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Renting the Good Life

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Renting the Good Life

Academic literature and court decisions are replete with calls to ban or severely inhibit the rent-to-own industry. The argument is simple enough: Rent-to-own firms charge exorbitant prices to the most needy and vulnerable segments of society.

The case for burdensome regulations, however, is much more difficult to make out than past scholarship has admitted. For the most part, academics have proceeded directly to propose specific regulations for the industry without first carefully analyzing the rent-to-own business or the reasons for imposing drastic regulations.

This Article examines the theoretical justifications for regulating the rent-to-own industry against the backdrop of interviews I conducted with key participants in the market, recent empirical data about the industry, and the industry's unique business model. I find that the case for completely banning the rent-to-own transaction is very weak. On the other hand, guided by insights from behavioral law and economics, policy makers have strong justifications for imposing regulations tailored to address the cognitive defects from which customers are most likely to suffer.

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At first glance, the case for banning or severely regulating rent-to-own transactions seems plain enough. The transaction, aimed at customers with lower incomes, is extremely expensive. In the typical rent-to-own transaction, a customer acquires ownership of a good by paying weekly rental payments for the duration of the rental agreement. The overall cost for the merchandise ends up doubling or tripling the cost of purchasing it outright at another store. Why should the poorest members of society pay more to purchase goods than the rich? If someone from the middle class can walk into Target and pay \$170 for a television, why should a consumer with a lower income have to pay \$500 for the exact same product at Rent-A-Center?

Academics, courts, and journalists often appeal to the high price of rent-to-own transactions as an automatic justification for regulation. Using the high-cost of these transactions, however, turns out to be a deceptively hollow foundation for imposing burdensome regulations. The case for severely regulating the rent-to-own industry is harder to make than past commentary has admitted. In part, scholarship has failed to justify rent-to-own regulations because it has neglected to take account of the unique nature of the rent-to-own transaction, the customers who use this product, and the business environment in which firms operate. Instead of looking at the empirical data on the industry, policy makers, courts, and academics have relied on a faulty heuristic to evaluate the industry: They attempt to force this unique product into the conceptual category of either a credit sale or a lease.

Take two examples, one from the courts and the other from academic commentary. In 2006, the New Jersey Supreme Court, in *Perez v. Rent-A-Center, Inc.*,¹ issued an opinion that determined the future of rent-to-own in that state. To conclude rent-to-own products are really credit sales subject to harsher regulation, the court made several critical empirical assumptions about the rent-to-own industry: that customers always intend to obtain ownership of rent-to-own goods,² that customers do not value the ability to cancel their rental-agreements,³ and that the goods that rent-to-own stores rent are necessities for life.⁴ The best empirical data on the industry, however, reveal that each of these critical assumptions turns out to be either patently false or at least highly debatable.

Recently, there has been a renewed academic interest in studying the fringe economy,⁵ including the rent-to-own industry.⁶ Just like the judges in *Perez*, academics have fallen into the

¹ 892 A.2d 1255 (N.J. 2006).

² *Id.* at 1258.

³ *Id.* at 1269 n.14.

⁴ *Id.* at 1264-65.

⁵ For sample of the literature, see Richard R.W. Brooks, *Credit Past Due*, 106 COLUM. L. REV. 994 (2006); Angela Littwin, *Beyond Usury: A Study of Credit Card Use and Preferences among Low-Income Consumers*, 86 TEX. L. REV. (forthcoming 2007); Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855 (2007); Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. REV. 513 (2005); Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121 (2004).

⁶ E.g., Jason Scott Johnston, *The Return of Bargain: An Economic Theory of How Standard-Form Contracts Enable Cooperative Negotiation between Business and Consumers*, 104 MICH. L. REV. 857, 873 (2006); Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided "Reform" of Bankruptcy Law*, 84 TEX. L. REV. 1481, 1550 (2006); Colin Camerer et. al, *Regulation for Conservatives:*

same trap of drawing false conclusions from incorrect empirical assumptions.⁷ For instance, Camerer et al.'s 2003 *Pennsylvania Law Review* article on asymmetric paternalism argues that requiring rent-to-own firms to disclose implied annual percentage rates (APRs) would not eliminate consumer choice by limiting the availability of the rent-to-own transaction.⁸ Interviews I conducted with industry participants, however, reveal this is not the case. Requiring APR disclosures eliminates almost half the market's participants because some companies refuse to operate in states with APR disclosures.⁹ Consumers in Minnesota, a state that requires APR disclosures, may have some choice to use rent-to-own, but it is severely limited—only eleven rent-to-own stores operate in the entire state.¹⁰

This Article combines the best empirical research on the rent-to-own industry, most of which has gone unnoticed by legal academics, with interviews I conducted with key industry participants. It argues that regulations that prohibit or severely limit the rent-to-own industry are very difficult to justify. Instead, guided by insights from behavioral law and economics, policy makers have strong justifications for imposing narrow regulations tailored to address the cognitive defects from which customers are most likely to suffer. Whereas past rent-to-own scholarship has primarily offered regulatory solutions,¹¹ this Article proceeds on the premise that the best regulations are those that address real problems. Using the unique nature of the rent-to-own transaction and evidence of how the industry operates, I offer justifications for imposing regulation on this industry.

Much of the data presented in this Article come from interviews I conducted with rent-to-own operators. Remarkably, past attempts to analyze this industry have never looked to the firms populating the market to understand how the industry functions. This Article presents the first-ever academic analysis of rent-to-own that is informed by industry participants.

Behavioral Economics and the Case for "Asymmetric Paternalism", 151 U. PA. L. REV. 1211, 1231-32 (2003); James J. White, *The Usury Trompe L'Oeil*, 51 S.C. L. REV. 445, 458-65 (2000).

⁷ Past scholarship has noted the need for empirical studies to adequately address regulating this industry. Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates v. The Rent-To-Own Industry: Reaching a Reasonable Accommodation*, 34 AM. BUS. L.J. 385, 393 (1997). Only recently has this data become available.

⁸ Camerer et. al, *supra* note 6, at 1231-23.

⁹ Interview with Christopher Korst, General Counsel of Rent-A-Center (May 7, 2007) [hereinafter Korst Interview] (on file with author). It is important to ask why operators dislike APR disclosures so intensely. It might be because APR disclosures allow customers to compare renting-to-own with other credit products, and operators want to prevent this comparison through framing rent-to-own transactions in actual costs, not percentages. This would suggest that operators leave jurisdictions with APR disclosure requirements because this deceptive framing is fundamental to their business model. I do not think so. For the explanation of why bona fide operators may be driven out of a market because of this rule, see notes 283 – 287 and accompanying text.

¹⁰ Association of Progressive Rental Organizations, *State RTO Statutes and Economic Impact*, [hereinafter APRO, *State RTO Statutes*], http://www.rtohq.org/Legislative_activity/State_statutes_and_economic_impact/index.aspx (last visited Aug. 3, 2007).

¹¹ See, e.g., Martin & Huckins, *supra* note 7; Eligio Pimental, *Renting-to-Own: Exploitation or Market Efficiency?*, 13 LAW AND INEQUALITY 369 (1995); James P. Nehf, *Effective Regulation of Rent-to-Own Contracts*, 52 OHIO ST. L.J. 751 (1991); Scott J. Burnham, *The Regulation of Rent-to-Own Transactions*, 3 LOY. CONSUMER L. REP. 40 (1991).

Part I describes and analyzes the rent-to-own business, addressing the transaction, the customers, and the market itself. Far from being background material, this description and analysis unveil important aspects of this industry that have gone unnoticed in the literature. Furthermore, this Part drives my recommendations about optimal regulatory policy. Part II evaluates the best arguments for banning or severely regulating the rent-to-own industry. Concluding that the case for severe regulations is weak, I look to behavioral law and economics to chart out the conceptual justifications for narrow, tailored rent-to-own regulations. Part III concludes by critically analyzing specific rent-to-own regulations—some of which are currently law and some of which I propose as new regulations.

I. THE RENT-TO-OWN BUSINESS

Mapping out a basic analysis of the rent-to-own business turns out to be a relatively complicated task, but the work is well worth it. A rich understanding of how this business operates is essential to determining what regulations are justified. This Part considers three key elements of the industry in turn: the transaction itself, the customer base, and the market.

A. The Rent-to-Own Transaction

The basics of the rent-to-own transaction are easy to describe: Customers agree to pay weekly or monthly rental payments, and stores deliver merchandise to the customer's home and take on the responsibility to service the merchandise.¹² The store, however, retains title to the goods. If the customer decides to terminate the contract or stops making the payments, the store takes back the merchandise. Although the customer does not have any ownership interest in the property based on the prior payments, the customer does not have any obligation to continue making payments. If the customer makes all the payments required under the contract, the customer acquires title to the merchandise. The customer can also obtain ownership at any point during the pendency of the contract by making a lump payment—usually the aggregate of the total remaining payments discounted by some percentage, depending on how early in the contract the consumer makes the payment.

1. Disguised Credit Sales or True Leases? (Or Who Cares?)

Though the transaction is easy to describe, it is difficult to categorize. A debate has raged for years about whether rent-to-own transactions are leases or credit sales.¹³ Traditionally,

¹² For more background on the information contained in this paragraph, see Association of Progressive Rental Organizations, *Industry Overview*, [hereinafter APRO, *Industry Overview*] http://www.rtohq.org/About_rent-to-own/Industry_overview/index.aspx#transaction (last visited Aug. 3, 2007).

¹³ See, e.g., Ingrid Michelsen Hillinger & Michael G. Hillinger, *Section 365 in the Consumer Context: Something Old, Something Borrowed, Something Blue*, 104 COM. L.J. 377, 412 (1999) (“Much litigation, both in and outside of bankruptcy, has focused on characterizing the true nature of a RTO transaction.”); James M. Lacko et al., *Customer Experience with Rent-to-Own Transactions*, 21 J. OF PUB. POLICY & MKTG. 126, 126 (2002) (“[T]he nature of the transaction has been controversial”); Pimental, *supra* note 11, at 373 (“The pivotal issue with respect to RTO contracts is whether they should be characterized as a lease or a sale.”); Clark et al., “*Rent-to-Own*” *Agreements in Bankruptcy: Sales or Leases?*, 2 AM. BANKR. INST. L. REV. 115 (1994); Martin & Huckins, *supra* note 7, at 417 (“The most significant legal issue for [rent-to-own] operators has been whether a [rent-to-own] transaction is a sale

academics have allowed this debate to consume the discussion of renting-to-own: “The controversy about rent-to-own is based on identifying the essential nature of the agreement.”¹⁴ Like most debates about the rent-to-own business, this debate has the potential to have real consequences. If rent-to-own transactions are really credit sales under existing law, then they are subject to the Truth-in-Lending Act,¹⁵ and they have extremely high APRs.¹⁶ Also, if the transactions are credit sales, a customer has a higher likelihood of keeping possession of rented goods in bankruptcy because she can often retain ownership of the goods for less than what she owes the store.¹⁷ If rent-to-own transactions are leases, on the other hand, a debtor in bankruptcy who wishes to keep the goods must (1) cure the default on the contract by paying everything due to date and (2) assume the contract, paying the full amount due.¹⁸ Additionally, if these transactions are credit sales, customers have more rights upon defaulting on the agreement outside of bankruptcy under Article 9 of the Uniform Commercial Code (UCC) because they have rights to be given notice of a sale, to redeem the goods, and to be paid any surplus of a sale.¹⁹ But in the event default under Article 2A of the UCC, which governs leases, a lessee has no right to notice of enforcement, and a lessor can repossess the goods without judicial process and without giving the lessee any residual value the lessee may have in the goods.²⁰ The disparate treatment afforded to secured transactions and leases emanates from a more fundamental distinction: The customer forfeits all equity she has in the goods in the context of a lease, but she retains her residual interest if the transaction is a credit sale.

or a lease.”); Nehf, *supra* note 11, at 788 (“Perhaps the most often litigated [rent-to-own] issue is whether the [rent-to-own] contract should be characterized as a true lease or as a security agreement.”).

¹⁴ Michael H. Anderson & Raymond Jackson, *Rent-to-Own Agreements: Purchases or Rentals?*, 20 J. OF APPLIED BUS. RESEARCH 13, 2 (2004) [*hereinafter* Anderson & Jackson, *Rent-to-Own Agreements*].

¹⁵ 15 U.S.C. §§ 1601-1677 (2000).

¹⁶ Michael H. Anderson & Raymond Jackson, *A Reconsideration of Rent-to-Own*, 35 J. OF CONSUMER AFFAIRS 295, 303 (2001) [*hereinafter* Anderson & Jackson, *A Reconsideration*] (“When viewed simply as installment contracts, the implied APRs are indeed extremely high even when the value of additional services provided by the RTO firms are included in the calculations.”).

¹⁷ If the rent-to-own transaction is a credit sale, the firm has a purchase money security interest in the asset the customer is renting, UCC § 9-103(b), but the customer owns it, so as a general rule, the asset becomes the property of the bankruptcy estate when an individual files for bankruptcy. 11 U.S.C. § 541(a)(1). But under either Chapter 7 or 13, a debtor may recover the assets at a lower price than she actually owes. When the customer declares bankruptcy under Chapter 7, she may redeem “tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title . . . by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien in full at the time of redemption.” *Id.* § 722. A rent-to-own good is exempt property, and thus eligible for redemption under § 722, if (1) the state where the debtor is domiciled has not “opted-out” of the federal exemptions, *id.* § 522(b), or the good is exempt under the state’s provision; and (2) the individual asset is worth less than \$475 (or \$1,225 if the asset is jewelry). *Id.* § 522(d)(3) & (4). So, instead of the debtor paying the full amount of the debt owed in order to retain the good, the debtor would only have to pay the value of the collateral (i.e., “the amount of the allowed secure claim” defined in § 506(a)) to redeem it. When filing under Chapter 13, she may retain the property through a reaffirmation agreement, potentially for an amount less than owed before bankruptcy, *id.* § 524; or through making periodic payments under the plan. *Id.* § 1325(a)(5)(B)(I)(aa). *See also* Hillinger & Hillinger, *supra* note 13, at 409-410; Clark et al, *supra* note 13, at 122-24.

¹⁸ 11 U.S.C. § 365(b)(1).

¹⁹ UCC § 9-611 (right to notice of sale); *id.* § 9-615 (right to surplus from sale); *id.* § 9-623 (right of redemption).

²⁰ UCC § 2A-502 (no right to notice after default); *id.* § 2A-525 (lessor’s right to repossession).

Academics and courts have proffered numerous arguments to prove that rent-to-own transactions are really credit sales in disguise. The most important argument is that rent-to-own transactions are credit sales because they are structured like credit sales—customers obtain ownership of durable goods over time through periodic payments.²¹ In addition, others argue that customers perceive the transactions as credit transactions;²² that the name of “rental-purchase” reveals the transactions as disguised sales;²³ that consumers “b[ear] the risk of loss, [are] responsible for paying the sales tax, [and are] the beneficiaries of warranty provisions”;²⁴ and that most consumers complete the rental agreements and obtain ownership.²⁵ My analysis of public firms’ annual reports adds an additional argument in favor of categorizing rent-to-own transactions as credit sales. Rent-to-own companies themselves see the transaction as a replacement for credit sales.²⁶

The main justification for categorizing rent-to-own transactions as leases and not credit sales is that these transactions permit customers to cancel the contract at any time with absolutely no further obligation to pay.²⁷ Also, the dealer, not the customer, has the obligation to maintain

²¹ JOHN P. CASKEY, LOWER INCOME AMERICANS, HIGHER COST FINANCIAL SERVICES 49 (1997); HOWARD KARGER, SHORTCHANGED: LIFE AND DEBT IN THE FRINGE ECONOMY 105 (2005); Johnston, *supra* note 6, at 872; Roger M. Swagler & Paula Wheeler, *Rental-Purchase Agreements: A Preliminary Investigation of Consumer Attitudes and Behaviors*, 23 J. OF CONSUMER AFFAIR 145, 146 (1989); Ronald Paul Hill et al., *The Rent-to-Own Industry and Pricing Disclosure Tactics*, 17 J. OF PUB. POL’Y & MKTG. 3, 3 (1998); Perez v. Rent-A-Center, Inc., 892 A.2d 1255, 1268 (N.J. 2006).

²² Manoj Hastak, *Regulation of the Rent-to-Own Industry: Implications of the Wisconsin Settlement with Rent-A-Center*, 23 J. OF PUB. POL’Y & MKTG. 89, 90 (2004). Consumer behavior in bankruptcy may bolster this claim because “[d]ebtors in bankruptcy who have [rent-to-own] contracts typically list them as either unsecured or secured debts, and not as leases.” Nathaniel C. Nichols, *The Poor Need Not Apply: Moralistic Barriers to Bankruptcy’s Fresh Start*, 25 RUTGERS L.J. 329, 356 (1994).

²³ Hillinger & Hillinger, *supra* note 13, at 414 (discussing *In re Jarrells*, 205 B.R. 994 (M.D. Ga. 1997)).

²⁴ *Id.* at 414-15 (discussing *In re Goin*, 141 B.R. 730, 731 (Bankr. D. Idaho 1992)).

²⁵ This claim is extremely contentious by itself. Two contrasting studies, coming to very different results, are good examples of the two major positions in the debate. The FTC’s extensive survey of rent-to-own customers found that 70% of rent-to-own goods were purchased by the customer. FEDERAL TRADE COMMISSION (FTC), SURVEY OF RENT-TO-OWN CUSTOMERS ES-1 (2000). Anderson and Jackson analyzed thousands of transactions drawn from 100 rent-to-own stores in 46 states and concluded based on these transactions that 39.09% of agreements lead to ownership. Anderson & Jackson, *Rent-to-Own Agreements*, *supra* note 14, at ii, 10. Both the FTC’s Survey and Anderson and Jackson’s papers criticize the other’s empirical methods. Lacko, *supra* note 13, at 135; Anderson & Jackson, *Rent-to-Own Agreements*, *supra* note 14, at 6.

²⁶ See Aaron Rents, Inc., Annual Report (Form 10-K), at 4 (Feb. 22, 2007) (“Our sales and lease ownership division focuses on providing durable household goods to lower to middle income consumers who have limited or no access to traditional credit sources such as bank financing, installment credit or credit cards.”); Rent-Way, Inc., Annual Report (Form 10-K), at 2 (Dec. 29, 2005) (“[T]he rental-purchase business offers an alternative to traditional retail installment sales”); Rent-A-Center, Inc., Annual Report (Form 10-K), at 1 (Feb. 23, 2007) (stating that renting-to-own allows consumers to obtain “merchandise that they might otherwise be unable to obtain due to insufficient cash resources or a lack of access to credit”).

²⁷ For instance, despite the statute’s plain language, one bankruptcy court refused to treat a rent-to-own transaction as a credit sale because it would lead to an absurd result: “Such an interpretation would call an agreement a contract of sale even though it lacked one of the essential elements of a contract of sale, namely an obligation to pay the purchase price agreed upon.” *In re Colin*, 136 B.R. 856, 858 (Bankr. D. Or. 1991). See also Brian S. Prestes,

and repair the product.²⁸ Courts intervene to treat these transactions as secured loans, we are told, *only* to protect consumers.²⁹ Advocates also point to the evidence that many agreements do not lead to ownership as proof that renting-to-own should be thought of as a lease.³⁰

This debate has outlived its usefulness to regulators—both because current laws do not require us to fit rent-to-own into one of these two categories and because the transaction has aspects of both credit sales and leases. While it is true that there are significant implications under current commercial law if rent-to-own transactions are credit sales or leases, rent-to-own is almost always defined by specific regulations, so these distinctions are inapposite.³¹ Consider, for instance, the California Rental Purchase Act.³² That Act defines a rental-purchase agreement just as the transaction is described above,³³ and explicitly states: “A rental-purchase agreement is a lease . . . [and] shall not be construed to be” a retail installment sale, a retail installment contract, a retail installment account, a lease or agreement that constitutes a security interest, or a consumer credit contract.³⁴ As a legal matter, the credit-sale–lease question in states like California is of no practical importance because the legislature has already provided the definitive answer.

In the current legal landscape, the only reason that academics, courts, and regulators attempt to classify rent-to-own transactions as credit sales or leases is because these two concepts provide regulators with a heuristic device for regulating.³⁵ If renting-to-own is a credit sale, we will regulate it using principles we have developed for regulating other credit sales; if it is a

Comment, *Application of the Equal Credit Opportunity Act to Housing Leases*, 67 U. CHI. L. REV. 865, 885-86 (2000) (“Mere payment in the form of installments does not render a lease a credit transaction . . . [A] lease that is paid in installments, where the installment payments are merely payments for contemporaneous use of the good and nothing more, is not a credit transaction because the lessor is only providing the lessee with the right to enjoy that which he has paid for to-date.”).

²⁸ Michael L. Walden, *The Economics of Rent-to-Own Contracts*, 24 J. OF CONSUMER AFFAIRS 326, 326 (1990).

²⁹ Hillinger & Hillinger, *supra* note 13, at 417. *Perez* provides support for this claim. There, the court admitted that the statutory language protecting consumers did not cover rent-to-own transactions, but it nevertheless extended the protection because of the mandate to liberally construe consumer protection statutes. *Perez v. Rent-A-Center, Inc.*, 892 A.2d 1255, 1267-68 (N.J. 2006).

³⁰ *See supra* note 25.

³¹ Only three states do not have industry-specific regulations: New Jersey, Wisconsin, and North Carolina. APRO, *State RTO Statutes*, *supra* note 10.

³² West’s Ann. Cal. Civ. Code § 1812.620 et seq. (2006).

³³ *Id.* § 1812.622(2) (“‘Rental-purchase agreement,’ . . . means an agreement between a lessor and a consumer pursuant to which the lessor rents or leases, for valuable consideration, personal property for use by a consumer for personal, family, or household purposes for an initial term not exceeding four months that may be renewed or otherwise extended, if under the terms of the agreement the consumer acquires an option or other legally enforceable right to become owner of the property.”).

³⁴ *Id.*

³⁵ *See* Douglas Glen Whitman & Mario J. Rizzo, *Paternalistic Slopes*, NYU J. OF L. & LIB. 8-10 (forthcoming 2007), available at <http://ssrn.com/abstract=960610> (explaining that legislators, as much as consumers, are boundedly rational).

lease, we will regulate it like a lease.³⁶ But, as the persuasive arguments for both sides of this debate indicate, rent-to-own transactions are neither leases nor credit sales. They participate in some attributes of both of these transactions.³⁷ Regulators need to abandon this credit-sale–lease dichotomy and refocus the debate on the unique characteristics of rent-to-own.

2. Characteristics for Regulators to Consider

Instead of relying on the traditional heuristic policy makers used to approach rent-to-own transactions, this Section discusses the unique characteristics of rent-to-own transactions that regulators should take into account when crafting policy.

A Single Decision for Goods and Terms of Acquisition

In many situations where consumers acquire goods, the consumer makes one decision about what good to purchase and a completely distinct decision about how to pay for the good, either by a credit card, a loan, or cash. In the rent-to-own transaction, however, the *what* and the *how* are collapsed together into one decision. If a consumer likes the furniture at a specific rent-to-own store, the consumer must accept the store’s rental agreement to obtain the goods. This feature is significant for regulators to consider because it could lead to customers focusing exclusively on one aspect of the transaction—most likely the goods themselves—and neglecting to consider carefully the terms under which they will pay for the goods. For instance, an interviewee explained to me that rent-to-own firms compete on the quality and selection of goods at a store³⁸ and on the personal relationships store personnel develop with clients.³⁹ Price and other contract terms are not salient terms for customers, and regulators must decide what to do with terms that are not susceptible to competitive forces.

³⁶ For an excellent discussion of the differences between the leases and credit sales, see Charles W. Mooney, Jr., *The Mystery and Myth of ‘Ostensible Ownership’ and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases*, 39 ALA. L. REV. 683, 693-94 (1988). For a trenchant criticism of the sale-lease distinction, see John D. Ayer, *On the Vacuity of the Sale/Lease Distinction*, 68 IOWA L. REV. 667(1983).

³⁷ Many economists, both those who oppose and support the rent-to-own industry, recognize the complexity of this transaction as a hybrid between a credit sale and a lease. Signe-Mary McKernan, James M. Lacko, & Manoj Hastak, *Empirical Evidence on the Determinants of Rent-to-Own Use and Purchase Behavior*, 17 ECON. DEVELOPMENT QUARTERLY 33, 37 (2003); Walden, *supra* note 28, at 326-27. Anderson and Jackson have even specifically articulated how renting-to-own is a hybrid transaction:

One approach is to look at an RTO contract as a series of payments that purchase a bundle of services and financial instruments that includes (1) the service of the product for the time period, (2) a put option with a zero strike price that expires at the end of the period, and (3) an option to acquire a call with a zero strike price when the final rent-to-own payment is made. A decision not to make the next payment means the consumer no longer has the services of the product, exercises the put option by selling the merchandise back to the dealer-owner at a zero price, and foregoes the option to acquire a call on the product. Through time, as the final payment approaches, the value of the put option should decline while the value of the call option increases.

Anderson & Jackson, *A Reconsideration*, *supra* note 16, at 301.

³⁸ Korst Interview, *supra* note 9.

³⁹ Interview with Larry Carrico, Owner of Rent One (May 22, 2007) [hereinafter Carrico Interview] (on file with author).

Multiple In-Person Payment Decisions

The rent-to-own transaction functions like a series of successive contracts. Because the customer can always cancel the contract, each time a customer pays for the next period's rent, the customer must decide again whether to continue using and acquiring the merchandise through this vehicle or abandon the contract, perhaps to purchase the goods another way. Usually, customers make payments in person in cash, at the store itself,⁴⁰ and typically, these payments are made on a weekly basis.⁴¹ One interviewee estimated that 85% of customers pay at the store in person each week.⁴²

This feature raises several concerns regulators may consider. First, the successive points of agreement may complicate any disclosure regime, requiring multiple disclosures instead of a single disclosure at the initial time of purchase. When using credit cards, for instance, borrowers face multiple points of decision. They make decisions when they sign the credit card agreement, when they make a purchase, and when they decide whether to pay off the balance or borrow.⁴³ Regulators need to consider what dangers await customers both at the initial decision to rent and at the successive decisions to continue renting.

Also, because customers come into the store each week to make payments, rent-to-own firms have a tremendous business opportunity to encourage customers to rent more products. Rent-to-own firms admit that repeat business is important,⁴⁴ and critics have been quick to suggest that stores abuse this feature.⁴⁵ Firms say that they use weekly payments to “strengthen customer relationships and make these customers feel welcome in our stores.”⁴⁶ Policy makers are left to sort out how this repetitive personal interaction affects the dynamic between customers and sales people.

⁴⁰ Aaron Rents, Inc., *supra* note 26, at 6; Rent-A-Center, Inc, *supra* note 26, at 6.

⁴¹ “Approximately 86% of our agreements are on a weekly term.” Rent-A-Center, Inc, *supra* note 26, at 6. Rent-A-Center allows customers to pick whether they want to pay weekly or monthly, but most customers pick weekly payments. Korst Interview, *supra* note 9.

⁴² Korst Interview, *supra* note 9.

⁴³ RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS 129 (2006). For the potential regulatory implications of this feature in credit cards, see *id.* at 160-165 (proposing that disclosures be made to consumers at the point of sale and at the point of borrowing).

⁴⁴ Aaron Rents, Inc., *supra* note 26, at 13 (“In order to increase rentals at existing stores, we foster relationships with existing customers to attract recurring business, and many new rental and lease ownership agreements are attributable to repeat customers.”); Rent-A-Center, Inc, *supra* note 26, at 1 (Feb. 23, 2007) (“We estimate that approximately 70% of our business is from repeat customers.”); Interview with Ernie Lewallen, President of UHR Rents, Inc. (July 26, 2007) [hereinafter Lewallen Interview] (on file with author); Interview with Geron Vail, Owner of FAN Sales & Leasing, (July 26, 2007) [hereinafter Vail Interview] (on file with author).

⁴⁵ See KARGER, *supra* note 21, at 94 (recounting the plight of an interviewee who obtained a refrigerator she needed for \$30 a month but later was persuaded by the salesperson to rent a better refrigerator and a television, resulting in payments of \$120 a month); Will Rodgers, *On a Roll*, TAMPA TRIBUNE, Oct. 16, 2006, at 1 (arguing that firms require weekly payments for the specific purpose of selling customers more goods).

⁴⁶ Aaron Rents, Inc., *supra* note 26, at 7.

Fee Bundling and Behavior-Driven Pricing

Rent-to-own firms include many services as part of the rental agreement without any additional costs, such as same-day delivery, installation, repair or replacement, and pick-up.⁴⁷ However, customers also have the option to have other services bundled⁴⁸ into the contract at extra costs, such as insurance in the form of optional loss/damage waivers⁴⁹ or in the form of participation in preferred customer programs.⁵⁰ John Caskey reports that “[a]lmost all [rent-to-owns] encourage customers to buy theft and property damage insurance” and “the vast majority of customers purchase such coverage.”⁵¹ One example of a preferred customer program is the Club program offered by Rent One, a large regional chain. If a customer pays to join the Club, the customer receives extra benefits such as sales and discounts, payment waivers, and the ability to reinstate a terminated agreement at any time.⁵² Rent One’s owner estimates that 50-60% of customers pay to join this program.⁵³

In addition to these optional fees, rent-to-own firms also charge behavior-driven fees. These fees can include late fees, reinstatement fees,⁵⁴ and collection fees on delinquent accounts.⁵⁵ The risk to consumers of behavior-driven fees is higher for this financial service than for other services, like credit cards and installment loans, because payments are typically due once a week and are usually paid in cash, unlike other industries which accept payments once a month, often through an automatic withdrawal.⁵⁶ Rent-to-own operators report that these fees generate revenue, but they claim the fees are important because, as both a stick and a carrot, fees allow stores to encourage customers to pay their rent and avoid forfeiting the merchandise.⁵⁷

⁴⁷ Aaron Rents, Inc., *supra* note 26, at 9; Rent-A-Center, Inc, *supra* note 26, at 1, 6; Rent-Way, Inc., *supra* note 26, at 4.

⁴⁸ I follow here Oren Bar-Gill’s definition of a “bundled” product which includes “any case where a consumer purchasing product A from seller X has a sufficiently strong incentive to purchase product B from the same seller.” Oren Bar-Gill, *Bundling and Consumer Misperception*, 73 U. CHI. L. REV. 33, 34 (2006).

⁴⁹ Rent-A-Center, Inc, *supra* note 26, at 6.

⁵⁰ Rent-Way, Inc., *supra* note 26, at 4. Some states forbid operators from offering bundled services. *See infra* Part III.D

⁵¹ CASKEY, *supra* note 21, at 49. *See also*, Hill et al., *supra* note 21, at 6 (“[M]any customers believed they were pushed to purchase ‘insurance’ that protected the retailer from loss due to theft, arson, or natural disasters such as fire. Some informants held that they were charged for such services without their explicit permission.”).

⁵² http://rentone-rto.com/index.php?page=about_careplus (last visited Aug. 6, 2007).

⁵³ Carrico Interview, *supra* note 39.

⁵⁴ Rent-A-Center, Inc, *supra* note 26, at 6.

⁵⁵ *Id.* Like bundled services, some states limit the amount firms may charge customers. *See infra* Part III.D.

⁵⁶ Rodgers, *supra* note 45, at 1; Interview with Gary Romine, Owner of Show-Me Rent-to-Own (May 22, 2007) [hereinafter Romine Interview] (on file with author). *See also* Hill et al., *supra* note 21, at 4 (noting evidence that “more than 60% of [Rent-A-Center’s] customers make late payments at any given time”).

⁵⁷ Interview with Kim Van Wagner, Director of Franchise Development, Aaron Rents (July 26, 2007) [hereinafter Van Wagner Interview] (on file with author); Carrico Interview, *supra* note 39; Vail Interview, *supra* note 44. *See also* Lewallen Interview, *supra* note 44 (noting that fees are important to incentivize payments and to prevent large opportunity cost losses that stores face when customers keep merchandise without paying for it, precluding stores from renting the goods to other customers).

Though not unique to the rent-to-own business, bundled and behavior-driven fees may be particularly attractive targets for regulation because these fees prey on cognitive weaknesses that many consumers possess, such as the tendency to procrastinate.

The Risk of Losing of Equity

Customers do not obtain any ownership rights in rented goods until they complete the contract. Regardless of whether the customer has paid one week's rental payment of \$30, or seventy weeks' payment of \$2100, the customer has the exact same ownership interest in the goods. Customer payments to a rent-to-own store can be divided into a rental component, consisting of the reasonable rental costs, and an equity component, consisting of the excess payments that should amortize the value of the customer's interest. But, unlike a secured transaction where a customer has a right to recoup equity even in the event of default,⁵⁸ the rent-to-own customer is left with nothing if a payment is missed.⁵⁹ For centuries, courts have forbidden contracts in which borrowers forfeit equity in land,⁶⁰ and regulators must determine if the policy concerns animating that long-held rule apply in this industry.

High Switching Costs

After a customer has made payments to a specific rent-to-own firm, the customer faces high costs in switching to another firm or another product. A customer who has made even one-third of her payments on a product will face high costs to start the process over at another firm with, for instance, more favorable contract terms, because she will have to pay for the entire rental period at the new firm.⁶¹ It is not surprising that only 14% of people who terminate their retail agreements do so in order to obtain the goods from another source.⁶² Regulators need to consider the high switching costs in this transaction because when switching costs are too high, firms are more likely to impose abusive terms on their current customers because these customers have nowhere else to go.⁶³

B. The Rent-to-Own Customer

In addition to understanding the unique characteristics of this transaction, discovering the optimal rent-to-own regulations requires identifying who exactly rents-to-own. Interviews with

⁵⁸ UCC § 9-615(d).

⁵⁹ Most states require rent-to-own firms to reinstate agreements for a short time after the agreement terminates. After that period ends, however, the customers retain no interest in the merchandise. *See infra* Part III.C.

⁶⁰ Rashmi Dyal-Chand, *From Status to Contract: Evolving Paradigms for Regulating Consumer Credit*, 73 TENN. L. REV. 303, 307-09 (2006).

⁶¹ Notice this is different from the potential for customers to lose equity. The high cost of switching relate to the new costs a customer will have to pay when starting a rental agreement over at a new firm. The loss of equity refers to loss of the residual value a customer has built up by making payments that exceed the reasonable rental costs.

⁶² FTC, *supra* note 25, at 62.

⁶³ Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 376, 388.

industry participants, recent extensive empirical studies, and the annual reports of publicly held rent-to-own firms reveal some remarkable attributes of rent-to-own customers.

For instance, based on evidence from interviews and annual reports, I make the novel argument that customers neither rent low quality merchandise nor necessities from rent-to-own dealers. Instead, the goods people rent primarily enhance the quality of their lives. This new understanding has dramatic policy consequences. It unveils the crass, aggressive paternalism used to justify a ban on the industry—advocates of a ban wish to stop poorer renters from getting things that are “too nice.” But, it also undermines the argument that regulators should not ban rent-to-own because consumers need this option to survive. The harms of a ban are less significant because the ban would only prevent customers from enhancing the quality of their lives. It would not prevent them from having access to any durable goods.

Also, based on recent survey data, I explore the amazing lack of market segmentation among different types of rent-to-own customers. People with different economic and credit backgrounds utilize rent-to-own, and some rent for a short time and others until they own the merchandise. Everyone, however, rents on the exact same terms. This lack of market segmentation provides the groundwork for the most compelling argument in favor of banning the industry, the potential this industry promotes a regressive cross-subsidy.

Several surveys provide information about the general characteristics of rent-to-own customers, but the most important of these surveys was conducted by the FTC between December 1998 and February 1999.⁶⁴ In many ways, the FTC Survey’s findings match what we might expect about rent-to-own customers: “Compared with respondents who had not used [rent-to-own] transactions, [rent-to-own] customers were significantly more likely to be African American, younger, less educated; have a lower income; have children in the household; rent their residence; live in the South; and live in nonsuburban areas.”⁶⁵ Other data sources, including rent-to-own companies’ own annual reports, confirm that rent-to-own companies target individuals with lower incomes.⁶⁶

Some of the FTC’s data, however, is more surprising. Though customers may have lower incomes, the FTC found that 84% had a car or truck, virtually the same percentage as the

⁶⁴ Lacko, *supra* note 13, at 129. The FTC surveyed 12,136 people, yielding 532 people that qualified under the Survey’s perimeters as rent-to-own customers. *Id.*

⁶⁵ Lacko, *supra* note 13, at 130.

⁶⁶ KARGER, *supra* note 21, at 99 (“RTO marketing predominantly targets low-income consumers by advertising in media located in buses and around public housing projects that target people of color. The industry also promotes features attractive to low-income consumers: quick delivery, weekly payments, no or small down payments, quick repair service, no credit checks, and no harm to one’s credit if one cancels the transaction.”). Some rent-to-own firms admit that they target such individuals. Aaron Rents, Inc., *supra* note 26, at 8 (stating that stores are “strategically located in established working class neighborhoods and communities”); *id.* at 9 (“We assist each franchisee in selecting the proper site for each store. Because of the importance of location to the Aaron’s Sales & Lease Ownership concept”); Rent-Way, Inc., *supra* note 26, at 3 (“The Company uses a variety of information sources to identify store locations that are readily accessible to low and middle income customers.”).

general public.⁶⁷ Rent-to-own customers also have more access to credit than one might assume: 44% of customers had credit cards, compared to 88% in the general population; 64% had a checking account, compared to 87% in the general population; and 49% had a savings account, compared to 56% in the general population.⁶⁸ What is unknown, unfortunately, is how credit cards and savings accounts interact with rent-to-own transactions. Do customers turn to rent-to-own only when their credit cards have reached their limits or is renting-to-own their first choice?⁶⁹ Do people have savings sufficient to pay for rent-to-own merchandise upfront or do people only use the product when their savings accounts are depleted? Although no empirical data specifically answer these questions, evidence suggests that people use rent-to-own as a substitute for credit or savings.⁷⁰

Two important aspects of customers in this industry deserve an extend discussion: the type of goods customers rent and the industry's refusal to segment the market between different types of customers.

1. The Merchandise Consumers Rent

For many consumer credit products, regulators have little information about what consumer are using the credit to buy, so it is difficult to assess whether consumers are using loan proceeds judiciously. Do they pay for essential medical services or gamble and purchase drugs?⁷¹ In the rent-to-own industry, on the other hand, we know exactly what people are renting—both from the FTC survey data and from rent-to-own firms' annual reports. Table 1 below presents information from these sources, displaying the types of goods that people rent from rent-to-own stores.

⁶⁷ FTC, *supra* note 25, at 45 (reporting that 83.7% of customers using rent-to-own in the last year owned a car or truck, compared to 84% of all U.S. households).

⁶⁸ Lacko, *supra* note 13, at 130. John Caskey's research found similar results: He found that 36.7% of customers carry general use credit cards and 65.3% had some type of deposit account. CASKEY, *supra* note 21, at 29 Table 8.

⁶⁹ Lacko, *supra* note 13, at 135. Professor Manning has suggested that people use rent-to-own only after they are extended on credit cards. Rodgers, *supra* note 45, at 1. Without survey data, however, this claim would be hard to prove. One industry participant related his experience that customers will lease merchandise, even though they could have purchased the products on their credit card, because people want to keep open credit for both future living expenses and emergencies. Van Wagner Interview, *supra* note 57.

⁷⁰ See Subpart II.A.5 below.

⁷¹ See, e.g., Mann & Hawkins, *supra* note 5, at 859 n.6 ("There is little information about the most common uses of the borrowed funds [for payday loans].").

Table 1: Rent-to-Own Merchandise as a Percentage of Store Revenue

	Rent-A-Center ⁷²	Aaron's Rents ⁷³	Rent-Way ⁷⁴	FTC Survey ⁷⁵
Electronics	33%	33%	35%	36%
Appliances	16%	15%	16%	25%
Furniture	37%	33%	30%	36%
Computers	14%	15%	17%	2%
Other		4%		2%
Jewelry			2%	

In addition to knowing what types of goods people rent, we can obtain a sense of the quality of this merchandise by examining rent-to-own firms' annual reports. Earlier in this industry's history, critics asserted rent-to-own companies carried old, worn-out, inferior goods.⁷⁶ But this charge is almost certainly inaccurate. Rent-A-Center and Aaron Rents's annual reports emphatically and painstakingly illustrate the fact that rent-to-own companies offer top quality, name-brand goods.⁷⁷ Though some degree of puffery may be involved in this claims, a review of Rent-A-Center's website, as one example, reveals that Rent-A-Center does rent top quality goods. It offers Dell computers with Pentium chips⁷⁸ and front load washing machines.⁷⁹

⁷² Rent-A-Center, Inc, *supra* note 26, at 5-6.

⁷³ Aaron Rents, Inc., *supra* note 26, at 14.

⁷⁴ Rent-Way, Inc., *supra* note 26, at 3 (figures rounded to the nearest whole number).

⁷⁵ FTC, *supra* note 25, at 51 (figures rounded to the nearest whole number and presented as a percentage of consumer's reported behavior).

⁷⁶ See Creola Johnson, *Welfare Reform and Asset Accumulation: First We Need a Bed and a Car*, 2000 WIS. L. REV. 1221, 1249 ("Welfare recipients . . . spend millions of dollars annually at rent-to-own dealers trying to become owners of cheaply-made, exorbitantly-priced household durables.") (citations omitted); Angie Newsome, *Rent-to-Own stores offer the goods; but critics wonders (sic) if payment plans are worthwhile, even for people with bad credit*, THE ASHEVILLE CITIZEN-TIMES, Mar. 13, 2005, at 6C (explaining that rent-to-own dealers in the past offered damaged goods).

⁷⁷ Aaron Rents, Inc., *supra* note 26, at 4 ("We carry well-known brands such as JVC®, Mitsubishi®, Philips®, RCA®, Sony®, Dell®, Hewlett-Packard®, La-Z-Boy®, Simmons®, Frigidaire®, General Electric® and Maytag®."); Rent-A-Center, Inc, *supra* note 26, at 1 ("Our stores generally offer high quality, durable products We offer well known brands such as Sony, Philips, LG, Hitachi, Toshiba and Mitsubishi home electronics, Whirlpool appliances, Dell, Toshiba and Hewlett-Packard computers and Ashley, England, Berkline and Standard furniture.") *id.* at 4 (noting its "reputation as a leading provider of high quality branded merchandise and services."); *id.* at 5 ("We seek to provide a wide variety of high quality merchandise to our customers, and we emphasize high-end products from name-brand manufacturers."); Rent-Way, Inc., *supra* note 26, at 1 ("The Company offers quality, brand name home entertainment equipment, furniture, computers, major appliances and jewelry"); *id.* at 3 ("The Company's product line currently includes the Sharp, RCA, JVC, Phillips and Panasonic brands of home entertainment equipment; the Ashley, Bassett, Catnapper, Progressive and England Corsair brands of furniture; the Dell and IBM brand of personal computers; and, Crosley, Sears Kenmore and General Electric brands of major appliances.").

⁷⁸ http://www6.rentacenter.com/site/page/pg4313-as105901-ba22-pn_Sony_VAIO_VGNN325E_BC.html (last visited July 15, 2007).

⁷⁹ http://www6.rentacenter.com/site/page/pg4313-as876-ba10-pn_Whirlpool_WFW8300SW.html (last visited July 15, 2007).

While we may know the types of goods people rent and the quality of those goods, it is more difficult to determine whether rent-to-own goods rented are necessities essential for modern life or luxury goods meant to enhance customers' quality of life. Some members of the rent-to-own industry contend the goods are necessities for families—people need beds for sleeping, washers for laundry, and computers for homework assignments.⁸⁰ Creola Johnson has argued at some length against the “myth” that rent-to-own customers seek out luxury goods. She claims that rent-to-own goods—even computers and televisions—represent essential goods in modern society.⁸¹ Even the harshest critics of this industry agree that some rent-to-own products are essential products. For instance, Robert Manning has admitted that “he understands people who don't have money to buy a refrigerator getting one on a rental contract because there's food spoiling at home.”⁸²

Though the case has not yet been articulated, this Article contends that rent-to-own goods are not primarily essential goods but instead are goods that enhance the quality of customers' lives. Some merchandise falls outside the category of necessary goods altogether, and even those goods that are essentials are nicer than alternatives available in the market, suggesting they function to enhance quality of life.

As Table 1 demonstrates, around a third of the merchandise rented is electronics, a category that does not include personal computers. While the annual reports do not further break this category down, an industry source suggests that 10% of merchandise revenue comes from televisions,⁸³ and in the FTC Survey, people reported that 18.6% of the goods rented were televisions.⁸⁴ While televisions may be essential in a modern home, as Professor Johnson suggests, they are not essentials in the same way refrigerators or beds are necessary for life.⁸⁵ Some electronics would widely be accepted as luxury goods, such as “high definition televisions, home theatre systems, video game consoles and stereos from top name-brand manufacturers.”⁸⁶

⁸⁰ Korst Interview, *supra* note 9.

⁸¹ Johnson, *supra* note 76, at 1250 (“Contrary to the myth, the majority of rent-to-own customers do not pursue ownership of true luxury items, such as big-screen televisions or stereo entertainment systems. . . . In twenty-first century America, furniture and appliances are non-discretionary goods”); *id.* at 1251 (“In addition to basic household durables, at least one television is a necessity for single-parent families. . . . Personal computers are also becoming necessities, because they have revolutionized the ways we both learn and earn.”). Other academics share Johnson's view. See Anderson & Jackson, A Reconsideration, *supra* note 16, at 304.

⁸² Rodgers, *supra* note 45, at 1. See also Newsome, *supra* note 76, at 6C (“Celeste Collins, director of the Consumer Credit Counseling Service of Western North Carolina, said she has recommended the [RTO] service only once. Then, a client didn't have a washing machine or a car and lugged her laundry on the bus—with her children—to the coin-operated laundry.”).

⁸³ Korst Interview, *supra* note 9.

⁸⁴ FTC, *supra* note 25, at 51.

⁸⁵ For instance, courts find have found that prison conditions violate the Eighth Amendment if inmates do not have mattresses. *E.g.*, Thompson v. City of Los Angeles, 885 F.2d 1439, 1449 (9th Cir. 1989); Anela v. Wildwood, 790 F.2d 1063, 1069 (3rd Cir. 1986); Oladipopo v. Austin, 104 F. Supp.2d 626 (W.D. La. 2000).

⁸⁶ Rent-A-Center, Inc, *supra* note 26, at 6. For instance, Rent-A-Center rents Xbox 360s and Portable Sony Playstations. <http://www6.rentacenter.com/site/page/as29-pg4284.html> (last visited July 15, 2007).

Moreover, even goods that are considered necessities serve to enhance the quality of rent-to-own consumer's lives because firms provide top-quality, named-brand merchandise. Such goods, necessarily, cost more than lower-quality, off-brand goods or goods at thrift shops. Evidence from the industry's annual reports suggests that some firms, at least, see the role of rent-to-own product as enhancing the quality of renters' lives. Aaron Rents notes that it "enables these customers to obtain quality-of-life enhancing merchandise."⁸⁷ The industry also recognizes that customers who obtain used goods from rent-to-own firms get a significantly better product than they would in a consumer-to-consumer transaction because used goods are re-serviced and expertly detailed by rent-to-own stores before the next consumer's use.⁸⁸

My point here is not that rent-to-own firms ought to be condemned for offering luxury goods or that customers with lower incomes or troubled credit histories should be criticized for wanting to enhance the quality of their lives. However, it is important to classify rent-to-own merchandise in order to assess the policy rationales offered for regulating rent-to-own transactions. Advocates of banning rent-to-own altogether appear to rely implicitly on the argument that poor people should be denied the choice to obtain expensive, high-quality goods. Additionally, courts have assumed that rent-to-own products constitute "the basic necessities of life,"⁸⁹ so categorizing these items as non-essentials has the potential to affect litigation outcomes and shape judicial understandings of renting-to-own.⁹⁰

2. The Lack of Market Segmentation among Consumers

With regard to pricing and contract terms, rent-to-own firms treat the customers to whom they rent as a homogenous group. Unlike other credit products, the cost and structure of the rent-to-own transaction does not change if the consumer is rich or poor, has good credit or bad credit, or intends to obtain ownership of the good or just rent it for a week. This might seem like an unremarkable feature of this transaction—most consumer goods are sold for the same price regardless of the customer's credit history or intentions. But, in the realm of consumer credit, this lack of market segmentation among different type of customers in the rent-to-own business is extremely rare.

Consider, for instance, how credit card companies differentiate between different types of customers. Credit card companies charge different interest rates for customers with different credit histories and income levels.⁹¹ As technology has advanced, credit card firms have been able to increasingly segment consumers based on the small differences in risk each customer

⁸⁷ Aaron Rents, Inc., *supra* note 26, at 4.

⁸⁸ Korst Interview, *supra* note 9; Interview with Robert Briley, Franchise Owner of Aaron Rents (May 18, 2007) [hereinafter Briley Interview] (on file with author).

⁸⁹ *Perez v. Rent-A-Center, Inc.*, 892 A.2d 1255, 1264-65 (N.J. 2006).

⁹⁰ *Perez* used the fact that rent-to-own goods are necessities to undermine the compulsion rationale for treating loans of money different from loans associated with sales of durable goods. *Id.* at 1263-64.

⁹¹ UNITED KINGDOM DEP'T OF TRADE & INDUS., *THE EFFECT OF INTEREST RATE CONTROLS IN OTHER COUNTRIES* 19 (2004), http://microfinancegateway.com/files/25620_file_The_effect_of_interest_rate_controls.pdf; KARGER, *supra* note 21, at 45.

poses.⁹² This market segmentation has allowed credit card companies to price their cards much more accurately.⁹³ In contrast, rent-to-own transactions occur on the same terms and in the same way for all customers. Everyone pays the same price, everyone gets the same services.

Despite this one-size-fits-all approach, rent-to-own customers are heterogeneous in at least two important ways. The most obvious is that different customers have different levels of risk. Some customers pose significant risks to merchants, while others pose little risk. But, rent-to-own companies, unlike credit cards or mortgage firms, do not run credit checks on potential consumers.⁹⁴

There is a more nuanced difference between customers: Some customers rent goods for a short time while others rent goods for long enough to obtain ownership. The FTC Survey found that some customers enter the transaction intending to obtain ownership, some intend only to rent, and some are unsure.⁹⁵ Remarkably, customers' intentions at the outset of the transaction typically match the actual outcomes from those transactions: 87% of those who intended to purchase merchandise did so.⁹⁶

Rent-to-own firms and the FTC have a sharp difference in opinion about how many customers actually obtain ownership of rented merchandise,⁹⁷ but everyone agrees that rent-to-own customers fit into two distinct groups: those who end up purchasing the product and those who only rent and never obtain ownership. Renting-to-own is, thus, a misnomer for many customers who never intend to own the products at all but merely to rent. Rent-to-own firms recognize the many reasons people might want to only rent, such as trying a product out or using a product in a short-term living arrangement.⁹⁸

⁹² See MANN, *supra* note 43, at 40-41 (observing that the ability to use technology to “aggregate and analysis accounts electronically, using statistical analysis to discern creditworthiness” has led to “an ever-advancing differentiation of customers based on risk” into “ever-smaller groups” which allows issuers to differentiate “prices into more and more gradations, so that the price the lender offers each customer comes ever closer to a hypothetical ‘true’ assessment of that customer’s particular risk”).

⁹³ MANN, *supra* note 43, at 146; Littwin, *supra* note 5, at 46-47.

⁹⁴ Aaron Rents, Inc., *supra* note 26, at 13; Rent-A-Center, Inc, *supra* note 26, at 6; Brooks, *supra* note 5, at 997; CASKEY, *supra* note 21, at 50. This is not to say that the rent-to-own industry has no price discrimination. The industry discriminates by excluding some people based on the requirements firms impose on renting, such as having a reliable source of income and references. On the other end of the spectrum, the service itself excludes other people who simply do not want to use it because they have cash to purchase the merchandise outright or access to credit. Evidence suggests that people pick superior options when they are available to them. UNITED KINGDOM DEP’T OF TRADE & INDUS., *supra* note 91, at 13.

⁹⁵ Lacko, *supra* note 13, at 131 (noting that 67% rented intending to own, 25% rented intending to return the item, and 8% were unsure).

⁹⁶ *Id.*

⁹⁷ Rent-A-Center, Inc, *supra* note 26, at 6 (reporting 25% of agreements result in ownership); Aaron Rents, Inc., *supra* note 26, at 6 (45%); Lacko, *supra* note 13, at 131 (67%).

⁹⁸ Aaron Rents, Inc., *supra* note 26, at 5-6; Rent-A-Center, Inc, *supra* note 26, at 27. In Australia, rent-to-own customers similarly rent to try out products. *Try before You Buy It with Rent to Own*, GOLD COAST SUN (Austl.), Jan. 24, 2007, at 68. In Canada, reports indicate people use rent-to-own for seasonal work that requires relocation to a different city. Jeff Korenko, *Furniture for Rent; Many Newcomers to the Area Taking Advantage of Deals That Offer Different Financing Options*, THE DAILY HERALD-TRIBUNE (Grande Prairie, Alberta), Sept. 20, 2005, at 4.

The FTC Survey reveals that consumers who intend to obtain ownership even have different characteristics than consumer who rent and return the goods. McKernan, Lacko, and Hastak have analyzed the FTC's data, comparing the two groups of customers:

The means of the explanatory variables hypothesized to affect [rent-to-own] use and purchase differ by customer intent, suggesting that customers intending to purchase differ substantially from customers intending to temporarily rent. For example, compared to customers intending to rent temporarily, customers intending to purchase are less likely to own their home (38% v. 56%), more likely to have household incomes below \$25,000 (62% to 38%), and more likely to have less than a high school diploma (39% v. 19%). . . . African Americans are significantly more likely to use [rent-to-own] with the intent to purchase than are Whites (68%), even after controlling for income and education status.⁹⁹

Yet, despite the existence of these two distinct, diverse segments, the rent-to-own transaction treats all renters alike.

As subsequent sections will demonstrate, the lack of market segmentation is not merely a matter of academic interest. For instance, courts have mistakenly assumed that all rent-to-own customers intend to purchase the merchandise they rent.¹⁰⁰ Furthermore, a lack of market segmentation can cause cross-subsidies in which one segment of customers pays more than it should while another segment pay less than it should. If poorer customers subsidize richer customers, the cross-subsidy is regressive. The question of exactly how the lack of market segmentation affects the justifications for regulating rent-to-own transactions is tackled in Part II.A.4.

C. The Rent-to-Own Market

Having now looked at the transaction and the customers who use it, this section examines how this \$6.7 billion-a-year market operates.¹⁰¹ The market is populated with two large, publicly-held firms and many smaller, independent operators, provoking the policy question of whether regulators should encourage or prevent large companies from dominating this market. In contrast to some of the current literature, I argue that the market is competitive. More significantly, I offer new evidence of how firms compete for business, based on interview responses from industry leaders. Defining what forces drive competition is significant from a policy perspective. Regulation of terms over which firms do not compete is easier to justify than regulation of terms that firms must make attractive to compete for customers.

⁹⁹ McKernan, Lacko, & Hastak, *supra* note 37, at 43, 47 (internal citations omitted).

¹⁰⁰ The *Perez* court assumed that consumer in that case entered the contract “in order to become the owner of” the items. *Perez v. Rent-A-Center, Inc.*, 892 A.2d 1255, 1258 (N.J. 2006).

¹⁰¹ APRO, *Industry Overview*, *supra* note 12.

1. The Market Participants

Participants in the rent-to-own market can easily be categorized into two basic groups: large publicly held companies and small independent operators. The concentration in this market is pronounced—there are only two publicly held firms, and these firms make up 5,000 of the 8,300 rent-to-own stores across the country.¹⁰²

The biggest firm by far is Rent-A-Center. It has 3406 stores, which is approximately 41% of market based on store count.¹⁰³ If its 282 franchised locations¹⁰⁴ are included in the count, it controls 44% of the market.¹⁰⁵ Rent-A-Center has led the consolidation movement in the industry,¹⁰⁶ consistently increasing its market share. From the end of 2005 to the end of 2006, its market share jumped from 33%¹⁰⁷ to 41% because Rent-A-Center acquired Rainbow Rent-Way,¹⁰⁸ which had previously been the third largest publicly held company.¹⁰⁹

With almost two thousand less stores, Aaron Rents is the second largest player. Aaron Rents operates 1286 stores in 47 states.¹¹⁰ Along with Rent-A-Center, Aaron Rents has experienced significant growth: its total revenue has grown twenty percent over the past four years, its net earnings grew thirty percent;¹¹¹ and its stock rose 60% in 2003.¹¹²

Though both offer ownership through rental payments, these two companies have some notable differences. Aaron Rents requires that customers make monthly payments, but Rent-A-

¹⁰² Rent-A-Center, Inc, *supra* note 26, at 1.

¹⁰³ *Id.*

¹⁰⁴ Rent-A-Center's subsidiaries in the United States include Get It Now, LLC, operated in Wisconsin, and ColorTyme, a national franchisor of rent-to-own stores. *Id.* at 27.

¹⁰⁵ *Id.* at 9.

¹⁰⁶ Rent-A-Center's consolidation is not the only evidence of aggressive acquisitions of market share in the industry. Other rent-to-own firms, including Rent-Way before it was acquired by Rent-A-Center, demonstrate the model of aggressive growth that characterizes the largest players in this market. *See* Aaron Rents, Inc., *supra* note 26, at 4 ("Our strategic focus is on expanding our higher growth sales and lease ownership business through opening new company-operated stores, expanding our franchise program, and making selective acquisitions."); Rent-Way, Inc., *supra* note 26, at 1 ("Concurrent with the initial public offering, the Company began implementing a strategy of aggressive store expansion driven primarily by acquisitions and facilitated by the consolidation trend in the rent-to-own market.").

¹⁰⁷ Rent-A-Center, Inc, Annual Report (Form 10-K), at 1 (Mar. 8, 2006).

¹⁰⁸ Even though Rent-Way no longer exists as an independent company, I use information from its annual report in this Article as another—albeit imperfect—data point to understand the industry.

¹⁰⁹ Rent-A-Center, Inc, *supra* note 26, at 3 ("On November 15, 2006, we completed the acquisition of Rent-Way, Inc., which operated 782 stores in 34 states . . .").

¹¹⁰ Aaron Rents, Inc., *supra* note 26, at 4.

¹¹¹ Aaron Rents, Inc., *supra* note 26, at 4 ("Total revenues increased to \$1.327 billion in 2006 from \$640.7 million in 2002, representing a 20.0% compound annual growth rate. Our total net earnings increased to \$78.6 million in 2006 from \$27.4 million in 2002, representing a 30.1% compound annual growth rate. Total revenues for the year ended December 31, 2006 were \$1.327 billion, an increase of \$201.1 million, or 17.9%, over 2005.").

¹¹² KARGER, *supra* note 21, at 95.

Center is flexible, allowing customers to choose between weekly or monthly payments.¹¹³ Aaron Rents emphasizes that it is a leasing business, not a rent-to-own business, claiming that it deals with higher-income individuals because affluent people are not put off by the stigma associated with rent-to-own.¹¹⁴ In terms of the merchandise in its stores, Rent-A-Center's business focuses almost singularly on renting-to-own, but Aaron Rents sells more goods outright, manufacturers some of the goods it rents itself, and has a business rental division whose whole purpose is to rent items to meet short term business needs.¹¹⁵ Rent-A-Center, however, has expanded the financial services it offers to customers. In 150 of its stores, Rent-A-Center offers "short term secured and unsecured loans, debit cards, check cashing and money transfer services."¹¹⁶ This consolidation of different fringe banking products into one provider is unique in the fringe banking world, and Rent-A-Center's attempt to offer multiple fringe products out of one store warrants further research.

Most of the rest of the market is populated by small independent operators who are much more difficult to characterize than the publicly held companies. Rent-A-Center asserts that, excluding itself and Aaron Rents, "the majority of the remainder of the industry consists of operations with fewer than 20 stores."¹¹⁷ Small rent-to-own stores open and close everyday,¹¹⁸ but some larger, established chains boast over forty stores.¹¹⁹

One possible market participant conspicuously missing from this list is retail stores. The most notorious "rent-to-own" case, *Williams v. Walker-Thomas Furniture Co.*, involved a traditional retailer,¹²⁰ and "traditional financial providers [such as Sears, which offers financing,] are increasingly looking to nontraditional customers—those with less than perfect credit records—as a growth area for new business."¹²¹ Yet, retailers have almost completely abandoned this market.¹²² The most likely reason is that rent-to-own companies have distinctive competencies relevant to rent-to-own customers.¹²³

¹¹³ Compare Korst Interview, *supra* note 9 (detailing Rent-A-Center's procedure) with Briley Interview, *supra* note 88 (explaining Aaron Rents's procedure).

¹¹⁴ Briley Interview, *supra* note 88; Van Wagner Interview, *supra* note 57.

¹¹⁵ Briley Interview, *supra* note 88.

¹¹⁶ Rent-A-Center, Inc, *supra* note 26, at 10 ("We offer financial services products, such as short term secured and unsecured loans, debit cards, check cashing and money transfer services under the trade name 'Cash AdvantEdge.' As of December 31, 2006, we offered some or all of these financial services products in 150 Rent-A-Center store locations in 14 states. We expect to offer such financial services products in approximately 350 to 400 Rent-A-Center store locations by the end of 2007.")

¹¹⁷ Rent-A-Center, Inc, *supra* note 26, at 1.

¹¹⁸ Interview with Edward Winn, General Counsel for the Association of Progressive Rental Organizations (June 25, 2007) [hereinafter Winn Interview] (on file with author).

¹¹⁹ Carrico Interview, *supra* note 39.

¹²⁰ 350 F.2d 445 (D.C. Cir. 1965). As Douglas Baird points out, rent-to-own did not exist at the time *Walker-Thomas* was decided. Douglas G. Baird, *The Boiler Plate Puzzle*, 104 MICH. L. REV. 933, 951 (2006).

¹²¹ McKernan, Lacko, & Hastak, *supra* note 37, at 33-34.

¹²² There is some evidence of traditional retailers entering the market and offering rent-to-own services. Badcock & More, the U.S.'s fourteenth largest retail store operator, has opened several rent-to-own stores near their traditional retail stores. *10 Questions For Wogie Badcock - Executive VP of Badcock & More*, RTO MAGAZINE, July 9, 2007.

This discussion provokes a key policy question. Is the market better off because it is dominated by large publicly held companies that engage primarily in the fringe economy? I respond to this question in Part III.A, which discusses how some regulations drive the largest participants out of the market, leaving only small operators offering this product.

2. Competition

This section addresses two questions: Is the rent-to-own market competitive? If so, on what basis do rent-to-own firms compete for customers? The best evidence suggests the market is competitive, but the basis of that competition is different than one might think—the contract terms and price do not seem to be the primary drivers in the market.

Publicly held rent-to-own firms emphatically assert that the industry is “highly competitive.”¹²⁴ These companies are likely right. The industry is competitive because multiple rent-to-own stores are often placed in the same location,¹²⁵ debunking the myth that consumers use rent-to-own stores because they only have one choice. For example, counting just the stores affiliated with the major trade organization, Houston has 65 stores, Rochester has 13, and New Haven has 3.¹²⁶ Because almost all rent-to-own customers have vehicles and can drive to find lower prices,¹²⁷ all of the stores in a metropolitan area put forth competitive force. Rent-A-Center has faced declining same-store sales from stiffened competition in the industry.¹²⁸

Potential competitors also exert competitive pressure on existing rent-to-own firms. Rent-to-own firms believe that the “cost of entering the rental-purchase business is relatively low.”¹²⁹ Larry Sutton’s rent-to-own business in Florida exemplifies the possibility that small independent operators can grow quickly in this industry. Sutton rents tires and wheels in Tampa,

In Canada, a small, traditional furniture store began offering rent-to-own goods because of the unique demand of a seasonal workforce in its town. Korenko, *supra* note 98, at 4. A small group of Target stores also worked with a consumer group to offer an alternative to rent-to-own as a way to “inform consumers about RTO exploitation.” The stores offered a limited credit card to people with poor or little credit histories. Hill et al., *supra* note 21, at 8-9. Examples like these, however, are few and far between.

¹²³ Hastak, *supra* note 22, at 94.

¹²⁴ Aaron Rents, Inc., *supra* note 26, at 6; Rent-A-Center, Inc, *supra* note 26, at 9.

¹²⁵ Korenko, *supra* note 98, at 4. See also Aaron Rents, Inc., *supra* note 26, at 8 (“Many of our stores are placed near existing competitors’ stores.”); Rent-A-Center, Inc, *supra* note 26, at 27 (“In addition, we strategically open or acquire stores near market areas served by existing stores (‘cannibalize’) to enhance service levels, gain incremental sales and increase market penetration. This planned cannibalization may negatively impact our same store revenue and cause us to grow at a slower rate. There can be no assurance that we will open any new rent-to-own stores in the future, or as to the number, location or profitability thereof.”).

¹²⁶ To obtain this information, see <http://login.rtohq.org/source/Members/RentalMemberSearch.cfm> (last visited July 15, 2007).

¹²⁷ The extensive FTC Survey of rent-to-own customers found that 84% of customers had a car or truck. FTC, *supra* note 25, at 36.

¹²⁸ Erick Bergquist, *A New Contender Sets Sights on the Underbanked*, AM. BANKER, Apr. 17, 2006, at 1.

¹²⁹ Rent-Way, Inc., *supra* note 26, at 10.

and in just six years, his revenue jumped from \$10 million a year to \$25 million a year, and he added 20 stores to the 15 he had six years earlier.¹³⁰

Rent-to-own firms also face competition from forces outside the industry. To the extent that customers in the fringe economy have access to other fringe products, rent-to-own stores compete with credit card companies and other small loan providers.¹³¹ Firms compete most fiercely for customers who have better credit scores, and they sometimes lose customers who “graduate” to other credit products when their credit scores improve.¹³² Rent-to-own firms also compete to some extent with vendors that offer short term rentals, like apartment owners who lease washers and dryers to tenants.¹³³ Finally, some rent-to-own stores, depending on their business model, compete with retail stores.¹³⁴

Legal scholars in the past have asserted the market is not competitive. Martin and Huckins claim that rent-to-own stores are located too far from each other to exert competitive force, that customers lack access to credit cards, and that the industry is increasingly experiencing consolidation.¹³⁵ The first argument is plainly wrong. Not only do reports indicate stores are close together, rent-to-own customers almost all (84%) have vehicles, so the distance between stores is not a barrier to competition. The other two arguments have some merit. Most customers do use rent-to-own because they lack alternatives, although as the FTC survey describes, more customers have credit cards than we might expect.¹³⁶ The mere fact that rent-to-own companies do not face pressure from other forms of credit, however, does not entail the market is not competitive. There is internal competition among rent-to-own firms and pressure from other industries. Moreover, because there are less expensive alternatives in the market, rent-to-own firms have to convince customers to pay the extra costs associated with getting higher quality merchandise. The argument that consolidation has rendered the market uncompetitive is appealing because of Rent-A-Center and Aaron Rents’ market share. However in 2006, the Federal Trade Commission approved Rent-A-Center’s acquisition of the giant Rent-Way chain, indicating that under traditional antitrust rules, at least, the market is competitive.¹³⁷

¹³⁰ Rodgers, *supra* note 45, at 1.

¹³¹ Rent-A-Center, Inc, *supra* note 26, at 9 (“With respect to customers desiring to purchase merchandise for cash or on credit, we also compete with retail stores.”).

¹³² Carrico Interview, *supra* note 39.

¹³³ Aaron Rents, Inc., *supra* note 26, at 18 (“We compete in the rent-to-rent market with national and local companies and, to a lesser extent, with apartment owners who purchase or provide furniture for rental to tenants.”).

¹³⁴ See Vail Interview, *supra* note 44 (explaining that his managers compete with retail stores, and not other rent-to-own dealers, because his cash prices are competitive with retail stores).

¹³⁵ Martin & Huckins, *supra* note 7, at 405-06. See also Pimentel, *supra* note 11, at 394-95 (arguing the rent-to-own industry is not competitive because rent-to-own customers lack the resources to shop around for the best deals, forcing them to go to their local rent-to-own store, and because consumers cannot obtain credit cards, insulating rent-to-own markets from competitive pressure from credit card providers).

¹³⁶ Lacko, , *supra* note 13, at 130 (reporting 44% of rent-to-own customers have credit cards).

¹³⁷ But see Carrico Interview, *supra* note 39 (reporting that breaking into a market that already has a Rent-A-Center store is very difficult); Briley Interview, *supra* note 88 (explaining that he became an Aaron Rents’s franchise because Aaron Rents was moving to towns in which he had store and he did not want to suffer a loss of 25-30% of his business to Aaron Rents).

The mere fact that the rent-to-own market appears to be competitive should not alone exempt it from regulation. Oren Bar-Gill has argued that in the credit card market, for instance, the highly competitive market encourages businesses to exploit consumer irrationality.¹³⁸ Yet, in credit card markets as in other markets, competition makes regulatory intervention on terms over which firms compete much more difficult to justify.¹³⁹

Recognizing the market is competitive, however, demands a follow up question: How do firms compete for business? Past scholarship has not addressed this question at all, but interviews with market participants help fill in this critical gap. Both big and smaller rent-to-own operators emphasized the importance of personal relationships in building business.¹⁴⁰ Since almost all customers pay in person, companies have an opportunity to either gain or lose significant business through the relationships they develop with customers.¹⁴¹ Different stores also attract different customers because of branding: Some people want small, community operators as opposed to large corporate stores;¹⁴² some people want to go to stores that “lease” instead of “rent” goods because of a stigma associated with renting;¹⁴³ and other people want stores that are investing in the community.¹⁴⁴ The quality and selection of goods also drives competition, giving an advantage to companies with more floor space.¹⁴⁵ Finally, operators report that rent-to-own firms compete on the basis of price, though usually “price” means the weekly or monthly costs of renting the goods, not the total cost.¹⁴⁶

This small sampling of interviews is not definitive, and further research would give regulators a more complete picture of how firms compete. Still, it is worth noting what characteristics were not mentioned by any operator. No one claimed that firms compete on the basis of the costs of bundled fees, like insurance or preferred customer programs, and no one suggested that operators seek to attract customers by offering lower reinstatement fees or collection fees. Even the price of the goods—often the most salient term of a consumer

¹³⁸ Oren Bar-Gill, *Seduction by Plastic*, NW. U. L. REV. 1373, 1376 (2004) (“Interestingly, if the credit card market is indeed as competitive as it appears to be, issuers have to exploit consumers’ imperfect rationality in order to survive in this market.”).

¹³⁹ Cass R. Sunstein, *Boundedly Rational Borrowing*, 73 U. CHI. L. REV. 249, 269 (2006) (“[R]ecent evidence suggests that there is intense competition over interest rates in the credit card market. Because such competition has been occurring, a governmental response does not appear to be necessary or even desirable.”) (internal citations omitted).

¹⁴⁰ Korst Interview, *supra* note 9; Carrico Interview, *supra* note 39; Lewallen Interview, *supra* note 44; Romine Interview, *supra* note 56.

¹⁴¹ Korst Interview, *supra* note 9.

¹⁴² Carrico Interview, *supra* note 39; Romine Interview, *supra* note 56.

¹⁴³ See Briley Interview, *supra* note 88 (reporting that becoming an Aarons Rents franchise owner attracted different customers from those who shopped when the stores were called Rent City because customers were willing to be associated with leasing but not renting operations).

¹⁴⁴ Carrico Interview, *supra* note 39.

¹⁴⁵ Korst Interview, *supra* note 9.

¹⁴⁶ Korst Interview, *supra* note 9; Briley Interview, *supra* note 88.

deal¹⁴⁷—did not even make it on to some operators’ lists. Policy makers must regulate knowing that competition will not solve market inefficiencies for these terms of the deal.

II. JUSTIFICATIONS FOR REGULATION

Having parsed the relevant characteristics of the rent-to-own business, this Part discusses possible justifications regulators might offer for banning the transaction altogether, severely regulating it, or regulating specific aspects of it. Though the case for a ban or severe regulations is weak, there are strong justifications for legislatures to enact narrow, tailored regulations. Customers are prone to make some systematic mistakes using this product, so regulators are justified in mitigating the effects of those mistakes through tailored regulations.

A. The Case for Severe Regulations

First, I take up the question of whether policy makers should ban this transaction or severely regulate it. I define severe regulations as those that will effectively ban the industry by substantially decreasing the number of companies willing to do business in jurisdictions adopting the regulations. Three of the arguments in favor of severe regulations—the link to bankruptcy, the high price to consumers, and the fact consumers lose equity—are, in my estimation, non-starters. A fourth argument, the possible regressive cross-subsidy in this market, may provide some ground for severe regulations. The final subsection of this Part critiques banning the transaction by describing the costs of a ban to consumers.

1. Bankruptcy

A sure foundation for regulating a transaction is the fact that the transaction generates externalities,¹⁴⁸ and the most obvious way financial services create externalities is by pushing consumers towards bankruptcy. If rent-to-own increases the likelihood consumers will file for bankruptcy, regulators have a basis for severe regulatory intervention. However, the link between rent-to-own transactions and bankruptcy is actually quite weak. Regulators cannot use the externalities connected with bankruptcy to justify regulations.

Proponents of regulations frequently cite increased rates of consumers filing for bankruptcy as a reason to regulate a given financial transaction. Ronald Mann has, for instance, demonstrated that increased credit card debt leads to elevated levels of consumer bankruptcy.¹⁴⁹ The problem with this increase in filings, he urges, is that financial distress imposes costs on third parties, such as the debtor’s family, the welfare safety net, and other creditors.¹⁵⁰ In light of

¹⁴⁷ Bar-Gill, *supra* note 48, at 45.

¹⁴⁸ Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom To Contract*, 24 J. LEGAL STUD. 283, 284 (1995) (noting how courts enforce contracts that lack externalities but not those that impose them).

¹⁴⁹ MANN, *supra* note 43, at 67.

¹⁵⁰ *Id.* at 49-50. See also John A. E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 U. ILL. L. REV. 405, 411 (“Few scholars today maintain that personal bankruptcy is a fully isolated, internalized occurrence between a debtor and creditor alone.”).

these costs, he contends that “those designing regulatory policies for consumer credit markets and bankruptcy systems would be well advised to account for the causative link between borrowing and bankruptcy.”¹⁵¹

Though Mann’s data presents a credible link between credit card debt and financial distress, the nature of the rent-to-own transaction makes any link between rent-to-own and bankruptcy highly suspect. The most relevant feature is, of course, the fact that the consumer has no future obligation to continue making payments on the contract and has taken on no debt. If a customer takes on rental payments beyond their ability to pay, the contract is terminated, and the goods are returned to the dealer. In this sense, the rent-to-own transaction resembles the “fresh start” envisioned in a Chapter 7 Bankruptcy: The debtor loses the goods but also has no further obligation to pay creditors. The relationship between renting-to-own and financial distress may be correlative in that rent-to-own customers may be more likely to file for bankruptcy for independent reasons, such as being overextended already. No one, however, has ever filed bankruptcy because of an obligation to pay on a rent-to-own contract. Because renting-to-own does not have a causative relationship with bankruptcy, regulators must look elsewhere to justify banning the transaction. The next sections evaluate other bases for pursuing regulation.

2. Price

The most popular and enduring criticism against the rent-to-own industry is that consumers simply pay too much for the goods. Typically, customers end up paying more than double the purchase price of a product. When the total payments are conceptualized as an implied APR, the APR is frequently above 200%. Considered in tandem with the fact that most rent-to-own customers have low incomes, the high cost of obtaining goods invokes the common notion that “the poor pay more.”¹⁵² Harold Karger neatly sums up the point: “In the final analysis, the fringe economy preys upon society’s most vulnerable members by charging them more for goods and financial services than it does the middle class, both in absolute dollars and relative to income.”¹⁵³

Criticism based on high prices has come from a wide spectrum of voices. Courts have sided against rent-to-own companies because of the high prices charged,¹⁵⁴ and even when ruling in their favor, courts have vilified rent-to-own companies for high prices.¹⁵⁵ Academic criticism

¹⁵¹ MANN, *supra* note 43, 182. *See also* Pottow, *supra* note 150, at 412 n.34 (recognizing that “the case for legal intervention is strengthened by the degree to which externalities pervade”).

¹⁵² DAVID CAPLOVITZ, *THE POOR PAY MORE: CONSUMER PRACTICES OF LOW-INCOME FAMILIES* (1967).

¹⁵³ KARGER, *supra* note 21, at 198.

¹⁵⁴ *See* *Murphy v. McNamara*, 416 A.2d 170, 176 (Conn. Super. Ct. 1979) (holding unconscionable, “without doubt,” a contract “requiring [the customer] to pay over two and one-half times the regular retail sales price of the television set for the extension of credit”).

¹⁵⁵ *E.g.*, *In re Pellegrino*, 205 B.R. 479, 482 (Bankr. E.D. Pa. 1997) (“Rent-to-own transactions are usually characterized by gross overcharging of customers.”).

has overwhelmingly focused on consumer's costs,¹⁵⁶ and some academics cite the high price of transactions in the fringe credit economy as the only argument needed to support regulation.¹⁵⁷ Consumer advocates rail against low-income customers paying more than the middle class,¹⁵⁸ and even the popular press has joined this chorus of condemnation.¹⁵⁹ These criticisms are not lost on rent-to-own consumers. Several studies report that high prices are the main complaint customers have about their rent-to-own experience.¹⁶⁰ But most importantly for the purposes of this Article, regulators have latched on to the high price of renting-to-own as a sole justification for regulating the industry.¹⁶¹

Though it may be intuitively revolting to make poor people pay more for services than rich people, it is not entirely clear that the price of a service alone can provide a justification for severely regulating the service. Against the chorus of voices claiming price alone justifies severe rent-to-own regulations, I argue that price, by itself, cannot warrant severe regulation.

¹⁵⁶ E.g., Walden, *supra* note 28, at 336; Swagler & Wheeler, *supra* note 21, at 148; Brian J. Zikmund-Fisher & Andrew M. Parker, *Demand for Rent-to-Own Contracts: A Behavioral Economic Explanation*, 38 J. OF ECON. BEHAVIOR & ORG. 199, 200 (1999); McKernan, Lacko, & Hastak, *supra* note 37, at 35; Martin & Huckins, *supra* note 7, at 413-14; Pimental, *supra* note 11, at 370. See also Michael Hudson, *Just a Few Bucks a Week: The Rent-to-Own Industry*, Michael Hudson, editor, *MERCHANTS OF MISERY: HOW CORPORATE AMERICA PROFITS FROM POVERTY* (1996) at 145. ("Rent-to-own customers routinely pay three, four, five times what they'd spend on the same item at a retailer."); Nichols, *supra* note 22, at 354 (citing the benefits of renting-to-own but condemning the "pricing structure" which "requires low-income customers to pay anywhere from one and one-half to four times what a cash customer would pay for the item."); Thomas J. Methvin, *Alabama's Poverty Industry*, 58 ALA. LAW. 234, 239 (1997) ("A typical effective annual interest rate for many of these transactions is 600 to 700 percent.").

¹⁵⁷ *The other subprime*, Marketplace, NPR, Mar. 28, 2007, available at <http://marketplace.publicradio.org/shows/2007/03/28/PM200703285.html> ("Twenty years ago, if anyone said that people would be arguing that 360 percent small loans were defensible . . . I think people would think you were nuts.") (quoting Kathleen Keest).

¹⁵⁸ Allison Torres Burtka, *N.J. High Court Restricts Interest Rates in Rent-to-Own Contracts*, TRIAL, June 2006, at 80 (quoting Neil Fogarty, a consumer advocate from the Consumers League of New Jersey: "The urban poor should not be charged 80 percent or 100 percent while the middle class only pays 20 percent at the mall."); FTC, *supra* note 25, at 3 ("The primary criticism of the rent-to-own industry by consumer advocates has concerned the rent-to-own prices."); Martin & Huckins, *supra* note 7, at 386 ("The primary complaint of consumer advocates against the industry is that [rent-to-own] customers, many of whom are low-income, pay much more than if they purchased the same goods in retail stores.").

¹⁵⁹ See, e.g., *Rent-To-Own Regulation Merits Support*, WISCONSIN STATE J., Aug. 7, 2005) at B3 (arguing "consumers deserve to be protected by government regulation that caps the total cost of rent-to-own agreements" because "the consumer ends up paying far more than the cash purchase price"); David Leonhardt, *Economic View: TV's, DVD's: All Yours, but First Do the Math*, N.Y. TIMES, Dec. 16, 2001, § 3, at 4 ("Paying \$2,000 for a \$450 product is never a good idea.")

¹⁶⁰ See Lacko, *supra* note 13, at 133 (reporting that 27% of all rent-to-own customers and two-thirds of dissatisfied customer that the FTC surveyed complained about price); Swagler & Wheeler, *supra* note 21, at 152 (reporting similar findings in a different study); Hill et al., *supra* note 21, at 6 (same).

¹⁶¹ Joseph P. Fried, *Rent-a-Center Charged with Price Gouging*, N.Y. TIMES, Aug. 23, 2001, at B8 (reporting that the New York Department of Consumer Affairs objected to rent-to-own because "a survey of nearly half of the 40 New York City outlets of the company, which has 2,400 stores nationwide, found that the stores set base charges for TV's, DVD players, stereo systems and the like as high as triple the manufacturers' suggested retail prices."); Martin & Huckins, *supra* note 7, at 401 (describing the Attorney General of Pennsylvania's testimony to Congress that rent-to-own transactions are objectionable simply because of the high cost and effective interest rate).

One problem with relying on high prices as the justification to regulate the rent-to-own industry is that it leads to overly blunt regulations. As Part I.B explained, the rent-to-own market is unsegmented. All customers pay the same for a week or month's rental, but not all customers use the product in the same way. If regulators use price as the sole justification for severely regulating rent-to-own companies, the regulations will necessarily cut out sophisticated renters who intend to keep the goods for only a month as well as unsophisticated renters who intend to acquire the goods over time. Both pay the same high prices, but regulators would likely only intend to protect unsophisticated would-be purchasers, and not sophisticated pure renters.¹⁶² This is a classic example of regulation that is not asymmetrically paternalistic. It stops the beneficial use of a product by a party that is not suffering cognitive failure.¹⁶³

High prices are also an insufficient foundation for regulation because high prices—without correspondingly high profits—do not necessarily indicate anti-consumer conditions. Some services are very expensive, either because of the risks to the provider or because of the costs of doing business in that industry. If rent-to-own companies routinely posted above market profits, regulators would have good reason to regulate based on price alone. But, evidence from Rent-A-Center and Aarons' Rents indicates rent-to-own companies actually post normal profits.¹⁶⁴ Last year Rent-A-Center's operating profit as a percentage of total revenue was 9.1%;¹⁶⁵ Aarons posted 5.9% in 2006.¹⁶⁶ The regional chain Rent One has drawn a 3% - 7% profit margin over the last few years from its 44 stores.¹⁶⁷ As a point of comparison, these profits are in line with Starbucks which had a 7.2% profit margin last year.¹⁶⁸ Now, this normal profit margin does not entail rent-to-own companies should not be regulated, it just means that they should not be regulated purely on the basis of price as academics, courts, consumer advocates, and the press suggest.¹⁶⁹

Another way to understand why price alone is an insufficient basis for regulation is to look at sources that suggest restricting transactions based on high prices. When authors posit

¹⁶² The force of my argument is undercut by the fact most rent-to-own customers do have lower incomes, so the population of rich, sophisticated renters is relatively small. The FTC found that 5.8% of people who used rent-to-own in the last year made over \$50,000 a year and 10.4% of people who used it in the last five years made over that amount. FTC, *supra* note 25, at 42.

¹⁶³ Camerer et al. explain that “[a] regulation is asymmetrically paternalistic if it creates large benefits for those who make errors, while imposing little or no harm on those who are fully rational.” Camerer et. al, *supra* note 6, at 1212. Here, sophisticated short-term renters are harmed by being denied a useful and needed product.

¹⁶⁴ *But see* Martin & Huckins, *supra* note 7, at 416-17 (claiming rent-to-own firms have higher operating profits than their retail counterparts).

¹⁶⁵ Rent-A-Center, Inc, *supra* note 26, at 35.

¹⁶⁶ Aaron Rents, Inc., *supra* note 26, at exhibit 13.

¹⁶⁷ Carrico Interview, *supra* note 39.

¹⁶⁸ Starbuck Corporation, Annual Report (Form 10-K), at 3 (Mar. 31, 2007).

¹⁶⁹ *Cf.* Aaron Huckstep, *Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?*, 12 *FORDHAM J. CORP. & FIN. L.* 203, 204 (2007) (“[D]espite the common belief, payday lending firms do not always make extraordinary profits. In fact, when compared to many other well-known lending institutions, payday lenders may fall far short in terms of profitability. If that is the case, then the call for regulation should be based solely in principle, moral, or other subjective reasoning—not on high fees.”) (citations omitted).

that transactions should be regulated because of high costs, the true source of the authors' suggestions is not really the high price of the items. Instead, high prices serve as a proxy for some other underlying problem—like market failures or externalities. Ronald Mann has unmasked this phenomenon as it relates to Elizabeth Warren's and Eric Posner's justifications for usury restrictions:

Consider the social problems that motivate the proponents of price controls. Posner worries about the external effects on the welfare system of risky credit transactions. Warren is concerned about high-priced borrowing that reflects poor judgment on the part of those that engage in it. In neither case, however, is the concern simply that the rate is too high. The idea in each case is that high interest rates are a useful proxy for the types of transactions that would justify market intervention.¹⁷⁰

Frank Darr's argument that courts should restrict pricey transactions through the unconscionability doctrine provides another example. He asserts that courts should add price unconscionability to the existing framework, consisting of substantive and procedural unconscionability.¹⁷¹ Under his proposed doctrine, courts would find a contract unconscionable only if "the price [was] significantly different from a norm, measured by cost, fair market value, or historic prices."¹⁷² Yet, even in this relatively radical conception of unconscionability, Darr's real motive is not merely restricting high prices. Instead, he wants to stop market failures. In addition to having a high price, a contract, under his framework, would only be "price unconscionable" if (1) the contracting process was flawed and (2) the market does not provide for private-enforcement measures.¹⁷³

The real problems Warren, Posner, and Darr hope to address are distinct from price. Price is just a symptom. Alone, unaccompanied by market failure or externalities, it is not a secure foundation for regulating rent-to-own transactions. The next section addresses one of the problems to which advocates of regulation may point to demonstrate that price is symptomatic of a deeper concern: the equity consumers forfeit in rent-to-own transactions.

3. Lost Equity

Policy makers may wish to prohibit rent-to-own transactions because consumers lose all equity they have invested in the rented asset if the agreement is terminated and the firm recovers the asset. If part of the weekly payment a customer makes is attributed to equity and not just the reasonable rental cost, then customers build equity in the assets they are renting and risk forfeiting that equity if their agreements terminate.

¹⁷⁰ MANN, *supra* note 43, at 189.

¹⁷¹ Frank P. Darr, *Unconscionability and Price Fairness*, 30 HOUS. L. REV. 1819, 1840-41 (1994).

¹⁷² *Id.* at 1841.

¹⁷³ *Id.*

In other commercial contexts, most notably mortgages, courts and legislatures have, for centuries, effectively prohibited or restructured contracts that involve a borrower forfeiting the equity the borrower has in an asset.¹⁷⁴ Before the seventeenth century, a land owner who wished to borrow based on her land actually conveyed the land to a mortgage lender who only had an obligation to return it if the borrower repaid the debt.¹⁷⁵ If the borrower failed to pay or paid late, the lender kept the land, and the borrower forfeited her equity. Since the seventeenth century, however, courts have employed the doctrine of the borrower's equity of redemption: A borrower has the right to redeem real estate until the lender goes through the official procedure of foreclosure¹⁷⁶—a procedure that ensures the borrower receives any equity she has in the land.¹⁷⁷

More importantly, courts consistently strike down any contract in which a borrower waives her rights and thereby forfeits the equity—lenders cannot “clog” the borrower's equity of redemption.¹⁷⁸ Courts ferret out and reject creative attempts to clog borrowers' equity of redemption¹⁷⁹ in order to protect impecunious, ignorant landowners from exploitation by lenders.¹⁸⁰ This right to redemption and the rule forbidding contracts waiving it has survived even the massive deregulation of the consumer credit market in the last twenty five years that wore away other borrower protections.¹⁸¹ Additionally, bankruptcy laws¹⁸² and the UCC¹⁸³ reinforce the impetus to protect borrowers from forfeiting equity.

¹⁷⁴ See generally RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 3.1 (1996).

¹⁷⁵ *Id.* §3.1 cmt. a.

¹⁷⁶ Morris G. Shanker, *Will Mortgage Law Survive?: A Commentary and Critique on Mortgage Law's Birth, Long Life, and Current Proposals for Its Demise*, 54 CASE W. RES. L. REV. 69, 69 (2003).

¹⁷⁷ RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 6.4.

¹⁷⁸ John C. Murray, *Clogging Revisited*, 33 REAL PROP. PROB. & TR. J. 279, 280 (1998).

¹⁷⁹ For a survey of ways lenders have attempted to obviate the prohibition on clogging, see generally Murray, *supra* note 178, and RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 3.1 Illustrations 1-5.

¹⁸⁰ RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 3.1 cmt. a; Dyal-Chand, *supra* note 60, at 305. *But see* Marshall E. Tracht, *Renegotiation and Secured Credit: Explaining the Equity of Redemption*, 52 VAND. L. REV. 599 (1999) (suggesting “an alternative justification for the equity of redemption, stressing the role of the law in fostering efficient renegotiation upon default”).

¹⁸¹ Dyal-Chand, *supra* note 60, at 315. The proposed Uniform Nonjudicial Foreclosure Act also retains the provision that parties cannot contract around the statutory protections. Unif. Nonjudicial Foreclosure Act § 104(a) (2002), available at <http://www.law.upenn.edu/bll/ulc/UFBPOSA/2002final.pdf>. (“Except as otherwise provided in subsections (b) through (d), the parties to a security instrument may not vary by agreement the effect of a provision of this [Act].”). See Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399, 1443 n.166 (2004) (discussing §104).

¹⁸² The automatic stay prevents foreclosures, protecting consumer's equity. 11 U.S.C. § 362. See also Melissa B. Jacoby, *Bankruptcy Reform and Homeownership Risk*, 2007 U. ILL. L. REV. 323, 325 (explaining “chapter 13's on-the-books mortgage-protection function: it not only stops a foreclosure, but also allows the filer to try to cure a mortgage arrearage over a several year period”).

¹⁸³ See James E. Byrne, *Contracting Out of the Uniform Commercial Code: Contracting Out of Revised UCC Article 5 (Letters of Credit)*, 40 LOY. L.A. L. REV. 297, 323 (2006) (discussing the 1952 version of § 9-501(3) and its official comment 4 which forbade consumers from contracting out of the UCC's protection of equity, appealing to the prohibition on clogging the equity of redemption).

Regulators may extend this prohibition from real estate law to the rent-to-own transaction. The rent-to-own transaction resembles the pre-seventeenth century installment land loan because the individual forfeits all equity if the contract terminates. If the loss of equity is a fundamental, inseparable component of the rent-to-own transaction, regulators may prohibit any rental purchase agreement on the grounds that it clogs the customer's equity of redemption and strips away the equity the customer has invested into the rented asset.

But regulators would be mistaken to make this extension and ban rent-to-own transactions. As a doctrinal matter, the equity of redemption is inapplicable because under the definitions of credit sale and lease in Article 1 of the UCC, rent-to-own transactions are not secured transactions.¹⁸⁴ This answer, however, does not address the policy issue of customers losing equity. For that answer, I look to how the rent-to-own business operates, concluding (1) that most customers do not lose significant equity, and (2) that the loss of equity is not a fundamental, inseparable component to this product because many rent-to-own business guarantee customers a way to retain their equity. Thus, regulators should not use lost equity to prohibit rent-to-own.

First, despite assertions otherwise by some academics,¹⁸⁵ most customers do not lose equity when using the rent-to-own product. Ninety percent of people who rent goods for longer than six months obtain ownership of the goods,¹⁸⁶ so the people with the most equity are the most unlikely to lose the equity they have acquired. On the other hand, people who rent for a short time likely do not acquire significant equity, and most, I suspect, acquire none. When a customer rents a new product, the product immediately loses value to the rent-to-own firm because used goods are much harder to rent than new goods.¹⁸⁷ Also, for someone renting for a short time, the costs of delivering and picking up the merchandise—usually paid for by the store—would be taken out of a smaller number of payments, depleting any potential equity. For short term renters, these upfront costs most likely entail that their rental payments are well below the reasonable rental costs. In summary, those customers that do have equity almost always retain it by acquiring ownership, and those customers who do not acquire ownership mostly likely do not have any equity built up to lose.

Second, consumers' lost equity is not a fundamental component of this transaction—that is, the transaction can exist in a form that guarantees that consumers will not lose equity. The best evidence of this claim is that many firms offer lifetime reinstatement rights: Customers who have made rental payments but terminate their agreements can reinstate their agreements at any time, picking up with the same number of payments left to acquiring ownership. The market giants Rent-A-Center and Aaron Rents will both reinstate any contract if the customer resumes making payments, even if the customers allowed the contract to terminate months before.¹⁸⁸ A

¹⁸⁴ See UCC § 1-203 (defining leases).

¹⁸⁵ KARGER, *supra* note 21.

¹⁸⁶ FTC, *supra* note 25, at 65.

¹⁸⁷ Korst Interview, *supra* note 9.

¹⁸⁸ Korst Interview, *supra* note 9; Interview with Customer Service Representative of Garden Oaks, Houston, Texas Location of Aaron Rents (July 26, 2007) (on file with author).

smaller, privately-owned operator, Show-Me Rent-to-Own based out of Farmington, Missouri, also allows reinstatement at any time, even though Missouri's regulations only require reinstatement after a few weeks.¹⁸⁹ Gary Romine, Show-Me's owner, explained his decision to provide lifetime reinstatement rights was a business decision. His stores are more competitive in the market because he can advertise that customers can always continue terminated agreements.¹⁹⁰ Ernie Lewallen, the president of a ten store operation in Kentucky and Ohio, UHR Rents, Inc., explains that he offers lifetime reinstatement rights, despite the fact it hurts his bottom line in the specific transaction, because it allows him to retain customers and prevents them from going to the competition.¹⁹¹ These examples demonstrate that regulators do not need to ban the transaction entirely to prevent lost equity. Instead, regulators who want to address this problem can do so by mandating that firms offer lifetime reinstatement rights, as discussed in Part III.C.

4. Rent-to-Own's Cross-Subsidy

Part I.B explained that the rent-to-own market is not segmented despite the fact that different types of customers rent goods for different reasons—some to buy and some to rent short-term. This section tentatively argues that this lack of segmentation causes a cross-subsidy in which poorer customer who actually purchase merchandise subsidize relatively richer customers who only rent short-term. If the cross-subsidy is regressive, as it appears to be, regulators likely have an independent basis for severely regulating this industry. Because, however, we lack data to answer this question conclusively, the potential regressive cross subsidy does not yet offer a justification for a ban or severe regulations.

To understand the importance of the cross-subsidy in the rent-to-own market, consider how some theorists argue it works with credit cards. Significant research has attempted to demonstrate that credit card usage results in a regressive cross-subsidy. People who do not use credit cards at all pay more for goods than people who use credit cards because merchants charge the same price for all goods regardless of how a customer pays, but receiving payment by credit card is more expensive for merchants than receiving payment by cash.¹⁹² Merchants bundle the extra costs associated with credit cards into the goods themselves, increasing the price to all consumers in order to pay for the fees that credit card issuers charge the merchants. The result is a regressive cross-subsidy: People who pay in cash tend to be the poorest Americans whereas credit card users are relatively better off.¹⁹³ The rewards programs that rich Americans benefit from “are funded in part by a highly regressive, *sub rosa* subsidization of affluent credit

¹⁸⁹ Vernon's Ann. Missouri Statutes § 407.664 (2001).

¹⁹⁰ Romine Interview, *supra* note 56. Even operators that do not offer lifetime reinstatement rights report that they work with customers to reinstate agreements if they can. Carrico Interview, *supra* note 39.

¹⁹¹ Lewallen Interview, *supra* note 44. See also Vail Interview, *supra* note 44 (explaining he offers lifetime reinstatement rights for the same reason).

¹⁹² Adam J. Levitin, *Priceless? The Social Costs of Credit Card Merchant Restraints* 4-5 (Unpublished Manuscript) available at <http://ssrn.com/abstract=973970>

¹⁹³ The empirical data behind this point is subject to debate. More poor people are using credit cards, Littwin, *supra* note 5, whereas rich people are drawn to debit cards and check writing. This debate is outside the scope of this Article, so I do not address these objections here.

consumers by poor cash consumers. In its worst form, food stamp recipients are subsidizing frequent flier miles.”¹⁹⁴ The subsidy is widely condemned because it is regressive, and commentary suggests it provides a reason to intervene in credit card markets.¹⁹⁵

Rent-to-own has the potential to have such a subsidy. Relatively wealthy people tend to rent for only a short time period whereas relatively poor people tend to rent in order to acquire ownership.¹⁹⁶ These two groups pay the same amount per week even though some rent for a short time and end up with nothing from the transaction and others rent for a very long time, ending up with the goods but also a significant total cost over time.

There is no empirical evidence about whether rent-to-own firms make more money from those who rent for a long or a short time or about how they redistribute the extra costs associated with the less profitable segment. Thus, we do not know which group is subsidizing the other. Interviews I conducted with industry participants, however, suggest that people who eventually purchase merchandise subsidize short-term renters.

The re-rent or re-sale value of used goods is quite low because customers would rather rent new goods than old goods,¹⁹⁷ so the short-term renter costs rent-to-own firms money by decreasing the value of the goods by converting them into used goods—just like a car loses \$5000 of its value the minute it is driven off the lot. Also, short-term renters impose more costs on firms than long term renters because the rent-to-own company has to pay the costs of delivering the merchandise and picking it up from the customer’s house.¹⁹⁸ If a customer’s few rental payments are less than the value lost in the conversion from new goods to used goods and the cost of delivery and pick up, rent-to-own stores could potentially lose money from short term renters. Some operators admit this is the case,¹⁹⁹ and one interviewee went so far as to say that his firm makes no money if a customer only rents merchandise for four months or less and returns it.²⁰⁰ It appears, then, that long-term renters subsidize short term renters. If so, the poor person attempting to obtain ownership of a washing machine may be making it less expensive for the rich person to rent a big-screen TV to watch the Super Bowl.

¹⁹⁴ Levitin, *supra* note 192, at 1, 38-40.

¹⁹⁵ *E.g., id.* at 52 (stating that a regressive subsidy warrants regulatory intervention even if regulators cannot weigh the net effects of credit card use).

¹⁹⁶ McKernan, Lacko, & Hastak, *supra* note 37, at 52.

¹⁹⁷ Korst Interview, *supra* note 9; Carrico Interview, *supra* note 39. Against this view, one participant indicated that rent-to-own firms make the most money from customers who rent goods for a significant time period and then return the goods. In these cases, the firm can then re-rent the same goods, which look new when they are thoroughly detailed, for another extended period of time to a new customer. Van Wagner Interview, *supra* note 57. Because, however, the FTC’s evidence demonstrates that most people who return goods do so after a short period of time, the instances of long rentals that are returned is probably low, so the chance to make more profits this way are probably quite small.

¹⁹⁸ Vail Interview, *supra* note 44.

¹⁹⁹ *See* Lewallen Interview, *supra* note 44 (noting that if people pay until the end of the agreement, these customers would be more profitable, but contending that few people do so); Vail Interview, *supra* note 44 (unqualifiedly asserting long-term purchasers are more profitable).

²⁰⁰ Vail Interview, *supra* note 44.

Despite this initial investigation into the question, more empirical studies are needed to understand how rent-to-own firms reconcile the costs and benefits derived from the two types of people who use the product. To determine that people paying cash subsidized credit card users, Levitin examined several empirical studies that tracked prices of retail gasoline when gas stations offered cash discounts.²⁰¹ Without empirical data like this in the rent-to-own industry, regulators are left without clear evidence that the poor pay more though many payments over time because short-term renters are less profitable for rent-to-own firms. Though this potential regressive cross-subsidy provides the best argument for severe regulations, regulators are on very shaky ground justifying such regulations without more evidence about exactly how these two segments of the rent-to-own market interact.

5. The Case against Severe Regulations: The Problems of Unsatisfied Demand and Relative Inefficiency

The last four subsections contend that the case for severely regulating the rent-to-own market is weak. This part extends that argument by demonstrating the costs of eliminating the rent-to-own transaction. Eliminating the option for consumers to rent-to-own will either leave consumer demand for durable goods unsatisfied or it will force consumers towards inferior, more costly alternatives.

It has been well documented that demand for consumer credit is constant. The United Kingdom Department of Trade and Industry conducted an expansive study of consumer borrowing in the United Kingdom, the United States, Germany, and France. These four countries have different restraints on the availability of credit, but the demand for credit appeared to be independent of the availability of credit.²⁰² The study found that the most deeply felt impact of state-imposed restrictions on consumers' ability to obtain credit was an inability to make major purchases,²⁰³ indicating that much of the constant demand for credit is really a demand for major purchases, such as purchases of durable goods.

Rent-to-own satisfies the need to obtain durable goods without purchasing them outright. The question regulators must address is what consumers will do if severe regulations eliminate renting-to-own as mechanism for meeting the constant demand for obtaining durable goods without paying cash for them. The answer, I think, is that some customers will not obtain the demanded goods and others will use less efficient acquisition vehicles.

²⁰¹ Levitin, *supra* note 192, at 30

²⁰² UNITED KINGDOM DEP'T OF TRADE & INDUS., *supra* note 91, at 10. *See also* MANN, *supra* note 43, at 109 (demonstrating that demand for credit is a function of economic growth by comparing borrowing in Japan and the United States); Block-Lieb & Janger, *supra* note 6, at 1497 (explaining Joseph E. Stiglitz and Andrew Weiss's theoretical argument that high-risk borrowers' demand for credit is inelastic).

²⁰³ UNITED KINGDOM DEP'T OF TRADE & INDUS., *supra* note 91, at 11.

Rent-to-own is often the only option available to the consumers that use it.²⁰⁴ Rent-to-own companies report that people turn to them because they do not have other options.²⁰⁵ Empirical research substantiates this claim.²⁰⁶ Hill et. al summarize their findings on this issue: “customers’ willingness to pay originally or continue to pay the higher prices charged by [rent-to-own] retailers is not a function of relative desire but of relative constraint.”²⁰⁷ Consumer turn to rent-to-own because they cannot qualify for credit;²⁰⁸ because they have erratic income and want to acquire goods without a long-term commitment;²⁰⁹ or because they are unbanked and must make cash payments.²¹⁰ The fact that so many people use rent-to-own because they do not have other options entails that if regulators eliminate this transaction, those people will go without.²¹¹

Wisconsin provides a real-world example of the theoretical argument I have sketched above. In Wisconsin, the state attorney general sued Rent-A-Center for violating consumer protection laws.²¹² As part of the settlement agreement in the case, Rent-A-Center agreed to disclose APR information to consumers. Directly because of this settlement, Rent-A-Center stopped offering rent-to-own products and instead offered pure sales and traditional credit. Manoj Hastak developed an analytical framework for analyzing the effect of the settlement and the changed business model. He postulated that if Rent-A-Center was no longer serving the same customers, the most-needy consumers would worse off from this settlement.²¹³ The information I gathered from an interview with Rent-A-Center reveals that, in fact, Rent-A-Center is not serving the same customers.²¹⁴ Though the “best” customers continued to use Rent-A-Center’s revamped product, those customers with troubled credit histories were left out.²¹⁵

²⁰⁴ For a short history of why rent-to-own firms became the only source of financing durable goods, see Nehf, *supra* note 11, at 753-55.

²⁰⁵ Aaron Rents, Inc., *supra* note 26, at 4; Rent-A-Center, Inc, *supra* note 26, at 1.

²⁰⁶ E.g., CASKEY, *supra* note 21, at 19; UNITED KINGDOM DEP’T OF TRADE & INDUS., *supra* note 91, at 13.

²⁰⁷ Hill et al., *supra* note 21, at 7.

²⁰⁸ McKernan, Lacko, & Hastak, *supra* note 37, at 51. Swagler and Wheeler found that 59% of RTO users surveyed had been denied credit. Swagler & Wheeler, *supra* note 21, at 150 Table 3; *see also id.* at 153 (“The most notable difference had to do with the denial of credit; among repeat users, 70.8 percent reported having been denied credit, as compared with only 51.4 percent of those who had participated just once.”). *But see* Zikmund-Fisher & Parker, *supra* note 156, at 213 (“In particular, present access to credit cards is completely non-predictive of [whether someone is willing to recommend rent-to-own], indicating that at least some consumers would chose to use rental-purchase even given access to revolving credit accounts.”).

²⁰⁹ Anderson & Jackson, A Reconsideration, *supra* note 16, at 300.

²¹⁰ *See* Anderson & Jackson, A Reconsideration, *supra* note 16, at 300 (“The alternative of using cash payments with RTO is vital to the 23 percent of its users who are *unbanked* with no access to a credit card, checking account, or savings account.”).

²¹¹ For the argument that usury laws restrict consumers’ access to credit cards, see Mark Furletti, Note, *The Debate over the National Bank Act and the Preemption of State Efforts to Regulate Credit Cards*, 77 TEMPLE L. REV. 425, 441 (2004).

²¹² Hastak, *supra* note 22, at 89.

²¹³ Hastak, *supra* note 22, at 93-94.

²¹⁴ Korst Interview, *supra* note 9.

²¹⁵ *Id.*

For some customers, rent-to-own is not the *only* alternative, but it is often the *best* option. Consider the following alternatives to using rent-to-own products to obtain goods over time:

Layaway: Layaway, to the extent it is available at all,²¹⁶ is both costly and disadvantageous. Under a K-Mart plan that was studied, “[t]he APR for a layaway on a portable television with a retail price of \$152 is 57.1 percent.”²¹⁷ Though this APR is lower than the implied APR of many rent-to-own transactions, customers using layaway (1) do not obtain the right to use the goods immediately; (2) must pay the total price in a shorter time period than rent-to-own; (3) often must pay a large deposit; and (4) often are unprotected by any consumer protection statutes.²¹⁸ Given these constraints, layaway is a poor substitute.

Credit Cards: Credit cards with APRs closer to 20% appear to be a less expensive alternative than rent-to-own.²¹⁹ And certainly, they can be. However, if a customer with a credit card with a 20% APR charges \$450 to purchase a television from Best Buy, it will take the customer 81 months to pay off the debt if the customer makes the minimum payment, assuming that payment is 2.5% of the total debt.²²⁰ The interest charged over those 81 months would be \$364.60, bringing to total cost of the television to \$814.60.²²¹ Paying with a credit card would approximate the cost of acquiring the television from a rent-to-own dealer, but the consumer would take around four and a half times the length of time to pay off the debt. Moreover, for the customers who use rent-to-own because of impaired credit, the credit card interest rate will be much higher than the generous 20% assumed in this example.

Payday Loans: Taking out a payday loan to purchase a \$450 television over 78 weeks would cost a customer around \$2205,²²² more than double the cost of obtaining the television through renting-to-own.²²³

²¹⁶ Alyson Ward, *Layaway, R.I.P.*, FORT WORTH STAR-TELEGRAM, Jan. 3, 2007 at F1 (reporting Wal-Mart has stopped offering layaway).

²¹⁷ Anderson & Jackson, A Reconsideration, *supra* note 16, at 299.

²¹⁸ Johnson, *supra* note 76, at 1259-62.

²¹⁹ Christopher Korst suggested this comparison to me.

²²⁰ Of course, the customer does not have to make the minimum payment, and if a customer paid the same weekly payments towards a credit card bill that a rent-to-own contract would require, the customer would end up paying much less. In the general population, around seven percent of customers make only minimum payments. Julia Lane, Note, *Will Credit Card Holders Default over Minimum Payment Hikes?*, 18 LOY. CONSUMER L. REV. 331, 334 (2006). But among potential rent-to-own customers, I suspect the number is much higher.

²²¹ To perform this calculation, see <http://www.bankrate.com/brm/calc/MinPayment.asp>.

²²² \$45 (the \$10 per \$100s lent fee charged every pay cycle) X 39 weeks (assuming a two week pay period) + \$450 (the amount required to pay off the initial loan) = \$2205.

²²³ It is more likely that the loan amount will decrease over time because the customer would pay down some of the principle with each fee payment. Still, the cost of acquiring durable goods through payday loans is much greater than rent-to-own.

These three examples are not meant to be exhaustive but merely to point to the reality that the typical rent-to-own customer often will have less desirable options if regulators ban rent-to-own transactions.

The force of this argument is certainly diminished because rent-to-own goods are not essentials but instead enhance the quality of people's lives.²²⁴ The demand for rent-to-own is not inelastic, and the social welfare harm from regulators eliminating this industry is less significant because the goods are not necessities. Still, although the harm is less significant than the harm of eliminating access to all credit, it exists nonetheless. Because of this harm, policy makers wanting to ban the rent-to-own market must show benefits that outweigh the harm.

But these benefits cannot be established. Research has not demonstrated a link to financial distress and the corresponding negative externalities, consumers do not typically lose equity, and the high price of the goods—without more—has proven insufficient to justify severe restrictions. The best case for restrictive regulation is the potential regressive cross-subsidy in the market, but this justification still requires further study to establish it conclusively. At the end of the analysis, the case for a ban or severe regulations is very weak.

B. The Case for Narrow, Tailored Regulations: Paternalism

Since severe regulation cannot be justified, this subpart examines the best argument for less burdensome regulations. I conclude that paternalism provides a justification for some restrictions because, as behavioral law and economics have revealed, customers are prone to make systematic mistakes. Though these consumer weaknesses justify narrow regulatory intervention, they do not, however, justify banning the industry entirely.

Behavioral law and economics challenges the standard economic model of consumers as fully rational decision-makers.²²⁵ Instead of seeing people as utility-maximizing machines, behavioral law and economics recognizes the reality that people are plagued with cognitive failures that sometimes prevent them from making choices in their own best interests. For example, some people sacrifice future happiness for instant gratification, others discount the risk they will suffer economic adversity in the future, and so on.²²⁶ In competitive markets, it is

²²⁴ See *supra* notes 83 – 88 and accompanying text.

²²⁵ Full rationality usually means that people “have well-defined preferences” that they maximize; that the “preferences accurately reflect . . . the true costs and benefits of the available options”; and that “in situations that involve uncertainty, people have well-formed beliefs about how uncertainty will resolve itself” Camerer et. al, *supra* note 6, at 1214-15.

²²⁶ *Id.* at 1217-18. Behavioral law and economics has produced a prodigious amount of literature. *E.g.*, Owen D. Jones & Timothy H. Goldsmith, *Law and Behavioral Biology*, 105 COLUM. L. REV. 405, 424 (2005); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051 (2000); Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); Thomas S. Ulen, *The Growing Pains of Behavioral Law and Economics*, 51 VAND. L. REV. 1747 (1998); Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608 (1998).

urged, businesses will capitalize on consumers' sub-optimal decision-making.²²⁷ To the extent that businesses exploit consumers' cognitive failures, behavioral law and economics suggests that regulators may use paternalistic concerns to justify regulations that force or steer consumers to make decisions that benefit them.²²⁸ Such regulations are justified even if the transaction has no effect whatsoever on third parties.²²⁹

The traditional cognitive limitations that behavioral law and economics use to justify paternalistic regulations are not as pronounced in the rent-to-own market as one might expect. Though rent-to-own customers likely suffer from some cognitive failures, the proper regulatory response, this section argues, is to limit specific aspects of the transaction, not ban or severely limit the transaction as a whole. To the extent that paternalism motivates proponents of severe rent-to-own regulations, it appears to be an extremely aggressive form of paternalism that robustly seeks to hinder consumer preferences and choices—it does not fit the mode of the weak paternalism advocated by behavioral economists.

The following sections analyze several relevant cognitive failures that might affect customers in the rent-to-own market and may justify regulation.

1. The Optimism Bias

Behavioral economists contend that some customers suffer from excessive optimism when using products that require payments over an extended period of time, much like young

²²⁷ Bar-Gill, *supra* note 138, at 1373 (“Absent legal intervention, the sophisticated seller will often exploit the consumer’s behavioral biases. The contract itself, commonly designed by the seller, will be shaped around consumers’ systematic deviations from perfect rationality.”); Sunstein, *supra* note 139, at 254 (“It is even plausible to suggest that market pressures will lead companies to appeal to the human tendency, grounded in the factors just outlined, to borrow excessively.”).

²²⁸ Camerer et. al, *supra* note 6, at 1218 (“It is such errors—apparent violations of rationality—that can justify the need for paternalistic policies to help people make better decisions and come closer to behaving in their own best interest.”); Jeffrey J. Rachlinski, *Cognitive Errors, Individual Differences, and Paternalism*, 73 U. CHI. L. REV. 207, 224 (2006) (“The most common use of cognitive psychology in legal scholarship is to support paternalistic legal interventions.”); Pottow, *supra* note 150, at 455 (“If the premise of a cognitive bias is that a consumer, due to underestimation or myopia or some other psychological impediment, is unable to say what she truly wants in terms of credit, then the state’s putting certain items, like unaffordable credit, off limits should be acceptable.”); *id.* at 457 (“Indeed, the problem of the sweatbox lending model that exploits the cognitive defects of certain borrowers is an independent ground for policy intervention wholly apart from any trouble with externalities.”); Bar-Gill, *supra* note 138, at 1377 (arguing that the underestimation bias generates welfare costs because it distorts competition in the credit card market, causes prices to deviate from marginal costs, and gives rise to a troubling distributive effect through transactors being cross-subsidized by borrowers).

²²⁹ See Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism is Not an Oxymoron*, 70 U. CHI. L. REV. 1159, 1162 (2003) (“The paternalistic aspect consists in the claim that it is legitimate for private and public institutions to attempt to influence people’s behavior even when third-party effects are absent. In other words, we argue for self-conscious efforts, by private and public institutions, to steer people’s choices in directions that will improve the choosers’ own welfare.”); Kristin Siegesmund & Leah Weaver, *Minnesota Progressive?: Minnesota Statutes Chapter 325N: A Model for Substantive Consumer Protection*, 33 WM. MITCHELL L. REV. 223, 226 (2006) (positing in the context of mortgages that “when the impetus to make a rational decision is removed from one side of the equation,” regulators must step to ensure the market operates correctly).

smokers who (falsely) think they will probably quit smoking in the future.²³⁰ In the context of credit cards, for instance, consumers are excessively optimistic about how much money they will make in the future and how much they will have to pay to cover expenses; they underestimate their future need for credit; and they underestimate the likelihood that unforeseen misfortune will disrupt their income or ability to pay expenses.²³¹

In the rent-to-own market, the optimism bias has the potential to show up when consumers begin a transaction intending to acquire the good. Severe regulations might be justified to alleviate this bias since a majority of consumers intend to purchase the goods.²³² Due to the optimism bias, consumers would overestimate the likelihood that they will be able to complete the payments required for ownership. Hoping to acquire goods, people may make a substantial number of payments towards ownership but end up having to return the goods before the contract is up because some negative turn of events that they should have anticipated prevents them from completing the contract. Based on the optimism bias, we might expect that a significant number of people fall into this category.

But we'd be wrong. The best empirical evidence indicates the exact opposite. Rent-to-own customers are remarkably accurate in their predictions of whether they will obtain ownership. The FTC Survey found that of the customers who entered the rent-to-own transaction intending to purchase the goods, 87% of customers actually acquired ownership.²³³ In contrast, only 16% of people intending only to rent obtained the goods.²³⁴ Even more remarkably, only 8% of rent-to-own customers who returned merchandise did so because they could no longer afford the payments or had other expenses, meaning that *only* 2.4% of all rent-to-own customers returned merchandise because they faced liquidity problems.²³⁵ Given this small percentage, the claim that rent-to-own customers overestimate their future ability to complete the contract lacks merit.²³⁶

²³⁰ Block-Lieb & Janger, *supra* note 6, at 1540-41; Sunstein, *supra* note 139, at 252.

²³¹ Levitin, *supra* note 192, at 45-46; Bar-Gill, *supra* note 138, at 1400. See also, Block-Lieb & Janger, *supra* note 6, at 1541 (“Potential borrowers are more likely to underestimate than overestimate the risks associated with uncertainty, particularly when they believe themselves to have control over these events.”); Patricia A. McCoy, *A Behavioral Analysis of Predatory Lending*, 38 AKRON L. REV. 725, 736 (2005) (noting studies demonstrating that “people tend to overestimate the probability of compound events,” such as, in this case, multiple rent-to-own payments over a 78 week contract).

²³² Lacko, *supra* note 13, at 131 (reporting 67% rent in order to own).

²³³ McKernan, Lacko, & Hastak, *supra* note 37, at 43.

²³⁴ *Id.*

²³⁵ FTC, *supra* note 25, at 62, 63 n.100. Five percent of those who returned merchandise did so because of “changed circumstances, such as a move, divorce, or death in the family.” *Id.* Because these unexpected events are not fundamentally financial, I do not think they implicate the optimism bias.

²³⁶ Rent-to-own customers may underestimate ex ante the probability they will need to reinstate the agreement. See Bar-Gill, *supra* note 138, at 1433 (making this argument in the credit card context). If so, the case for mandatory reinstatement agreements is strong, see Part III.C, because customers will undervalue but actually require this contractual provision.

Instead of being overly optimistic, customers use rent-to-own transactions precisely to address the risk of future contingencies. Another survey, conducted by economists Zikmund-Fisher and Parker, found that consumers choose rent-to-own because they are aware of risks of future losses of income: “Households are more likely to rent-to-own when they face uncertain or unstable levels of disposable income”²³⁷ The ability to walk away from the transaction if customers’ finances go south is very valuable to customers because they can terminate the contract with no future damages to their credit and no risk that their creditors could seize their other assets to satisfy the debt.²³⁸ Instead of demonstrating a propensity to underestimate future liquidity problems, rent-to-own customers use the product precisely because they have a risk-averse preference.²³⁹ Far from being a justification for severe regulation, the optimism bias in this context supports permitting the rent-to-own industry to operate.

2. The Anchoring Effect and Framing

Behaviorists suggest, and Madison Avenue powerfully demonstrates, that consumers are affected by how a seller presents the terms of a deal. The anchoring effect refers to the fact that “individuals tend to focus on an obvious or convenient number or event; although individuals adjust their perceptions upward or downward, they continue to skew their estimates toward the anchor.”²⁴⁰ The anchoring effect causes consumers evaluating whether to borrow money to look only at whether they can afford the monthly payment.²⁴¹ Focusing on that one aspect of the transaction causes consumers to ignore the total cost of the transaction and renders APRs virtually meaningless.²⁴²

The anchoring effect works in conjunction with seller’s framing the transactions for the buyers. Sellers can exploit consumers’ tendency to anchor by framing decisions in such a way as to elicit irrational behavior. Patricia McCoy precisely quips: “Predatory lenders make attractive terms salient and obscure terms that might pose concern.”²⁴³

²³⁷ Zikmund-Fisher & Parker, *supra* note 156, at 214.

²³⁸ See McKernan, Lacko, & Hastak, *supra* note 37, at 37 (reporting the FTC’s finding that “customers value the option to terminate the agreement at any time without further financial liability of damage to their credit rating”).

²³⁹ Zikmund-Fisher & Parker, *supra* note 156, at 214. Zikmund-Fisher and Parker also found that hyperbolic discounting does not account for rent-to-own usage. Hyperbolic discounting refers to the phenomenon that people “exhibit higher rates of discount between time periods the closer those periods are to the present.” Whitman & Rizzo, *supra* note 35, at 10. The best evidence suggests people do not rent-to-own because of inter-temporal discount rates. In Zikmund-Fisher and Parker’s study, “most subjects demonstrated a strong preference for shorter contracts,” indicating they did not want to defer payments into the future because of hyperbolic discounting. Zikmund-Fisher & Parker, *supra* note 156, at 210. *But see* Swagler & Wheeler, *supra* note 21, at 156 (arguing that rent-to-own consumers value the ability to cancel rental purchase agreements and return the goods because of “a short term horizon (or high rate of discount) . . .”).

²⁴⁰ Block-Lieb & Janger, *supra* note 6, at 1533.

²⁴¹ *Id.* at 1539.

²⁴² *Id.*

²⁴³ McCoy, *supra* note 231, at 737.

Anchoring and framing operate in the rent-to-own industry, according to industry participants, when people latch on to—and companies promote—the weekly or monthly payments, not the overall cost or the implied APR associated with acquiring goods over time.²⁴⁴ If rent-to-own customers do not consider the total cost, they will not be able to weigh whether to purchase the goods outright using savings or to rent the goods until they acquire the title. Also, if they do not calculate or appreciate the implied APR, they will not be able to compare renting-to-own to obtaining the goods using credit.

Instead of seeing the decision to frame the rental agreement in terms of fixed payments as exploitive and justifying severe regulation, however, I assert that framing the transaction in periodic payments in real dollar amounts benefits customers. Since people have a predisposition to make decisions based on fixed periodic amounts and not relatively abstract APRs, the fact rent-to-own companies present the terms of the contract in fixed dollars leads to a more transparent, relevant disclosure regime than many legally-mandated regimes that focus on APRs.

To appreciate this point, consider the credit card customer. With credit cards, customers are told the card's APR—though often that is obscured through an introductory teaser rate offer.²⁴⁵ However, evidence shows that American consumers cannot understand basic arithmetic and financial terms,²⁴⁶ and even if they could, they cannot calculate the effective interest rate (i.e., the rate that includes the stated APR plus the cost of additional fees).²⁴⁷ Yet, people do understand a credit card's finance charge because this fee is represented in dollars, not as a percentage.²⁴⁸

To combat consumers' inability to perceive and understand credit card functionality, Angela Littwin has proposed an entirely fixed-fee credit card product. She describes how it would operate:

The credit card company would determine the ratio of interest and fees to principal ahead of time and convey this information to the consumer when it issued the card. For example, for a \$1,000 credit card, the credit card company would specify that, say, \$600 of this \$1,000 was interest and fees and \$400 of it was the actual limit on the amount the consumer could spend. The \$600 would represent the entire amount of interest and fees to be charged over the life of the loan.²⁴⁹

²⁴⁴ See notes 140 – 146 (stating that rent-to-own firms report that they compete on the basis of price per week or month, not total cost).

²⁴⁵ Littwin, *supra* note 5, at 47.

²⁴⁶ Block-Lieb & Janger, *supra* note 6, at 1538.

²⁴⁷ Littwin, *supra* note 5, at 47.

²⁴⁸ Diane Hellwig, Comment, *Exposing the Loansharks in Sheep's Clothing: Why Re-Regulating the Consumer Credit Market Makes Economic Sense*, 80 NOTRE DAME L. REV. 1567, 1591-93 (2005).

²⁴⁹ Littwin, *supra* note 5, at 37.

One of the chief benefits of such a fixed-fee card is that it allows consumers to understand the real cost of the loan by making “the financial terms of credit cards much less complicated and lessen[ing] the misunderstandings associated with how credit cards work.”²⁵⁰ Also, a fixed-rate credit card “would force consumers to internalize psychologically these costs earlier in the decision making process.”²⁵¹

This improved credit card looks and acts almost exactly like the current rent-to-own transaction. The costs are explained to the customer in fixed dollar amounts, not APRs, so customers can understand the terms, and the customer knows upfront the entire cost of the transaction. Moreover, by making customers pay the same weekly or monthly rate during the entire contract, renting-to-own forces customers to internalize the costs immediately, unlike traditional credit cards which offer a gap between the customer’s purchase and actual payment. By reformulating the credit card product to fit the way consumers actually behave, Littwin has demonstrated how the rent-to-own transaction operates in a way that makes sense to customers, does not obfuscate the terms most relevant to them, and forces them to internalize the costs of their conduct upfront.²⁵²

I have argued that framing is relatively benign and does not warrant banning the industry. Still, the anchoring effect and framing have a strong potential to cause irrational consumer decision making with regards to bundled fees and behavior-driven fees. Because consumers make decisions only with the weekly price in mind, they neglect to appreciate the additional costs when a dealer tries to sell them insurance or a membership in a preferred customer club. Also, despite the fact late fees can drastically increase the actual costs of ownership if the customer misses some payments, customers, focused on the weekly payment, skew the estimate costs of ownership toward that weekly payment amount instead of calculating the weekly payment amount plus the estimated number of extra fees.

3. Procrastination

Cass Sunstein explains the role procrastination plays in consumer markets:

For many borrowers, it is not difficult to avoid high interest rates and late charges. Timely payments will eliminate the problem. But some borrowers procrastinate, ensuring that some bills are paid late. As a result, significant charges can accumulate. It is apparently difficult for some people to overcome the costs of inertia even when transaction costs are minuscule; I speculate that the economic level of late fees is, in nontrivial part, a result of procrastination.²⁵³

²⁵⁰ *Id.*

²⁵¹ *Id.* at 38.

²⁵² For another example of a reform that brings a credit product away from an APR-dominated disclosure regime to a fixed-fee model, see Mann & Hawkins, *supra* note 5, at 903-04 (suggesting that regulators require payday lenders to post a fixed fee to represent the cost of a payday loan instead of posting an APR).

²⁵³ Sunstein, *supra* note 139, at 251-52.

Procrastination's role in the rent-to-own market likely works just as Sustain postulates. People pay late fees, reinstatement fees, and other behavior-driven fees because they put off paying their weekly or monthly payment. Though this is hardly a reason to ban the transaction entirely, regulators should consider how the rent-to-own transaction may foment this behavior. Because most contracts require payment every single week, customers have roughly four times the potential to incur late fees as the typical credit card user who pays on a monthly basis. Also, the costs of procrastination are more significant for rent-to-own users. If a credit card customer fails to pay a credit card bill, late fees and interest are the only repercussions, but a rent-to-own firm may repossess the goods of a delinquent customer.

4. Self-Control, Miswanting, and Cumulative Cost Neglect

I group these three frailties because they likely relate to the same aspect of the rent-to-own transaction. Behavioral economists posit that people lack self-control and therefore make decisions that undermine their long-term welfare, like spending when they should be saving or eating Twinkies when they should be eating leafy green vegetables.²⁵⁴ Further, people may suffer from miswanting. They desire goods that will not actually enhance their well-being, and they do not desire goods that will provide a higher quality of life.²⁵⁵ Finally, consumers are prone to cumulative cost neglect in that they will make many small borrowing decisions without realizing that the aggregate amount of the borrowing is very high.²⁵⁶ Though someone may refuse to take out a loan for \$20,000 because the amount is too high, that same person will take out numerous small loans that all total to \$20,000 because the consumer neglects the cumulative costs.²⁵⁷

In the rent-to-own market, these three behaviors most likely cause sub-optimal decision making when consumers decide whether to rent merchandise at all and whether to rent more than one item. In terms of the initial decision to rent one item, some consumers would be better off saving the weekly payments they make to their rent-to-own store and buying the item at a much lower total cost after saving a sufficient amount. But, because of problems with self-control, they rent the item immediately. Other customers rent the wrong goods because of miswanting. They start renting a plasma television or jewelry when really they should rent a bed or obtain an inferior product from a second-hand store or a charity.

These two forces act in the same way when consumers decide to rent a second item, but in addition, customers have the potential to suffer from cumulative cost neglect. Perhaps a customer initially deciding to rent a mattress would never think of taking on a total cost of a several thousand dollars to obtain an entire bedroom suite. After successfully paying for a mattress for a few weeks, however, the customer may add different pieces of the bedroom set incrementally until finally being committed to a large weekly payment and a very large total cost. Because the customer comes into the store displaying new items and talks to sales people

²⁵⁴ *Id.* at 252.

²⁵⁵ *Id.* at 253.

²⁵⁶ *Id.* at 251.

²⁵⁷ *Id.* See also TERESA A. SULLIVAN, ELIZABETH WARREN, & JAY LAWRENCE WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 179 (1989) (referring to this as “the seductiveness of incremental irresponsibility”) (quoted in Bar-Gill, *supra* note 138).

to make payments each week, the rent-to-own customer faces a particularly powerful risk of renting more products than initially anticipated.

For some consumer advocates, deficient self control and miswanting serve as the real justifications for banning or severely restricting rent-to-own firms. Advocates urge that “most people are just trying to live beyond their means”²⁵⁸ and that customers must be “protected from their own folly.”²⁵⁹ Though they do not articulate it, their position relies on my argument that rent-to-own firms sell quality-of-life enhancing goods, not true essentials for life. These consumer advocates do not want consumers making choices to get luxury goods from rent-to-own stores when consumers can get essential goods for much less.

This aggressive form of paternalism justifies severely limiting rent-to-own transactions, but it looks nothing like the weak and asymmetric paternalism advocated by behavioral economists. A paternalism that denies customers choices—even if those customers are informed—will not likely have much currency with policy makers. Moreover, it is not easy to justify other choices we allow people to make if we will not allow them to obtain luxury goods at a higher cost. Should poor people be banned from shopping Neiman Marcus? On balance, this aggressive, choice-denying paternalism probably lacks the power to sway many regulators in the current political environment.

But, even though without aggressive paternalism, regulators can confront problems of self-control, miswanting, and cumulative cost neglect. The answer, this Part has argued, is not to ban or severely restrict the entire transaction, but to tailor regulations to address these cognitive failures as well as the other failures identified in this Part. Part III takes up that task.

III. INTELLIGENT REGULATING

The final Part of this Article applies the rich understanding of the rent-to-own business constructed in Part I to the paternalistic justifications for regulation in Part II to generate recommendations about what regulations policy makers should impose on rent-to-own companies.

A. Annual Percentage Rate Disclosures

One commonly suggested regulation is a requirement that rent-to-own companies disclose the implied APR of transactions. Vermont, Wisconsin, and Minnesota all require rent-to-own companies to disclose the implied APRs.²⁶⁰ Vermont’s statute compels the attorney general to adopt requirements for “full and conspicuous” disclosures,²⁶¹ and the attorney general

²⁵⁸ Rodgers, *supra* note 45, at 1.

²⁵⁹ Martin & Huckins, *supra* note 7, at 387.

²⁶⁰ Minnesota and Wisconsin both require APR disclosures because of judicial decisions. See *Miller v. Colortyme, Inc.*, 518 N.W.2d 544, 547 (Minn. 1994) (concluding that rent-to-own transactions were credit sales under Minnesota’s Consumer Credit Sales Act); *Rent-A-Center v. Hall*, 510 N.W.2d 789, 795 (Wis. App. 1994) (holding that Wisconsin’s consumer credit sale act covered rent-to-own transactions).

²⁶¹ 9 V.S.A. § 41b(a) (1993).

has promulgated regulations requiring rent-to-own firms to disclose effective APRs on price tags and in contracts.²⁶² The regulation defines “effective annual percentage rate” as

the annual percentage rate of the merchandise subject to a rent-to-own transaction, calculated in the same manner as an annual percentage rate under section 107 of the federal Truth in Lending Act, 15 U.S.C. §1606, except that (a) in place of the finance charge, there shall be substituted the difference between the total of payments to acquire ownership and the cash price, less any amounts specifically excluded from the finance charge under the Truth in Lending Act; (b) in place of the amount financed, there shall be substituted the cash price less any downpayment; and (c) it shall be assumed that the consumer will pay the total of payments to acquire ownership in the merchandise.²⁶³

Legal academics have overwhelmingly supported APR disclosure regimes.²⁶⁴ My research convinces me that APR disclosures for the rent-to-own transaction are a strong paternalistic measure that severely limits or eliminates consumer choice, effectively banning the industry. The case for APR disclosures is especially weak because for most customers, an APR that is based on the total cost of the transaction is inaccurate or inappropriate.

Requiring disclosures, including APR disclosures, is “the most obvious example” of a weak paternalistic regulation because customers, despite having the new information, still have the choice to enter the transaction.²⁶⁵ Also, disclosure regulations are the “most ubiquitous and recognizable form” of asymmetrically paternalistic regulation because they benefit the irrational and uninformed customers while imposing few costs on informed customers who may ignore them or on businesses who can easily calculate and post the disclosures.²⁶⁶ In fact, in their discussion of asymmetric paternalism, Camerer et. al. specifically suggest that requiring rent-to-own companies to disclose implied APRs would not affect customers who knew the true costs but instead would only help the uninformed:

The final prices that consumers pay are high [in rent-to-own transactions]—typically two or three times normal retail price of the good—and the implicit interest rates, if one views these contracts as loans, are astronomical—100% per year or more. An asymmetrically paternalistic regulation might force firms to clearly state the true cost of purchasing an item, along with the interest rate implied by doing so. Provision of such information would help consumers who would otherwise enter the transaction without understanding the economic ramifications, while not affecting those who understand the true cost from the beginning.²⁶⁷

²⁶² Rule CF 115.04(b)(4) (disclosure on price tag); Rule CF 115.05(b) (disclosure in contract).

²⁶³ Rule CF 115.08(d).

²⁶⁴ Pimentel, *supra* note 11, at 380-81; Martin & Huckins, *supra* note 7, at 394-95.

²⁶⁵ Sunstein, *supra* note 139, at 260.

²⁶⁶ Camerer et. al, *supra* note 6, at 1232.

²⁶⁷ *Id.* at 1231-32 (internal citations omitted).

This analysis, however, does not account for the facts on the ground. In the rent-to-own context, requiring APR disclosures is more like a strong, symmetric paternalistic measure because it drives most—and the biggest—rent-to-own companies from the jurisdiction, limiting or eliminating consumer choice. The most powerful evidence of this claim is Rent-A-Center’s categorical refusal to operate rent-to-own stores in states with APR disclosures.²⁶⁸ Its complete withdrawal from the rent-to-own business in Wisconsin in response to APR disclosure requirements demonstrates its commitment to this policy.²⁶⁹ Considering the fact that Rent-A-Center represents 44% of the rent-to-own market nationally,²⁷⁰ APR disclosure requirements severely limit the competition and consumer choice in states that enact them.

The mere fact that Rent-A-Center refuses to operate in states with APR disclosure requirements should give regulators reason to pause because the market benefits from larger operators like Rent-A-Center.²⁷¹ Large firms realize economies of scale,²⁷² so they should be able to charge less to customers.²⁷³ Also, unlike smaller firms which can be judgment-proof, large firms face the risk of actually having to pay damages if customers sue them for illicit behavior.²⁷⁴ Finally, large firms are more attuned to reputational damage that might result from malfeasance.²⁷⁵

Beyond Rent-A-Center, the behavior of other rent-to-own firms also reveals the extent to which APR disclosures eliminates competition. Aaron’s Rents describes APR disclosure requirements as “disadvantageous or otherwise materially adverse to us.”²⁷⁶ And, while it was in business, Rent-Way had no operations in jurisdictions that required APR disclosures.²⁷⁷ Small firms also react to APR disclosures. In Vermont, where APR disclosures are mandated by

²⁶⁸ Korst Interview, *supra* note 9.

²⁶⁹ See *supra* notes 103 – 105 and accompanying text.

²⁷⁰ Rent-A-Center, Inc, *supra* note 26, at 9.

²⁷¹ For an analysis of this same argument in the credit card and payday lending markets, see MANN, *supra* note 43, at 191, and Mann & Hawkins, *supra* note 5, at 906-08. *But see* KARGER, *supra* note 21, at 201-02 (arguing that large national providers are worse for customers because, *inter alia*, they have more lobbying power).

²⁷² Aaron Rents, Inc., *supra* note 26, at 8; Rent-A-Center, Inc, *supra* note 26, at 2.

²⁷³ See Briley Interview, *supra* note 88 (indicating that he can charge less as an Aaron Rents franchise because Aaron Rents can ship different goods to his store in one truck whereas he required multiple trucks to obtain different types of merchandise as a smaller operation ordering from multiple wholesalers).

²⁷⁴ For instance, as of December 2006, Rent-A-Center “had accrued \$77.0 million relating to probable losses for our outstanding litigation” Rent-A-Center, Inc, *supra* note 26, at 30. See also Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More Than They Can Chew?*, 56 Am. U. L. Rev. 515, 541 (“The primary deterrent to predatory lending in the American legal system is the risk of compensating victims for damages they have sustained. Indeed the threat of damages is the primary tool used to enforce most law in our system. This is why the growing trend of judgment proof commercial enterprises, particularly higher risk enterprises, is such a troubling development.”).

²⁷⁵ Mann, Sweat Box, *supra* note 63, at 391 & n.79.

²⁷⁶ Aaron Rents, Inc., *supra* note 26, at 20.

²⁷⁷ Rent-Way, Inc., *supra* note 26, at 6.

statute, only 16 stores operate, and in Minnesota, there are only 11 stores.²⁷⁸ It is estimated that rent-to-own companies would open somewhere between 150²⁷⁹ and 300²⁸⁰ more rent-to-own stores if Wisconsin changed its requirements, but there are currently only 57 rent-to-own stores operating there today. Conversely, one industry source has contended that the proposed New York legislation containing an APR disclosure requirement “would eliminate the rent-to-own business in New York”²⁸¹

We might wonder, however, if the market is not better off without these operators who refuse to operate in jurisdictions requiring APR disclosures. The strong aversion to disclosures is truly remarkable—rent-to-own firms would rather have price controls in place than APR disclosures.²⁸² This might suggest that framing plays an acutely strong role in the market: Firms dislike APR disclosures, we might suppose, because they want to frame the transactions in unique terms, perhaps to shield themselves from competing with other credit options that disclose APRs.

The better view, I think, is that there are credible reasons that a legitimate operator would oppose APR disclosures. First, rent-to-own operators are very suspicious that courts will flaunt legislative enactments and treat the rent-to-own transaction as a credit sale and not a lease,²⁸³ and operators oppose implied APR disclosures because they cause the transaction to look like a credit sale.²⁸⁴ Operators act carefully to avoid the impression the transaction is a credit sale, for instance, by not doing credit checks because they are not extending credit.²⁸⁵ Closely related to this objection is the position that customers should not compare renting-to-own to credit sales, via implied APRs, because the product is simply different—the customer does not take on any debt in a rent-to-own agreement, so the customer assumes less risk than when signing a credit contract.²⁸⁶ Finally, operators contend that calculating implied APRs is impossible. APRs are dependent on the base value of the goods and services provided, which is difficult to determine, for the reasons explained in the next paragraph. Moreover, the cash price of goods is easy to inflate if an unscrupulous operator wishes the APR to appear lower.²⁸⁷

²⁷⁸ APRO, *States RTO Statutes*, *supra* note 10.

²⁷⁹ Paul Gores, *Will legislators buy rent-to-own bill?*, THE MILWAUKEE J. SENTINEL, Oct. 10, 2005.

²⁸⁰ Jeremy Janes, *Rent-To-Own Industry up to Old Tricks*, WISCONSIN STATE J., Aug. 10, 2005, at A6.

²⁸¹ Jonathan D. Epstein, *Bill would control rent-to-own industry; Consumer advocates say measure doesn't go far enough*, BUFFALO NEWS (NEW YORK), Jan. 31, 2007, at B1 (quoting Christopher Korst, General Counsel for Rent-A-Center). *See also* Lewallen Interview, *supra* note 44 (claiming APR disclosure requirements would destroy the rent-to-own business).

²⁸² *See infra* Part II.B.

²⁸³ The industry wants federal rent-to-own legislation precisely because of the fear that courts will categorize the transaction as a credit sale. Briley Interview, *supra* note 88; Winn Interview, *supra* note 118.

²⁸⁴ *See* Winn Interview, *supra* note 118 (noting the real problem with APR disclosures is that they are misleading).

²⁸⁵ Korst Interview, *supra* note 9.

²⁸⁶ Lewallen Interview, *supra* note 44; Vail Interview, *supra* note 44. For this reason, Rent-A-Center will not give its business, so to speak, to states that make the public policy choice to treat rent-to-own transactions like credit sales. Korst Interview, *supra* note 9.

²⁸⁷ Carrico Interview, *supra* note 39.

The preceding argument demonstrates that APR disclosures are not weak or asymmetrically paternalistic because they severely limit consumer choice by eliminating the vast majority of market participants. In addition, they also fall outside the rubric of asymmetric paternalism because they impose high costs on rent-to-own firms. It is not immediately clear how a rent-to-own firm should calculate the APR. Should it base the APR off only the sale price of the good or should it include the value of the other services that rent-to-own companies provide but other creditors do not? Rent-to-own firms do not charge the customer for the costs of delivery, maintenance or replacement, and the potential for reinstatement if the agreement is terminated.²⁸⁸ Dealers who include too little or too many of these other fees in the APR calculation risk liability under state deceptive trade practices laws,²⁸⁹ so these requirements impose real costs on dealers.

This strong, symmetric paternalistic measure could still be justified if the benefits to consumers were compelling. The evidence, however, that APR disclosures benefit uninformed or irrational customers is weak. Consumer advocates and academics posit that APR disclosures permit customers to compare acquiring goods through renting-to-own to other credit products like small loans or credit cards.²⁹⁰ This argument certainly has force, as 44% of rent-to-own customers have credit cards.²⁹¹ But, it is not clear that customers understand or use APRs because people measure costs in real dollar amounts²⁹² and lack the financial literacy to realize APR's importance.²⁹³

Furthermore, for many rent-to-own customers, the APR is not a relevant figure. At least 30% of customers do not purchase the goods, so APR is not an appropriate disclosure.²⁹⁴ More to the point, one industry source believes only 2% of customers acquire ownership by paying the weekly fees through the life of the agreement.²⁹⁵ Most who acquire ownership do so by paying something less than the "total cost" under the contract by purchasing part way through the agreement. For everyone except the 2% that pay the total cost, the APR is inaccurate.²⁹⁶ By forcing rent-to-own firms to disclose this largely irrelevant figure, regulators are likely diluting

²⁸⁸ Christopher A. Korst, Statement before the Senate Banking Committee, June 21, 2005, at 1, available at http://banking.senate.gov/_files/korst.pdf.

²⁸⁹ Janes, *supra* note 280, at A6.

²⁹⁰ Hill et al., *supra* note 21, at 8; Janes, *supra* note 280, at A6.

²⁹¹ Lacko, *supra* note 13, at 130.

²⁹² Hellwig, *supra* note 248, at 1593.

²⁹³ *Id.* 1591-92; Hastak, *supra* note 22, at 92.

²⁹⁴ Hastak, *supra* note 22, at 92. Even Martin and Huckins, who suggest "[a]ny RTO disclosure law that intends to provide useful information to consumers should include an APR equivalency rate," admit this problem: APRs are relevant for customers who purchase the goods but not the most meaningful measure of cost for customers who terminate the agreement before ownership. Martin & Huckins, *supra* note 7, at 394-95. *See also* Winn Interview, *supra* note 118 (claiming that APR disclosure regimes require the pretense that all customers will rent long enough to own the merchandise).

²⁹⁵ Korst Interview, *supra* note 9.

²⁹⁶ Anderson & Jackson, Rent-to-Own Agreements, *supra* note 14, at 9-10.

the importance of other disclosures because customers get more information than they can process.²⁹⁷

Based on the justifications for regulating rent-to-own transactions, the case for requiring APR disclosures is suspect. Not only would this requirement likely eliminate the benefits these operators provide, but it also is strongly paternalistic without clear benefits to customers.

B. Price Controls

Nine states statutorily impose limits on the total costs that rent-to-own firms may charge customers: Connecticut, Hawaii, Iowa, Maine, Michigan, New York, Ohio, Pennsylvania, and West Virginia.²⁹⁸ New Jersey's Supreme Court recently imposed this requirement by holding that rent-to-own agreements were subject to the retail sales statute.²⁹⁹ Connecticut's statute, as an example, states that "[n]o lessor shall offer a rent-to-own agreement in which the total of rental payments necessary to acquire ownership exceeds twice the cash price of the rented property."³⁰⁰ "Cash price" is defined in the statute to mean "the price at which a lessor in the ordinary course of business would in good faith offer the property that is the subject of a rent-to-own agreement to the lessee for cash on the date of the rent-to-own agreement."³⁰¹

Usury limits in other credit markets have often resulted in effectively banning credit products.³⁰² So far, however, the current price controls have not had this effect in the rent-to-own industry because they are high enough to allow operators to function. The current caps all require the total cost of the rental agreement to be less than 2 or 2.4 times the purchase price of the goods,³⁰³ and rent-to-own firms indicate that the total cost of ownership for most of their

²⁹⁷ Testimony of Todd J. Zywicki before the House of Representatives Financial Services Committee Subcommittee on Financial Institutions and Consumer Credit, Apr. 26, 2007, at 26, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htzywicki042607.pdf (arguing that "mandating some disclosures necessarily makes it more difficult to disclose fully other card terms that some consumers may care more about or may make it more difficult for consumers to find the information that they care about."); Camerer et. al, *supra* note 6, at 1235 ("One important cost is the negative effect of new information on the likelihood of consumers paying attention to existing information as consumers begin to suffer from 'information overload.'").

²⁹⁸ Ed Winn, *Rent-to-Own State Rules and Regulations*, available at http://www.rtohq.org/PDFs/statutesregs/LegUpdate_2006.pdf (last visited July 17, 2007).

²⁹⁹ *Perez v. Rent-A-Center, Inc.*, 892 A.2d 1255 (N.J. 2006).

³⁰⁰ C.G.S.A. § 42-248(a). Another common formulation of a price control is found in Ohio's law:

No lessor shall offer a lease-purchase agreement in which fifty per cent of all lease payments necessary to acquire ownership of the leased property exceed the cash price of the leased property. When fifty per cent of all lease payments made by a lessee equals the cash price of the property disclosed to the lessee . . . , the lessee shall acquire ownership of the leased property and the lease-purchase agreement shall terminate.

Baldwin's Ohio Revised Code, R.C. § 1351.06(A).

³⁰¹ C.G.S.A. § 42-240(2).

³⁰² See e.g., Littwin, *supra* note 5, at 2 n.6 (citing empirical studies that have established that usury limits are associated with restricted access to credit cards).

³⁰³ Winn, *supra* note 298.

merchandise is around double the cash price.³⁰⁴ Rent-to-own firms continue to operate in these states, as demonstrated by the high number of stores in states with caps, such as 405 stores in Ohio, 267 in New York, and 236 in Pennsylvania.³⁰⁵ Rent-A-Center's decision to continue operating in New Jersey after the Supreme Court in *Perez* applied price controls to renting-to-own also illustrates the fact that price controls do not eliminate consumer choice in the same way as APR disclosures.³⁰⁶

Price controls partially address the concerns raised by deficient self-control and miswanting by limiting how much money customers can “waste” on products that are not in their best interest. By capping the total cost consumers pay at two times the purchase price, policy makers prevent uncontrolled, miswanting consumers who would pay three or four times the purchase price from doing so. As long as the price controls are not set too low that they drive a significant number of participants out of the market, policy makers who want to limit the effects of these weaknesses can do so without completely eliminating the option for customers to rent-to-own.

C. Lifetime Reinstatement Rights

Most states currently require rent-to-own firms to reinstate terminated agreements if the customer (1) returns the property to the company and (2) makes a new payment within a limited number of days, ranging from 21 days to 180 days.³⁰⁷ Ohio's provision, for example, states that a customer “who fails to make timely lease payments has the right to reinstate the original lease-purchase agreement without losing any rights or options previously acquired under the lease-purchase agreement within three lease terms after the expiration of the last lease term,”³⁰⁸ if the customer “surrenders the leased property to the lessor” when asked to do so³⁰⁹ and if the customer pays “any unpaid lease payments, delinquency charges, a reasonable reinstatement fee of not more than five dollars, and a delivery charge” if these charges are required by the rent-to-own store.³¹⁰ Connecticut's statute treats customers different based on what percentage of the total cost they have paid, mandating that customers who have paid more than two-thirds of the total cost have 180 days to reinstate, while customers who have paid less than a third only have thirty days.³¹¹

While states may allow customers more or less time to seek reinstatement, no state requires firms to reinstate any agreement regardless of how much time has passed since the agreement was terminated, and Massachusetts has no reinstatement requirement. This section

³⁰⁴ Korst Interview, *supra* note 9.

³⁰⁵ APRO, *State RTO Statutes*, *supra* note 10.

³⁰⁶ Korst Interview, *supra* note 9.

³⁰⁷ Winn, *supra* note 298, at 2.

³⁰⁸ Baldwin's Ohio Revised Code, R.C. § 1351.05(A).

³⁰⁹ *Id.*

³¹⁰ *Id.* § 1351.05(B).

³¹¹ C.G.S.A. § 42-246(a)(1)-(3).

argues that there is a strong case for a paternalistic regulation requiring rent-to-own firms to offer lifetime reinstatement rights, despite my earlier argument that lost equity does not justify prohibiting rent-to-own transactions.³¹² Even if a customer lets the agreement lapse for several months, the rent-to-own company would be obligated to let the customer pick up at the same point in the payment schedule if the customer paid off the fees and rental payment due. The company would give the customer the same goods, if they still had them, or suitable replacement goods, and would allow the customer to continue the progression towards ownership.

Behavioral law and economics predicts that boundedly rational customers would need lifetime reinstatement rights. People are prone to procrastinate making their rental payments, and if they make them after the due date, they risk terminating their agreements. Empirical evidence confirms that many customers rely on reinstatement to keep the goods they are renting and to acquire ownership of the goods. Analysis of the FTC Survey revealed that “customers in states with reinstatement laws [are] more likely to ultimately purchase the merchandise than are customers in other states.”³¹³ Earlier surveys made even more striking findings: 60% of Rent-A-Center’s “customers make late payments at any given time, and more than 60% of these persons pay the reinstatement fee to avoid terminability.”³¹⁴

Without lifetime reinstatement rights, customers feel the full effect of the industry’s high switching costs—they are forced to switch to a new store or product when their contract terminates, so they have to pay the total cost of ownership all over again.³¹⁵ Rent-A-Center, Aaron Rents, and Show-Me Rent-to-Own’s business decision to offer lifetime reinstatement demonstrates that firms can successfully operate while offering lifetime reinstatement, so this regulation would not severely restrict the industry. States are justified in imposing lifetime reinstatement requirements.

D. Behavior-Driven Fees and Bundling

If a customer pays late, reinstates a lapsed rental contract, requires a store to pick up an item after the contract lapses, or requires the company to redeliver an item after a contract is reinstated, the rent-to-own company charges a fee that is above the actual cost to the company cause by the customer’s behavior. Currently, every jurisdiction permits firms to charge late fees, though some states put limits on the amount of these fees, somewhere between \$3 and \$15.³¹⁶ Some states permit a reinstatement fee, a collection fee, and a redelivery fee. Ohio’s statute

³¹² In Part II.A.3 I concluded that the loss of equity was not a reason for regulators to ban rent-to-own transactions because customers do not lose equity and firms can offer lifetime reinstatement. That section concluded customers do not lose equity; though related, this section makes the distinct point that customers without lifetime reinstatement rights do face high costs in acquiring new goods because they have to start their rental agreements over again.

³¹³ McKernan, Lacko, & Hastak, *supra* note 37, at 51.

³¹⁴ Hill et al., *supra* note 21, at 4.

³¹⁵ A customer’s switching costs could be mitigated if the customer rents a used item that is roughly as old as the forfeited item. But, some stores focus almost entirely on new goods, so customers might not have this option. More importantly, rent-to-own firms would likely charge more for used goods of roughly the same age because the firm undertakes the costs associated with detailing and marketing the used goods.

³¹⁶ Winn, *supra* note 298, at 4.

again provides a useful example because while it limits the reinstatement fee a lessor may charge to five dollars, it places no restrictions on other fees that the statute explicitly permits, including “delinquency charges” and “a delivery charge.”³¹⁷ Montana’s statute places no limits whatsoever on the fees dealers can charge.³¹⁸

These fees are troubling because they exploit customers’ inclination to procrastinate.³¹⁹ Also, firms do not compete for customers based on the amount of their behavior-driven fees. These fees are not disclosed at the start of the transaction; consumers’ expectations are anchored to the weekly payment amount; the fees’ cumulative effects are difficult even for the astute customer to calculate,³²⁰ and customers discount the importance of late fees since they are overly optimistic about the likelihood that they will have to pay any. These fees increase the effective total cost of the rent-to-own transaction, but the disclosures of total cost do not reflect the increase.³²¹ A rent-to-own consumer faces a greater risk of paying behavior-driven fees than a credit card holder or someone using a payday loan because most rental contracts require weekly payments—every week a customer must overcome problems with procrastination or the customer will have to pay a late fee and a reinstatement fee.³²²

In the same way, rent-to-own firms do not likely compete on the basis of bundled products such as insurance and preferred customer programs. Some states prohibit dealers from offering optional damage waivers and property insurance. California allows a consumer to void any contract containing “any provision by which . . . [t]he consumer agrees to purchase from the lessor insurance or a liability waiver against loss or damage to the rental property.”³²³ Other states limit the fees dealers can charge, but many states permit rent-to-own firms to sell bundled products without any limit on the fees charged.³²⁴

Policy makers should be concerned about bundling products because in addition to exploiting the anchoring effect, bundling products also permit rent-to-own firms to exploit consumers’ propensity toward cumulative cost neglect. If the cost of insurance was presented at the start of the transaction as part of the total cost or weekly payment amount, customers might decide not to rent because of the high cost, but they are less likely, after having already decided

³¹⁷ Baldwin’s Ohio Revised Code, R.C. § 1351.05(B).

³¹⁸ See M.C.A. 30-19-101 et seq.

³¹⁹ Sunstein, *supra* note 139, at 269.

³²⁰ Nehf, *supra* note 11, at 824.

³²¹ See UNITED KINGDOM DEP’T OF TRADE & INDUS., *supra* note 91, at 24 (“Unless borrowers maintain a perfect payment record, the cost of credit to the consumer will be significantly higher than the APR would suggest.”). See also Martin & Huckins, *supra* note 7, at 403 (recounting consumer advocates’ complaint that customers cannot know the true cost of the transaction because of additional fees).

³²² See note 56 and accompanying text. *But see* Johnston, *supra* note 6, at 873 (noting that customers were satisfied with how rent-to-own stores treated them in dealing with their late payments and that a common practice is giving managers discretion to forgive late fees).

³²³ West’s Ann. Cal. Civ. Code § 1812.624(a)(3).

³²⁴ Winn, *supra* note 298, at 4. Montana, again, is an example of a state with no limits on bundled products. M.C.A. 30-19-101 et seq.

to rent, to turn down the additional cost when they are signing the contract at the end of the transaction. Furthermore, unsophisticated customers will likely have problems estimating the likelihood they will need insurance or understanding the benefits of a preferred program. These calculations involve weighing the future and present value of the money spent on the bundled product versus unknown future costs.

In light of these concerns, regulators should consider whether behavior-driven fees and bundled products should be a source of profit for rent-to-own companies. In the United Kingdom, regulators have proposed a fixed cap on late fees equal to the amount of the administrative costs to the company.³²⁵ California has a similar cap in place already. The statute forbids contracts requiring the customer “to pay any fee permitted by the rental-purchase agreement and this title that is not reasonable and actually incurred by the lessor. The lessor has the burden of proof to establish that a fee was reasonable and was an actual cost incurred by the lessor.”³²⁶ Given the structure of the rent-to-own transaction and the cognitive defects these characteristics exploit, regulators are justified to place restrictions on these aspects of the transaction.

E. Cooling-Off Periods and Monthly Contract Defaults

The practice of having weekly payments that are made in person at a store poses a risk that rent-to-own companies will exploit their personal relationships with customers and put customers in more rental products than the customers really want or need. Rent-to-own companies are upfront about both the importance of repeat business and the conscious effort to develop personal relationships with customers to obtain a competitive advantage. This use of personal power to obtain a business advantage, however, is troubling. John Commons, for instance, believed that courts use the unconscionability doctrine to prevent parties from using personal power to abuse personal trust in order to extract excessive profits: “[I]t is perfectly lawful . . . to exercise superior economic power or superior mental and managerial faculties, over others, provided advantage is not taken of recognized special relations of confidence, trust, dependence, or the like.”³²⁷ Furthermore, customers suffering from cumulative cost neglect will be likely to rent more items than they initially intended in their initial visit if these items are rented over a series of visits to a store over time.

Because of this risk of exploitation, regulations could impose cooling-off periods, though no state has chosen this path yet in the rent-to-own industry. But, in other contexts, individuals prone to cognitive failures have a right to cancel an agreement within a short time period. Texas’s Structured Settlement Protection Act, for instance, protects litigants from their own decisions by mandating that firms entering into structured settlement contracts with individuals include a bold “statement that the payee has the right to cancel the transfer agreement, without

³²⁵ MANN, *supra* note 43, at 152.

³²⁶ West’s Ann. Cal. Civ. Code § 1812.624(a)(7).

³²⁷ Daniel T. Ostas, *Economics and the Law of Unconscionability*, 27 J. ECON. ISSUES 647, 652 (1993) (quoting John R. COMMONS, *LEGAL FOUNDATIONS OF CAPITALISM* 58-59 (1924) and explicating Commons’s view).

penalty or further obligation, not later than the third business day after the date the agreement is signed by the payee.”³²⁸

If customers are given a chance to return rented goods with no fees, then rent-to-own firms will be motivated to make sure a customer really wants and can afford new merchandise before attempting to rent new merchandise to a current customer.³²⁹ The cost of delivering and picking up the goods would be very high, so firms would take great effort to help consumers make good choices.

Another less invasive regulatory response, also absent in the current regulations, is setting a monthly term as the default term in rent-to-own contracts. Aaron Rents has prospered offering primarily monthly lease terms, demonstrating that this sort of regulation will not eliminate the profitability of rent-to-own stores.³³⁰ If regulations required firms to advertise monthly prices instead of weekly prices and to write rental agreements with monthly terms as the default, customers would be more likely to choose a monthly term,³³¹ and firms would have less opportunity to sell their existing consumers multiple products. This sort of default is asymmetrically paternalistic because fully rational consumers could opt out of the monthly default and chose a weekly contract term.³³²

F. Disclosures

Disclosures are “the least controversial mode of legal intervention,”³³³ so the task of justifying disclosure regulations is less onerous than justifying other intrusive statutes. This is especially true for rent-to-own because market participants themselves actively promote disclosure regulations. The proposed federal rent-to-own bill backed heavily by the industry requires that, at a minimum, price tags disclose the total weeks required to acquire the item and the total cost.³³⁴ In some jurisdictions, the rent-to-own industry has already successfully urged

³²⁸ Civil Practice & Remedies Code § 141.003(8).

³²⁹ See Camerer et. al, *supra* note 6, at 1240 (explaining how cooling off periods motivate sales people to ensure the customer “has deliberated about the costs and benefits of the purchase”).

³³⁰ Aaron Rents, Inc., *supra* note 26, at 9 (“Approximately 78% of our sales and lease ownership agreements are monthly and approximately 22% are semi-monthly as compared to the industry standard of weekly agreements . . .”).

³³¹ Camerer et. al, *supra* note 6, at 1125 (“[F]or boundedly rational people who have a status quo bias, the choice of defaults is important.”).

³³² *Id.* (“As long as actively making a choice requires very little effort, the choice of defaults has essentially no effect on fully rational consumers.”).

³³³ Bar-Gill, *supra* note 138, at 1378.

³³⁴ The proposed House bill, HR 1767, sets out the following price tag disclosure requirements:

SEC. 1010. POINT-OF-RENTAL DISCLOSURES.

(a) In General- For any item of property or set of items displayed or offered for rental-purchase, the merchant shall display on or next to the item or set of items a card, tag, or label that clearly and conspicuously discloses the following:

- (1) A brief description of the property.

legislatures to adopt the same strict disclosure requirements that prominent academics ask legislatures to enact.³³⁵

Legislation that requires rent-to-own firms to use price tags to disclose the total costs of ownership and the time required to obtain ownership makes perfect sense. Without such disclosures, some people probably start rent-to-own agreements not knowing how much it will end up costing them, so they may make irrational rental decisions.³³⁶ Forcing firms to calculate and post total cost and total time information costs almost nothing to the firm which can easily use a calculator to accomplish the task. Moreover, it is more efficient for the firm to calculate the total cost once than hundreds of shoppers independently doing the calculations.³³⁷ No one rationally using the service is prevented from doing so by the disclosure, so the disadvantages of such disclosures are low. Most important of all, requiring these disclosures on the price tag and not just the rental contract ensures that customers can evaluate their options with minimal transaction costs and that customers get the information in a timely manner—before critical information is lost in a sea of contract terms and before customers have already committed to the purchase in their own minds.³³⁸ Though much ink has been spilled over whether disclosures alone are effective to protect consumers, the case for requiring disclosures of total cost in the rent-to-own industry is strong.

CONCLUSION

Proceeding on the premise that the best regulations are those that solve real problems, this Article has addressed a fundamental question: Which regulations are policy makers justified in imposing on the rent-to-own industry to protect consumers? I generated novel insights into the rent-to-own business by combining interviews with industry participants with the best empirical data available. With the backdrop of this rich understanding, this Article has argued that the case for a ban or severe regulations is difficult to make out. Though the cost of using

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- (2) Whether the property is new or used.
 - (3) The cash price of the property.
 - (4) The amount of each rental payment.
 - (5) The total number of rental payments necessary to acquire ownership of the property.
 - (6) The rental-purchase cost.

Available at <http://thomas.loc.gov/cgi-bin/query/z?c110:H.R.1767:>.

³³⁵ Carrico Interview, *supra* note 39 (explaining his role in getting legislation passed in Illinois that required disclosures on price tags of weekly payment amount, number of weeks required for ownership, total payment amount, and new or used status). This exact legislation has been suggested by economists Lacko and Hastak. Lacko, *supra* note 13, at 135; Hastak, *supra* note 22, at 92.

³³⁶ Sunstein, *supra* note 139, at 251 (noting that the most obvious reason people borrow excessively is inadequate information).

³³⁷ Lacko, *supra* note 13, at 135.

³³⁸ Hastak, *supra* note 22, at 92 (explaining, based on research about the confirmation bias, that “[d]isclosure of total cost on only the rental agreement is unlikely to be useful to consumers, because they have already decided to enter into the rental transaction”). These arguments all assume that both parties speak the language of the disclosure, which of course is not always the case. Siegesmund & Weaver, *supra* note 229, at 228.

rent-to-own is high, there is no causative link between renting-to-own and financial distress, customers do not appear to lose significant equity through the transaction, and cognitive failures are not so pronounced in this market that they warrant intervention on a large scale. Instead, regulators should pursue narrow, specifically tailored regulations that address the cognitive weakness rent-to-own customers are most likely to exhibit. Overregulating this industry is not consumer protection. Instead, excessive regulation denies customers the opportunity to engage in beneficial transactions and robs them of the right to make choices about their own futures.