before that ruling could be appealed, the rental company went out of business.

Soon thereafter, a spate of lawsuits was filed against several different rental companies, perhaps the most noteworthy of which was *Robinson v. Thorn Americas Inc.* (1994). The judge in the Robinson case certified the class as including all customers of the company who had rented anything going back six years and held that the decisions in *Green* and a couple of other trial courts were the law in the state for RTO transactions—the decisions being that they are retail installment contracts under the New Jersey Retail Installment Sales Act (RISA). The judge in *Robinson* made additional rulings from the bench that allowed the parties to calculate damages in the case, which were in excess of \$120 million.

Thorn Americas—then parent company of Rent-A-Center—settled *Robinson* and litigation pending against two other companies, Crown Leasing Corp. and Renters’ Choice Inc., that Rent-A-Center had acquired while their cases were pending for \$60 million in 1998. Then Rent-A-Center changed its rental agreements in New Jersey by adding a fair market value balloon purchase option at the end of the rental term. Rental customers paid rent for possession and use of the product, but before they could obtain ownership, they had to purchase it for its estimated fair market value. The legal theory was that if customers always had to pay the fair market value for the property in order to own it, then any payments previously made must have been for the use of the property only and cannot have been part

of the purchase price. Therefore, the transaction, taken as a whole, cannot be a retail installment contract. Rent-A-Center has done business in New Jersey with balloon purchase option rental agreements from late 1998 until now.

THE PEREZ CASE AND HOLDING

It is important to understand the facts in *Perez*. While they may not have dictated the Supreme Court’s decision—New Jersey’s very liberal jurisprudential history can be held responsible for that—the facts certainly did not help. The chart below summarizes the history of Perez’s rental transactions with Rent-A-Center:

PAYMENT DATES	PRODUCT RENTED	CASH PRICE	WEEKLY RATE	WEEKS TO OWNERSHIP	TOTAL RTO PRICE	AMOUNTS PAID
March 3, 2001	Furniture	\$1,951.43	\$38.99	91.4	\$3,902.76	\$2,573.34
April 23, 2001	Washer/dryer	\$987.47	\$21.99	95.3	\$1,984.90	\$1,418.71
August 3, 2001	TV/DVD player	\$1,160.99	\$22.99	92.0	\$2,321.99	\$1,264.39
November 17, 2001	Computer	\$2,235.48	\$42.99	120.0	\$5,392.71	\$965.79
TOTALS		\$9,301.72	\$172.95		\$18,613.32	\$8,156.72

The totals are eye-popping. Perez was making rental payments of \$744 per month, not including “other fees” and taxes. The total rent-to-own price for all of the merchandise, including the balloon purchase option, was more than \$18,000. Perez was described in an amicus brief filed by a consumer advocacy group as “a low-income cook who receives food stamps.” Indeed, few traditional RTO customers could afford weekly rental payments of \$173 for very long. When she had paid more than \$8,000 on her agreements, she quit paying. Rent-A-Center sued her in small claims court for damages and return of the merchandise. Rent-A-Center had not been paid the cash price totals for the items Perez had rented, but almost certainly had recovered its cost of goods, if one assumes a three-to-four-turns pricing formula on most of the items.

When Perez got served with the Rent-A-Center lawsuit against her, she went to a lawyer and she countersued Rent-A-Center on her own behalf and “for all those similarly situated”—a class action complaint—for violations of New Jersey’s RISA and the state Consumer Fraud Act. The trial court, recognizing the economic and legal importance of the balloon purchase options in Rent-A-Center’s rental agreements, ruled in favor of Rent-A-Center and dismissed Perez’s lawsuit altogether.

Perez appealed, claiming that the trial court erred when it dismissed her suit. The court of appeals upheld the dismissal of Perez’s claims and in a detailed written opinion explained why Rent-A-Center’s rental agreements with balloon purchase options were not retail installment sales under state law.

Perez appealed to the state Supreme Court, which took the case, heard arguments last November and issued its six-to-one opinion reversing the appeals court on March 15, 2006.

The supreme court held that Rent-A-Center’s rental agreements with the fair market value balloon purchase options are retail installment contracts as defined in the state RISA, because the court’s obligation is to “interpret the statute reasonably to serve its apparent legislative purpose.” That purpose, according to the court is “the protection of the public interest through the regulation of charges associated with the time sale of goods.” After admitting that the transactions in the lawsuit did not fit neatly within the definitions in the statute, the court explained that “questions regarding the applicability of the statute must be resolved in favor of consumers for whose protection RISA was enacted.”

To reach this conclusion, the court had to ignore the plain language of the statute requiring an obligation on the part of the consumer to make payments—and it did so. The court concluded that Rent-A-Center’s agreements were “conditional sales,” a term included in the definition of retail installment contract, but nowhere defined. The court attached no importance to the no-obligation feature of the agreements, because Perez argued that this feature was of no value to her, since she intended to own everything, an argument that the court adopted.

What is curious is that the court made vague reference to “studies, including those by Rent-A-Center, [that] have concluded that between 64 percent and 70 percent of all rent-to-own merchandise is ultimately purchased by the customers.” The court also cited the 2002 FTC study to support this finding.

There was never a trial in *Perez*. No witnesses ever got on the stand. No expert witnesses were ever cross-examined and so this evidentiary conclusion is difficult to understand. However, it

helped the court get to the answer it wanted in the lawsuit: “[Our decision] is bolstered by the fact that the majority of rent-to-own contracts are intended for and in fact result in ownership, not cancellation. To exclude the many purchasers from the protective sweep of RISA by providing a cancellation that few would exercise would be an intolerably narrow interpretation of the statute limned for consumer protection purposes.”

This finding is all the more curious since in other lawsuits where evidence was tested in court, the Rent-A-Center keep rate has consistently been under 35 percent.

It appears as if the court is reaching conclusions based on findings not in evidence, but that does not make the ruling any less binding on Rent-A-Center. If such an error had occurred in a lower court, Rent-A-Center could appeal to a higher court, but in this instance, with only state claims at issue, the New Jersey Supreme Court has the last word. This is not the first time, certainly—nor will it be the last—that

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a court misconstrues the facts of a case to support the conclusion that it wants to reach.

The court went on to hold that the interest rate cap of 30 percent in the New Jersey criminal usury statute applies to Rent-A-Center’s rental transactions and made the finding that the entire amount between the cash price and the total of payments for ownership, including the balloon, is interest. Finally, because all of the *Perez* agreements have an undisclosed interest rate greater than 30 percent, the court found that the Consumer Fraud Act applies to all of the transactions. That means that the company may be liable for

treble damages under certain circumstances.

By its terms, the criminal usury statute applies only to loans of money. Not any more. After *Perez*, the statute applies to any transaction with an interest rate or a finance charge. In one fell swoop, the court did away with the 200-year distinction between usury limits on loans of money and finance charge limits on time price sales of goods. The majority view in the country is that these two kinds of transactions are fundamentally different and nearly every state has different rules for loans than for sales of goods.

The court sent the case back to the trial court where there will now be a trial on the amount of damages that Rent-A-Center must pay for its multiple violations of these several state statutes.

When Rent-A-Center settled the *Robinson* case for \$60 million, it had 22 stores in New Jersey. Now, according to the New Jersey Supreme Court, the company has about 50 stores in the state. While the record is not sufficiently com-



plete to make any realistic estimates of the cost of this suit, it can fairly be predicted that *Perez* will cost Rent-A-Center tens of millions of dollars. In addition, it will require Rent-A-Center, and perhaps other rental dealers in the state, to alter their business practices in substantial fashion.

A similar situation arose a few years ago in Wisconsin when Rent-A-Center and most other rental dealers in that state had to begin offering transactions that complied with the Wisconsin Consumer Act, that state's version of a retail installment sales act. The difference is that in Wisconsin, there is no limit on finance charges. The difference between the cash price and the total price for ownership in Wisconsin can be any amount that is agreed to by the parties, with the proviso that it must be disclosed as an interest rate.

The challenge in New Jersey will be for rental companies to craft transactions that fit under the 30 percent interest rate cap. Rental dealers may have some leeway in setting cash prices, but they may have to quit offering some lower-end electronic products that are heavily discounted in the retail marketplace.

Outside of New Jersey, the *Perez* decision has no real legal influence. It is a state court interpreting its own state's statutes and the precedential value of the opinion stops at the state line. It is true that sometimes court opinions are so powerfully and insightfully crafted that courts in other jurisdictions are so swayed by the force and beauty of the arguments that they choose to follow the decision even though not required to do so. *Perez* is no such case.

The decision gives succor to consumer advocates everywhere. New Jersey Public Interest Research Group have crowed often and publicly that *Perez* "is a complete and total victory for consumers." The industry can fairly expect some negative press from the decision. When *Robinson* was settled, the New York media picked up the story and several hostile pieces on the industry were aired nationally.

What is *not* likely is any unraveling of the time-tested rent-to-own statutes that are firmly in place in 47 states. The decision effectively killed any further consideration of the bill labeled "New Jersey Rental-Purchase Consumer Protection Act" that was wending its way through the state house in Trenton. The bill's Senate sponsor, himself a former vigorous and effective consumer advocate in state government and still a staunch supporter of his bill, has indicated that he cannot move the bill in the current political climate in the aftermath of *Perez*. This latest bill is part of the industry's effort to get a rent-to-own statute in New Jersey that has been ongoing since 1988.

W I S C O N S I N : Vetoing a rent-to-own bill

The other bad news that rained down on the industry in March came from the governor's desk in Wisconsin. Governor Jim Doyle has previously

served the state as attorney general and in that role bedeviled the rent-to-own industry in the state for years by extracting a series of settlements from rental companies there totaling more than \$25 million. One rental company agreed to a settlement with Doyle's attorney general's office of "only" \$500,000 and the company's agreement to shutter its store locations and leave the state. In addition, there had been a number of private class action lawsuits brought and in every one, the Wisconsin courts ruled against the industry.

The charges have always been that RTO transactions, however configured, are disguised retail installment contracts under the Wisconsin Consumer Act, one of the earliest and still one of the most comprehensive consumer protection statutes in the country.

Attorney General Doyle was a strident and vocal critic of the industry in the state. He sent his deputies to Washington, D.C., to testify against pending RTO legislation in 2001. Wisconsin rental dealers have been seeking safe-harbor legislation in Madison on and off since 1981. Once before, in 2001, a Wisconsin governor, this time a Republican and Doyle's predecessor, vetoed rent-to-own legislation that the industry was supporting. The veto occurred late in an election year and the sitting governor lost the next election to Doyle.

Despite Doyle's previous pronouncements against the industry while attorney general, the industry approached him in his new role as governor soon after his election and he indicated that if he got a good bill from the legislature he would sign it. Wisconsin rental dealers worked closely with the governor's office to craft a bill that would satisfy the governor's concerns about industry practices. It was that bill, blessed by the governor's staff, that the dealers finally worked through the legislature this spring. Once the bill got to the governor's desk after close votes in both houses and tons of negative press about the evils of rent-to-own, Wisconsin rental dealers thought that the governor was merely waiting for some of the heat over the issue to dissipate and then he was going to sign the bill into law. It was a crushing blow to the dealers in the state to learn that the governor had vetoed the bill.

Once again, the governor's actions will only finally be felt in his own state. Wisconsin remains one of the few remaining redoubts against the RTO industry.

And so, as much as rental dealers might wish their business were respected or at least tolerated everywhere, such is not the case today. Opposition has become concentrated in Minnesota, Wisconsin and New Jersey. Opposition exists elsewhere, to be sure, but elsewhere there is fair and balanced rent-to-own legislation on the books. These laws reflect the negotiated compromises made by rental dealers on the one hand and reasonable consumer advocates on the other. It is not true that Wisconsin and New Jersey have captured all of the rabid consumer advocates in the country. It only seems that way for the moment. There are plenty of unreasonable consumer advocates everywhere, but lately, they have turned their ire toward what they view as other, more egregious examples of capitalism run amuck, like the

payday loan industry.

As painful as these two events are, coming so close together, they are perhaps useful scourges for rental dealers everywhere against the tendency toward hubris. After long, quiet, successful spells of running businesses, a certain complacency can set into any business. Dealers are cautioned to remember that they do not have a divine right to run their businesses. They do so only with the permission of the government—and that permission can be granted or withdrawn at any time depending on the political winds of the moment. It is important that rental dealers everywhere not to forget that truth.

U . S . S U P R E M E C O U R T : Favoring mandatory consumer arbitration

Rarely is the news all bad, unless you are a sitting president. In addition to the bad news coming out of New Jersey and Wisconsin, good news came out of the U.S. Supreme Court this February when it ruled once again in favor of mandatory consumer arbitration in *Buckeye Check Cashing v. Cardegna*. This was a case arising from the payday loan industry and is one that offers some comfort and pleasant legal prospects to the rent-to-own industry.

In *Buckeye*, the plaintiff filed a class action lawsuit against a payday lender in Florida state court alleging that his loan was usurious under Florida law, violated several other state laws, was illegal on

its face and therefore void. The loan agreement contained an arbitration provision allowing either party to compel arbitration to resolve any disputes that might arise between the debtor and the creditor out of the loan transaction. The trial court denied the lender's motion to compel arbitration and the Florida Court of Appeals reversed, holding that the arbitration provision controlled the dispute. The Florida Supreme Court reversed the court of appeals and sent the case back to the trial court. Finally, the U.S. Supreme Court agreed to consider the case and in February ruled that arbitration was indeed the proper forum for resolving the plaintiff's claims against the lender. The Supreme Court repeated some the supportive comments about the Federal Arbitration Act, which "embodies the national policy favoring arbitration..."

The specific holding in *Buckeye* is that a mandatory arbitration provision in an agreement with a consumer as a party is enforceable against challenges to the validity of the underlying contract. The Supreme Court has been consistent in several previous rulings that mandatory consumer arbitration provisions are an acceptable mechanism for resolving disputes that arise out of the contract as long as the

arbitration process itself does not violate due process. The arbitration must not be too expensive for the consumer; the arbitrator must be competent and unbiased; the location of the arbitration must be reasonably convenient to the consumer; and certain procedural safeguards must be in place during the process. The three major national arbitration tribunals in the United States—the American Arbitration Association, the National Arbitration Forum and Judicial Arbitration and Mediation Services (JAMS)—all have such procedures in place in their codes of procedures for consumer arbitrations.

The clear message for rental dealers who worry about legal issues, class action lawsuits and the like, is to add arbitration provisions to their rental agreements. If they make sure that the process for arbitrating disputes is fundamentally fair for aggrieved consumers, then the chances are good that the provision will work almost everywhere, giving both sides a quicker and less expensive resolution to their disputes and protecting the dealer from the specter of defending a class action lawsuit.

Even in a perfect storm like the deluge that descended on rent-to-own in March, there is always a silver lining. ■

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