The Federal Government Takes on the Rent-to-Own Industry

by Jim Hawkins

In the summer of 2011, the U.S. House Subcommittee on Financial Institutions and Consumer Credit held a hearing about a rent-to-own bill, HR 1588, that Representative Francisco Canseco of Texas introduced along with 98 co-sponsors. Since the summer, the subcommittee approved the bill with some amendments. Now, the bill is slated to be considered by the Committee on Financial Services. I made the following statement in support of the bill, which is reproduced here with minor changes.

STATEMENT OF JIM HAWKINS
ASSISTANT PROFESSOR
UNIVERSITY OF HOUSTON LAW CENTER

"Examining Rental Purchase Agreements and the Potential Role for Federal Regulation"
U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

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Chair Capito, Ranking Member Maloney, and Distinguished Members of this Subcommittee:

Thank you for inviting me to testify about the role the federal government could play in the rent-to-own industry. My name is Jim Hawkins, and I am an Assistant Professor of Law at the University of Houston Law Center, where I teach Contracts, Consumer Protection Law, and Bankruptcy. I earned my J.D. (with highest honors) from the University of Texas School of Law. Prior to my academic appointment at the University of Houston, I was a litigation associate at Fulbright and Jaworski, L.L.P. and a law clerk for the Honorable Jerry E. Smith on the Fifth Circuit Court of Appeals. In my academic research, I have spent the past five years studying and writing about alternative financial services such as rent-to-own, payday lending, and auto title lending.[1]

I believe HR 1588 offers an opportunity for federal law to help the rent-to-own market operate efficiently. First, this bill ensures that all rent-to-own customers will have clear disclosures so that they can make informed financial decisions. Second, it provides a level of certainty to rent-to-own firms so that they can operate without the fear that a rogue judicial decision or legislative act will undermine their business in a state. Finally, while providing a baseline of consumer protection for customers in every state, the bill also allows states to have laws that further restrict or even ban rental-purchase agreements.

My statement today (1) briefly introduces the rent-to-own industry, (2) describes some of the important consumer protection measures present in HR 1588, and (3) explains the relationship between HR 1588 and state law.

I. An Introduction to the Rent-to-Own Industry

Rent-to-own companies offer consumers the opportunity to acquire ownership of durable goods by making weekly or monthly rental payments. The company delivers the good to the customer's residence, and the customer decides each week or month whether to keep the good and make a payment or to return the good. Customers have no long-term obligation to keep the good, but if they complete the required payments on the contract or exercise an option to purchase the goods before the contract is up, the company gives the title to the good to the customer.

Typically, people who turn to rent-to-own have limited access to mainstream financial services, either because of low or sporadic income, or because of poor or nonexistent credit histories. The Federal Trade Commission's survey ten years ago of rent-to-own customers, however, found that 84% of these customers had a car or truck, virtually the same percentage as the general public.[2] 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.[3]

In general, I believe people use rent-to-own companies to acquire goods that enhance the quality of their lives, not to obtain items necessary for their lives. A few years ago, I compiled information about the types of goods that people rent.

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

	Rent-A-Center[4]	Aaron's Rents[5]	Rent-Way[6]	FTC Survey[7]
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%	

Even goods in this table that are considered necessities for life really serve to enhance the quality of rent-to-own consumers' lives because firms provide top-quality, name-brand merchandise, in contrast to the same types of merchandise of lower quality available at second-hand stores.

The rent-to-own marketplace is occupied by two large, publicly-held companies, Rent-A-Center and Aaron Rents, and many smaller firms. The industry is competitive, as evidenced by the fact that multiple rent-to-own stores are often placed in the same location. And, because almost all rent-to-own customers have vehicles and can drive to find lower prices, all of the stores in a metropolitan area compete with each other.

Purchasing goods through rental-purchase agreements is expensive, but it is not outrageous given consumers' other options. For instance, credit cards with annual percentage rates around 20% appear to be a less expensive alternative than rent-to-own. However, if a customer with such a credit card charges $450 to purchase a television from a retailer, it will take the customer 81 months to pay off the debt if the customer makes only the minimum payment each month (assuming that payment is 2.5% of the total debt). The interest charged over those 81 months would be $364.60, bringing to total cost of the television to $814.60. 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. More disturbingly, if the consumer ran into financial problems in the middle of repaying the credit card debt, the consumer would be obligated to keep the goods and pay the debt, whereas in a rent-to-own transaction, the consumer would have the flexibility to walk away.

II. Baseline Consumer Protection Measures

HR 1588 is an important consumer protection law because it offers all rent-to-own customers a baseline of protections from unfair and misleading practices. In this section, I want to point out five of these protections and demonstrate how HR 1588 offers consumers protection that is superior to the protection provided by some existing state laws.

(1) Section 1004(b) requires some pertinent pricing information to be set off at the start of the rental purchase agreement under the title "important rental-purchase disclosures." Emphasizing this information is important for consumers who do not read every word of the contract but still need to know the basic terms of the transaction. This provision is very common in other consumer financial transactions, mirroring the Schumer box in credit card agreements, but it is absent from state rent-to-own laws.[8] Customers will benefit from having clear information about the most important terms of their agreement stated in a place where they are most likely to see it.

(2) Section 1007(9) limits the number of late fees that consumers can accumulate by forbidding rental-purchase agreements that require "the consumer to pay more than 1 late fee or charge for an unpaid or delinquent periodic payment." This provision is important because consumers may not factor in the cost of late fees when they decide to rent a good. Some current state rent-to-own laws, such as those in Georgia and Missouri, lack this protection, allowing companies to charge multiple late fees for a single delinquent payment.[9]

(3) Section 1005(a)(4) gives all consumers the right to reinstate their rental purchase agreements and to continue the process of obtaining ownership, with the time frame for reinstatement dependent on the percentage of total payments they have made. For instance, if consumers have paid 50% of the rental payments towards ownership and return the property when they stop making payments, then they have 120 days to reinstate the agreement. This right is important because some consumers might make substantial progress towards purchasing a good and then run into trouble making the final few payments. This section ensures that those customers will be able to purchase the goods if they can resume payments. Most states offer less protection to these customers who have made substantial payments towards ownership,[10] demonstrating the significance of HR 1588.

(4) Section 1007(3) prevents the situation made famous in the case *Williams v. Walker-Thomas Furniture Co.*,[11] which is taught to virtually all law students. In that case, a company made all the different goods that a consumer was acquiring from it collateral for all the different loans that the consumer had with the company. Defaulting on any one loan meant that all the goods were repossessed. Section 1007(3) forbids this practice in the rent-to-own context by prohibiting "a security interest or any other claim of a property interest in any goods, except those goods the use of which is provided by the merchant pursuant to the agreement." State rent-to-own laws, such as those in Texas, Florida, Missouri, and Georgia, for instance, do not forbid these cross-collateralization clauses,[12] leaving consumers vulnerable. In a hearing on a federal rent-to-own bill in 2001, a Representative stated that the modern rent-to-own industry was replaying the horrible facts of *Williams v. Walker-Thomas Furniture Co.* across the country.[13] HR 1588 would ensure that the practice would be illegal in every state.

(5) Finally, even the sections of HR 1588 that duplicate state laws are important because a federal rent-to-own law would be enforced by the Federal Trade Commission under section 1016(a). For example, if the FTC observed companies breaching the peace when repossessing goods, the FTC could enforce section 1007(7) to stop this conduct. While section 1007(7) is repetitive of Article 2A of the Uniform Commercial Code,[14] without HR 1588, the FTC is very unlikely to intervene to protect consumers.

III. The Relationship Between HR 1588 and State Law

Like other federal consumer protection statutes, such as the Fair Debt Collection Practices Act, HR 1588 does not prevent states from adopting laws that offer consumers greater protections than HR 1588.[15] Thus, if a state does not think HR 1588 goes far enough, it can take a wide variety of actions, from limiting the prices that rent-to-own companies can charge to banning the transaction from the state entirely.

The bill does, however, restrict states in two ways. It precludes states from regulating rental-purchase agreements as credit agreements, and it prevents states from requiring companies to disclose price information as an annual percentage rate (APR). In my opinion, neither of these restrictions are adverse to consumers' interests, but they both serve a beneficial function of ensuring that rent-to-own companies will be able to operate with reasonable levels of certainty about how courts will treat rental-purchase agreements.

First, restricting states from treating rental-purchase arrangements as credit recognizes the true nature of the rent-to-own transaction. Rent-to-own is not a credit arrangement primarily because consumers are not obligated to continue renting goods for any set amount of time. The obligation to pay back the entire amount that someone has borrowed is central to the definition of credit, but it is completely absent from the rent-to-own transaction. The ability to stop paying without consequences is important because consumers literally cannot experience financial distress or be driven into bankruptcy directly because of a rent-to-own agreement. They never take on any obligations to pay for a set period, so they cannot breach that agreement.

That rental-purchase agreements are not credit arrangements is further demonstrated by the fact that rent-to-own will not be regulated by the Consumer Financial Protection Bureau under the Dodd-Frank Act. Under the Act, the Bureau regulates "financial products and services," and the most expansive category in the definition of this phrase is "extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit."[16] Under the Act, "credit" means (1) "the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment" or (2) "the right granted by a person to . . . purchase property or services and defer payment for such purchase."[17] Rent-to-own agreements fall outside both of these parts of the definition. The statute does not define "debt," but debt is commonly defined as an obligation to pay money arising out of a transaction.[18] Rent to-own-agreements do not involve taking on debt because the rental agreements obligate consumers to pay for rental periods at the start of the rental period, not the end, so the consumer generally does not owe money because of the agreement.[19] Additionally, rent-to-own agreements do not involve deferring payment for a purchase because payments for renting are due before the rental period begins.

But more than arguments about the nature of the rent-to-own transaction, any legal protections that consumers obtain when states treat rent-to-own transactions as credit could still be enacted by states under HR 1588. For instance, if a state wants its usury laws to affect rental-purchase agreements, it can enact price controls on rent-to-own agreements. The only thing states cannot do is govern the transaction through a slight of hand that transforms a rental arrangement into a credit arrangement.

Second, preventing states from mandating that stores disclose annual percentage rates is a reasonable provision. APR disclosures are very difficult for most consumers to understand because people generally think in terms of actual dollar amounts, not abstract percentages. Furthermore, for many rent-to-own customers, the APR is not a relevant figure. At least 30% of customers do not ultimately purchase the goods that they have rented.[20] More to the point, some people in the industry estimate that only 2% of customers acquire ownership by paying the weekly fees through the life of the agreement. Most who acquire ownership do so by paying something less than the "total cost" under the contract by purchasing the goods part way through the agreement. For everyone except the 2% that pay the total

cost, the APR is inaccurate. If rent-to-own stores are required to disclose largely irrelevant or inaccurate information to consumers, it obscures the information that consumers really need to know.

Also, it is important to note that in the rent-to-own context, requiring APR disclosures drives most—and the biggest—rent-to-own companies from the jurisdiction, limiting or eliminating consumer choice in those states. When I gathered information in 2007, I found that in Vermont, where APR disclosures are mandated by rule, only 16 stores operate, and in Minnesota, which has an APR requirement, there are only 11 stores. It is estimated that rent-to-own companies would open somewhere between 150[21] and 300[22] more rent-to-own stores if Wisconsin changed its requirements, but currently, there are around 60 rent-to-own stores operating there. APR disclosure requirements severely limit competition and consumer choice in states that enact them.

The real effect of these two restrictions on state law is that rent-to-own firms can operate without the risk that a court will suddenly decide that a whole new body of law applies to the transaction. In 2006, this is exactly what happened in the New Jersey Supreme Court's decision in *Perez v. Rent-A-Center, Inc.*[23] The court concluded that rent-to-own products were really credit sales subject to harsher regulation, but it did so without the evidence-based, deliberative process that legislatures use to write laws. As a result, the court made several critical, erroneous empirical assumptions about the rent-to-own industry: that customers always intend to obtain ownership of rent-to-own goods,[24] that customers do not value the ability to cancel their rental-agreements,[25] and that the goods that rent-to-own stores rent are necessities for life.[26] If the state of New Jersey had to engage in the deliberative process of passing a law, it is unlikely that these same factual mistakes would be made.

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1 The views I present here are solely my own. This testimony draws heavily, sometimes verbatim, from my published articles that discuss rent-to-own, which are *Renting the Good Life*, 49 Wm. & Mary L. Rev. 2041 (2008); *Regulating on the Fringe: Reexamining the Link Between Fringe Banking and Financial Distress*, 86 Ind. L.J. 1361 (2011); *The Federal Government in the Fringe Economy*, 15 Chap. L. Rev. 23 (2011).

2 Federal Trade Commission, Survey of Rent-to-Own Customers ES-1 (2000).

3 James M. Lacko et al., *Customer Experience with Rent-to-Own Transactions*, 21 J. of Pub. Policy & Mktg. 126, 130 (2002). Economist 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. John P. Caskey, Lower Income Americans, Higher Cost Financial Services 29 Table 8 (1997).

4 Rent-A-Center, Inc, Annual Report (Form 10-K), at 5-6 (Feb. 23, 2007).

5 Aaron Rents, Inc., Annual Report (Form 10-K), at 14 (Feb. 22, 2007).

6 Rent-Way, Inc., Annual Report (Form 10-K), at 3 (Dec. 29, 2005) (figures rounded to the nearest whole number).

7 Federal Trade Commission, Survey of Rent-to-Own Customers 51 (2000) (figures rounded to the nearest whole number and presented as a percentage of consumer's reported behavior).

8 Every state law I examined to see if it had a requirement like section 1004(b) lacked any rule requiring that key terms be segregated at the start of the contract. *See, for instance*, Tex. Bus. & Comm. Code §§ 92.051 – 92.053 (West 2011) (not stating any rule about how information must be presented); Montana Code Ann. § 30-19-109 (2011) (stating some information must be before the customer's signature but not set off with a specific title or at the start of the agreement); Ga. Code Ann. § 10-1-682(b) (requiring that key information be placed together in the agreement but not at the start of the agreement); Fla. Stat. § 559.9233(6) (2011) (requiring that disclosures "be stated in a clear and coherent manner" but not all at the same time or at the start of the agreement); Revised Statutes of Mo. rev. stat. § 407.662 (2011) (requiring disclosures but not specifying that the disclosures be at the front of the agreement or grouped together); Ohio Rev. Code § 1351.02 (West 2011) (requiring that disclosures "be stated in a clear and coherent manner" but not all at the same time or at the start of the agreement).

9 Ga. Code Ann. § 10-1-686.(2011); Mo. Rev. Stat. § 407.660 et seq (2011).

10 Mont. Code § 30-19-112 (2011) (giving customers 45 days to reinstate the agreement if they have paid 2/3 of the rental payments and have returned the goods); Tex. Bus. & Comm. Code § 92.053 & § 92.103 (West 2011) (giving customers who have returned goods 37 days to reinstate the agreement); Ga. Code Ann. § 10-1-686 (2011) (giving customers who pay weekly 21 days to reinstate the agreement); Mo Rev. Stat. § 407.664.1 (2011) (giving customers who pay weekly 21 days to reinstate the agreement); Ohio Rev. Code Ann. 1351.05 (2011) (giving customers who pay weekly 21 days to reinstate the agreement); Fla Stat. § 559.9235(1) (2011) (giving customers who return the goods 60 days to reinstate the agreement).

11 350 F.2d 445 (D.C. Cir. 1965).

12 Tex. Bus. & Comm. Code § 92.054 (West 2011); Fla. Stat. § 559.9234 (2011); Mo. Rev. Stat. § 407.662 (2011); Ga. Code Ann. § 10-1-684 (2011).

13 Statement of Rep. Maxine Waters, Hearing Before the Subcommittee on Financial Institutions and Consumer Credit on HR 1701—The Consumer Rental Purchase Agreement Act 4 (July 12, 2001).

14 For Texas' version of this law, *see* Tex. Bus. & Comm. Code § 2A.525(c) (West 2011).

15 *See* HR 1588 § 1018.

16 Dodd-Frank Act §1002(15)(A)(i).

17 *Id.* §1002(7).

18 *See, e.g.*, 15 U.S.C. 1692a(5) (reporting the Fair Debt Collection Practices Act's definition of debt).

19 Even cases finding that rent-to-own agreements are credit sales state that rent-to-own does not entail accumulating debt. *Miller v. Colortyme, Inc.*, 518 N.W.2d 544, 549 (Minn. 1994).

20 Federal Trade Commission, Survey of Rent-to-Own Customers ES-1 (2000).

21 Paul Gores, *Will Legislators Buy Rent-to-Own Bill?*, The Milwaukee J. Sentinel, Oct. 10, 2005.

22 Jeremy Janes, *Rent-to-Own Industry up to Old Tricks*, Wisconsin State J., Aug. 10, 2005, at A6.

23 892 A.2d 1255 (N.J. 2006).

24 *Id.* at 1258. In reality, the FTC survey found that 33% of customers did not intend to purchase the goods they rented. Federal Trade Commission, Survey of Rent-to-Own Customers ES-2 (2000).

25 892 A.2d at 1269 n.14. Another survey found that the ability to cancel a rent-to-own agreement was one of the most important reasons people chose to rent-to-own. Brian J. Zikmund-Fisher & Andrew M. Parker, *Demand for Rent-to-Own Contracts: A Behavioral Economic Explanation*, 38 J. of Econ. Behavior & Org. 199 (1999).

26 892 A.2d at 1264-65. *See* Table 1 above for evidence that rent-to-own customers do not rent necessities.