

Effective Regulation of Rent-to-Own Contracts

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Due in large part to the higher cost of doing business with high credit risk individuals, the poor historically have paid more in consumer credit transactions than have other classes of our society.¹ Over the last fifteen years, however, low-income consumers have turned with increasing frequency to businesses offering consumer durable goods (e.g., furniture and home appliances) under lease-purchase or "rent-to-own" ("RTO") agreements as an alternative to traditional credit contracts. Over this period the RTO business has grown from a handful of companies with a negligible share of the market for consumer durables to a \$2.5 billion industry claiming a substantial part of this market.² This expansion has led to increased scrutiny from consumer groups and government officials who have questioned whether this relatively new transaction is fundamentally different from a credit sale and whether the RTO industry should be complying with the constraints of state and federal consumer protection legislation governing

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¹ See *In re Stewart*, 93 Bankr. 878, 879 (Bankr. E.D. Pa. 1988); C. BELL, *THE ECONOMICS OF THE GHETTO* 144–45 (1970); D. CAPLOVITZ, *THE POOR PAY MORE* 88 (1963); L. FELDMAN, *CONSUMER PROTECTION: PROBLEMS & PROSPECTS* 201–05 (1976); W. MAGNUSON & J. CARPER, *THE DARK SIDE OF THE MARKETPLACE* 32–41, 75–76, 118–20 (1968); UNITED STATES FEDERAL TRADE COMMISSION, *ECONOMIC REPORT ON INSTALLMENT CREDIT AND RETAIL SALES PRACTICES OF DISTRICT OF COLUMBIA RETAILERS* 48–49 (1968) [hereinafter *FTC Study*]; Mondale, *The Challenge of the Ghetto to Marketing* in *THE BLACK CONSUMER* 9 (G. Joyce ed. 1971); Comment, *Consumer Legislation and the Poor*, 76 *YALE L.J.* 745, 756 (1967).

² S. 1152 § 102(a), 98th Cong., 1st Sess., 2–3 ("Congress finds that the leasing of consumer goods continues to be a popular alternative to installment credit purchases."); *Hearing on S. 1152 Before the Subcomm. on Consumer Affairs of the Sen. Comm. on Banking, Housing and Urban Affairs*, 98th Cong., 1st Sess. 116, 117 (1983) (statement of J. Samuel Choate, Jr.) (hereinafter *Senate RTO Hearing*); Ramp, *Renting to Own in the United States*, 24 *CLEARINGHOUSE REV.* 797 (1990); Cooluris & Winn, *Consumer Leasing Developments*, 39 *BUS. LAW.* 1163, 1164 (1984) (predicting RTO market share of 15–25 percent by 1990).

the sale of goods.³ The resulting battles in the courts and legislatures have yielded a wide variety of proposed solutions—from efforts to prohibit the RTO transaction in some states⁴ to virtually no restraints on RTO dealers in others.⁵

Although the RTO industry serves customers from all socio-economic backgrounds, it has provoked strong opposition from consumer advocates and legal services organizations because many, if not most, RTO customers are low-income, high-credit-risk consumers.⁶ RTO dealers solicit low-income patrons by emphasizing easy credit, low periodic payments, quick delivery of household appliances, and no long term obligation to repay a debt.⁷ For many consumers who cannot obtain loans from finance companies or credit from traditional retailers, RTO may be the only way, or at least the most accessible means, of acquiring desired household items.⁸ The prices paid for these goods, however, may be more than double their retail prices by the time the RTO transaction has concluded.⁹ The controversy is heightened by the industry's insistence that it is exempt from usury limits and other consumer protection laws—most notably, the federal Truth in Lending Act, state retail installment sales acts, and the repossession provisions of Article 9 of the UCC—that govern the activities of most retailers and financiers of consumer goods under traditional credit arrangements. By charging high prices and not complying with the requirements of these laws, RTO dealers are often accused of deceiving and exploiting a particularly vulnerable class

³ See, e.g., J. SHELDON, UNFAIR AND DECEPTIVE ACTS AND PRACTICES 213-26 (National Consumer Law Center, 2d ed. 1988) (discussing legality of RTO transactions); Waters, *We Are the People Who do Good*, RTO Network News, Jan. 1990, at 3 (industry believes critics want RTO contracts declared illegal); *Special Update*, PROGRESSIVE RENTALS, June-July 1990, at 22 (RTO dealers observe increasingly well-organized opposition).

⁴ See *infra* text accompanying notes 102-17.

⁵ See *infra* text accompanying notes 273-77, 303-06.

⁶ See *Hawkes Television v. Maine Bureau of Consumer Credit Protection*, 462 A.2d 1167 (Me. 1983); *State v. Action TV Rentals*, 297 Md. 531, 535, 467 A.2d 1000, 1002 (1983); *Senate RTO Hearing*, *supra* note 2, at 53 (statement of Geraldine Azzata); PROGRESSIVE RENTALS, June-July 1989, at 25.

⁷ See E. SARASON, TRUTH IN LENDING 28 (1986).

⁸ *Senate RTO Hearing*, *supra* note 2, at 107 (statement of Jane Simmons); Waters, *supra* note 3, at 3 ("We are the people who . . . trust [consumers] with our merchandise—even when we know they have come to see us nine times out of ten because no one else will trust them with enough credit.").

⁹ See *infra* note 20 and accompanying text.

of consumers as the industry operates in an essentially unregulated environment.¹⁰

Dozens of state and federal courts have inquired into the nature of the RTO business. Although the confrontation between consumer representatives and RTO dealers produced mixed results in early decisions, the recent trend in the courts has favored accepting the industry's claim that RTO leases are not credit sales and therefore are exempt from many consumer protection statutes.¹¹ Over the last five years, the debate has moved to the legislatures, where the industry often has succeeded in obtaining protective legislation further insulating it from attack under credit laws and ensuring its continued operation outside usury limits and under modest regulation.¹²

This Article examines the relationship between low-income consumers and the RTO industry, and evaluates recent attempts to regulate the industry through the courts and legislatures. The article is arranged in four parts. Part I describes the RTO transaction and the more common objections to the industry voiced by consumer groups. Part II reviews judicial decisions that, for the most part, have refused to treat RTO contracts as credit sales under state and federal consumer credit laws and, more importantly, argues that amending traditional credit laws to cover RTO transactions would probably not be in the best interests of low-income RTO consumers. Part III examines the often-litigated question of whether RTO transactions are security interests under Article 9 of the UCC. Part III also discusses the limited value of the UCC, including Articles 9 and 2A, to most RTO consumers. Part IV reviews the recent efforts to enact special RTO laws directed at the particular needs of low-income consumers and concludes that such laws, with some important modifications, can provide the most meaningful protection for RTO consumers.

I. RTO BACKGROUND

The concept of a "rent-to-own" contract as an alternative to a traditional credit sale of goods was a response to the rapid growth of consumer credit in the 1960s and 1970s and the resulting proliferation of laws regulating credit enacted by Congress (e.g., the Truth in Lending Act) and state

¹⁰ See J. SHELDON, *supra* note 3, at 215; Ramp, *supra* note 2, at 805.

¹¹ See *infra* Parts II and III.

¹² See *infra* Part IV.

legislatures (e.g., retail installment sales acts).¹³ The combined effect of the credit laws enacted in this era was to mandate standard disclosures of pertinent information in credit transactions, to codify many of the rights and duties of debtor and creditor, and, through state usury limits, to set interest rate ceilings for retail credit sales in an effort to control the cost of buying goods over time.¹⁴ During the same period, courts began taking a more active role as guardians of consumer interests, and judges invalidated, as unconscionable, several commonly used pro-creditor contract provisions, such as cross-collateral clauses and provisions for a consumer's waiver of defenses upon default.¹⁵

These legislative and judicial developments made it more costly for businesses to extend credit to low-income, high-credit-risk individuals. Creditors could no longer openly charge high interest rates to reflect high credit risk, nor could they ensure profits by taking other revenue increasing measures, such as requiring that the debt be oversecured or that judgment could be quickly obtained upon the debtor's default. While these developments were hailed as benefiting consumers generally, one result was the increased likelihood that low-income consumers would be denied credit. For consumers who were excluded from traditional credit markets, the available options for purchasing relatively high priced consumer goods were to save money for retail cash purchases, to frequent local retailers who inflated the disclosed "cash price" of goods to stay within usury limits and still earn a profit, or to engage the services of illegal lenders (i.e., "loan sharks").¹⁶

¹³ Although there is some evidence that the transaction originated in 1959 in Wichita, Kansas, RTO consumer agreements did not begin to gain popularity in the United States until the 1970s. *See* Fassitt v. United T.V. Rental, 297 So. 2d 283 (La. App. 1974); State v. Action TV Rentals, 297 Md. App. 531, 467 A.2d 1000, 1002 (1983); *In re Royer's Bakery*, 1 U.C.C. Rep. Serv. (Callaghan) 342 (E.D. Pa. 1963); Ramp, *supra* note 2, at 797 (observing that renting home appliances has long been popular in England).

¹⁴ *E.g.*, Truth in Lending Act, 15 U.S.C. §§ 1601-1667e (1991) [hereinafter TILA]; 7 U.L.A. Uniform Consumer Credit Code § 1.102 (1968) [hereinafter U.C.C.C.]. *See infra* text accompanying notes 29-38.

¹⁵ *See, e.g.*, Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965); Fairfield Credit Corp. v. Donnelly, 158 Conn. 543, 264 A.2d 547 (1969); *see also* U.C.C.C. §§ 2.404, 3.404(4).

¹⁶ V. CHAPMAN, THE CONSUMER FINANCE INDUSTRY 18, 143-45 (1967); UNITED STATES NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 104-05 (1972) [hereinafter NATIONAL CONSUMER CREDIT REPORT]; Nathan, *Economic Analysis of Usury Laws*, J. BANK. RES. 200, 201 (Winter 1980).

Eventually, entrepreneurs noticed an apparent void in consumer credit laws. When read literally, many statutes applied only to transactions in which a "debt" was created and the consumer was obligated to pay for the full value of the goods.¹⁷ They did not cover a transaction in which the consumer was obligated for only a week or two and then had the option of renewing the agreement for a number of successive weeks or months in order to complete the contract. By 1960, businesses had opened in low-income neighborhoods offering short-term renewable leases, with no credit check, that promised immediate possession of furniture and home appliances. Moreover, a consumer renewing the lease long enough would obtain ownership of those goods. The contract was thus styled not as a sale of goods on credit but as a weekly or monthly lease that ultimately would lead to a transfer of ownership if the customer continued leasing for a stated period, usually twelve or eighteen months.¹⁸ A market for the RTO service was quickly established.¹⁹

Since it is relatively costly to sell or lease goods to consumers who are high credit risks, the prices charged under these lease-purchase agreements are far above what is charged for similar goods sold by traditional retailers to more creditworthy buyers.²⁰ Thus, through RTO transactions the poor pay substantially more for many consumer goods than do those who have ready access to other sources of credit. In return for the higher price, an RTO customer receives (1) the use of a product he or she otherwise might not be able to obtain, (2) the possibility of ownership in the future without the economic burden of a long term obligation, and (3) use of a product without the responsibility for maintenance, which the RTO dealer typically

¹⁷ *E.g.*, Truth in Lending Act, 15 U.S.C. § 1602(g) (definition of "credit sale"); U.C.C.C. §§ 1.301(12), (35) (definition of "consumer credit sale" and "sale of goods"); Uniform Commercial Code § 1-201(37) (1989) [hereinafter U.C.C.] (definition of "security interest"). See *infra* text accompanying notes 40-77, 78-117, 176-213.

¹⁸ See, *e.g.*, *In re Glenn*, 102 Bankr. 153, 154 (Bankr. E.D. Ark. 1989); *In re Unger*, 95 Bankr. 761 (Bankr. D. Or. 1989); *Senate RTO Hearing*, *supra* note 2, at 76-78, 98-106, 138 (statement of Geraldine Azzata).

¹⁹ See *supra* note 2. In 1988, two RTO companies were designated among the 500 fastest growing privately owned firms in the United States. 1989: *A Time for Advancement in RTO*, RTO Network News, Jan. 1990, at 1.

²⁰ See, *e.g.*, *In re Unger*, 95 Bankr. 761, 762 (Bankr. D. Or. 1989) (cash price of television, \$369.00; RTO price, \$600.00); *In re Harris*, 102 Bankr. 128 (Bankr. S.D. Ohio 1989) (cash price of washer/dryer, \$711.65; RTO price, \$1,423.26); *In re Hanley*, 105 Bankr. 458, 460 (Bankr. C.D. Ill. 1989) (cash price of dryer, \$338.00; RTO price, \$788.06); *Crumley v. Berry*, 298 Ark. 112, 766 S.W.2d 7 (1989) (cash price of refrigerator, \$599.95; RTO price \$930.80).

assumes under the lease.²¹ Industry representatives maintain that RTO as an alternative to traditional credit financing can have value to individuals with little or no money and a desire for good quality consumer durables. Because no debt is created and the goods can be returned at any time with no further obligation, budget problems and the hardships attendant to the enforcement of default judgments (e.g., wage garnishment or bankruptcy) are less likely to arise. Moreover, consumers have the opportunity to return goods that simply do not work as well as anticipated, or are no longer needed or wanted, a benefit not available to those who purchase similar items under traditional credit contracts.²²

Opponents of the industry maintain that the problems caused by the RTO transaction outweigh whatever benefits might be received. Critics charge that the "rental" feature of the contract is a convenient formality not important to most RTO customers who view the transaction as equivalent to a credit sale, and that the transaction should therefore be governed by the same consumer protection laws regulating other transfers of consumer goods.²³ Perhaps the central issue for consumer advocates is the exorbitant pricing structure for RTO goods. Low-income RTO customers who pay two to three times what a creditworthy consumer would pay for the same merchandise are charged an effective interest rate far above usury limits.²⁴ The high prices place a considerable strain on already tight budgets, precipitating default on other obligations, and perhaps contributing to consumer bankruptcy. Moreover, while RTO customers often enter into contracts knowing the weekly or monthly rental rate, they can be unaware of the high total price and numerous incidental charges they will pay to obtain ownership by the

²¹ *Senate RTO Hearing*, *supra* note 2, at 112-13 (statement of J. Samuel Choate, Jr.); *id.* at 107 (statement of Jane Simmons).

²² *See APRO Special Report*, PROGRESSIVE RENTALS, June-July 1987, at 43 ("There is a large segment of the population who cannot own a nice washing machine or other home furnishing unless they deal with a rent-to-own company"); *Senate RTO Hearing*, *supra* note 2, at 107 (statement of Jane Simmons) (legal services representative acknowledging that terminable RTO contract might benefit individuals who have no cash resources).

²³ *See* K. BROWN & K. KEEST, USURY AND CONSUMER CREDIT REGULATION 129 (1987); Ramp, *supra* note 2, at 805.

²⁴ *See id.* at 130 (computing RTO effective interest rates at over 400 percent in some instances). The RTO industry has also received a substantial amount of adverse publicity recently in the popular press. *See* Hinds, *Rent-to-Own Ripoff*, Providence Journal-Bulletin, Sept. 1, 1988, at E-1; Kraft, *The High Priced Models: Are Rent-to-Own Appliance Businesses Practicing Usury?*, New Haven Advocate, Feb. 13, 1985; Quinn, *Harrisburg Patriot News*, Sept. 15, 1985, at 1; *False Alarm*, RTO Network News, November 1990, at 1 (reviewing Oct. 19, 1990, CBS News broadcast on RTO contracts).

end of the contract. Other sources of complaints include deceptive, overly aggressive repossession tactics, delivery of used merchandise when new products were promised, and the imposition of late payment fees and other charges that either were not disclosed to the consumer or are not justified under the circumstances.²⁵

Critics contend that the application of a few key consumer protection laws to RTO transactions would make important information available to consumers, resulting in lower prices and more rational decisionmaking. Consumer representatives have usually challenged the legality of RTO transactions by maintaining that the contract is covered by the federal Truth in Lending Act, a state's retail installment sales act, or a state's version of the UCC governing sales of goods.²⁶ Perhaps perceiving some inequities in allowing the industry to operate unregulated, some courts have construed these federal and state statutes to apply and have characterized RTO transactions as disguised sales by looking beyond the "form" to the "substance" of the transaction.²⁷ Judges in these cases have often been faced with compelling facts in which confused consumers have paid high prices for goods and appear to have been victimized by unscrupulous dealers. Sympathetic jurists have looked hard for a way to remedy an apparent injustice.

Other courts, interpreting what they perceive to be the "plain language" of the relevant statutes, have excluded RTO agreements from their coverage.²⁸ The statutes generally employed to provide a remedy were drafted before the RTO transaction became popular and without the RTO consumer in mind. The statutory language thus does not neatly fit the transaction. Judges' efforts to "right a wrong" and yet remain true to the words of a statute have yielded interesting theories and sometimes strained results.

²⁵ See J. SHELDON, *supra* note 3, at 215; Ramp, *supra* note 2, at 810 n.95.

²⁶ The applicability of TILA and retail installment sales laws to RTO contracts is discussed in Part II; the UCC is addressed in Part III.

²⁷ See *infra* notes 48-60, 103-117, and 183 and accompanying text.

²⁸ See *infra* notes 47, 80-102, and 184-205 and accompanying text.

II. THE LIMITED SCOPE OF THE TRUTH-IN-LENDING ACT AND STATE RETAIL INSTALLMENT SALES LAWS

The federal Truth in Lending Act²⁹ is the cornerstone of consumer credit legislation. The statute is Congress' most comprehensive effort to guarantee the accurate and meaningful disclosure of the costs of consumer credit and thereby to enable consumers to make informed choices in the credit market.³⁰ When Congress passed the law in 1968, it was the first extensive federal consumer credit legislation in the country. TILA provides that prior to extending consumer credit (or at least contemporaneously therewith), a creditor must disclose information Congress deemed important to consumers, such as the annual percentage rate of interest, the amount of debt financed, the finance charge, the total sale price (including finance charges), rebates for early prepayment, delinquency charges for late payments, and the existence of any security interest retained by the creditor.³¹ Extensive revision and simplification of TILA in 1980 reaffirmed Congress' view that consumers can benefit from the protections provided in the Act.³²

²⁹ 15 U.S.C. §§ 1601-1667 (1991). TILA was enacted in 1968 as Title I of the Consumer Credit Protection Act. *See* Act of May 29, 1968, Pub. L. No. 90-321, 82 Stat. 146, 1968 U.S. CODE CONG. & ADMIN. NEWS 176. Subsequent titles amended to the original act include the Fair Credit Reporting Act (Title VI), the Equal Credit Opportunity Act (Title VII), the Fair Debt Collection Practices Act (Title VIII), and the Electronic Fund Transfer Act (Title IX). TILA is divided into five "chapters"—general provisions, credit transactions, credit advertising, credit billing, and consumer leases. Chapter 5 on consumer leases is also known as the Consumer Leasing Act and is discussed separately in text accompanying notes 278-302.

³⁰ *See* Landers, *Some Reflections on Truth in Lending*, 1977 U. ILL. L. REV. at 669-70; Kofele-Kale, *The Impact of Truth-in-Lending Disclosures on Consumer Market Behavior: A Critique of the Critics of Truth-in-Lending Law*, 9 OKLA. CITY U.L. REV. 117, 120 (1984).

³¹ 15 U.S.C. §§ 1637, 1638 (1991). Section 1638 contains the disclosures required for extension of "closed-end" credit, *i.e.*, a fixed amount of credit extended for a one-time financing arrangement, as opposed to an "open-end" plan that contemplates multiple extensions of credit over a period of time (*e.g.*, revolving charge accounts). To the extent that RTO contracts are covered by TILA, the "closed-end" disclosures of § 1638 would apply. *See* 15 U.S.C. § 1602(i) (definition of "open-end credit plan"). For a list of TILA disclosures typically missing from an RTO contract, see *Lemay v. Stroman's, Inc.*, 510 F. Supp. 921-22 (E.D. Ark. 1981).

³² Truth-in-Lending Simplification and Reform Act of 1980, Pub. L. No. 96-221, 1980 U.S. CODE CONG. & ADMIN. NEWS 94 Stat. 168 (1980).

Prior to TILA's enactment, consumers often were confronted with confusing disclosures or the lack of relevant credit information. Creditors expressed finance charges and total credit sale prices in different, frequently misleading ways. Some creditors simply disclosed the monthly dollar payments required under the contract, making no interest rate disclosures at all, while others disclosed a finance charge or interest rate but computed them under a variety of different methods.³³ In addition, creditors often failed to include incidental charges, such as mandatory credit insurance, within the disclosed finance charge, thus giving the consumer a distorted picture of the overall credit cost.³⁴ Consumers found it difficult, if not impossible, to compare charges and rates among competing creditors who used different computational methods and varying terms to describe similar concepts. These inconsistencies inhibited consumers from shopping for the most favorable credit terms.³⁵ As the consumer credit industry rapidly expanded during the 1960s, the need for complete and uniform disclosure of important credit information became evident.

Every state has enacted some form of retail installment sales ("RIS") law to supplement the TILA disclosures and to encourage uniformity in consumer credit transactions. In general, these laws mandate certain disclosures in retail credit contracts and impose substantive consumer protections such as interest

³³ See NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 169-70. The report observed that retailers and finance companies often quoted interest rates as a dollar "add-on," and thus disclosed the finance charge in terms of a dollar amount per year based on the initial balance. For example, the finance charge might have been stated as \$7 per \$100 per year, indicating that on a three year loan of \$2,000 the finance charge would be \$420 (\$7 x 20 x 3 years). The effective interest rate on such a contract is actually 12.83%. Banks often quoted rates on a "discount basis," which could result in higher effective interest rates (e.g., a charge of \$7 per \$100 per year for a three year loan would be equivalent to a rate of 16.01%). Consumer credit unions and banks offering revolving credit accounts stated monthly instead of annual rates. Still other institutions combined computational methods to form hybrid formulae. *Id.* See also K. BROWN & K. KEEST, *supra* note 23, at 63-108 (guides for calculating effective interest rates under various computational methods).

³⁴ See generally Sheffey, *Credit Life and Disability Insurance Disclosures Under Truth-in-Lending: The Triumph of Form over Substance*, 8 FLA. ST. U.L. REV. 463 (1980).

³⁵ Several studies confirmed consumers' lack of understanding and inability to compare credit alternatives. See Due, *Consumer Knowledge of Installment Credit Charges*, 20 J. MARKETING 162, 164 (Oct. 1955); Juster & Shay, *Consumer Sensitivity to Finance Rates: An Empirical and Analytical Investigation* 61, 73 (New York: National Bureau of Econ. Res. 1964). See generally, *National Consumer Credit Report*, *supra* note 16, at 170-72.

rate ceilings, limitations on incidental charges creditors may impose, and restrictions on creditors' rights, as well as providing sufficient administrative enforcement power to support remedial actions by consumer debtors against creditors who violate the laws.³⁶

If an RTO transaction is characterized as a credit sale under TILA or an RIS statute, the consequences for an RTO dealer are severe. The dealer would have to disclose in the contract, among other things, the cash price of the merchandise, the total RTO price, the finance charge or price paid for the privilege of paying for the goods over time, and an interest rate computed according to statutory guidelines based on the finance charge imposed. Most importantly, the transaction would be subject to the state's interest rate ceiling on consumer credit sales.³⁷ Because RTO prices are high and many RTO customers present too great a risk to qualify for credit under traditional credit arrangements, the RTO dealer might find it impossible to give the required disclosures and remain within the interest rate ceiling. The dealer's alternatives would be either to substantially lower the total RTO price (and probably incur losses) or to substantially inflate the stated "cash price" to bring the disclosed finance charge and interest rate within allowable limits (and perhaps be accused of imposing "hidden" finance charges).³⁸ Neither

³⁶ For a thorough discussion of the scope of RIS laws in different jurisdictions, see B. CURRAN, *TRENDS IN CONSUMER CREDIT LEGISLATION* (1966). While the substance of RIS laws can differ widely among jurisdictions, several states have rewritten and consolidated all or parts of their credit laws in a single consumer credit code. The Uniform Consumer Credit Code is a model code that has been enacted, in one form or another, in eleven states (Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah, Wisconsin, and Wyoming). In other states, consumer credit legislation is often scattered in several statutes that address particular types of credit transactions (e.g., bank loan, automobile financing, or pawnbrokers). Most states have a law dealing with the sale of consumer goods on credit, and in this article "RIS" is used to designate such laws as well as the provisions of the U.C.C.C. that address credit sales.

³⁷ See K. BROWN & K. KEEST, *supra* note 23, at 32; *Tennessee v. Rentavision Corp.* of Am., No. 83-1647-I (Chancery Ct. 7th Div. 1983); *Crumley v. Berry*, 298 Ark. 112, 766 S.W.2d 7 (1989); *Hawkes Television, Inc. v. Bureau of Consumer Credit Protection*, 462 A.2d 1167 (Me. 1983); *State v. Action TV Rentals, Inc.*, 297 Md. App. 531, 467 A.2d 1000 (1983); *Palacios v. ABC TV & Stereo Rental of Milwaukee, Inc.*, 123 Wisc. 2d 79, 365 N.W.2d 882 (1985).

³⁸ "Hidden interest" can be loosely defined as the imposition of any charge paid in connection with a consumer credit contract that can be classified as interest under local law but is not designated as such in the credit agreement. See K. BROWN & K. KEEST, *supra* note 23, at 109. It can take many forms, such as up front loan origination fees or points, brokers' fees, mandatory attorneys' fees, or contract processing fees. One of the most common means of collecting hidden interest in consumer credit sales is to inflate the stated "cash price" of the goods. The practice has been noted by the U.S. Supreme

alternative is attractive to the industry. Consequently, the battle over the inclusion of RTO transactions in TILA and RIS statutes has been intense.

Because TILA and RIS laws only cover "credit" transactions, courts faced with a consumer's allegations that an RTO dealer failed to comply with these laws must first decide whether the statute's definition of covered credit transactions includes terminable RTO leases. While the issue is not entirely settled, a clear majority of courts have held that RTO transactions do not come within the definitions set forth in TILA or state credit laws.³⁹ The remainder of this section examines the reasons supporting this judicial reluctance to characterize RTO contracts as credit sales, and concludes that RTO consumers may ultimately benefit from the courts' inaction if the regulatory void is filled by legislation better tailored to the problems facing the poor.

A. TILA's Coverage Is Limited to Debt-Creating Sales

TILA's uniform disclosure requirements only apply to "creditors" as defined in the statute and its implementing Regulation Z.⁴⁰ TILA defines "creditor" to include all persons who regularly allow consumers to "defer payment of a debt" that is payable "in more than four installments or for which the payment of a finance charge is or may be required."⁴¹ Recognizing, however, that extensions of credit by retail sellers of goods might require different disclosures (e.g., cash price and amount of down payment) than loans made by cash lenders like banks and finance companies, Congress defined a subcategory of covered creditors who engage in "credit sales." Most importantly for those interested in the RTO industry, Congress recognized that some leases were nothing more than disguised credit sales, and thus defined "credit sale" to include:

Court, *see Mourning v. Family Publications Serv.*, 411 U.S. 356 (1973), and can be a violation of TILA. *See Yazzie v. Reynolds*, 623 F.2d 638 (10th Cir. 1980); *Joseph v. Norman's Health Club*, 532 F.2d 86 (8th Cir. 1976). The difficulty, of course, is proving the actual value of the goods, which can vary widely among retailers.

³⁹ *See infra* notes 47 and 63.

⁴⁰ *See* 15 U.S.C. § 1631 (1991) (disclosures must be made by the "creditor," or, in contracts covered by the Consumer Leasing Act, by the "lessor").

⁴¹ 15 U.S.C. § 1602(f) (1991). *See also* 12 C.F.R. § 226.2(a)(17) (1990). Persons who do not expressly charge interest but who collect a debt in "more than four installments" are covered because a hidden interest charge is presumed when a creditor allows a debt to be repaid over time, even if no express interest component is stated. *See Mourning v. Family Publications Serv.*, 411 U.S. 356 (1983) (upholding Federal Reserve Board regulation applying four-installment rule).

any contract in the form of a bailment or *lease* if the bailee or lessee *contracts to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the property and services involved* and it is agreed that the bailee or lessee will become, or for no other or a *nominal consideration* has the option to become, the owner of the property upon full compliance with his obligations under the contract.⁴²

Consumer representatives view this language as covering RTO agreements because the typical RTO contract allows the lessee to become the owner of the goods automatically at the end of the lease without paying any additional consideration.⁴³ The RTO industry has consistently argued that its agreements are not "credit sales" because the consumer does not "contract to pay" for the full value of the goods, but rather agrees to pay rent for only one week or one month and can terminate the agreement at any time.⁴⁴ Absent an obligation to pay for the value of the goods, the industry contends, the question of "nominal consideration" under the statute is not even reached.

The Federal Reserve Board, which promulgated Regulation Z and is charged with implementing TILA, has supported the industry's view. In a series of unofficial staff opinions beginning in 1974, the Board concluded that because the lessee's option to terminate the rental agreement negates any obligation to pay the full market value of the property, the lessee does not "contract to pay" for the goods and the transaction falls outside the definition of "credit sale" even if ownership transfers for no consideration at the end of the lease.⁴⁵ The Board's position follows from its view that it would be difficult to calculate a finance charge or annual percentage rate on such a

⁴² 15 U.S.C. § 1602(g) (1988) (emphasis added). See 12 C.F.R. § 226.2(a)(16) (1990) and comment 2(a)(16) (if transaction is a credit sale, the creditor must disclose, in addition to the general disclosures of 12 C.F.R. § 226.18, the special disclosures of 12 C.F.R. § 226.18(j) (e.g., "total sale price," "cash price")).

⁴³ See E. SARASON, *supra* note 7, at 29.

⁴⁴ *Id.*

⁴⁵ See Informal FRB Staff Opinion Letters: No. 750, Consumer Cred. Guide (CCH) ¶ 31,069 (Jan. 11, 1974); No. 761, Consumer Cred. Guide (CCH) ¶ 31,083 (Mar. 12, 1974); No. 783, Consumer Cred. Guide (CCH) ¶ 31,105 (Apr. 18, 1974); No. 871, Consumer Cred. Guide (CCH) at ¶ 31,202 (Feb. 28, 1975); No. 1010, Consumer Cred. Guide (CCH) ¶ 31,350 (Feb. 25, 1976); No. 1169, Consumer Cred. Guide (CCH) ¶ 31,566 (Mar. 28, 1977); No. 1192, Consumer Cred. Guide (CCH) ¶ 31,623; No. 1217, Consumer Cred. Guide (CCH) ¶ 31,656 (July 15, 1977). See generally Note, *The Applicability of the Federal Truth in Lending Act to Rental Purchase Contracts*, 66 CORNELL L. REV. 118 (1980) (discussing some early decisions applying TILA to RTO contracts).

lease. Whereas true sellers of property calculate finance charges by reference to either the total amount financed or the difference between the cash price and the deferred payment price, rental payments derive, at least in part, from the value of using the property during each rental term and not merely from the retail value of the goods at the beginning of the lease increased by the time value of money.⁴⁶ This "use" value must be accounted for in any calculation of interest rates but, as a practical matter, it is difficult to quantify. Courts in fourteen cases deferred to the Board's early interpretation and held, without further analysis, that RTO contracts were not covered by TILA.⁴⁷

Beginning in the late 1970s, however, several courts held to the contrary. Rejecting the Board's pronouncements as too formalistic and semantic, they either held that an RTO contract was a "credit sale" or that the question raised factual issues making the dismissal of a TILA claim inappropriate.⁴⁸ These courts criticized the Board and previous decisions for mechanically applying the "contracts to pay" language of the statute and instead focused on the substance of the RTO transaction. In the leading case, *Clark v. Rent-It Corp.*,⁴⁹ the Eighth Circuit reversed the dismissal of a TILA claim brought

⁴⁶ See *Truth in Lending—1967: Hearings on S.5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 663 (1987) (statement of Governor Robertson of the FRB). See also *id.* at 353 (statement of Darrel M. Holt, Mortgage Bankers Ass'n of America).

⁴⁷ *In re Homeway Rentals*, 64 Bankr. 1 (Bankr. S.D. Ga. 1984); *Lemay v. Stromans, Inc.*, 510 F. Supp. 921 (E.D. Ark. 1981); *Blackshear v. S&S Television Rental*, No. C-79-490 (N.D. Ohio, Oct. 23, 1981); *Dodson v. Remco Enters.*, 504 F. Supp. 540 (E.D. Va. 1980); *Steward v. Remco Enters.*, 487 F. Supp. 361 (D. Nev. 1980); *Smith v. ABC Rental Sys. of New Orleans*, 491 F. Supp. 127 (E.D. La. 1978), *aff'd* 618 F.2d 397 (5th Cir. 1980) (per curiam); *Dorsey v. Curtis Mathes Sales Co.*, No. 4-78 Civ. 436 (D. Minn., Mar. 26, 1979); *In re Turner*, No. 3-78-1135D (Bankr. D. Minn., Mar. 19, 1979); *Ellis v. ABC Rental Sys. of Louisville*, No. C-75-0032-L(B) (W.D. Ky., Apr. 27, 1976); *Clark v. Aquarius TV Rental*, No. CA-4-77-133 (N.D. Tex., Oct. 18, 1977); *Griggs v. Easy TV Rentals*, No. C-75-2509A (N.D. Ga., Apr. 8, 1976); *Terrell v. Mr. T's Rental*, No. C-75-2058A (N.D. Ga., June 4, 1976); *Boyd v. ABC Rental Sys.*, No. C-74-456-1(B) (W.D. Ky., Sept. 12, 1975); *Remco Enters. v. Houston*, 677 P.2d 567, 9 Kan. App. 2d 296 (1984).

⁴⁸ See *Clark v. Rent-It Corp.*, 685 F.2d 245 (8th Cir. 1982) (reversing dismissal of TILA claim); *In re Hanley*, 105 Bankr. 458 (Bankr. C.D. Ill. 1989) (refusing to dismiss TILA claim); *Davis v. Colonial Securities Corp.*, 541 F. Supp. 302 (E.D. Pa. 1982) (holding RTO contract to be credit sale); *Burks v. Curtis Mathes Centers*, No. 4-79-429 (D. Minn. Nov. 14, 1980) (refusing to dismiss TILA claim); *Jones v. Action T.V. Rental, Inc.*, No. 79-1535 (E.D. Pa. June 30, 1980); *Johnson v. McNamara*, No. H-78-238 (D. Conn. Apr. 13, 1979) (holding RTO contract to be a credit sale).

⁴⁹ 685 F.2d 245 (8th Cir. 1982).

by a consumer who had entered into a typical RTO contract. The agreement provided that the consumer could rent a television on a week-to-week basis and would become the owner if he renewed the agreement for seventy-eight weeks at seventeen dollars per week. Noting that TILA was "remedial in nature, and the substance rather than the form of credit transaction should be examined," the court found it relevant to look at the practices of trade, the course of dealing of the parties and their "intentions" rather than the mere language of specific contractual provisions.⁵⁰ The district court therefore erred by not considering evidence that the parties intended a sale rather than a lease. Relevant evidence included proffered testimony that many customers in fact became the owners of the rented property, that the dealer led the plaintiff to believe the transaction was a sale, and that the RTO industry targets low-income consumers who cannot obtain other forms of credit and who look at RTO as the equivalent of a credit sale.⁵¹ The court was influenced by portions of TILA's legislative history in which Congress expressed concern that "some creditors would attempt to characterize their transactions so as to fall one step outside whatever boundary Congress attempted to establish."⁵² The intent of Congress was to include disguised sales under TILA, and that intent is frustrated if the form of the contract is considered to the exclusion of other evidence.⁵³

Several federal district courts reiterated this focus on the "practical consequences" of the transaction rather than the form of the agreement in holding RTO contracts subject to TILA's disclosure requirements.⁵⁴ These courts supplemented the *Clark* analysis with discussion of another aspect of congressional intent—the TILA definition of "credit sale" should be consistent with the interpretation given to terms serving similar functions under state law. Observing that the TILA definition of "credit sale" was nearly identical to language used in the old Uniform Conditional Sales Act, these courts looked to analogous state laws for guidance. District courts in *Waldron v. Best T.V. & Stereo Rentals*⁵⁵ and *Jones v. Action T.V. Rental*⁵⁶

⁵⁰ *Id.* at 248.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ See *supra* note 48.

⁵⁵ 485 F. Supp. 718 (D. Md. 1979). The *Waldron* court relied on a Maryland Court of Appeals (that state's highest court) decision, *United Rental Equipment Co. v. Potts & Callahan Contracting Co.*, 231 Md. 552, 191 A.2d 570 (1963), which had held that a terminable RTO-type lease was a "security agreement" under the commercial code. The Maryland Court of Appeals subsequently refused to follow *United Rental Equipment* in a case seeking to characterize an RTO lease as a "credit sale" under the Maryland RIS

thus relied on state court precedent holding that RTO-type renewable leases created security interests under the state's version of the Uniform Commercial Code, and since a finding of security interest implies a credit sale rather than a true lease, RTO contracts should be treated like credit sales under TILA. In *Johnson v. McNamara*,⁵⁷ the district court observed that an RTO agreement is virtually identical to a credit sale, the only practical difference being that under an RTO agreement the consumer is not liable for a deficiency should he return the goods and stop paying. Under a Connecticut anti-deficiency law,⁵⁸ however, and similar laws of several other states,⁵⁹ consumers are liable for neither a deficiency following default nor repossession of the goods under retail credit sale contracts. Thus, the asserted difference, which was critical to the Board staff opinions and courts previously holding RTO agreements exempt from TILA, was not dispositive. Instead, the court attempted to ascertain the intention of the parties by looking at the overall "effect" of the agreement, and held that the transaction

statute. See *State v. Action TV Rentals*, 297 Md. App. 531, 467 A.2d 1000 (1983); *infra* text accompanying notes 89-101. Thus, *Waldron* might be decided differently today.

⁵⁶ No. 79-1535 (E.D. Pa. June 30, 1980) (relying on *In re Royer's Bakery*, 1 U.C.C. Rep. Serv. (Callaghan) 342 (E.D. Pa. 1963)).

⁵⁷ No. H-78-238 (D. Conn. Apr. 13, 1979). *Johnson* was widely circulated and cited as one of the first decisions to look beyond FRB staff opinions to the substance of the underlying transaction. As authority for relying on local law, the court observed that Congress borrowed the definition of "credit sale" from the Uniform Conditional Sales Act. *Id.* at 8 (citing H.R. REP. NO. 1040, 90th Cong., 2d sess., reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 1960, 1980; S. REP. NO. 392, 90th Cong., 1st Sess. 12-13 (1967)).

⁵⁸ See CONN. GEN. STAT. ANN. § 42-98(f), (h) (West 1990).

⁵⁹ E.g., COLO. REV. STAT. ANN. § 5-5-103(2) (West 1990); FLA. STAT. ANN. § 516.31(3) (West 1991); IDAHO CODE § 28-45-103(2) (1990); IND. CODE ANN. § 24-4.5-5-103(2) (West 1990); KAN. STAT. ANN. § 16a-5-103(2) (1989); ME. REV. STAT. ANN. tit. 9A § 5-103(2) (West 1990); MINN. STAT. § 325 G.22 (1990); WIS. STAT. ANN. § 425.209(2) (West 1990). See J. SHELDON & R. SABLE, REPOSSESSIONS 250 (2d ed. 1988). In states where anti-deficiency laws have been enacted, a typical consumer credit transaction does resemble an RTO contract because in both transactions the consumer will owe no money if payments are stopped and the property is returned. Even in these states, however, the transactions are not identical. Whereas failure to pay under a credit contract results in a default, which may be so noted on the consumer's credit history, return of property under an RTO agreement is not a contract breach. In addition, under an RTO contract, the lessor is responsible for repair and maintenance, benefits not received by purchasers of goods on credit unless the defect is covered under warranty or the consumer has purchased a service contract.

was indeed a credit sale under TILA.⁶⁰ None of these courts explored the wisdom of relying on state law doctrines to determine the application of a federal statute and the resulting possibility that the same contract could be subject to TILA in one jurisdiction but not in another.

By 1980 the question whether an RTO contract was covered by TILA was largely unsettled. Those courts which chose not to follow the Board staff opinions created great uncertainty for RTO dealers and opened the door to costly class action suits alleging TILA noncompliance.⁶¹ The divided opinion, however, was not surprising. The statutory language requires that there be a "contract to pay" for the value of the goods and the overall statutory scheme contemplates a consumer entering into some type of "debt" relationship. On the other hand, it could not be seriously disputed that for many consumers an RTO contract was the only means of acquiring consumer durable goods and these consumers considered the transaction a way of purchasing on credit, and not just renting the article. If these individuals were to understand the essential terms and costs of their deferred payment decision, the TILA disclosures might be beneficial.

Amid all the uncertainty, it was undeniably true that the unpredictability of the situation was inadequate for all concerned. Thus, the Board in 1982 promulgated a revised Regulation Z that attempted to settle the issue. The revised (and current) definition of "credit sale" is nearly identical to its predecessor except that it specifically exempts leases that are "terminable without penalty at any time by the consumer."⁶² This should have resolved the debate in favor of the RTO industry because the heart of an RTO contract

⁶⁰ *Johnson v. McNamara*, No. H-78-838, slip op. at 8 (D. Conn. Apr. 13, 1979) (court must "ascertain the intention of the parties by looking at the effect of the terms of the agreement on the parties" (quoting *Alban Tractor Co. v. State Tax Comm'n*, 219 Md. 593, 150 A.2d 456, 459 (1959))).

⁶¹ Since RTO dealers generally use form contracts, a finding that one contract is covered by TILA may mean that all of its contracts violate the statute. Damages in a TILA class action, while limited by statute, can be substantial. *See* 15 U.S.C. § 1640(a)(2)(B) (1991) (damages in class action are subject to court's discretion, but may not exceed the lesser of \$500,000 or one percent of creditor's "net worth").

⁶² Regulation Z, 12 C.F.R. § 226.2(a)(16) (1990), now provides:

Credit sale means a sale in which the seller is a creditor. The term includes a bailment or lease (unless terminable without penalty at any time by the consumer) under which the consumer: (i) Agrees to pay as compensation for use a sum substantially equivalent to, or in excess of, the total value of the property and services involved; and (ii) Will become (or has the option to become), for no additional consideration or for nominal consideration, the owner of the property upon compliance with the agreement.

is its provision for the consumer to return the property at any time without further payment. Several courts have since held that the regulation does indeed end the discussion.⁶³

As is often the case when perceived inequities are involved, however, the issue is still debated. One court has observed that there may in fact be a penalty when a consumer terminates an RTO contract.⁶⁴ By making a substantial early investment in the goods through periodic rental payments, a consumer may be building equity in the goods. The sacrifice of this equity upon termination of the contract could constitute a penalty and thereby render inapplicable the TILA exemption. For example, if there is only one hundred dollars remaining rent to be paid on a television whose depreciated value is one hundred fifty dollars, one could say that the consumer has fifty dollars of equity in the product. A consumer terminating such an agreement, especially where substantial payments have already been made over several months, could be viewed as committing "economic suicide"⁶⁵ and suffering a fifty dollar penalty.

This somewhat strained concept of penalty was rejected in one recent decision. In *In re Hanley*⁶⁶ a bankruptcy court held that the reference to "penalty" in Regulation Z means an "additional sum" imposed on a lessee for the privilege of terminating the lease.⁶⁷ When a consumer terminates an RTO contract, he loses the use of the property without any refund of money already paid, but the dealer charges no additional fee, such as the remaining contract balance or a liquidated damages amount. The loss of lease payments and the possible equity they created, the court concluded, is the normal consequence of terminating any lease and cannot be the type of penalty the Board contemplated. A lease does not impose a termination penalty unless by ending the agreement the lessee becomes liable for some additional amount of money.⁶⁸

⁶³ See *Homeway Rentals v. Martin*, 64 Bankr. 1 (Bankr. S.D. Ga. 1984); *Remco Enterprises, Inc. v. Houston*, 9 Kan. App. 2d 296, 677 P.2d 567 (1984).

⁶⁴ *In re Puckett*, 60 Bankr. 223, 239-40 (Bankr. M.D. Tenn. 1986) ("where the right to terminate involves a forfeiture, the option on paper cannot overcome the substance of the transaction"); see *In re J.A. Thompson & Son, Inc.*, 665 F.2d 941, 946 n.7 (9th Cir. 1982).

⁶⁵ *Puckett*, 60 Bankr. at 240. The notion of forfeiture and economic compulsion to complete the transaction appears frequently in RTO cases and is often cited by RTO critics. See, e.g., E. SARASON, *supra* note 7, at 30.

⁶⁶ 105 Bankr. 458 (Bankr. C.D. Ill. 1989).

⁶⁷ *Id.* at 462.

⁶⁸ *Id.*

Given the controversy over this issue, which led to the Board's clarification, it seems unlikely that the sacrifice of lessee equity upon termination is the type of penalty the Board had in mind. If a broader notion of penalty were accepted, the only lease-purchase agreements that would not be deemed credit sales would be those in which equity is never created, *i.e.*, leases in which the remaining price to be paid for obtaining ownership is at all times equal to or greater than the fair market value of the goods. As a practical matter, such an interpretation would require that, to be exempt from TILA, a terminable lease could not transfer ownership unless the dealer charged a final payment approximating the product's then-fair market value. This view is difficult to justify under the statute because it would render part of the definition of credit sale superfluous. Both the statute and Regulation Z provide that a lease is a credit sale only if the lessee becomes the owner of the leased goods for nominal consideration at the end of the agreement.⁶⁹ An option purchase price approximating fair market value is generally considered to be more than nominal,⁷⁰ and all leases, even long-term obligation leases, containing such options are generally held not to be credit sales.⁷¹ Thus, an RTO contract with a fair market value purchase option would be exempt from TILA in any event, irrespective of its terminability, and TILA's "contracts to pay" clause, as well as the Board's "penalty" language in revised Regulation Z, would add little, if anything, to the definition.

The court in *Hanley* properly dismissed the consumer debtor's interpretation of penalty, but it created an even larger opening for finding that an RTO contract is covered by TILA. The court concluded that satisfying the definition of credit sale is only one way to come under TILA,

⁶⁹ 15 U.S.C. § 1602(g) (1991); 12 C.F.R. § 226.2(a)(16)(ii) (1990).

⁷⁰ See, e.g., *In re Marhoefer*, 674 F.2d 1139, 1144 (7th Cir. 1982); *Percival Constr. Co. v. Miller & Miller Auctioneers*, 532 F.2d 166 (10th Cir. 1977); see also B. CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 1.05[4] (2d ed. 1988). In the 1987 proposed amendments to the Uniform Commercial Code, the drafters provided that "[a]dditional consideration is not nominal if . . . the [option] price is stated to be the fair market value of the goods determined at the time the option is to be performed." U.C.C. § 1-201(37)(x) (1987 Official Text).

⁷¹ See *Agristor Leasing v. Maili*, 634 F. Supp. 1208, 1214-15 (D. Kan. 1987) ("this court is convinced that an option to purchase for fair market value is not nominal"); *In re Bolling*, 13 Bankr. 79 (Bankr. Tenn. 1981) (comparison of fair market value to option price is "best" test for nominality). If the anticipated value of the goods at the end of the lease is negligible, however, a small option payment could still be deemed nominal even if it accurately reflected that negligible value. See U.C.C. § 1-201(37) (1987 Official Text) (lease for economic life of goods is secured transaction).

and that the entire definition of "creditor" must also be addressed.⁷² Although the court held that the terminability feature of the lease renders an RTO contract not a credit sale, an RTO dealer could still be a creditor under TILA, and thereby subject to its disclosure requirements, if it regularly imposed a finance charge on its customers.⁷³ It was therefore relevant to inquire whether the RTO dealer did in fact impose a finance charge. The court denied the dealer's motion to dismiss the TILA claim because the regular imposition of a finance charge might be proved.

If followed by other courts, *Hanley* revives the debate that the 1982 version of Regulation Z was thought to have settled, and in some respects, may create even greater uncertainty on this issue. TILA's definition of finance charge is quite broad and includes "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit."⁷⁴ The *Hanley* court presumed that, if an RTO price is substantially higher than the cash price of the property, a finance charge of some amount is imposed whenever a consumer rents to the point of ownership. To decide whether the dealer was a creditor, the court only needed evidence of how many customers completed their contracts and paid more than the cash price, *i.e.*, whether the dealer regularly imposed the finance charge on consumers.⁷⁵ If this approach is followed, virtually all RTO dealers will be deemed TILA creditors.

Hanley injects unnecessary uncertainty into this issue and suffers from an incomplete reading of the statute and Regulation Z. One cannot be a creditor or impose a finance charge unless one extends credit, which means the "right to defer payment of debt or to incur debt and defer its payment."⁷⁶ "Debt" is not defined in the statute or regulation, but a reasonable interpretation would lead to the conclusion that a terminable RTO lease does not create a debt because the consumer can stop paying at any time.⁷⁷ More importantly, Congress and the Board probably never intended that such an inquiry be made because TILA and Regulation Z expressly

⁷² *In re Hanley*, 105 Bankr. 458, 463 (Bankr. C.D. Ill. 1989).

⁷³ *Id.* at 461. "Creditor" is defined as a person who "regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments" 12 C.F.R. § 226.2(a)(17)(i) (1990).

⁷⁴ 12 C.F.R. § 226.4(a); *see* 15 U.S.C. § 1605(a) (1988).

⁷⁵ *Hanley*, 105 Bankr. at 463.

⁷⁶ 12 C.F.R. § 226.2(a)(14); *see* 15 U.S.C. § 1602(e).

⁷⁷ The concept of debt is closely tied to the usury doctrine, which historically has required an agreement to repay a sum absolutely, *i.e.*, an obligation to repay a borrowed amount. *See* 2 H. ALPERIN & R. CHASE, CONSUMER LAW § 472 (West 1986).

equate certain leases with traditional debt-creating transactions. The definition of "credit sale" accomplishes this by defining which leases will be deemed debt-creating extensions of credit. With this expression on the subject, courts need not look back to the general definition of "creditor" when a transaction is styled as a lease. The definition of credit sale sets forth the conditions under which a lessor extends credit. To say that a lessor can be a creditor without the lease falling within the definition of "credit sale" is to ignore the one definition in the statute that speaks directly to the issue.

B. *The Limited Scope of State Retail Installment Sales Acts*

The RIS act for each state defines which transactions are credit sales within its scope, and not surprisingly, the definitions vary. Many RIS laws derive their definition from the Uniform Conditional Sales Act and thus, like TILA, cover leases only where the lessee "contracts to pay" or "agrees to pay" a sum substantially equal to the value of the goods.⁷⁸ Courts in these states generally have followed Regulation Z and TILA precedent by analogy, and have held that the lack of a lessee's obligation in an RTO contract means that the lease is not a credit sale.⁷⁹

But even in states where the RIS law requires a "contract to pay" for the value of the goods, courts have struggled with the issue. In *Hawkes Television v. Bureau of Consumer Credit Protection*,⁸⁰ a state agency sought reimbursements and other relief from an RTO dealer on behalf of RTO customers who were charged allegedly usurious rates in violation of the Maine RIS act. One RTO contract at issue provided for the payment of \$1,768 for a television having an alleged retail cash price of about \$900, thus levying an effective interest rate of over seventy percent.⁸¹ The evidence

⁷⁸ E.g., ALA. CODE § 5-19-1(4) (1990) (definition of "credit sale"); MICH. COMP. LAWS ANN. § 445.852(g) (West 1990) (definition of "retail installment contract"); NEV. REV. STAT. § 97.105 (1989) (definition of "retail installment contract"); N.J. REV. STAT. § 17:16C-1(b) (1990) (definition of "retail installment contract"); N.M. STAT. ANN. § 56-1-1(H) (1978) (definition of "retail installment contract"); N.Y. PERS. PROP. LAWS § 401(6) (Consol. 1991) (definition of "retail installment contract").

⁷⁹ See *Givens v. Rent-A-Center*, 720 F. Supp. 160, 162 (S.D. Ala. 1988), *aff'd*, 885 F.2d 879 (11th Cir. 1989); *Hawkes Television v. Bureau of Consumer Credit Protection*, 462 A.2d 1167 (Me. 1983); *Williams v. Bill Coleman T.V.*, No. 82-38523-CZ (Mich. Cir. Ct., July 2, 1985); *Tennessee v. Rentavision Corp.*, No. 83-1647-I (Tenn. Chancery Ct., 1983); cf. *Crumley v. Berry*, 298 Ark. 112, 117, 766 S.W.2d 7, 9 (1989) (RTO contract not sale subject to Arkansas usury laws).

⁸⁰ 462 A.2d 1167 (Me. 1983).

⁸¹ *Id.* at 1168.

further showed that the dealer had two adjacent showrooms—one for sales and the other for rentals—but had made less than five outright credit sales per year, and the dealer's advertisements clearly linked the denial of traditional credit to the RTO alternative.⁸² The trial court found that the dealer thus had led customers to believe that RTO was indeed a purchasing alternative for persons who could not obtain ordinary credit.⁸³ Refusing to let the form of the transaction control over its substance, the trial court held that the Maine RIS act applied despite a statutory requirement that the lessee must agree to pay for the value of the goods.⁸⁴ The court cited the RIS definition of "agreement," which included not only the written contract but the bargain of the parties found "by implication from other circumstances."⁸⁵ This allowed the court to distinguish contrary precedent under TILA, which has no parallel language. On appeal, the Supreme Court of Maine reversed, but it sympathized with the RTO customer who "pays dearly for the privilege of renting his television set."⁸⁶ The court conceded that the situation does resemble usury, yet in a notable display of judicial restraint, the court held that the extension of credit under the law requires that the buyer incur a debt, and an RTO transaction creates no debtor-creditor relationship.⁸⁷ To hold otherwise, in the court's view, would do violence to the statutory language.⁸⁸

RTO contracts have also been excluded from coverage under RIS statutes in states with more expansive definitions of credit sales. In *State v. Action T.V. Rentals*,⁸⁹ the Maryland Attorney General sought injunctive relief and \$20,000 in civil penalties against an RTO dealer for violations of the state's RIS law. Like TILA, the Maryland statute covered leases where the lessee contracts to pay for the value of the goods, but it also covered transactions that create purchase money security agreements.⁹⁰ Regarding the "contracts

⁸² *Hawkes Television v. Bureau of Consumer Credit Protection*, No. CV 82-686, slip op. at 2 (Maine Super. Ct., Oct. 19, 1982).

⁸³ *Id.*

⁸⁴ *Id.*, slip op. at 10.

⁸⁵ *Id.*, slip op. at 5.

⁸⁶ *Hawkes Television v. Bureau of Consumer Credit Protection*, 462 A.2d 1167, 1171 (Me. 1985).

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ 297 Md. 531, 467 A.2d 1000 (1983).

⁹⁰ See MD. COM. LAW CODE ANN. § 12-601(l) (1990) (definition of "installment sale agreement").

to pay" part of the definition,⁹¹ the court relied on other aspects of the overall statutory scheme which demonstrated a legislative intent to cover leases only where the lessee is obligated to pay for the goods. The court first observed that several of the required RIS disclosures, such as the "principal balance owed" and the "time balance owed by the buyer to the seller," presumed that a person is obligated to pay off a debt.⁹² The statute also contemplated a creditor's right to sell repossessed goods, the proceeds of which would be applied, after the payment of repossession costs, to the "unpaid balance owing under the agreement at the time the goods are repossessed."⁹³ If there is no resale, then "all obligations of the buyer under the agreement shall be discharged."⁹⁴ Since, in the court's view, these provisions make little sense when the lessee owes nothing upon repossession, the legislature must not have intended to include lease transactions unless the lessee "makes an enforceable promise to pay" for the goods.⁹⁵

Although the court in *Action T.V.* found evidence of legislative intent to support its holding under the "contracts to pay" part of the RIS definition, the court was less convincing in holding that RTO contracts are not "purchase money security agreements," a distinct class of covered transactions under the Maryland law.⁹⁶ In a previous case applying Pennsylvania law, the Maryland Court of Appeals held that a terminable

⁹¹ MD. COM. LAW CODE ANN. § 12-601(l)(2)(iii) (1990) ("installment sale agreement" includes . . . (iii) [a] contract for the bailment or leasing of consumer goods under which the bailee or lessee contracts to pay as compensation a sum that is substantially equal to or is more than the value of the goods").

⁹² 297 Md. at 542, 467 A.2d at 1006; *see* MD. COM. LAW CODE ANN. § 12-606(b)(8), (b)(10) (1990).

⁹³ MD. COM. LAW CODE ANN. § 12-626(e)(2)(iii) (1990).

⁹⁴ MD. COM. LAW CODE ANN. § 12-627 (1990).

⁹⁵ *State v. Action T.V. Rentals*, 297 Md. 531, 549, 467 A.2d 1000, 1010 (1983). The court analogized to the legislature's treatment of layaway plans, which are expressly exempt from the RIS law under Maryland Commercial Law Code §§ 14-1101 to 14-1110. Under Maryland law, if a layaway plan does not obligate the consumer to continue making payments, the consumer is entitled to a full refund (less a nominal service charge) upon cancellation. MD. COM. LAW CODE ANN. § 14-1106 (1990). The court viewed this as reflecting the legislature's intent to exclude "no obligation" agreements from the RIS law. Of course, a significant difference between a layaway plan and an RTO contract is that the RTO customer does not receive a refund upon termination of the agreement. On the other hand, a layaway customer does not receive use of the property until the full purchase price is paid.

⁹⁶ MD. COM. LAW CODE ANN. § 12-601(l)(2)(ii) (1990) ("installment sale agreement includes . . . (ii) [a] purchase money security agreement").

lease similar to an RTO contract did create a security interest.⁹⁷ Since the Pennsylvania and Maryland definitions of security interest were virtually identical,⁹⁸ the court in *Action T.V.* could have brought RTO transactions under the RIS by simply following this precedent. In choosing not to do so, the court reasoned that in the one part of the RIS statute which specifically mentions leases, the definition requires a contract to pay for the value of the goods. Having decided to honor the part of the statute that addresses the issue directly, the court disregarded precedent supporting a contrary result.⁹⁹ The difficulty with the court's reasoning is that the definition of security agreements in another part of the commercial code also deals specifically with leases,¹⁰⁰ so the court really was faced with two comparatively specific, yet conflicting, legislative pronouncements on the issue. Since the issue seemed to have already been decided by the Maryland Court of Appeals, the precedent probably should have either been followed or distinguished more persuasively. The decision creates the anomalous situation of an RTO contract being treated as a security agreement under one state statute but not under nearly identical language of another.¹⁰¹

While RTO dealers in Maine and Maryland were narrowly escaping adverse judicial action, dealers in Wisconsin found greater cause for concern. The Wisconsin RIS act defines consumer credit sales to include leases where the "lessee pays or agrees to pay" for the value of the goods and can become the owner of those goods by paying a nominal consideration at the end of the contract.¹⁰² Under this definition, the terminability feature of an RTO contract does not insulate the agreement from RIS coverage if the lessee in

⁹⁷ *United Rental Equip. Co. v. Potts & Callahan Contracting Co.*, 231 Md. 552, 191 A.2d 570 (Md. 1963). In *United Rental*, the Maryland Court of Appeals held that a commercial equipment lease was a security agreement under Pennsylvania law despite a provision in the lease allowing the lessee to terminate the contract at will.

⁹⁸ Both Maryland and Pennsylvania had adopted the definition of "security interest" set forth in section 1-201(37) of the U.C.C. See *infra* text accompanying notes 176-205.

⁹⁹ 297 Md. at 553-54, 467 A.2d at 1011-12.

¹⁰⁰ U.C.C. § 1-201(37) is quoted *infra* at text accompanying note 178.

¹⁰¹ A similar pattern was followed in Connecticut. A Connecticut Superior Court in *Murphy v. McNamara*, 36 Conn. Supp. 183, 416 A.2d 170 (Conn. Super. Ct. 1979), held that an RTO contract was a disguised sale and security agreement under Connecticut's version of § 1-201(37), and that the agreement was an unconscionable violation of the state's unfair trade practices law. Seven years later another Superior Court judge held that RTO contracts were not retail installment sales under Connecticut's RIS law, even though the statute defined retail installment contract to include any security agreement. *Allen v. Rent-A-Center*, No. 207044 (Conn. Super. Ct. New Haven, Apr. 9, 1986); see CONN. GEN. STAT. § 42-83(3)(e) (1990).

¹⁰² WISC. STAT. § 421.301(9) (1989-90) (definition of "consumer credit sale").

fact pays an amount equal to the original value of the goods over the life of the contract. The Wisconsin Supreme Court so held in *Palacios v. ABC T.V. & Stereo Rental*,¹⁰³ where the lessee actually paid \$1,652 over sixteen months to lease a television/stereo unit with an estimated retail value of only \$800.¹⁰⁴ The court distinguished the TILA line of cases because, unlike TILA, the Wisconsin law expressly covers agreements where the lessee pays for the value of the property even if there was no contractual obligation to do so. This conclusion follows from a straightforward reading of the statute, and seems correct as a matter of statutory construction.¹⁰⁵ *Palacios* created an awkward condition, however, because a terminable RTO lease might not be considered a credit sale at the inception of the contract but would become one at some point down the road if the lessee eventually paid rent exceeding the property's original value. Since by then it would be too late for the dealer to comply with the RIS disclosures,¹⁰⁶ a prudent RTO dealer attempting to comply with the statute would have to assume at the outset that the law (and usury limits) will govern the transaction and disclose the required information. This could have been disastrous for RTO dealers, but the law provided a means of escape. The Wisconsin statute, like TILA, allows a lessor to avoid coverage by providing in the agreement that ownership will transfer to the lessee at the end of the contract only if the lessee pays an additional sum of money deemed to be more than a nominal amount.¹⁰⁷ Thus, by requiring a balloon payment at the end of the contract, RTO dealers in Wisconsin can insulate themselves from the act's coverage. The practical result is that consumers in Wisconsin do not receive the RIS protections and

¹⁰³ 123 Wisc. 2d 79, 365 N.W.2d 882 (1985).

¹⁰⁴ *Id.* at 80, 365 N.W.2d at 884.

¹⁰⁵ While there is no recorded evidence that the Wisconsin legislature sought to create a definition substantially different from TILA's definition of credit sale, the adopted language unmistakably supports the court's conclusion that TILA precedent, as well as state law cases like *Hawkes Television* and *Action T.V.*, is not persuasive in construing the Wisconsin act. *See id.* at 80, 365 N.W.2d at 886.

¹⁰⁶ Under the Wisconsin RIS act, all required disclosures must be made "before the transaction is consummated." WISC. STAT. § 422.302(2) (1989-90); *cf.* 12 C.F.R. § 226.17(b) (1990) (same for TILA disclosures).

¹⁰⁷ WISC. STAT. § 421.301(9) (1989-90) provides that a lease is a credit sale only if the lessee "pays or agrees to pay" for the value of the goods *and* "it is agreed that the . . . lessee will become, or for no other or a nominal consideration has the option to become, the owner of the goods or real property upon full compliance with the terms of the agreement." The latter language parallels TILA, *see* 15 U.S.C. § 1602(g) (1991), and Regulation Z, 12 C.F.R. § 226.2(a)(16) (1990). For definitions of "nominal consideration," *see supra* text accompanying note 71; *see also* N.C. GEN. STAT. § 25A-2(b)(1) (1990) (not nominal if more than 10% of cash price).

must pay an additional amount to purchase the property at the end of the rental term.

The RTO industry has encountered its most effective opposition in Pennsylvania. Before 1982, the Pennsylvania RIS act paralleled TILA and covered only leases in which the lessee contracted to pay for the value of the goods.¹⁰⁸ Following public hearings and widespread media coverage of alleged abuses in the RTO industry, the Pennsylvania legislature amended the RIS law in 1982 to include terminable leases if the lessor has the obligation to transfer ownership to the lessee, after a succession of even optional renewals, for nominal consideration at the end of the agreement.¹⁰⁹ The amendment failed to meet its objective because RTO dealers in Pennsylvania, like those in Wisconsin, simply revised their agreements to transfer ownership only upon the payment of an additional purchase option price after the lessee had made a stated number of optional renewals.¹¹⁰

Following unsuccessful challenges in the courts by consumers who alleged that the purchase option prices being charged by some RTO dealers

¹⁰⁸ 69 PA. CONS. STAT. § 1201(6) (1989) (definition of "retail installment contract" similar to TILA definition of "credit sale").

¹⁰⁹ The 1982 amendment provided that a lease was a retail installment contract if:

the . . . lessee has the option to renew the contract by making the payments specified in the contract, the contract obligates the . . . lessor to transfer ownership of the property to the . . . lessee for no other or a nominal consideration upon full compliance by the . . . lessee with his obligations under the contract, including any obligation incurred with respect to the exercise of an *option by the . . . lessee to renew the contract*, and the payments contracted for by the . . . lessee, including those payments pursuant to the exercise of an option by the . . . lessee to renew the contract, are substantially equivalent to or in excess of the aggregate value of the property and services involved

69 PA. CONS. STAT. § 1201(6) (1989) (emphasis added). The revision obviously was drafted to cover RTO transactions as they existed in Pennsylvania at the time, i.e., a terminable lease that automatically transferred ownership to the lessee for no additional consideration at the end of the lease term.

¹¹⁰ See *Senate RTO Hearing*, *supra* note 2, at 122 (statement of J. Samuel Choate); *Chandler v. Riverview Leasing, Inc.*, No. 1984-CE-2736, (Pa. Com. Pl., May 14, 1986), *vacated*, order dated Nov. 29, 1988. The RTO defendant in *Chandler* transferred ownership to lessees only upon the payment of \$100, 15% of the original value of the goods, or a price equal to the fair market value of the goods at the time the option was exercised. *Id.* at 5, 6 n.2.

were indeed "nominal,"¹¹¹ in 1988 the Pennsylvania legislature again attempted to bring RTO transactions under the RIS law by amending the statute to close the nominal consideration loophole. The amended RIS act covered all consumer leases, even if terminable by the lessee, so long as the lessee eventually could become the owner of the property regardless of how much consideration was paid at the end of the lease.¹¹² The RTO industry successfully challenged the 1988 amendment on grounds that it had been hurriedly passed in violation of procedural rules set forth in the Pennsylvania Constitution,¹¹³ but the amendment passed again in 1989 without procedural improprieties.¹¹⁴ Pennsylvania is thus the only state expressly to include terminable RTO agreements under an RIS statute.¹¹⁵ The practical effect of the law, however, is unclear. Assuming that RTO prices cannot be substantially reduced without incurring losses, RTO dealers who wish to remain operating in Pennsylvania have two choices. They can either offer no ownership option (*i.e.*, the lessee rents indefinitely) and thereby remain unregulated by the RIS, or they can facially comply with the RIS by stating a cash price high enough to permit computation of interest charges within the

¹¹¹ The most notable was *Chandler v. Riverview Leasing, Inc.*, No. 1984-CE-2736 (Pa. Com. Pl., May 14, 1986), in which several consumers sought class action relief on grounds that Riverview's purchase option prices in three different contracts (a \$100 purchase option, a fair market value purchase option, and an option of 15% of the original value) were "nominal," thereby rendering the RTO leases subject to Pennsylvania's RIS act. The plaintiffs obtained summary judgment in their favor, but the decision was later vacated by a successor judge in the case, who ruled that material issues of fact remained to be resolved, particularly whether the option prices approximated the estimated value of the goods at the end of the lease.

¹¹² Act of Feb. 26, 1988, Act No. 1988-15, P.L. No. 78 (*nullified as unconstitutional* by *Pennsylvania Ass'n of Rental Dealers v. Commonwealth*, 123 Pa. Commw. 533, 554 A.2d 998 (1989)).

¹¹³ *Pennsylvania Ass'n of Rental Dealers v. Commonwealth*, 123 Pa. Commw. 533, 554 A.2d 998 (1989) (statute enacted in violation of PA. CONST. art. III, sec. 1, 2 and 4).

¹¹⁴ Installment Sales Act, Act No. 1989-57, P.L. No. 573 (1989).

¹¹⁵ The North Carolina legislature also attempted to bring RTO leases within its RIS law by expressly including renewable, no-obligation leases in the definition of "sale," but the statute excludes all such leases when the purchase option price is at least 10% of the cash price. N.C. GEN. STAT. § 25A-2(b) (1990). The law thus allows RTO dealers to operate outside the RIS act if the contract includes a 10% balloon payment at the end of the lease term.

allowable rate.¹¹⁶ The former course may result in the loss of customers who value ownership options, but the latter exposes the dealer to charges of collecting hidden interest by artificially inflating the disclosed cash price.¹¹⁷ Neither results in low-income consumers receiving lower prices, more accurate disclosures, or any other protections intended by the legislature.

C. The Limited Benefit of TILA and RIS Laws for Low-Income Consumers

The failure of the courts to provide a satisfactory forum for resolving these issues can be viewed, depending on one's perspective, as either a justifiably restrained construction of statutory language or an unfortunate lack of judicial resolve to remedy an injustice. RTO dealers maintain that their leases are fundamentally different from traditional credit transactions. Dissatisfied consumer representatives blame inartful drafting of legislation and clever lawyering for the inability of most judges to expose RTO as nothing more than a thinly disguised credit sale. More is involved, however, than a semantic battle over the correct interpretation of contract language and defined statutory terms. Statutes can be amended to fill loopholes, as was done in Pennsylvania. The important issues are whether traditional consumer credit laws are likely to benefit low-income RTO customers, or whether other regulatory schemes might better perform the task.

TILA and RIS acts provide a consumer with valuable rights and information so that the consumer is better equipped to deal with a more economically powerful and commercially sophisticated seller,¹¹⁸ but the acts serve this function best for a particular type of consumer. Although obviously drafted broadly enough to include consumers of all socio-economic backgrounds, the statutory protections presuppose a consumer who (1)

¹¹⁶ One industry representative has indicated that RTO dealers would likely drop the ownership option rather than comply with the restrictions imposed by an RIS law. *See Senate RTO Hearing, supra* note 2, at 124 (statement of J. Samuel Choate, Jr.). For a description of some practical problems occurring when an RTO agreement is characterized a sale under an RIS law, *see id.* at 128-32 (letter to Sen. Hawkins).

¹¹⁷ For a discussion of the practice of hiding interest by inflating sale prices, *see* K. BROWN & K. KEEST, *supra* note 23, at 124-26.

¹¹⁸ Betty Furness, former Special Assistant for Consumer Affairs to President Johnson, aptly summarized consumerism as: "An effort to put the buyer on an equal footing with the seller Consumers do not want to be manipulated, hornswoggled or lied to. They want truth, not just in lending, labeling and packaging, but in everything in the whole vast, bewildering marketplace." *What Is Consumerism? Context*, No. 1, 1983, *quoted in* L. FELDMAN, *CONSUMER PROTECTION: PROBLEMS AND PROSPECTS* 4 (1976).

desires to buy a commodity that may involve financing, (2) has a choice whether to pay cash or to finance, or at least has a choice among financing alternatives, and (3) is aware of his rights, or is at least capable of becoming aware, and has the ability and motivation to assert those rights when necessary.¹¹⁹

For this type of consumer, the credit laws serve valuable functions. They allow comparative shopping for the most attractive credit terms available. They can influence a consumer's decision whether to enter into a credit transaction at all, or whether to avoid debt by using liquid assets for cash purchases or by deferring consumption and saving for a cash purchase in the future. Armed with this battery of knowledge, the consumer can, in theory, enter the credit marketplace with an improved chance of understanding and accepting satisfactory credit terms. If enough consumers use their knowledge by shopping for the best terms and by insisting that their rights be honored, credit markets will operate efficiently, and overpriced or unscrupulous creditors will either lose money or change their ways. Everyone will benefit.¹²⁰

¹¹⁹ See Curran, *Legislative Controls as a Response to Consumer Credit Problems*, 8 B.C. IND. & COMM. L. REV. 409 (1967); Jordan & Warren, *Disclosure of Finance Charges: A Rationale*, 64 MICH. L. REV. 1285, 1295 (1966); Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 WISC. L. REV. 400, 405, 417 (1973); Comment, *Consumer Legislation and the Poor*, 76 YALE L.J. 745, 748 (1967); *National Consumer Credit Report*, *supra* note 16, at 172.

¹²⁰ See authorities cited in *supra* note 119. Most consumer credit legislation presumes that if consumers are provided with information necessary for making intelligent buying decisions, they will in fact use the information in their decisionmaking process. See Whitford, *supra* note 119, at 423; Barber, *Government and the Consumer*, 64 MICH. L. REV. 1203, 1227 (1966) ("Knowledge is the key to the consumer problem"); *National Consumer Credit Report*, *supra* note 16, at 172. While there is some evidence that credit disclosure legislation is effective in improving consumer awareness of important credit terms, see Whitford, *supra* note 119, at 412, studies have shown that most consumers tend to focus on product, price, and product options, and that credit shopping, at least in the retail sale environment, is seldom pursued. See A. DAY & W. BRANDT, A STUDY OF CONSUMER CREDIT DECISIONS, IMPLICATIONS FOR PRESENT AND PROSPECTIVE LEGISLATION, pt. III at 31-35; pt. V at 7-8 (1972), discussed in Whitford, *supra* note 119, at 417-18; Jordan & Warren, *supra* note 119, at 1299-1304; Kofele-Kale, *The Impact of Truth-in-Lending Disclosures on Consumer Market Behavior: A Critique of the Critics of Truth-in-Lending Law*, 9 OKLA. CITY U.L. REV. 117, 118, 134-37 (1984); Kripke, *Gesture and Reality in Consumer Credit Reform*, 44 N.Y.U. L. REV. 1, 1-13 (1969); Landus & Chandler, *The Truth-in-Lending Act, Variable Rate Mortgages and Balloon Notes*, 1976 AM. BUS. RES. J. 35 nn.63-65. The effects of disclosure can nevertheless be far reaching if an economically significant minority of the market shops for credit because creditors will compete for that market share, thereby reducing credit

The model outlined above does not describe the condition of many low-income consumers. Individuals who have incomes at or near poverty levels, and who may be burdened further with uncertain employment experience, inferior education opportunities, unstable family circumstances, and substandard housing, are seldom serviced by traditional lenders.¹²¹ Commercial banks and personal finance companies exclude these families from their markets. Department stores and suburban discount dealers seldom include these individuals among their regular customers.¹²² The lack of transportation alternatives,¹²³ particularly outside urban areas, and consumers' general unwillingness to enter unfamiliar retailing environments, perhaps out of fear of credit rejection, tend to render lower income consumers captive to local merchants.¹²⁴ They may shop wherever credit is available with affordable down payments, small periodic payment schedules, and long periods in which to repay the debt.¹²⁵ The patronage

costs for all, even those who ignore credit disclosures. See Kofele-Kale, *supra*, at 135 ("efficient market thesis"); Marriman and Schellie, *Truth in Lending Simplification*, 37 BUS. LAW. 1297, 1315 (1981); R. PULLEN, THE IMPACT OF TIL LEGISLATION: THE MASSACHUSETTS EXPERIENCE 5-6 (Res. Rep. No. 43 to Federal Reserve Bank of Boston, Oct. 1968), *cited in* Whitford, *supra* note 119, at 405.

¹²¹ C. BELL, *supra* note 1, at 144-45; NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 156, *citing* U.S. DEPT. OF COMMERCE, CHARACTERISTICS OF THE LOW INCOME POPULATION 1970, CURRENT POPULATION REPORTS, Series P-60 No. 81 (Nov. 1971). For a good discussion of the problems facing low-income consumers, see L. FELDMAN, *supra* note 1 at 200-07. Poor education and a lack of technical knowledge concerning product value and credit terms may contribute to the purchasing problems of the poor. See D. CAPLOVITZ, *supra* note 1, at 14, 189; Note, *Translating Sympathy for Deceived Consumers into Effective Programs for Protection*, 114 PA. L. REV. 395, 448 n.447, 449 n.449 (1966); 110 CONG. REC. 1960 (1964).

¹²² See C. BELL, *supra* note 1, at 145.

¹²³ See L. FELDMAN, *supra* note 1, at 236.

¹²⁴ See *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965) (welfare recipient making credit purchases from same merchant over five years); D. CAPLOVITZ, *supra* note 1, at 20; L. FELDMAN, *supra* note 1, at 230-42; R. KERIN & R. PETERSON, STRATEGIC MARKETING: CASES AND COMMENTS 270 (1978); Kofele-Kale, *supra* note 120, at 143. Many low-income consumers feel that they cannot obtain credit outside their community and thus do not regard an attempt to find alternative credit sources as worthwhile. See Comment, *supra* note 119, at 752-53, 759.

¹²⁵ NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 178. One study showed that while only one-third of higher income buyers considered down payment and monthly payments important factors in making credit decisions, two-thirds of low-income buyers did. These consumers often shop by seeking the lowest monthly payment and the longest maturity term. See *id.*, *citing* A. DAY & W. BRANDT, A STUDY OF CONSUMER CREDIT DECISIONS: IMPLICATIONS FOR PRESENT AND PROSPECTIVE LEGISLATION (1972); see also

of inefficient, high-priced neighborhood stores, including RTO establishments, appears to be the norm and may be the only realistic way in which the poor perceive they can acquire relatively expensive items like furniture, appliances, and other products that can be highly desired possessions regardless of household income.¹²⁶

Consequently, even when shopping at non-RTO retail stores, low-income buyers historically have paid higher prices for furniture and appliances than more affluent consumers shopping elsewhere.¹²⁷ Several studies have shown that retailers in low-income neighborhoods tend to increase cash prices to accommodate open credit arrangements for high risk individuals.¹²⁸ To ensure adequate profit, retailers may also offer lower quality merchandise and pursue default judgments or garnishment remedies with vigor against nonpaying debtors.¹²⁹ Yet in spite of higher prices, evidence suggests that these retailers have not realized higher rates of return on investment than

AUTOBIOGRAPHY OF MALCOM X 192 (1964); White & Munger, *Consumer Sensitivity to Interest Rates: An Empirical Study of New-Car Buyers and Auto Loans*, 69 MICH. L. REV. 1207 (1971); Whitford, *supra* note 119, at 422; Comment, *supra* note 119, at 750 n.28.

¹²⁶ See L. FELDMAN, *supra* note 1. Purchases of appliances and furniture may have a greater impact on low-income buyers than on other households because a higher proportion of their income tends to be devoted to household furnishings. See C. BELL, *supra* note 1, at 143; Comment, *supra* note 119, at 760 (poor are at least as active buyers of appliances as middle income individuals).

¹²⁷ See L. FELDMAN, *supra* note 1, at 16-17, 49-57, 80-93; C. BELL, *supra* note 1, at 145; *Hearings on S. 2755 Before Senate Comm. on Banking and Currency*, 86th Cong. 2d Sess. 101 (1960); Comment, *supra* note 119, at 756-57; ECONOMIC REPORT OF INSTALLMENT CREDIT AND RETAIL SALES PRACTICES OF DISTRICT OF COLUMBIA RETAILERS 48-49 (1968) (hereinafter *FTC Study*) (televisions 50% cheaper outside low income neighborhoods). Even today, the poor still pay more for consumer goods. See *In re Stewart*, 93 Bankr. 878, 880 (Bankr. E.D. Pa. 1988) (cash price of television more than twice estimated value); New York Times, July 28, 1990, § 1, at 46, col. 3 (retail prices in urban area for a particular model of stereo speakers ranged between \$49 and \$299).

¹²⁸ See L. FELDMAN, *supra* note 1, at 203; W. MAGNUSON & J. CARPER, *supra* note 1, at 32-41, 75-76, 118-20 (1960); *FTC Study*, *supra* note 127, at 48-49; *Hearings, Consumer Credit and the Poor, Before the Sen. Comm. on Banking and Currency*, 90th Cong. 2d Sess. 5 (1968); Sterling & Schrag, *Default Judgments Against Consumers: Has the System Failed?*, 67 DEN. U.L. REV. 357, 381 (1990) (cash price of television and bunk beds inflated more than 50%).

¹²⁹ See D. CAPLOVITZ, *supra* note 1, at 19, 160-65, 189; Comment, *supra* note 119, at 757.

their counterparts in more affluent areas.¹³⁰ The cost of doing business in poor communities is high; the reason for which is principally due to greater risks involved, such as theft, late payments, higher default rates, and bad debt losses.¹³¹ As a result, even before the RTO transaction became popular, the poor paid more to satisfy their consumer needs and desires.

Consumers theoretically benefit from TILA and RIS acts in two ways. First, if they are aware of the cost of credit, consumers can shop for the best terms available.¹³² Second, if creditors adhere to the usury limits, consumers are assured of reasonable finance charges above the cash price.¹³³ TILA and RIS acts thus can assist the vast majority of consumers who engage in credit shopping and have opportunities to obtain credit at or below the maximum allowable rate. For the minority who do not have such credit opportunities, the benefits are illusory.¹³⁴ There is little incentive to

¹³⁰ In the most widely cited study on this issue, the FTC found that, despite charging substantially higher prices, retailers in low-income markets had a below-average rate of return on investment. *FTC Study*, *supra* note 127, at 16, 21; *see also* NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 181; L. FELDMAN, *supra* note 1, at 205; Nathan, *Economic Analysis of Usury Laws*, J. BANK. RES. 200, 208 (Winter 1980) (usury rates do not affect creditor profitability).

¹³¹ Kofele-Kale, *supra* note 120, at 142. One study found bad debt ratios among low-income retailers in the District to be 23 times higher than ratios for dealers in more affluent areas. *See* NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 157.

¹³² The "shopping function" is the most often cited rationale for credit term disclosure. *See* Jordan & Warren, *supra* note 119, at 1299-1300; NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 175. There is conflicting evidence, however, on whether disclosure does, in fact, increase awareness of credit alternatives and facilitate credit shopping. *Compare id.* at 175 (a significant marginal group of consumers benefits from disclosure) with Whitford, *supra* note 119, at 418 (disclosures have at best a "modest" effect on credit shopping) (citing Day & Brandt, *supra* note 125, at 31-35, pt. V at 7, 8 & 18).

¹³³ One of the most popular justifications for usury limits is that they guarantee a "fair" rate of interest. *See* NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 95; Nathan, *supra* note 130, at 201. The "fair" rates are available, however, only to debtors who qualify for credit. To the extent that rate limits exclude high-risk individuals from obtaining credit, usury laws can actually hurt the poorer segments of the population. *See id.* at 203; J. CHAPMAN, *THE CONSUMER FINANCE INDUSTRY* 143 (1967); NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 104-05; Shay, *The Impact of State Legal Rate Ceilings Upon the Availability and Price of Consumer Installment Credit*, THE NATIONAL COMM'N ON CONSUMER FINANCE, TECHNICAL STUDIES, Vol. 4, p. 387-418 (Dec. 1972).

¹³⁴ The benefits of credit disclosure regulation almost entirely are received by those who may least need protection—middle and upper income consumers. NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 174-78, 182; Davis, *Protecting*

search for the lowest credit terms if those terms are not likely to be available to a high-risk buyer. These consumers will regard a disclosed interest rate and finance charge as essentially meaningless figures.¹³⁵ If the product is desired and someone is willing to provide it at affordable periodic payments, the transaction will be made.

Notwithstanding that credit information may be of little use to low-income consumers, TILA and RIS disclosure laws arguably should still apply to RTO transactions if the only risk is in disclosing some information that may be irrelevant or ignored. So long as the information is accurate, superfluous disclosure does relatively little harm. In credit transactions with high-risk customers, however, the likelihood of misleading disclosures is substantial because credit costs, in terms of a stated interest rate and finance charge, can be minimized by inflating the cash price. When part of the credit cost is incorporated into the cash price of the goods, the disclosed interest rate and finance charge become arbitrary figures misleading to all consumers, even those who may be interested in credit shopping.¹³⁶ The principal

Consumers from Over Disclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts, 63 VA. L. REV. 841, 842 (1977); Jordan & Warren, *supra* note 119 at 1300, 1303-04; Whitford, *supra* note 119, at 404, 409-11 (citing Federal Reserve Board surveys) and 418; S. REP. NO. 392, Sen. Comm. on Banking and Currency 8-9 (1967). Explanations for the limited impact of disclosure regulation on low-income individuals include (1) the lack of credit alternatives, thereby reducing the incentive for consumers to shop for the best terms, (2) a lack of mobility, which restricts shopping to neighborhood businesses, (3) the practice of "burying" finance charges in cash prices, which reduces the reliability of disclosed information, and (4) substandard education. D. CAPLOVITZ, *supra* note 1 at 12-20; NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 176-78, 180; Kofele-Kale, *supra* note 30, at 132; Whitford, *supra* note 119, at 420-21 and n.81. As a result, many consumers in high-risk markets emphasize shopping for the good rather than the credit terms. NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 182.

¹³⁵ Of course, not all information disclosed to low-income buyers is meaningless. RIS statutes often require disclosure of terms that might be beneficial to all consumers regardless of income (e.g., a description of warranties or rights upon default, or a grace period for late payments). The principal focus of TILA and RIS statutes, however, is on disclosure of the cost of credit transactions. If disclosure of credit costs does not benefit low income consumers, and may indeed mislead them, then useful disclosure regulation for this marginal group should come in another form. See NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 177 (TILA disclosure ineffective for low-income individuals; "rifle shot" approach recommended); McLean, *The Federal Consumer Credit Protection Act*, 24 BUS. LAW. 199, 207 (Nov. 1968).

¹³⁶ See *In re Stewart*, 93 Bankr. 878, 884 (Bankr. E.D. Pa. 1988) (finance charges likely to be buried in installment contract with high-risk individual). One report observed that burying finance charges in the cash price is "definitely encouraged by the

constraint on the arbitrary increase of cash prices is the loss of potential cash customers, which can be a powerful constraint on businesses competing in a market for cash sales. In low-income areas, where cash customers for furniture and appliances are likely to be few, the potential loss in cash sales resulting from increased cash prices will probably be minimal.¹³⁷ For RTO dealers, who rarely even offer items for cash, there is virtually no limit, short of the doctrine of unconscionability,¹³⁸ on the level of stated cash prices. These merchants can offer goods at zero percent interest, bury the entire cost of credit in the cash price, and lose little or no business.¹³⁹

requirement of an annual rate. [Merchants] sell cheap merchandise at a high price with as big a down payment as they can squeeze, and advertise terms of 24-36 months, sometimes with no finance charge. The people buying from them are from the lowest income level . . . [and] cannot buy anywhere else." *National Consumer Credit Report*, *supra* note 16, at 181 (quoting R. PULLEN, THE IMPACT OF TIL LEGISLATION: THE MASSACHUSETTS EXPERIENCE (Res. Rep. No. 43 to Federal Reserve Bank of Boston, Oct. 1968)); *see also id.* at 182; Jordan & Warren, *supra* note 119, at 1301-02; Comment, *supra* note 119, at 762. Burying finance charges in the cash price is unlawful under TILA and RIS laws and may also constitute an unfair and deceptive trade practice. *In re Tashof*, Trade Reg. Rep. (CCH) ¶ 18,606 at 20,941 (1968), *aff'd in part*, 437 F.2d 707 (D.C. Cir. 1970); Whitford, *supra* note 119, at 420-21 n.81. Enforcement is difficult, however, in part because it is not always easy to distinguish the cash price from the finance charge, and also because the practice is widespread in low-income areas. *See* J. CHAPMAN, THE CONSUMER FINANCE INDUSTRY—ITS COST AND REGULATION 145 (1967).

¹³⁷ *See* Jordan & Warren, *supra* note 119, at 1301.

¹³⁸ With the ultimate sale prices of RTO products more than twice the normal retail cash price, one would expect unconscionability analysis to be a fertile ground for attacking the transaction. While some have forecast success in attacking RTO contracts under this theory, *see* Miller, *Consumer Leases Under Uniform Commercial Code Article 2A*, 39 ALA. L. REV. 957, 966 n.48 (1988), the argument has not been well received in the courts. *See* Remco Enters. v. Houston, 9 Kan. App. 2d 296, 677 P.2d 567 (1984) (RTO contract price, twice retail value, held not unconscionable because consumer receives service agreement, option to cancel, and use of property she otherwise might not obtain); *cf.* Murphy v. McNamara, 416 A.2d 170 (Conn. Super. 1979) (RTO contract may be unconscionable). The Federal Reserve Board has taken the position that comparison between retail prices and RTO prices may not be meaningful because the transactions have important differences. *See Senate RTO Hearing*, *supra* note 2, at 47-48 (Statement of Nancy H. Teeters, Governor of FRB). Claims of unconscionability may become more frequent with the passage of Article 2A of the UCC, which allows a court to award damages and attorneys fees when an unconscionability claim succeeds. *See* U.C.C. § 2A-108(4) and *infra* text accompanying notes 255-65.

¹³⁹ Representatives of the RTO industry acknowledge that the level of cash prices has little effect on business because RTO dealers are not in the retail sale business and do not compete with traditional retail sellers. *See* 6 PROGRESSIVE RENTALS 22 (Feb. 1986).

Proponents of applying TILA and RIS laws to RTO transactions maintain that even if the disclosed information is unreliable, an RTO exemption is still unwarranted because, absent some form of regulation, consumers in low-income areas have no way of comparing costs among RTO dealers or between RTO dealers and non-RTO retailers.¹⁴⁰ Application of the same disclosure laws to all vendors would at least place similarly situated businesses on the same playing field. Moreover, with all of the TILA-type restrictions on retail sales applicable to the RTO industry, there would be less incentive to operate under the cover of a leasing plan, and more merchandise might be offered to the public by retailers giving the same required disclosures. While this uniformity might occur, it does not follow that consumer welfare would be enhanced by the change. Removing the RTO transaction from the market will not extinguish the demand of high-risk consumers for RTO-type products, nor will it reduce the cost of doing business with high-risk individuals. High prices will remain for those who desire the product. They will find it available at local retailers who, while ostensibly complying with all credit laws, can make a profit by charging inflated cash prices and disclosing credit terms within allowable limits. Unless local officials strictly enforce the credit laws to expose hidden finance charges, which historically has been a formidable endeavor,¹⁴¹ the form of contract may change and most consumers would still not be better served.¹⁴²

Critics may contend that allowing RTO dealers to charge high prices for their goods, while escaping coverage under traditional consumer credit laws is tantamount to granting an exception to the usury laws for RTO

¹⁴⁰ See E. SARASON, *supra* note 7, at 29.

¹⁴¹ The difficulty of exposing hidden interest charges is demonstrated by the fact that inflating cash prices is so openly practiced. See K. BROWN & K. KEEST, *supra* note 23, at 122-28; Langley, *Cut-Rate Loans on Some Cars Are No Bargain*, Wall St. J., Aug. 20, 1986, at 7, col. 2 (§ 2, at 7). The main problem is proving the "actual" cash price. This is especially problematic in RTO contracts because the price includes a mixture of goods and services. See *supra* text accompanying note 21.

¹⁴² The "shock value" of disclosing high interest rates on cash prices might discourage immediate purchases by some low-income consumers. See NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 173. If, however, RTO transactions have grown in popularity in large part because consumers tend to prefer immediate acquisition to delayed consumption, the overall effect of such disclosures would be minimal. RTO-type contracts will still be made, and consumers will continue to be misinformed. Moreover, even assuming that some consumption would be discouraged by "shocking" disclosures, the view seems indefensible if the shock results from misleading figures. See Jordan & Warren, *supra* note 119, at 1317.

transactions.¹⁴³ The characterization is fair, but the exception may be justified.¹⁴⁴ The principal modern justification for interest rate ceilings is to protect consumers who unwittingly, or under desperate circumstances, agree to pay high finance charges, thereby incurring excessive debts that must be repaid.¹⁴⁵ Overburdened with debt, such individuals are more likely to default on their loans and experience the resulting hardships. Even if they are able to keep up with their payments, these debt-ridden consumers may find it difficult to extricate themselves from their predicament as they devote too much of their incomes to paying off finance charges.¹⁴⁶ For these individuals, the RTO contract may actually offer some relief. In a transaction where the consumer can return the property with no further obligation, the hardships attendant to default are minimized and the consumer can shift

¹⁴³ See K. BROWN & K. KEEST, *supra* note 23, at 129.

¹⁴⁴ Statutory exceptions to usury laws have long been recognized. Small loan statutes, which may authorize interest rates as high as 36%, are the most notable examples. See, e.g., ARIZ. REV. STAT. § 6-622 (1990) (up to 3% per month); CAL. FIN. CODE § 22451 (Deering 1991) (up to 2½% per month); IOWA CODE § 536.13 (1989) (up to 36% per year); N.C. GEN. STAT. § 53-173 (1990) (same). The exceptions become necessary when economic realities demonstrate a need to provide legal sources of credit to those who cannot obtain credit at the legal rate. See NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 158, 160. Common law usury exceptions were also recognized. For many years courts held that sellers could avoid usury limits by offering goods for sale at two prices—a credit price and a cash price. The difference, often referred to as the time-price differential, was not considered “interest” because the buyer was not deemed to be a borrower of money. The emergence of this “time-price doctrine” led to the enactment of RIS laws that cap installment credit rates, but usually at levels exceeding the general usury limit. See Jordan & Warren, *supra* note 119, at 1289. For an early history of small loan regulation, see J. CHAPMAN, *supra* note 136, at 12–13.

¹⁴⁵ See *In re Russell*, 72 Bankr. 855, 867–68 (Bankr. E.D. Pa. 1987); NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 95, 99–100, 174; Nathan, *supra* note 130, at 200–01. Scholars have debated whether usury laws serve any useful function in an era when competition in credit markets is commonplace. Several studies have shown that usury limits serve only to exclude high-risk individuals from obtaining credit from legal sources. See *id.* at 99, 1031; J. CHAPMAN, *supra* note 136, at 143; FTC Study, *supra* note 127, at 387–418; Nathan, *supra* note 130, at 203 (citing several studies); cf. K. BROWN & K. KEEST, *supra* note 23, at 36–38 (questioning whether rate ceilings actually limit credit availability).

¹⁴⁶ See Campen & Lazonick, *Regulation of Small Loan Interest Rates*, 1 N.E. J. BUS. & ECON. 30, 42–43 (1980) (“Consumer can remain indebted year after year . . . thus hampering him from meeting the basic necessities for himself and his family.”).

income to more pressing obligations with greater economic freedom.¹⁴⁷ This does not mean that RTO transactions are bargains, or that they should not be regulated in some manner, but if the goal is to ease the hardship on low-income consumers, the better approach may be to accept higher prices as an unavoidable consequence of unfortunate economic circumstances,¹⁴⁸ and require meaningful disclosure and limitations on the truly misleading aspects of the RTO transaction.¹⁴⁹ As the discussion in Part IV of this article suggests, TILA and RIS acts would not accomplish this as effectively as legislation targeted at the particular problems of the low-income consumer.¹⁵⁰

¹⁴⁷ RTO critics maintain that RTO customers are often reluctant to stop paying on their contracts after they have paid substantial sums because the "equity" created in the goods will be lost. This, in effect, leads RTO consumers to treat the contract as if it created an obligation, thereby putting the same strain on family budgets as would an outright credit sale. Even if this perception is accurate, however, the appropriate solution is not to treat RTO contracts like credit sales (which would not relieve the strain), but to enact laws that allow the consumer to stop paying on the contract temporarily when money is tight and reinstate the agreement at a later time. RTO laws enacted to date provide for such reinstatement rights, *see infra* text accompanying notes 340-42, whereas RIS acts and TILA do not.

¹⁴⁸ Developments over the past few decades demonstrate that when legislatures ignore market realities, entrepreneurs find and exploit loopholes in the law. Legislatures attempt to close the loopholes, but the market usually stays a step or two ahead. This cyclical adjustment can be wasteful and seldom fulfills the governmental objective. *See* Nathan, *supra* note 130, at 201. The experience of the Pennsylvania legislature's attempt to regulate RTO contracts, *see supra* notes 108-14 and accompanying text, exemplifies the frustration, and ultimate futility, of ignoring economic conditions. Full access to traditional credit markets by the poor will effectively arise only by improving their incomes, lowering the credit risk, and educating them to exercise their rights. *See* C. BELL, *supra* note 1, at 146; NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 160, 179. Until the causes of poverty are addressed, the symptoms of poverty (such as the RTO industry in one form or another) will persist.

¹⁴⁹ It has been suggested that the problems of low-income consumers are best addressed by "rifle shot" legislation aimed at particular abuses rather than the "shotgun" of general TILA-like regulations which are directed at the average consumer. *See* NATIONAL CONSUMER CREDIT REPORT, *supra* note 16, at 101, 102, 177; Jordan & Warren, *supra* note 119, at 1321-22 (most fruitful approach to the credit problems of the poor is to take away some of the creditor's weapons, such as repossession without process, garnishment, deficiency judgments, and collection abuses); McLean, *supra* note 135, at 207.

¹⁵⁰ *See infra* discussion in Part IV.

III. COVERAGE OF RTO TRANSACTIONS UNDER ARTICLES 9 AND 2A OF THE UCC

The UCC was drafted during a time when consumer law was just beginning to develop. Even in 1966, when most states had adopted versions of the UCC,¹⁵¹ Congress was still debating the first major effort to expand consumer protection at the federal level through its enactment of TILA.¹⁵² The rules set forth in the UCC were largely fashioned for commercial transactions, and it is therefore not surprising that the UCC expressly recognizes little consumer law.¹⁵³ This is particularly true with respect to leases of consumer goods, the popularity of which accelerated after 1970.¹⁵⁴

Despite its focus on commercial transactions, the UCC offers some protection to consumers. Recognized examples of consumer law include the unconscionability provisions,¹⁵⁵ the limitations on disclaiming implied warranties,¹⁵⁶ the abrogation of privity requirements when a family member or house guest is injured,¹⁵⁷ and the limitation on disclaiming liability for consequential damages.¹⁵⁸ In addition, and most relevant for RTO

¹⁵¹ See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REPORT NO. 3 (Dec. 15, 1966), 1 U.L.A. p. XXXIII (1976) (all but three states had enacted the UCC by 1966).

¹⁵² See Pub. L. No. 90-321, 82 Stat. 146 (1968).

¹⁵³ See Miller, *supra* note 138, at 959.

¹⁵⁴ The popularity of consumer leases eventually led to the enactment of the federal Consumer Leasing Act in 1977. 15 U.S.C. §§ 1667-1667(e) (1990).

¹⁵⁵ U.C.C. § 2-302. Although not expressly limited to consumer transactions, most courts effectively limit the application of § 2-302 to consumer sales. See J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 4-2 (3d ed. 1988); cf. *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 186 Cal. Rptr. 114 (1982) (§ 2-302 applies to commercial transactions).

¹⁵⁶ U.C.C. § 2-316. This provision protects commercial as well as consumer purchasers of goods, although it was designed principally with the unsophisticated consumer in mind. See Miller, *supra* note 138, at 960 n.22.

¹⁵⁷ U.C.C. § 2-318 (alternative A). Section 2-318 addresses the issue of "horizontal privity," and expands the universe of individuals who can sue a seller for breach of warranty. The section does not address the doctrine of "vertical privity," which may preclude a warranty action against anyone other than the actual seller of the product (*i.e.*, the retailer but not the manufacturer). See Greenberg, *Vertical Privity and Damages for Breach of Implied Warranty Under the U.C.C.: It's Time for Indiana to Abandon the Citadel*, 21 IND. L. REV. 23 (1988).

¹⁵⁸ U.C.C. § 2-719(3) (declaring any limitation of consequential damages for personal injuries *prima facie* unconscionable when goods are consumer goods).

consumers, the provisions of Article 9 relating to repossessions of secured collateral and the recently promulgated Article 2A governing leases include some consumer protections that could benefit RTO customers.¹⁵⁹

A. Lease vs. Security Interest: An Open Issue

Perhaps the most often litigated RTO issue is whether the RTO contract should be characterized as a true lease or as a security agreement. The distinction has important ramifications for the consumer and lessor because, upon termination of the contract, the rights of a consumer in goods deemed subject to a security interest will be governed by Article 9 and generally are greater than those of a lessee.¹⁶⁰ The issue typically is raised when an RTO dealer has repossessed the leased goods for failure of the lessee to make rental payments or when the lessee files a bankruptcy petition and the RTO dealer seeks to reclaim the goods from the bankruptcy estate.

The repossession practices of RTO firms have long been the subject of consumer complaints. Judicial decisions reveal allegations of forced entry into customer residences,¹⁶¹ harassing communications with consumers whose payments are late,¹⁶² deceptive collection efforts, and other conduct ranging from the unfair to the criminal.¹⁶³ Consumer advocates also complain of dissatisfied consumers who have defaulted and returned goods after having paid substantial sums under RTO agreements, only to discover that their periodic payments have created no equity in the repossessed goods and that they have no statutory or contractual right to cure default or reinstate the agreement.¹⁶⁴

Breaches of the peace and unfair or deceptive collection efforts of RTO dealers are prohibited under local law in every jurisdiction, whether or not

¹⁵⁹ The applicability of Articles 9 and 2A to RTO contracts is discussed *infra* at text accompanying notes 160–221 and 222–72, respectively.

¹⁶⁰ See discussion *infra* at text accompanying notes 166–75; B. CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 1.05[8] (2d ed. 1988).

¹⁶¹ See *Kimble v. Universal TV Rental*, 65 Ohio Misc. 17, 417 N.E.2d 597 (1980) (RTO dealer entered home by “turning lock” when customer was not home).

¹⁶² See *State v. Action TV Rentals*, 297 Md. 531, 534, 467 A.2d 1000, 1003 (1983) (pressures exerted on RTO customers range from “stupid to outrageous to criminal”).

¹⁶³ See *Taylor v. Action Household Rentals*, 351 So. 2d 865 (La. Ct. App. 1977) (threats and kicking down door to repossess leased refrigerator); *Fassitt v. United TV Rentals*, 297 So. 2d 283, 287 (La. Ct. App. 1974) (contract provision authorizing home entry held unenforceable as against public policy).

¹⁶⁴ See *J. Sheldon*, *supra* note 3, at 220–22.

the lease is characterized as a security interest.¹⁶⁵ Characterization becomes important, however, when the consumer or his creditors wish to claim a continuing interest in the goods after they have been repossessed. If the agreement is deemed to have created a security interest, the state's version of Article 9 will impose several restraints on the repossessing firm that do not apply to lessors. For instance, after a dealer lawfully repossesses, the consumer has a right under section 9-506 to cure the default by tendering the amount secured by the obligation.¹⁶⁶ If default is not cured and the dealer decides to retain the collateral (instead of selling it or re-renting it to another customer), section 9-505 requires the dealer to give written notice of the proposed retention to the consumer, and if the consumer does not object, the dealer may keep the collateral in full satisfaction of the debt and the consumer would not owe any additional amount.¹⁶⁷ Retention is not permitted, however, where the consumer has paid 60% of the original purchase price; the dealer must then sell or lease the goods within ninety days unless the consumer signs a waiver of this right.¹⁶⁸ Most importantly, under section 9-504 if the dealer sells or leases the repossessed property, it must notify the consumer before the disposition and account to the consumer

¹⁶⁵ Section 9-503 of the UCC authorizes self-help repossession of secured collateral only if the act can be accomplished without "breach of the peace." For all types of consumer agreements, even those not deemed to create a security interest, breaches of the peace and unfair collection efforts are often prohibited in a state's unfair trade practices statute. See generally J. SHELDON & R. SABLE, REPOSSESSIONS § 2.4.3.1 (National Consumer Law Center, 2d ed. 1988).

¹⁶⁶ This "right of redemption" requires the debtor to tender the full obligation secured by the collateral (*i.e.*, the entire unpaid balance of the debt) plus the reasonable expenses incurred by the creditor repossessing the collateral and, perhaps, the creditor's attorneys' fees. U.C.C. § 9-506. The limited value of these Article 9 rights to RTO consumers is discussed *infra* at text accompanying notes 214-21.

¹⁶⁷ U.C.C. § 9-505(2). The process of "strict foreclosure" is particularly attractive to the creditor when the value of the collateral exceeds the amount of the debt, or where the likelihood of collecting a deficiency from the debtor is slight and the inconvenience of disposing of the collateral under the § 9-504 procedures is substantial. The rule recognizes the possibility that the parties often are better off without a forced resale of the collateral. See U.C.C. § 9-505, Official Comment 1.

¹⁶⁸ U.C.C. § 9-505(1). The effect of this provision is that a consumer debtor's silence will not be deemed a waiver of his right to insist that the creditor dispose of the collateral pursuant to § 9-504. Only an affirmative, written waiver following repossession will permit a creditor to retain the goods in full satisfaction of the debt where a consumer has paid at least 60% of the cash price.

for any surplus realized from the sale or lease above the amount owed.¹⁶⁹ Because the percentage of RTO contracts that result in repossessions is relatively high,¹⁷⁰ the notice and accounting requirements of Article 9 would impose a substantial administrative burden on RTO operations. Noncompliance would subject the dealer to a statutory damages formula which, particularly in a class action alleging a pattern of noncompliance, could be substantial.¹⁷¹

In a bankruptcy proceeding the consequences of characterizing an RTO transaction as a security interest are not as potentially harmful to an RTO dealer but are important nonetheless. The automatic stay provision in section 362 of the Bankruptcy Code protects the property from immediate repossession regardless of the characterization,¹⁷² but the dealer's chances of ultimately recovering the property are enhanced if the transaction is deemed a true lease.¹⁷³ The debtor may retain possession of leased goods only if the trustee "accepts" the lease, cures default (by paying any past due rent), assures future payments under the agreement and, in general, compensates the lessor for any pecuniary loss.¹⁷⁴ Because this means that the debtor must essentially affirm the contract, RTO consumers will usually not agree to the conditions and will "reject" the lease, thereby allowing the lessor to repossess. If the transaction is deemed a security agreement, the debtor or trustee may attack the validity of the security interest (e.g., claim

¹⁶⁹ Before returning any surplus to the debtor, the secured party is allowed to deduct its reasonable expenses of repossessing and selling the goods, as well as legal expenses unless prohibited by law. See U.C.C. § 9-504(1)(a). The likelihood of any surplus reaching the consumer following a resale of relatively low-priced used merchandise is therefore remote. See discussion *infra* at text accompanying notes 214-16.

¹⁷⁰ Experience shows that at least 80% of all RTO agreements end in a consumer's default. See *Progressive Rentals*, Dec. 1988-Jan. 1989, at 34; St. Paul Pioneer Press Dispatch, Nov. 21, 1989, at 1B; cf. Ramp, *supra* note 2, at 798 ("keep-rate" of 20% is misleading figure because eventually all RTO merchandise is re-rented until sold; acknowledges, however, that most RTO customers suffer at least one repossession).

¹⁷¹ See U.C.C. § 9-507 (consumer debtor's damages for creditor's failure to comply with Article 9 are the greater of (1) actual damages or (2) the total finance charge contemplated by the contract plus 10% of the cash price).

¹⁷² 11 U.S.C. § 362(3) prohibits "any act to obtain possession of property of the estate" See B. CLARK, *supra* note 160 at ¶ 1.05[8], and 6.08.

¹⁷³ See *id.* at ¶ 1.05[8].

¹⁷⁴ 11 U.S.C. § 365; see *In re Mitchell*, 108 Bankr. 166 (S.D. Ohio 1989); *In re Loop Hosp. Partnership*, 35 Bankr. 929 (N.D. Ill., 1983). In Chapter 7 bankruptcies, the decision to "accept" or "reject" the lease must be made within 60 days under § 365(d)(1). See A. COHEN & M. MILLER, CONSUMER BANKRUPTCY MANUAL ¶ 3.08[4], [5] (1985).

that it is unperfected), pay the creditor only the "value" of the used goods, which will usually be much less than the anticipated rent, or adversely modify the rights of the secured party in other ways.¹⁷⁵

Regardless of whether the issue arises in an action for damages for noncompliance with Article 9 or in a bankruptcy proceeding, characterization of the agreement depends upon the definition of security interest in the state's version of section 1-201(37) of the UCC.¹⁷⁶ In the vast majority of states that have not yet adopted the 1987 amendments to the UCC approved by the National Conference of Commissioners on Uniform State Laws,¹⁷⁷ a "security interest" is defined as:

an interest in personal property or fixtures which *secures payment or performance of an obligation* Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the

¹⁷⁵ See 11 U.S.C. §§ 722, 1322(b)(2), 1325(a)(5); A. COHEN & M. MILLER, *supra* note 174, at ¶ 12.04[2], 12.05[1]. The trustee must provide adequate assurance to the secured creditor that the value of the collateral will not be impaired during the bankruptcy. See 11 U.S.C. § 363 (authorizing relief from the stay if "adequate protection" is not afforded); B. CLARK, *supra* note 160, at ¶ 1.05[6]; *In re Huffman*, 63 Bankr. 737 (N.D. Ga. 1986). In many instances, classification of an RTO contract as a security interest instead of a lease would not significantly impair the dealer's status in a bankruptcy proceeding. The transaction would probably be deemed a "purchase money security interest" under § 9-107 of the UCC and therefore would be automatically perfected under § 9-302(1)(d). The dealer could petition for possession of the goods under Bankruptcy Code § 363(d), but must establish that the debtor has no equity in the goods and the property is not necessary to a reorganization. In a Chapter 7 liquidation, the secured RTO dealer thus may obtain possession of the property regardless of the classification. In a Chapter 13 reorganization, the property might not be as easily repossessed. See A. COHEN & M. MILLER, *supra* note 174, at ¶ 12.05[1].

¹⁷⁶ The Bankruptcy Code defines "security interest" as a "lien created by an agreement." 11 U.S.C. § 101(51). "Lien" is defined as a "charge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(37). The legislative history reveals that Congress intended for state law to control the issue whether a transaction was a lease or security interest. See S. REP. NO. 989, 95th Cong., 2d Sess. 26, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5812-13; H.R. REP. NO. 585, 95th Cong., 2d Sess. 314, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6271.

¹⁷⁷ The 1987 Official Text of the Uniform Commercial Code revised the definition of "security interest" substantially. As of January 1, 1991, eight states had adopted the revision. (California, Florida, Louisiana, Oklahoma, Oregon, South Dakota, and Texas). See U.C.C. Rep. Serv. (Callaghan), State Correlation Tables (March 1991 Variations and Options sections). See also *infra* text accompanying note 206.

lease the lessee shall become or *has the option to become the owner of the property for no additional consideration or for a nominal consideration* does make the lease one intended for security.¹⁷⁸

Much has been written by judges and commentators interpreting this definition.¹⁷⁹ At least sixteen different factors, in various combinations depending on the factual circumstances under scrutiny, have been cited as relevant to the inquiry.¹⁸⁰ A common theme is that the intent of the parties governs, but the intent should be gleaned circumstantially from the contents of the written contract and the factual setting of the transaction.¹⁸¹ Citing

¹⁷⁸ U.C.C. § 1-201(37) (1978) (emphasis added).

¹⁷⁹ The distinction between leases and security interests is one of the most often litigated issues under the U.C.C. See J. WHITE & R. SUMMERS, *supra* note 155, at § 23-3. For a thoughtful analysis of the distinction, see Ayer, *On the Vacuity of the Sale/Lease Distinction*, 68 IOWA L. REV. 667 (1983); Jones, *Lease or Secured Transaction - The Saga Continues Under the Bankruptcy Act*, 1985 COM. L.J. 281 (June/July); see also *In re Puckett*, 60 Bankr. 223, 234 n. 26 (M.D. Tenn. 1986) (listing several judicial decisions discussing lease/security interest issue).

¹⁸⁰ One bankruptcy court listed these factors as follows:

(1) whether there was an option to purchase for a nominal sum, (2) whether there was a provision in the lease granting the lessee an equity or property interest in the equipment, (3) whether the nature of the lessor's business was to act as a financing agency, (4) whether the lessee paid a sales tax incident to acquisition of the equipment, (5) whether the lessee paid all other taxes incident to ownership of the equipment, (6) whether the lessee was responsible for comprehensive insurance on the equipment, (7) whether the lessee was required to pay any and all license fees for operation of the equipment, and to maintain the equipment at his expense, (8) whether the agreement placed the entire risk of loss upon the lessee, (9) whether the agreement included a clause permitting the lessor to accelerate the payment of rent upon default of the lessee and granted remedies similar to those of a mortgagee, (10) whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lessee, (11) whether the lessee was required to pay a substantial security deposit in order to obtain the equipment, (12) whether the agreement required the lessee to join the lessor, or permit the lessor by himself, to execute a UCC financing statement, (13) whether there was a default provision in the lease inordinately favorable to the lessor, (14) whether there was a provision in the lease for liquidated damages, (15) whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor, (16) whether the aggregate rentals approximate the value or purchase price of the equipment.

In re Brookside Drug Store, 3 Bankr. 120, 122-23 (Bankr. D. Conn. 1980).

¹⁸¹ See *Sight & Sound of Ohio v. Wright*, 36 Bankr. 885, 889-90 (Bankr. S.D. Ohio 1983); *Yankee Leasing Co. v. Mountain Carpet, Inc.*, 11 Bankr. 729, 731 (Bankr. D. Vt. 1979); *In re Witkowski*, 38 Bankr. 352, 353 (N.D. 1984); *In re Alpha Creamery*

clause (b) near the end of the definition, however, many courts have given determinative weight to a single factor and have held that where a lease grants the lessee an option to become the owner of the property for no additional or nominal consideration at the end of the lease, the transaction is not a true lease but should be treated as a disguised sale with the retention of a security interest.¹⁸² The reasoning is straightforward: where the lessee automatically becomes the absolute owner of the property at the end of the lease, periodic lease payments are indistinguishable from payments under an installment sales contract, and the lessee has in fact been purchasing the goods over the contract term. Several courts have pointed to this feature in RTO contracts as the determinative factor in holding that RTO agreements create security interests.¹⁸³

Other courts have disagreed. Relying on the first sentence of section 1-201(37), which provides that a security interest "secures payment or performance of an obligation," several courts have held that, despite the possible transfer of ownership for no additional consideration at the end of the lease, an RTO contract does not create a security interest because the

Co., 4 U.C.C. Rep. Serv. (Callaghan) 794, 797 (Bankr. W.D. Mich. 1967).

¹⁸² See, e.g., *Sight & Sound of Ohio*, 36 Bankr. at 890 (broad inquiry "cut short" where lease transfers ownership for nominal consideration); *In re J.A. Thompson & Son*, 665 F.2d 941, 947 (9th Cir. 1982); *In re National Welding of Mich.*, 17 Bankr. 624, 625-26 (Bankr. W.D. Mich. 1982). This view is supported by the last clause of the definition, which declares that a nominal consideration provision "does make the lease one intended for security." *Id.* at 626.

¹⁸³ See *Sight & Sound of Ohio*, 36 Bankr. at 885; *In re Aguilar*, 101 Bankr. 481 (Bankr. W.D. Tex. 1989); *In re Bailey*, 103 Bankr. 886 (Bankr. S.D. Ohio 1988); *In re Rose*, 94 Bankr. 103 (Bankr. S.D. Ohio 1988); *In re Fogelsong*, 88 Bankr. 194 (Bankr. C.D. Ill. 1988); *In re Brown*, 82 Bankr. 68 (Bankr. W.D. Ark. 1987); *In re Elliott*, 18 Bankr. 602 (Bankr. D. Neb. 1982); *Murphy v. McNamara*, 36 Conn. Supp. 183, 416 A.2d 170 (Conn. Super. Ct. 1979); *In re Graham*, No. CV 86-H-1055-W (Bankr. N.D. Ala., Sept. 11, 1986); *In re Holder*, No. B78-00527C (Bankr. N.D. Ohio 1979); *Tackett v. Mid-Continent Refrig. Co.*, 579 S.W.2d 545 (Tex. Civ. App. 1979). Other courts have held leases to be security agreements under facts similar to the typical consumer RTO lease. See *In re Puckett*, 60 Bankr. 223 (M.D. Tenn. 1986) (terminable lease drafted by finance company requiring large non-refundable deposit and transferring ownership for no consideration); *United Rental Equip. Co. v. Potts & Callahan Contracting Co.*, 231 Md. 552, 191 A.2d 570 (1963) (terminable commercial equipment lease); *In re Royer's Bakery*, 1 U.C.C. Rep. Serv. (Callaghan) 342 (E.D. Pa. 1963) (same).

consumer undertakes no obligation to repay a debt.¹⁸⁴ The lessor does retain an interest in the property, but that interest does not secure an "obligation" of the lessee.¹⁸⁵ The RTO cases in this line followed the reasoning of the Seventh Circuit's often-cited decision in *In re Marhoefer Packing Co.*,¹⁸⁶ which did not involve an RTO lease but a commercial lease of equipment. The lease provided for monthly payments of \$665.00 over a term of four years. At the end of four years, Marhoefer had the option of returning the equipment, purchasing it for \$9,968.00 or renewing the lease for another four years, at which time Marhoefer could purchase the equipment for one dollar. Marhoefer never exercised any of the options because approximately one year after delivery, it ceased all payments under the lease and filed a voluntary petition in bankruptcy. A dispute between the trustee and the lessor over possession of the equipment ensued. Claiming that the lease was intended as security and that the lessor had failed to perfect the security interest, the trustee sought permission to sell the equipment free of

¹⁸⁴ See *In re Glenn*, 102 Bankr. 153 (Bankr. E.D. Ark. 1989); *In re Unger*, 95 Bankr. 761 (Bankr. D. Or. 1989); *In re Armstrong*, 84 Bankr. 84 (Bankr. W.D. Tex. 1988); *In re Martin*, 64 Bankr. 1 (Bankr. S.D. Ga. 1984); *In re Huffman*, 63 Bankr. 737 (Bankr. N.D. Ga. 1986); *In re Shangri-La Nursing Center*, 31 Bankr. 367 (Bankr. E.D. N.Y. 1983) (dictum); *In re Pledger Roy Wood*, 7 Bankr. 543 (Bankr. N.D. Ga. 1980); *In re Parker*, No. 89-40167-13 (Bankr. D. Kan. 1989); *In re Howard*, No. 87-00240 (Bankr. M.D. Ala. 1987) (dictum); *In re Jones*, No. A86-04145-WHD (Bankr. N.D. Ga. 1986); *In re Ramage*, No. 86-50956 (Bankr. M.D. Ga., Dec. 4, 1986); *In re Jackson*, No. 85-51674 (Bankr. M.D. Ga., June 17, 1986); *In re Brown*, No. 585-1016 (Bankr. N.D. Ohio, Dec. 20, 1985); *In re Martin*, No. 183-00568 (Bankr. S.D. Ga., Mar. 15, 1984); *Valas Stores, Inc. v. Hicks*, No. 83-G-0081 (Bankr. D. Colo., July 11, 1983); *In re Turner*, No. 3-78-1135(D) (Bankr. D. Minn., Mar. 19, 1979); *Crumley v. Berry*, 298 Ark. 112, 766 S.W.2d 7 (1989); *Elcan Investments v. Kirk*, 187 Ga. App. 676, 371 S.E.2d 146 (1988); *State v. Action TV Rentals*, 297 Md. 531, 467 A.2d 1000 (1983); *Allen v. Rent-A-Center*, No. 207044 (Sup. Ct. Conn., Apr. 9, 1986).

¹⁸⁵ A leading commentator on the UCC stated this view perhaps most strongly:

[T]he pre-Code authorities are decidedly correct when they state that if the facts of a transaction include the presence of the usual right of a consignee to return consigned goods, or if a lease contains an option in the lessee to terminate, then there is no obligation to pay an amount substantially equal to the purchase price and thus no conditional sale under pre-Code law as well as no security interest under the UCC.

Coogan, *Leases of Equipment and Some Other Unconventional Security Devices: An Analysis of UCC Section 1-201(37) and Article 9*, 1973 DUKE L.J. 909, 916; see also Note, *Crumley v. Barry: Conditional Sale Contracts, True Leases, and the Lessee's Right to Terminate*, 43 ARK. L. REV. 899 (1990).

¹⁸⁶ 674 F.2d 1139 (7th Cir. 1982).

all liens. The lessor alleged that the agreement was a true lease, Marhoefer was in default, and if the lease was not accepted, its equipment should be returned. The district court held that the one dollar purchase option created a conclusive presumption under clause (b) of section 1-201(37) that the lease was intended as security.¹⁸⁷ The court of appeals disagreed, reasoning that the presumption in clause (b) applies only where the lessee is contractually bound to pay rent over a set period at the conclusion of which he automatically becomes the owner of the goods. Only then is the transaction in substance an installment sale. Because Marhoefer could terminate the lease after four years and was under no obligation to continue renting until the time when the one dollar ownership option would arise, the district court's reliance on clause (b) was erroneous.¹⁸⁸

Marhoefer was the first appellate decision to support the position of the RTO industry that its contracts did not create security interests, and its authority stemmed the tide of decisions ruling otherwise. Courts applying *Marhoefer* to RTO contracts thus reduced the test for defining "security interest" to an analysis similar to that for defining "credit sale" under TILA: the lessee must be obligated to pay an amount equivalent to the value of the goods, and the lessee must have an option to become the owner for nominal additional consideration at the end of the lease.¹⁸⁹ Since the first inquiry is not satisfied, the courts held for the RTO dealer.

The rule of *Marhoefer* finds support among commentators on Article 9. Grant Gilmore, a principal draftsman of Article 9, regarded the first sentence of section 1-201(37) as the "basic definition" of security interest and the remainder, including the reference to nominal consideration, as refinement of the basic concept.¹⁹⁰ For Gilmore, a lease that gives the lessee the "right to terminate the lease at any time during the term should no doubt lead to the conclusion that the lease was a true lease."¹⁹¹ Decisions under state laws

¹⁸⁷ *Id.* at 1141.

¹⁸⁸ *Id.* at 1143.

¹⁸⁹ See, e.g., *In re Huffman*, 63 Bankr. 737, 738 (Bankr. N.D. Ga. 1986) (no security interest unless (1) agreement to pay a set amount, (2) the amount must be equivalent to the original value of the goods and (3) ownership must transfer for nominal consideration at the end of the lease) (citing *In re Pledger Roy Wood*, 7 Bankr. 543, 545 (Bankr. N.D. Ga. 1980)).

¹⁹⁰ G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, vol. 1, p. 334 (1965) ("It is clear that there must be some sort of 'obligation' which underlies or supports the interest; this will normally be a money debt but could conceivably be something else . . .") see also Cöogan, *supra* note 185.

¹⁹¹ G. GILMORE, *supra* note 190, at 339.

preceding Article 9 and on which the principles of Article 9 were based apparently concurred.¹⁹²

The issue is far from settled, however. Perhaps because section 1-201(37) provides that the lease/security interest question "depends on the facts of each case," courts have been reluctant to allow any single factor to be determinative. Eschewing both the conclusive presumption of clause (b) and the determinative effect of a "no obligation" contract, some post-*Marhoefer* courts have looked to other circumstances of the transaction to decide whether an RTO contract creates a security interest. Several courts, for instance, have attempted to determine whether "equity" is created in an RTO contract.¹⁹³ Since the creation of buyer equity has historically been held to be more consistent with an installment sale than a true lease,¹⁹⁴ an RTO contract that allows the lessee to build equity during the course of the agreement can be a security interest. Others have observed that where RTO contracts charge the lessee sales tax¹⁹⁵ or impose the risk of loss by theft or destruction on the lessee,¹⁹⁶ the transaction resembles an installment sale more than a lease. Still others have rejected any "laundry list" of criteria and have held that where the parties subjectively intended a sale from the beginning, they should be held to that intent despite the contract form.¹⁹⁷ Indicative of the uncertainty surrounding this issue, a bankruptcy judge recently ruled in one case that an RTO contract did not create a security interest because the lease was terminable and, in a virtually identical case a

¹⁹² G. GILMORE, *supra* note 190, at 77 n.3, 339; *see* *Da Rocha v. MaComber*, 330 Mass. 611, 116 N.E.2d 139 (1953).

¹⁹³ *See, e.g., In re Rose*, 94 Bankr. 103 (Bankr. S.D. Ohio 1988); *In re Puckett*, 60 Bankr. 223 (M.D. Tenn. 1986); *In re Elliott*, 18 Bankr. 602 (Bankr. D. Neb. 1982); *In re Royer's Bakery*, 1 U.C.C. Rep. Serv. (Callaghan) 342 (Bankr. E.D. Pa. 1963).

¹⁹⁴ Perhaps the most notable early case identifying the creation of equity with a sale rather than a true lease is *In re Alpha Creamery*, 4 U.C.C. Rep. Serv. (Callaghan) 794 (Bankr. W.D. Mich. 1967).

¹⁹⁵ *See, e.g., In re Brown*, 82 Bankr. 68 (Bankr. W.D. Ark. 1987); *In re Sight & Sound of Ohio*, 36 Bankr. 885 (Bankr. S.D. Ohio 1983).

¹⁹⁶ *See, e.g., In re Sight & Sound of Ohio*, 36 Bankr. 885 (Bankr. S.D. Ohio 1983); *In re Puckett*, 60 Bankr. 223 (Bankr. M.D. Tenn. 1986); *In re Brown*, 82 Bankr. 68 (Bankr. W.D. Ark. 1987).

¹⁹⁷ *See, e.g., In re Fogelson*, 88 Bankr. 194 (Bankr. C.D. Ill. 1988); *In re Bailey*, 103 Bankr. 886, 887 (1988) ("It is an assessment of the parties' intent, taken as a whole, which controls"); *In re Puckett*, 60 Bankr. 223 (Bankr. N.D. Tenn. 1986).

year later, held that the lease did create a security interest.¹⁹⁸ The court was persuaded in the interim that the "economic incentives" for completing an RTO lease were so strong that, as a practical matter, a lessee would not surrender the equipment for any reason other than his inability to make the payments.¹⁹⁹ In the court's view, while the contract imposed no obligation on the lessee to continue renting, at some point a de facto obligation arose because termination would forfeit a sizable investment.²⁰⁰

The root of continued confusion on this issue is the language of section 1-201(37). While the "basic definition" of security interest may include the requirement of an obligation, the definition also states that the issue depends on the intent of the parties and the "facts of each case," thereby inviting inquiry into all of the circumstances surrounding the transaction. The process of choosing which circumstances are the most relevant and evaluating their effect can become an unpredictable judicial exercise. The imposition of a sales tax, for example, may reflect an intent to sell the property, but it might be imposed simply because local tax laws require lessors to charge such a tax when leasing goods. Similarly, placing liability on the lessee for theft or

¹⁹⁸ Compare *In re Armstrong*, 84 Bankr. 94 (Bankr. W.D. Wisc. 1988) (RTO lease not security agreement) with *In re Aguillar*, 101 Bankr. 481 (Bankr. W.D. Tex. 1989) (RTO lease is security agreement).

¹⁹⁹ "[E]conomic incentives . . . are so complete that, as a practical matter, a debtor would not surrender the equipment in question for any reason whatsoever other than his or her inability to make the payments." *Aguillar*, 101 Bankr. at 482. The focus on the "economic realities" facing an RTO customer is a frequent theme in judicial opinions characterizing RTO leases as security agreements. See, e.g., *Bailey*, 103 Bankr. at 888 (if agreement is renewed many times, at some point the lessee's "only feasible option is to continue to renew the lease . . ."); *Fogelson*, 88 Bankr. at 196 ("Who in his right mind would invest nearly \$150 per week in household furnishings, knowing they will automatically be his after a set number of weeks, without intending to keep paying to accomplish that result?"); *Puckett*, 60 Bankr. at 240; *Sight & Sound of Ohio*, 36 Bankr. at 891 (after paying \$1,400, lessee had "no plausible alternative" except to finish the contract). The economic imperative is much weaker, or even nonexistent, in the early stages of the contract, when the terminability feature may have substantial value to the lessee.

²⁰⁰ *Marhoefer* itself does not foreclose consideration of any of these types of factors. The Seventh Circuit did not end its inquiry by observing that the lessee could terminate the lease before ownership passed. *In re Marhoefer Packing Co.*, 674 F.2d 1139, 1144 (7th Cir. 1982). The terminability feature only meant that the conclusive presumption of clause (b) did not apply. The court then considered some of the other factors found by courts to be relevant in making the determination, including whether the lessee acquired any equity in the property and whether the lessee paid taxes, insurance, or other charges normally incident to the purchase of property under an installment credit sale. *Id.* at 1146.

destruction of the goods may indicate an intent to treat the lessee as owner, but it also may reflect a practical decision that the lessee is in the best position to protect against such a risk through insurance or the exercise of caution, whereas the lessor is in a better position to guard against other risks, such as mechanical malfunctions, which are typically borne by the RTO dealer who agrees to keep the property in good working order. Relying on these elements of the transaction to determine the intent of the parties can often yield a conclusion that the parties "intended" different things.²⁰¹

The "equity" factor relied upon by some courts is particularly troubling because, in essence, it is a restatement of the nominal consideration factor in clause (b) of section 1-201(37). A lessee has equity in property whenever the remaining cost of ownership is less than the value of the goods at a given time. Equity will therefore exist at some point in any lease in which the lessee can acquire ownership for less than the fair market value of the goods. In such circumstances the "economic incentives" of the transaction may urge a rational lessee to complete the contract, even if the contract says the lessee can terminate. If the creation of "equity" is the touchstone of section 1-201(37) analysis, then the lessee's lack of contractual obligation becomes irrelevant, and the pertinent inquiry is whether ownership can pass for a sum that is substantially less than the value of the goods, *i.e.* for nominal consideration. In all such cases an "economic obligation" will be found and a security interest would exist. The reference to "obligation" in the definition of security interest may as well be deleted.

Unlike the controversies concerning the treatment of RTO contracts under TILA and state RIS acts, which have largely been settled in favor of the RTO industry,²⁰² the lease/security interest debate continues. Since the issues are in many ways similar, *i.e.*, whether the transaction is essentially a sale or a lease and whether the lack of a lessee's obligation should be the determinative factor, one wonders why only this issue still generates substantial litigation and controversy. One explanation may be that unlike section 1-201(37), the relevant defined terms in the other statutes do not invite courts to undertake the relatively unguided task of examining the "facts of each case" to divine the "intention" of the parties.²⁰³ Another

²⁰¹ Cf. G. GILMORE, *supra* note 190, at 338 (the reference to "intent" in § 1-201(37) has nothing to do with the subjective intent of the parties to sell or lease the goods).

²⁰² See *supra* notes 61-63, 79 and accompanying text.

²⁰³ The definition of "credit sale" in TILA and definitions of similar terms in RIS laws generally cover leases where the lessee agrees or is contractually bound to pay for the value of the goods during the lease term and can become the owner upon payment of nominal consideration at the conclusion of the agreement, without any reference to the parties' intent or other factors to be considered. See *supra* notes 42, 78 and

explanation may be that many of the lease/security interest cases arise in bankruptcy courts, which are charged with overseeing the debtor's estate and preserving property for distribution among the debtor's creditors. Conditioned by the "fresh start" promise of the bankruptcy code, bankruptcy courts may be inclined to presume RTO merchandise as part of the debtor's estate and not merely as goods on loan, especially where the debtor has devoted a substantial part of his recent income to RTO lease payments and has few other possessions.²⁰⁴ In contrast, the object of TILA and other disclosure laws is principally to provide consumers with relevant cost information at the outset of the transaction. Courts may find it less compelling to mandate disclosures that presume a commitment to repay a stated sum over a period of time when the transaction by its terms creates no such commitment, and the consumer may only rent for a short period.²⁰⁵

The inconsistent decisions on the lease/security interest issue may be short lived. The revised definition of security interest proposed in the 1987 amendments to the UCC²⁰⁶ should tip the scales in favor of the RTO industry. The new section 1-201(37) begins with the same basic definition that a security interest is an interest in personal property which "secures payment or performance of an obligation," but the section then provides more extensive elaboration on the lease/security interest question. Most important for RTO purposes, the revised section states that a transaction creates a security interest if the lease payments constitute "an obligation for the term of the lease not subject to termination by the lessee" and if one of four additional criteria (which expand upon the nominal consideration concept) are satisfied.²⁰⁷ RTO dealers can be expected to make the

accompanying text.

²⁰⁴ One judge has openly acknowledged that bankruptcy court may be a friendly forum for consumers. See Scholl, *Bankruptcy Court: The Ultimate Consumer Law Forum?* 44 BUS. LAW. 935 (1989). Judge Scholl, a former legal services lawyer, represented low income individuals in litigation against RTO companies. See *Not All Judges Ruling Against RTO*, RTO NETWORK NEWS, Feb. 1990, at 1.

²⁰⁵ The "no obligation" feature of an RTO agreement may have more meaning to a consumer at the outset of the transaction, when TILA-type disclosures must be made, than to a consumer who has already paid a substantial sum under an RTO agreement and finds himself in bankruptcy court. The equitable considerations flowing from this temporal distinction may explain the divergence of doctrine in this area.

²⁰⁶ The revision has been enacted in at least eight states. See *supra* note 177.

²⁰⁷ Revised § 1-201(37) provides, in pertinent part:

Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an

converse argument implicit in the revision, *i.e.*, a lease does not create a security interest if the lessee is not obligated for the full term. Revised section 1-201(37) might be viewed as an effort toward clarifying this issue parallel to the 1982 revision of Regulation Z by the Federal Reserve Board.²⁰⁸

The revised definition also omits reference to the "intention" of the parties, which according to the Official Comments led to "unfortunate results" in the past, and instead purports to focus on the economics of the transaction.²⁰⁹ The economic principal invoked is that a lease is a disguised sale only if the lessee, by completing his obligations under the contract, will for all practical purposes own the property free of any residual interest of the lessor at the contract's conclusion. This emphasis on the residual interest retained by the lessor is reinforced by statutory language providing that a transaction does not create a security interest merely because it allocates certain costs, such as taxes, insurance, and maintenance, to the lessee.²¹⁰

obligation for the term of the lease not subject to termination by the lessee, and

- (a) the original term of the lease is equal to or greater than the remaining economic life of the goods,
- (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,
- (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
- (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

²⁰⁸ The Official Comment to revised § 1-201(37) concedes that the previous version is "vague and outmoded," and that the definition was revised "to resolve an issue that has created considerable confusion in the courts: what is a lease?" U.C.C. § 1-201, Official Comment 37. The Comment expressly disapproves of one case (*In re Royer's Bakery*, 1 U.C.C. Rep. Serv. (Callaghan) 342 (Bankr. E.D. Pa. 1963)) holding that a terminable lease was a security agreement. *Id.*

²⁰⁹ See U.C.C. § 1-201, Official Comment 37 ("All of these tests [*see supra* note 207] focus on economics, not the intent of the parties.").

²¹⁰ See § 1-201(37), providing in part:

A transaction does not create a security interest merely because it provides that

- (a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,

The revision properly views these cost allocations as consistent with both leases and secured sales, and they do not affect the basic economic inquiry.²¹¹ The revision thus appears to reject those decisions which relied upon such facts as support for finding that the parties to an RTO contract intended to create a security interest.

In the states where revised section 1-201(37) is enacted, RTO dealers will likely contend that the issue has been resolved in their favor. The Official Comments lend support to this view by disapproving of one widely cited decision that characterized a short term "no obligation" equipment lease as a security interest.²¹² Consumer advocates, however, need not concede the cause. They can still center their arguments on the statute's continued direction that the issue be "determined by the facts of each case." Moreover, while the Official Comments discourage inquiry into the intent of the parties, section 9-102 still provides that Article 9 applies to "any transaction (regardless of form) which is *intended* to create a security interest in personal

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- (b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,
 - (c) the lessee has an option to renew the lease or to become the owner of the goods,
 - (d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or
 - (e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

²¹¹ See U.C.C. § 1-201, Official Comment 37 ("Most of these criteria . . . are as applicable to true leases as to security interests.").

²¹² See U.C.C. § 1-201, Official Comment 37:

The second paragraph further provides that a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee (thus correcting early statutory gloss, e.g., *In re Royer's Bakery, Inc.*, 1 U.C.C. Rep. Serv. (Callaghan) 342 (Bankr. E.D. Pa. 1963)) and if one of four additional tests is met.

See also R. HILLMAN, J. McDONALD & S. NICKLES, COMMON LAW & EQUITY UNDER THE UNIFORM COMMERCIAL CODE § 18.05[3][a] (1990 Cum. Supp.) ("[T]he new definition rejects the cases finding that a lease is intended as security even though the lessee has a free right to terminate the arrangement."); *Crumley v. Berry*, 298 Ark. 112, 116, 766 S.W.2d 7, 10 (1989).

property”²¹³ The statute may leave room for contending that the absence of a contractual obligation only negates the presumption of security interest arising from a nominal purchase option. Other facts surrounding the transaction must then be considered. This argument, however, will be difficult to sustain because certain facts seem to have been eliminated as no longer relevant and others have been given greater weight. The revision highlights the non-terminability of a lease as a threshold fact to be considered, and it counsels reduced reliance on other facts that supported findings of a security interest in past RTO cases. Revised section 1-201(37) thus appears to make it much more difficult for consumers to allege facts that could tip the balance in their favor.

B. The Inadequacies of Article 9 for RTO Consumers

In jurisdictions where RTO transactions are deemed security interests, the default protections of Article 9 promise some assistance to RTO consumers. Article 9 gives defaulting buyers in secured transactions rights against repossessing creditors. The three most significant of these are the debtor’s right under sections 9-504 and 9-505 to realize any equity that may have been created by periodic payments, the debtor’s opportunity under section 9-506 to recover the property after repossession by tendering the outstanding balance, and the preferential treatment afforded buyers (as opposed to lessees) under bankruptcy laws. These rights, however, would have limited value to most RTO customers.

Sections 9-504 and 9-505 allow consumers to insist that the creditor dispose of repossessed property through sale or lease to a third party²¹⁴ and remit any surplus from the disposition to the consumer, after deducting the

²¹³ U.C.C. § 9-102(1)(a) (emphasis added). *See also* U.C.C. § 9-102(2) (“This Article applies to security interests created by contract including . . . lease or consignment intended as security.”). Despite the apparent goal of “delet[ing] all reference to the parties’ intent” (*see* U.C.C. § 1-201, Official Comment 37), the drafters did not amend section 9-102.

²¹⁴ Under § 9-505, the resale must take place if the consumer has paid “sixty percent of the cash price” and has not signed a waiver of resale rights after default. U.C.C. § 9-505(1). If the consumer has paid less than 60%, the seller can propose, in writing, to keep the goods in full satisfaction of the debt, and can do so if the consumer does not object within 21 days. U.C.C. § 9-505(2). The effect of these provisions is that a consumer’s silence can harm him only if he has paid less than 60% of the original cash price before default.

outstanding debt and repossession costs.²¹⁵ In theory, this permits the consumer to recoup any equity created by his periodic payments over the contract term. RTO customers who rent for a relatively short time, however, would realize no benefit from this provision because the price received upon disposition of the used goods would seldom exceed the amount of remaining RTO payments. Longer term renters who have paid more than the initial cash value of the property and who are near the end of the RTO contract would have a better hope of receiving a surplus, but even for these consumers the chances are slim. Heavily used consumer goods are not likely to bring high prices in a secondary market,²¹⁶ and any amount realized on such a disposition would first be reduced by the costs of repossession and sale. In short, except in extraordinary circumstances, the possibility of an RTO consumer receiving a surplus under section 9-505 is remote.

The right of redemption provided in Article 9 also would have limited value to an RTO customer. Section 9-506 provides that the debtor can reacquire the property after repossession, but only by tendering to the creditor all "obligations" secured by the collateral plus any reasonable expenses incurred in repossession.²¹⁷ In the typical credit transaction, this means that the consumer can get the collateral back only by paying off the total outstanding debt in full. For the RTO customer, this provision creates a problem of interpretation and could operate in either of two ways. Since the contract only requires weekly or monthly obligations and no long term commitment, the provision could be construed as giving the RTO customer a right to redeem the goods by tendering only the overdue periodic payments, which would ordinarily be a relatively small amount compared to the total rent called for under the agreement.²¹⁸ Presumably the customer would then resume making periodic rental payments. Alternatively, the provision could be construed to require the customer to tender all past due rental payments plus all remaining payments under the lease. The consumer would clearly prefer the first construction, but the latter is more consistent with operation of the provision under traditional credit contracts. For

²¹⁵ U.C.C. § 9-504(1),(2). For a good discussion of the rights of debtor and creditor following repossession, see B. CLARK, *supra* note 160, ch. 4.

²¹⁶ This criticism of Article 9 remedies applies equally to non-RTO credit transactions, when the consumer's statutory right to a surplus is also largely illusory. See J. SHELDON & R. SABLE, *supra* note 59, at 246 (surplus uncommon when consumer goods sold).

²¹⁷ U.C.C. § 9-506. The debtor must also pay for reasonable expenses incurred by the secured party in holding the collateral, arranging for the resale, plus attorneys' fees to the extent permitted by law. *Id.*

²¹⁸ See J. SHELDON & R. SABLE, *supra* note 59, at 49 ("[i]t is unclear whether the [RTO] consumer must tender just past due payments, or also future payments as well.").

traditional credit arrangements, the statute does not require the seller, after the buyer has defaulted, to reinstate the contract and give the buyer another opportunity to make timely installment payments. The seller is entitled to demand the full contract balance and, unless satisfied, it can dispose of the property by sale to others.²¹⁹ If the redemption provision were construed in this way, most RTO consumers would gain little from section 9-506 because they would seldom have the cash to pay the lump sum amount required to redeem the collateral. If the customer did offer the cash, the RTO dealer would likely accept the payment even in the absence of a statutory directive.

Characterizing an RTO agreement as a secured transaction may have its greatest potential for consumer benefit in a bankruptcy proceeding. If the property is treated as secured collateral and not as leased goods, the merchandise becomes part of the bankruptcy estate, and the RTO dealer is less likely to be awarded immediate possession.²²⁰ Moreover, the security interest may be deemed unperfected, in which case the RTO dealer would be forced to stand in line as an unsecured creditor to share equally with other creditors in the assets of the consumer. Even under these circumstances, however, the extent of consumer benefit is likely to be small. Relatively few RTO customers seek protection under bankruptcy laws, and in many of those cases the leased merchandise will merely increase the value of the estate for distribution to the consumer's other creditors.²²¹

²¹⁹ Since an RTO contract will be deemed a security agreement only if the contract is construed to create an "obligation" of the lessee to pay for the goods, it would seem inconsistent to allow redemption without the lessee tendering the full amount of outstanding rental payments. The "obligations" referred to in § 9-506 should be construed in the same way as "obligation" in § 1-201(37).

²²⁰ See *supra* note 174 and accompanying text.

²²¹ U.C.C. § 9-301, together with § 544(a) of the Bankruptcy Code, 11 U.S.C. § 544(a), provide that a trustee has superior rights to collateral that is subject to an unperfected security interest. Generally speaking, the creditor must file a financing statement to perfect a security interest in goods, see U.C.C. § 9-302, but RTO dealers might claim automatic perfection without filing pursuant to U.C.C. § 9-302(1)(d), which abrogates the filing requirement for creditors who retain a purchase money security interest in consumer goods. See U.C.C. § 9-107 (definition of purchase money security interest). If the security interest is deemed perfected, the RTO dealer could petition the court for permission to recover the collateral if the consumer has no "equity" in the goods and the goods are not necessary to a reorganization plan. See 11 U.S.C. § 362(d)(2) (relief from automatic stay).

C. Article 2A and RTO Consumers

After five years of study and drafting, the National Conference of Commissioners on Uniform State Laws and the American Law Institute in 1987 approved UCC Article 2A governing leases of personal property.²²² Recognizing the increased popularity of leasing transactions over the last few decades,²²³ Article 2A applies a uniform set of rules to all leases of personal property, including RTO transactions. The new code thus expands the scope of the UCC which, under Article 2, previously covered only sales of goods and leases deemed to be disguised sales. State legislatures are now in the process of considering and enacting this uniform law.²²⁴

RTO transactions fall within the general definition of "lease"²²⁵ and the subcategory of "consumer lease"²²⁶ in Article 2A. Yet the article is not a consumer protection statute, and its rules offer only limited assistance to RTO customers. The major impetus for the statute was dissatisfaction among commercial lessors with inconsistent and unpredictable court decisions on product warranties and remedies for breach of a true lease.²²⁷ The statute

²²² See Huddleson, *Old Wine in New Bottles: UCC Article 2A - Leases*, 39 ALA. L. REV. 615, 616-17 (1988). For a good discussion of the drafting history of Article 2A, see Boss, *The History of Article 2A: A Lesson for Practitioner and Scholar Alike*, 39 ALA. L. REV. 575 (1988).

²²³ See U.S. DEP'T OF COMMERCE, EQUIPMENT LEASING, in INDUSTRIAL OUTLOOK 5101 (1991). In 1989, approximately 20% of capital investment in the United States was related to equipment leasing. Boss, *supra* note 222, at 576-77.

²²⁴ As of September 1990, nine states (California, Florida, Kentucky, Minnesota, Nevada, Oklahoma, Oregon, South Dakota, and Utah) had enacted Article 2A. See U.C.C. Rep. Serv. (Callaghan) State Correlation Tables, *supra* note 177, at xiii.

²²⁵ "Lease" is broadly defined as "a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease." U.C.C. § 2A-103(1)(j). As the definition indicates, an RTO contract would not be a lease, and therefore would fall outside Article 2A, if the contract is deemed to create a security interest. The provisions of either Article 9 or 2A could thus apply to RTO contracts, but not both.

²²⁶ "Consumer" lease is defined as "a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee, except an organization, who takes under the lease primarily for a personal, family, or household purpose, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed \$25,000." U.C.C. § 2A-103(1)(e).

²²⁷ See Huddleson, *supra* note 222, at 641. To the extent that courts ruled somewhat consistently on issues affecting the leasing industry, it resulted from applying the provisions of Article 2 by analogy. See *Redfern Meats, Inc. v. Hertz Corp.*, 134 Ga.

primarily deals with these issues and provides only isolated instances of consumer protection on other topics.²²⁸ Nevertheless, RTO consumers may see some benefit from Article 2A.

1. Warranties

The warranty provisions of Article 2A reflect common law developments that had recognized implied warranties of minimum standards of merchantability.²²⁹ The statute codifies and standardizes the emerging law of lease warranties by essentially tracking the provisions of Article 2 on the creation of implied warranties of merchantability²³⁰ and fitness for a particular purpose.²³¹ The new Article also repeats the sales Article's requirements for conspicuous disclaimer of the implied warranties.²³²

In the world of RTO, however, the implied warranty provisions of Article 2A do not serve a significant purpose because RTO leases typically provide expressly that defective goods will either be repaired or replaced by the RTO dealer at any time during the lease term. More importantly, unlike a sale of goods under Article 2 or a long term lease, if an RTO dealer does

App. 381, 389, 215 S.E.2d 10, 16 (1975) (implied warranties); *Dillman & Assoc. v. Capitol Leasing Co.*, 110 Ill. App. 3d 335, 342, 442 N.E.2d 311, 316 (1982) (unconscionability); *Willamette-Western Corp. v. Lowry*, 279 Or. 525, 529-30, 568 P.2d 1339, 1341 (1977) (battle of the forms); *Fairfield Lease Corp. v. George Umbrella Co.*, 8 U.C.C. Rep. Serv. (Callaghan) 184, 185-86 (N.Y. Civ. Ct. 1970) (risk of loss); *Asco Mining Co. v. Gross Contracting Co.*, 3 U.C.C. Rep. Serv. (Callaghan) 293, 295-96 (Pa. Com. Pl. 1965) (modifications); see generally *Hawkland, The Impact of the Uniform Commercial Code on Equipment Leasing*, 1972 ILL. L. REV. 446. Murray, *Under the Spreading Analogy of Article 2 of the Uniform Commercial Code*, 39 FORDHAM L. REV. 447 (1971).

²²⁸ See Miller, *Consumer Leases Under Uniform Commercial Code Article 2A*, 39 ALA. L. REV. 957, 958-59 (1988). Moreover, the principal commentators during the drafting of Article 2A predominately represented business interests. See Boss, *supra* note 222, at 591-92.

²²⁹ Several courts had applied Article 2 warranties to lease transactions, either directly or by analogy. See, e.g., *Glenn Dick Equip. Co. v. Galez Constr.*, 97 Idaho 216, 222, 541 P.2d 1184, 1190 (1975); *Owens v. Patent Scaffolding Co.*, 77 Misc. 2d 992, 998, 354 N.Y.S.2d 778, 784 (Sup. Ct. 1974), *rev'd on other grounds*, 50 A.D.2d 866, 376 N.Y.S.2d 948 (1975).

²³⁰ Compare U.C.C. § 2A-212 with § 2-314.

²³¹ Compare U.C.C. § 2A-213 with § 2-315.

²³² Compare U.C.C. § 2A-214 with § 2-316. Section 2A-214 differs slightly from § 2-316. With respect to the warranty of merchantability, for instance, § 2A-214(2) requires the disclaimer to be in writing, whereas § 2-316(2) does not.

not promptly replace defective goods or if the RTO consumer is not satisfied with an attempted repair, the consumer can simply terminate the agreement without further obligation. Indeed, an RTO customer can terminate the agreement even if the goods are perfectly satisfactory. Thus, even without a contractual or statutory directive to remedy defective products, RTO lessors have every incentive to provide acceptable remedies or risk termination and loss of income. The RTO lease and business necessity will likely provide more consumer protection than the statutory warranty provisions mandate.

2. Remedies

Article 2A contains elaborate statutory remedy provisions that become effective upon default by either the lessor or the lessee. This minimum “safety net” of remedies governs the rights of the parties, however, only if the lease is silent on remedy issues.²³³ Within conscionable limits, the parties are free to contract for their own set of rights and remedies in the lease agreement.²³⁴ Any remedial benefit to consumers provided by Article 2A thus largely can be eliminated by a lessor carefully drafting the lease to address the rights of the parties upon the other’s default. In the absence of an enforceable lease provision on a particular remedies issue, Article 2A can provide the RTO consumer with some rights he might not have had at common law.

a. Lessee’s Remedies for Lessor’s Breach

The statutory remedies available to lessees for default by the lessor include the right to cancel the lease,²³⁵ the right to recover rent and

²³³ See generally Huddleson, *supra* note 222, at 641-57. Section 2A-503(1) provides:

Except as otherwise provided in this Article, the lease agreement may include rights and remedies for default in addition to or *in substitution for* those provided in this Article and may limit or alter the measure of damages recoverable under this Article.

U.C.C. § 2A-503(1) (emphasis added). The Official Comment makes clear that the Article “implies no restriction on freedom to contract.” U.C.C. § 2A-503, Official Comment.

²³⁴ If a contractual remedy is deemed unconscionable, it is void and the gap will be filled by the remedies set forth in the Code. U.C.C. § 2A-503(2).

²³⁵ U.C.C. § 2A-508(1)(a).

security deposits paid to the lessor,²³⁶ the right to sell the leased goods under certain conditions,²³⁷ and the right to obtain substitute goods from another source.²³⁸ The lessee's basic rights to cancel the RTO agreement and recover any security deposit following default by the dealer usually will be stated expressly in the lease and, if not, would be recognized under common law.²³⁹ Similarly, to the extent that the RTO lessee paid rent during a period in which a product was either not delivered or was not serviceable, recovery of paid-in rent would also be permitted under non-Code law.²⁴⁰ The latter two statutory lessee's remedies, however, either clarify or extend existing law in a way that could benefit RTO consumers.

Under section 2A-508(5), a lessee who rightfully rejects goods or revokes acceptance following the lessor's nonperformance can, after holding the goods for a reasonable time to allow the lessor to reclaim them, dispose of the property in good faith and in a commercially reasonable manner and can retain the proceeds of the disposition as reimbursement for rent paid and any unrefunded security deposit.²⁴¹ This right may extend current law by recognizing that a lessee, who unlike a buyer has no ownership rights in the goods,²⁴² nevertheless has a limited interest in the goods supporting a right

²³⁶ U.C.C. § 2A-508(1)(b).

²³⁷ U.C.C. § 2A-508(5). Under § 2A-527(5), a lessee who disposes of leased goods after the lessor's default must pay the lessor any money received above that owing to the lessee. *See infra* notes 241-44 and accompanying text.

²³⁸ U.C.C. § 2A-518(1). *See infra* notes 245-47 and accompanying text.

²³⁹ *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 237, 241, 242 (1981) (material breach discharges non-breaching party's obligations); *id.* § 373 (when one contracting party breaches, injured party is entitled to return of benefits conferred on breaching party). *See also* A. Reisman & C. Mooney, Jr., *Drafting, Negotiating, and Construing the Equipment Lease—An Overview*, EQUIPMENT LEASING—LEVERAGED LEASING 1, 93 (1988).

²⁴⁰ *See* RESTATEMENT (SECOND) OF CONTRACTS § 373 (1981).

²⁴¹ Under § 2A-511(4), a purchaser from a lessee in good faith takes free of the breaching lessor's interest in the goods, so long as the goods were rightfully rejected and were properly disposed of under § 2A-512. Section 2A-512(1)(a) provides that the lessee must hold the goods for a reasonable time after the lessor has been notified of the rejection.

²⁴² *See* RESTATEMENT (SECOND) OF TORTS §§ 234, 252-54 (1965) (lessee's sale may constitute conversion); *Younger v. Plunkett*, 395 F. Supp. 702, 707-11 (E.D. Pa. 1975) (goods cannot be sold to satisfy possessory lien); *Metropolitan Vacuum Cleaner Co. v. Douglas-Guardian Warehouse Corp.*, 208 F. Supp. 195, 198 (S.D.N.Y. 1962) (conversion liability for wrongful disposition).

to sell them and retain money owed by the defaulting lessor.²⁴³ This means, for example, that if an RTO dealer does not repair or replace defective merchandise and does not pick up the goods within a reasonable time after receiving notice of the lessee's rejection, the RTO consumer could sell the goods and retain some of the sale proceeds to offset any security deposit or rent paid for the period during which the goods were not working.²⁴⁴ The dealer, of course, can protect against this problem by promptly reclaiming leased property when the lessee makes it available, but those who delay unreasonably risk a lessee taking matters into his own hands and disposing of the goods to recover his damages.

Section 2A-518 provides a second new remedy for a dissatisfied RTO consumer. The section states that upon a lessor's default the lessee may, in good faith and in a commercially reasonable manner, "cover" by leasing substitute goods under a lease agreement "substantially similar to the original lease"²⁴⁵ The lessee then can recover as damages the actual out-of-pocket costs and any consequential damages resulting from the cover.²⁴⁶ Thus, if the original RTO lease of a television called for monthly payments of twenty dollars for eighteen months, and following the lessor's default the lessee enters into an eighteen month lease of a similar television from another dealer for twenty-five dollars per month, section 2A-518 may permit recovery of ninety dollars (five dollars per month for eighteen months) plus any consequential damages. RTO dealers may contend that any recovery under a terminable lease should be much less because the actual term was only one month, and the lessee could have simply terminated the lease and entered into a new agreement with the lessor for a similar television at the twenty-dollar rate. In the language of section 2A-518,²⁴⁷ a lessee running

²⁴³ Section 2A-508(5) is a revised version of § 2-711(3), which gives a purchaser rights to dispose of rightfully rejected goods in a reasonable manner. U.C.C. § 2A-508, Official Comment.

²⁴⁴ The lessee can dispose of the goods, of course, only if they have been rightfully rejected under § 2A-509 or if the lessee has properly revoked acceptance under § 2A-517.

²⁴⁵ U.C.C. § 2A-518(1), (2).

²⁴⁶ U.C.C. § 2A-518(2). Damages would be "the difference between the total rent for the term of the new lease" and the "total rent for the remaining lease term of the original lease," plus any incidental or consequential damages. *Id.*

²⁴⁷ The RTO dealer's argument would find some support in the literal language of § 2A-518(2), which computes damages as the difference between the value of rent under the new lease for the remaining term of the old lease minus the value of the remaining term under the old lease. Since the lease term in the hypothetical is only one month, the damages would be \$5. Such a formula should be rejected, however, if the lessee actually leases for the full eighteen months under the substitute lease. Otherwise, the lessee is not

immediately to another dealer, without giving the original lessor an opportunity to provide another product, may not be acting in a commercially reasonable manner. But if the original lessor refused or failed to repair the defective television, the lessee may be justified in seeking merchandise from another dealer regardless of the original lessor's lower rate. If that substitute lease ends up costing ninety dollars more over eighteen months, the lessee did not receive the full benefit of the original bargain and should be allowed to recover the additional expense from the defaulting lessor.

b. *Lessor's Remedies for Lessee's Breach*

When an RTO lessee breaches the lease by refusing to make periodic rental payments or by failing to return the property, the dealer is concerned with only two remedies, each of which will ordinarily be set forth in the lease agreement. The lessor wants the right to repossess the property without legal process and to assert a claim for unpaid rent for the period when the lessee had possession of the goods. Article 2A confirms the right to repossession and to damages for unpaid rent, even where the lease is silent.²⁴⁸ The lessor's repossession remedy contrasts with the corollary Article 9 remedy for secured creditors, which may require disposition of repossessed goods after notice to the debtor.²⁴⁹ Except in circumstances not relevant to RTO contracts, Article 2A does not require the lessor to dispose of the goods or account to the debtor for any "surplus" after repossession.

Most of the other Article 2A provisions regarding lessor remedies concern the lessor's duty to mitigate damages when seeking to accelerate future rent as damages under a long term lease.²⁵⁰ Since RTO contracts expressly provide that the lessee is only liable for rent during periods of the lessee's possession, these provisions will be superseded by the RTO agreement. Article 2A does have relevance, however, in one additional circumstance of lessee default. RTO contracts often provide that the lessee

made whole.

²⁴⁸ U.C.C. § 2A-525(2). The lessor may repossess without legal process if it can be done without a breach of the peace. U.C.C. § 2A-525(3); cf. U.C.C. § 9-503 (similar right for secured creditors). The lessor's action for unpaid rent is authorized in § 2A-529.

²⁴⁹ See U.C.C. § 9-504, which recognizes that a debtor may have equity in repossessed collateral and may therefore be entitled to any surplus realized upon the resale, after the secured party has deducted the outstanding debt and reasonable costs incurred by the repossession and disposition. *

²⁵⁰ See U.C.C. § 2A-528 (action for present value of unpaid rent); § 2A-527 (right to dispose of the goods and seek deficiency from lessee; lessor not accountable to lessee for any profit made upon disposition); 2A-526 (right to stop delivery).

is liable for the value of the property if it is lost, stolen or damaged while in the lessee's possession. The contract may stipulate an original value of the property and provide a depreciation formula to determine the value at subsequent dates, or it may simply state that the lessee is liable for the fair market value of the used property, which will be determined at the time of the loss.²⁵¹ Section 2A-504 may assist the lessor by approving liquidated damage formulas that meet a reasonableness test. The section provides that a lease may include an amount or formula stipulating the damages of a defaulting party, so long as it is "reasonable in light of the then anticipated harm caused by the default or other act or omission."²⁵² Section 2A-504 also eliminates some of the limitations on liquidated damage clauses that appear in section 2-718 governing sales agreements. Section 2A-504(1) does not require, for example, that actual damages be difficult to quantify or that it is somehow inconvenient to obtain an adequate remedy before the lessor can invoke a damages formula in a lease.²⁵³ This clarification grants lessors latitude in crafting such clauses and furthers one purpose of the statute, which is to "invite parties to liquidate damages."²⁵⁴ The "reasonableness" of the provision will still be an issue for courts to decide, but RTO dealers who in good faith seek to estimate the lost value of stolen or damaged merchandise should see their formulas upheld.

3. *Specific Consumer Protection Provisions*

In addition to the limited consumer benefits provided by the general provisions of Article 2A, the statute contains a handful of provisions that apply only to consumer leases. The most important of these is the

²⁵¹ See *Senate RTO Hearing*, *supra* note 2 at 77 (Appendix (C) to Statement of Geraldine Azzata); *id.* at 135-37 (statement of J. Samuel Choate).

²⁵² U.C.C. § 2A-504(1). The formula could conceivably include estimated lost profits caused by the loss or destruction of the leased goods. See *Atlas Truck Leasing, v. First N.H. Banks*, 808 F.2d 902, 904-05 (1st Cir. 1987) (upholding damage award including lessor's lost profits arising from breach of truck lease).

²⁵³ With respect to the sale of goods, U.C.C. § 2-718 provides: "Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy"

²⁵⁴ See U.C.C. § 2A-504, Official Comment.

unconscionability provision of section 2A-108.²⁵⁵ The section is modeled after section 2-302 of the sales Article,²⁵⁶ but goes further by creating two special rules for consumer leases that may benefit RTO consumers. The first allows a court to grant "appropriate relief" when a lessor has engaged in unconscionable conduct inducing a consumer to enter into a lease or has committed unconscionable acts in collection of a claim arising from a consumer lease.²⁵⁷ Unlike section 2-302, which consumers generally can employ only defensively to render unconscionable contract terms unenforceable,²⁵⁸ section 2A-108 leaves room for affirmative damage awards for unconscionable inducement or collection activities. Unconscionable inducement might include a situation in which a lessor makes oral promises to a lessee and then relies on an integration clause and the parol evidence rule to avoid liability for those promises.²⁵⁹ The prohibition of unconscionable collection activities can be even more important to RTO consumers because it provides a remedy in an area where abuses have occurred in the past.²⁶⁰ While defining unconscionable collection tactics is a difficult task,²⁶¹ courts can be expected to find guidance in the federal Fair Debt Collection Practices Act²⁶² and similar state laws²⁶³ that often

²⁵⁵ U.C.C. § 2A-108 provides:

(1) If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

²⁵⁶ Section 2A-108(1) is virtually identical to § 2-302(1). Likewise, § 2A-108(3) is nearly the same as § 2-302(2). The remainder of § 2A-108, however, constitutes an expansion of the Code's unconscionability doctrine.

²⁵⁷ U.C.C. § 2A-108(2), quoted *supra* note 255.

²⁵⁸ See *Cowin Equip. Co. v. General Motors Corp.*, 734 F.2d 1581 (11th Cir. 1984); *Givens v. Rent-A-Center*, 720 F. Supp. 160, 163 (S.D. Ala. 1988).

²⁵⁹ See *Miller*, *supra* note 228 at 966-67; U.C.C. §§ 2A-202, 2A-108, Official Comment.

²⁶⁰ See *supra* text accompanying notes 161-64.

²⁶¹ U.C.C. § 2A-108, Official Comment, gives nonexclusive examples of using or threatening to use force or violence in the collection of payments.

²⁶² 15 U.S.C. § 1692(f) (1982).

enumerate certain activities deemed to be per se unlawful. Section 2A-108 thus gives consumers a potent weapon to obtain compensation for unreasonable lessor conduct.

The second consumer benefit from section 2A-108, and for practical purposes perhaps more vital to low-income consumers, is a provision authorizing the recovery of attorney's fees when a consumer lessee prevails on an unconscionability claim.²⁶⁴ This provision has no counterpart in Article 2 and will be useful to representatives of RTO customers. The section conforms with the trend in modern consumer protection legislation, which recognizes that consumer rights often will not be asserted when the recovery is small compared to the prospect of paying large legal bills. Potential for abuse is high, however, so section 2A-108 provides that the lessor can recover attorney's fees when a consumer's claim of unconscionability is not successful, but only where the consumer "knew" the claim to be groundless.²⁶⁵

The only other provision of Article 2A that might benefit RTO consumers is section 2A-106, which limits the validity of contract provisions attempting to choose the law or forum governing the transaction.²⁶⁶ Perceiving a

²⁶³ See, e.g., U.C.C. § 5.108(5) (1974); MINN. STAT. § 8.31 (1990) (attorney general shall investigate unfair practices).

²⁶⁴ U.C.C. § 2A-108(4) provides:

- (4) In an action in which the lessee claims unconscionability with respect to a consumer lease:
 - (a) If the court finds unconscionability under subsection (1) or (2), the court shall award reasonable attorney's fees to the lessee.
 - (b) If the court does not find unconscionability and the lessee claiming unconscionability has brought or maintained an action he [or she] knew to be groundless, the court shall award reasonable attorney's fees to the party against whom the claim is made.
 - (c) In determining attorney's fees, the amount of the recovery on behalf of the claimant under subsections (1) and (2) is not controlling.

²⁶⁵ "Knowledge" in the UCC means "actual knowledge." U.C.C. § 1-201(25).

²⁶⁶ U.C.C. § 2A-106 provides:

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

danger that a lessor might induce a lessee to agree that the applicable law will be a jurisdiction with little effective consumer protection,²⁶⁷ the drafters limited valid choice of law provisions to the jurisdiction where the consumer lessee resides at the time the lease becomes enforceable, the jurisdiction where the lessee will reside within thirty days thereafter, or the law of the jurisdiction where the goods will be used. While this provision can benefit consumer lessees, it may conflict with other laws. For example, the Pennsylvania RIS act states that it applies to all RTO agreements made within the Commonwealth,²⁶⁸ yet section 2A-106 would validate a contract provision asserting that New Jersey law applies so long as the lessee is a resident of New Jersey, or will be a resident of New Jersey within thirty days thereafter. Section 2A-104 resolves this conflict by giving preference to the consumer protection statute of the jurisdiction over the provisions of Article 2A.²⁶⁹

Article 2A refers to consumer leases in a few other contexts, but the provisions have little relevance to RTO lessees. Three of the provisions address issues arising when a lessor seeks to accelerate future rent upon the lessee's breach.²⁷⁰ They therefore will not affect the rights of the parties to a terminable lease in which the lessee is only obligated to pay rent for periods of property use. Two other provisions similarly concern potential problems arising in a long term lease that have little significance to short term rentals. They address the lessee's rights not to pay for the original value of goods when they are damaged before delivery,²⁷¹ or when the lessor unreasonably delays in delivering a portion of the goods subject to the contract.²⁷² Neither of these problems is likely to arise in RTO transactions because the lessee will seldom be liable to pay anything until conforming goods are delivered. The RTO lessee has adequate remedies under the

²⁶⁷ U.C.C. § 2A-106, Official Comment. *See* *Paragon Homes of Midwest v. Crace*, 4 U.C.C. Rep. Serv. (Callaghan) 19 (N.Y. Sup. Ct. 1967); U.C.C.C. § 1.201(8) (1974).

²⁶⁸ *See* 69 PA. CONS. STAT. § 1103 (1989).

²⁶⁹ U.C.C. 2A-104(2): "In case of conflict between this Article . . . and a [consumer protection statute of this State or final consumer protection decision of a court of this State], the statute or decision controls."

²⁷⁰ *See* U.C.C. § 2A-109 (options to accelerate at will); § 2A-407(1) (special damages rule for "finance leases" that are not consumer leases); § 2A-504(3) (limitation on lessor's damages for unpaid rent when lessee defaults or becomes insolvent before delivery of goods).

²⁷¹ U.C.C. § 2A-221.

²⁷² U.C.C. § 2A-406.

contract—the lessee can demand conforming goods and need not make any future payments until conforming goods are delivered.

IV. LEGISLATIVE SOLUTIONS SPECIFICALLY REGULATING RTO TRANSACTIONS

Allowing the RTO industry to continue operating under no meaningful regulation, or with only the limited protections of Article 2A, as is the case in most states,²⁷³ is not defensible. In some respects, this is a classic case for government intervention. A long history of consumer confusion and abuse is testimony to the inefficient operation of this unregulated market. Evidence in reported decisions alone shows that consumers often have entered into RTO contracts fundamentally unaware of the nature of the transaction and their rights or obligations under it.²⁷⁴ The unique vulnerability of this class of consumers, due perhaps to educational deficiencies and substandard economic conditions, further justifies some government protection. If ever there was a need to protect the average consumer through the enactment of TILA and complementary state statutes, surely a need is present here.

The trend in legislatures over the past few years has been to enact special legislation directed at the RTO industry rather than to amend existing laws to cover the transaction. Most of the legislation has been at the state level, with occasional activity in Congress. The federal proposals, none of which has resulted in an enactment, have sought to amend the Consumer Leasing Act ("CLA")²⁷⁵ to mandate minimum disclosures in RTO contracts without providing many substantive limits on the transaction in areas consumer representatives deem most abusive.²⁷⁶ At the state level, the efforts have been more productive. Twenty-three states have enacted laws regulating the industry,²⁷⁷ insulating it from attack under other consumer credit laws, effectively removing the transaction from usury limits, and providing varying degrees of consumer protection. This section reviews the federal and state efforts.

²⁷³ See *infra* note 303.

²⁷⁴ See *supra* text accompanying notes 21–27.

²⁷⁵ 15 U.S.C. § 1667 (1991).

²⁷⁶ See *infra* text accompanying note 300.

²⁷⁷ See *infra* note 303.

A. *The Limited Protection of the Federal CLA*

Following recommendations of the Federal Reserve Board, the CLA was enacted in 1976 to ensure adequate disclosure in consumer leases of personal property.²⁷⁸ Added to TILA as a new Chapter 5, the CLA responded to the development of leasing as an alternative to purchasing consumer goods on credit.²⁷⁹ The CLA covers many of the leases that do not fall within TILA's definition of "credit sale," most importantly leases in which there is no ownership option and those in which ownership vests upon the lessee's payment of consideration deemed to be more than nominal.²⁸⁰ Automobiles are probably the most common type of leased property subject to the CLA,²⁸¹ but the act can also cover leases of home furnishings and consumer appliances. Like TILA, the CLA is primarily a disclosure statute, but rather than focusing on disclosure of finance charges and the applicable interest rate, the CLA and its implementing Regulation M²⁸² require lessors to disclose basic information peculiar to leasing arrangements, such as the total payment due at the inception of the lease, the term of the lease, the monthly (or other periodic) rent, the total of payments, any penalties for early termination of the lease, and the amount, or method of calculating, the purchase option price if a purchase option is offered.²⁸³

The disclosures under the current CLA are not inappropriate for an RTO transaction. In fact, the Board's suggested disclosure form for a furniture lease is readily adaptable to an RTO contract.²⁸⁴ Because the CLA imposes

²⁷⁸ *Senate RTO Hearing*, *supra* note 2, at 29 (statement of Nancy H. Teeters, FRB).

²⁷⁹ *Id.*

²⁸⁰ TILA covers leases in which the lessee "contracts to pay" for the value of the goods and has an option to become the owner of the goods at the end of the lease upon the payment of a nominal consideration. 15 U.S.C. § 1602(g) (1991); 12 C.F.R. § 226.2(a)(16) (1990); *see supra* text accompanying note 42.

²⁸¹ *See Senate RTO Hearing*, *supra* note 2, at 29, 30 (statement of Nancy H. Teeters, FRB) (expectations of significant growth in automobile leasing industry).

²⁸² 12 C.F.R. § 213 (1990). The provisions of Regulation M were formerly part of Regulation Z, but were segregated in 1980 and reissued under the current designation as part of the effort to simplify TILA. *See* 46 Fed. Reg. 20, 949 (1981); 45 Fed. Reg. 80, 648, 80, 689 (1980). *See generally*, Cooluris & Winn, *Consumer Leasing Developments*, 39 BUS. LAW. 1163, 1167 (1984).

²⁸³ 12 C.F.R. § 213.4(g) (1990). Regulation M enumerates 15 specific contract disclosures. *Id.* § 213.4(g)(1)-(15) (1990).

²⁸⁴ *See* 12 C.F.R. § 213 (1990) (Appendix C-3, Model Furniture Lease Disclosures).

civil penalties for noncompliance²⁸⁵ and contains some restrictions on advertising,²⁸⁶ however, the RTO industry has consistently maintained that its leases are not covered by the act.²⁸⁷ The industry's position has largely succeeded because the CLA only covers contracts "in the form of a lease or bailment for the use of personal property by a natural person *for a period of time exceeding four months*, and for a total contractual obligation not exceeding \$25,000."²⁸⁸ The industry, of course, maintains that because its leases do not create an obligation beyond one week or one month, they are not agreements "for a period of time exceeding four months." Shortly after the enactment of the CLA, unofficial staff opinions of the Board agreed, stating that such a lease does not come within the act, even though it might be renewed to extend beyond four months.²⁸⁹ Early court decisions for the most part concurred, upholding the "plain language" of the definition and not challenging the staff interpretations.²⁹⁰ Two courts voiced dissent.²⁹¹ Noting language in one unofficial staff opinion that the renewable lease exemption did not apply if "employed by the lessor for the purpose of circumvention or evasion of the statutory . . . requirements,"²⁹² and employing the maxim that as remedial legislation the CLA should be broadly construed, these courts refused to dismiss CLA claims against RTO dealers

²⁸⁵ For breach of the lease disclosure requirements, § 1667(d) imposes the same civil liabilities as those imposed under the rest of TILA. *See* 15 U.S.C. § 1640(a) (1982) (actual damages or statutory damages).

²⁸⁶ 15 U.S.C. § 1667c (1991); 12 C.F.R. § 213.5 (1990). Damages for failure to comply with the advertising disclosure requirements, however, are limited to the lessee's actual injury. 15 U.S.C. § 1667d(b) (1991).

²⁸⁷ *See infra* decisions cited in notes 290, 291 and 297.

²⁸⁸ 15 U.S.C. § 1667(1) (1991).

²⁸⁹ *See* FRB Letter No. 1169, Cons. Cred. Guide (CCH) ¶ 31,556 (March 28, 1977).

²⁹⁰ *See* Lemay v. Stroman's, Inc., 510 F. Supp. 921, 923 (E.D. Ark. 1981); Dodson v. Remco Enters., 504 F. Supp. 540, 542 (E.D. Va. 1980); Stewart v. Remco Enters., 487 F. Supp. 361, 363 (D. Neb. 1980); Smith v. ABC Rental Sys., 491 F. Supp. 127, 129 (E.D. La. 1978), *aff'd*, 618 F.2d 397 (5th Cir. 1980) (per curiam); Blackshear v. S&S Television Rental, No. C-79-490 (N.D. Ohio, Oct. 23, 1981); *In re* Turner, No. 3-78-1135D (Bankr. D. Minn. 1979).

²⁹¹ Jones v. Action TV Rental, No. 79-1535 (E.D. Pa., June 30, 1980); Hooker v. Sight & Sound of Mich., No. 79-10120 (E.D. Mich., Jan. 15, 1980).

²⁹² FRB Letter No. 1169, Cons. Cred. Guide (CCH) ¶ 31,556 (March 28, 1977).

and allowed plaintiffs to conduct discovery on whether the dealer actually intended a sale and was attempting to circumvent the statute.²⁹³

The Board subsequently removed any uncertainty on the scope of the CLA in 1982 when it issued official staff commentary to Regulation M to replace the unofficial staff opinions. The official commentary reiterated the Board's view that short term, renewable leases are not "consumer leases" under the CLA and omitted any reference to circumvention.²⁹⁴ Although the language of the act is broad enough to justify a contrary finding,²⁹⁵ the Board's resolution of the issue is a defensible interpretation. Congress determined that the disclosure provisions and other protections of the CLA are most important in relatively long-term leases.²⁹⁶ The Board could reasonably conclude that when a lessee commits to a term of only one week or one month at the outset of the agreement, there is a reduced likelihood of the lease continuing for a long duration. Imposing the restrictions of the CLA on every short term lease simply because the agreement might continue for

²⁹³ The quoted language from the staff opinion letter was subject to criticism. If a statute defines the covered transaction in a way that permits avoidance by drafting the contract in a certain manner, such "evasions" are arguably permitted, perhaps even invited, by the law. No business can fairly be criticized for electing not to be governed by a statute and drafting its agreements accordingly. The practice is not uncommon. *See Senate RTO Hearing, supra* note 2, at 141 (statement of Robert McGregor, Furniture Rental Ass'n of America) (35% of FRAA members have no leases of more than four months, making a "conscious decision . . . not to be covered" by the CLA).

²⁹⁴ *See* 12 C.F.R. § 213 (1990), FRB Official Staff Commentary, Comment 2(a)(6)-2:

To be a consumer lease, the initial term of the lease must be more than 4 months. Thus, a lease of personal property for 4 months, 3 months or on a month-to-month or week-to-week basis (even though the lease actually extends beyond 4 months) is not a consumer lease and is not subject to the disclosure requirements of the regulation. A lease with a penalty for canceling during the first 4 months is considered to have a term of more than 4 months. A month-to-month or week-to-week extension of a lease that was originally for 4 months or less is not a consumer lease, even if the extension actually lasts for more than 4 months. For example, a 3-month lease extended on a month-to-month basis and terminated after 1 year does not require consumer lease disclosures.

²⁹⁵ The statutory phrase, "for a period of time exceeding four months," can reasonably be interpreted to encompass agreements that exceed four months following renewals. The statute does not expressly state that the original term must be longer than four months, only that the "lease" exist for that duration. 15 U.S.C. § 1667(1) (1982).

²⁹⁶ *See* S. Rep. No. 94-590, 94th Cong., 2d sess. 4, *reprinted in* 2 U.S. CODE CONG. ADMIN. NEWS 431, 434 (1976) ("Nor would [the CLA] apply to a shorter term convenience-type lease arrangement where the lessee is not obligated *at the outset* to a term of more than four months") (emphasis added).

a longer period could prove unnecessary and wasteful in those circumstances where the lessee terminates after a few weeks. Following the Board's pronouncement, courts have held uniformly that RTO leases are not within the CLA.²⁹⁷

Because the CLA deals exclusively with consumer leases, its existing disclosure provisions are relevant to RTO customers, but the minimal disclosures mandated by the act would not assist consumers with the most troublesome aspects of an RTO transaction.²⁹⁸ One exception is the required advertising disclosure, which provides that any advertisement stating the amount of any rental payment must also disclose the number, due dates and total of rental payments under the lease, and a description of the option price the lessee must pay to acquire ownership.²⁹⁹ This would prevent an RTO dealer, for example, from advertising a television for "five dollars first week" without also conspicuously disclosing that to acquire ownership the lessee must make subsequent weekly payments of twenty dollars per week for seventy-two weeks totalling \$1,440. The statute thus discourages the use of "teaser" rates that lure customers to a store without revealing other important features of the contract. Application of these restrictions to RTO contracts surely would benefit consumers.

²⁹⁷ See *In re Hanley*, 105 Bankr. 458 (Bankr. C.D. Ill. 1989); *Givens v. Rent-A-Center, Inc.*, 720 F. Supp. 161, 162, (S.D. Ala. 1988); cf. *In re Rent-a-Color, Inc.*, FTC Order No. 9163, Cons. Cred. Guide (CCH) ¶ 96,516 (Apr. 16, 1984) (where lease obligated consumer to rent for 12 months, CLA applied).

²⁹⁸ See *Senate RTO Hearing*, *supra* note 2, at 78 (Appendix D to testimony of Geraldine Assata) (example of RTO lease giving CLA contract disclosures). The CLA was enacted primarily to address problems arising from the growing popularity of automobile leases, not leases of household items by low income consumers. See CONSUMER FINANCIAL SERVICES POLICY SESSION 76 (FTC 1979). A comparison of the disclosures mandated in 12 C.F.R. § 213.4 (1990) with the provisions discussed *infra* at notes 307-63 demonstrates the value of regulation directed specifically at RTO transactions.

²⁹⁹ 15 U.S.C. § 1667c (1991); 12 C.F.R. § 213.5 (1990). The statements triggering additional disclosure are: (1) the amount of any payment, (2) the number of required payments, or (3) a statement that no down payment is required at the outset of the lease. If any of these representations appear in an advertisement, then all of the following must also be disclosed: (1) a statement that the transaction is a lease, (2) the amount of any additional payment (such as a security deposit) due at the inception of the lease, (3) the number, amounts, due dates, and total of payments under the lease, (4) a statement of any purchase option, and the time and method of computing the option price, and (5) a statement of the amount or method of computing any lessee liability at termination of the lease. *Id.*

Apart from the advertising disclosures, however, the current CLA does not offer protection where the low income RTO consumer needs it most. It does not address, for example, issues such as the high prices of RTO contracts, limitations on extra fees charged by RTO dealers (e.g., charges for late payments) that can substantially increase the cost of an RTO contract, reinstatement rights for defaulting customers, or the timing of required disclosures to increase their effectiveness. Moreover, proposed amendments to the CLA, including one drafted by the Federal Reserve Board,³⁰⁰ would have done little more than apply the current CLA disclosures and advertising limitations to an RTO transaction, with relatively minor modifications to tailor the disclosures to the legal relationship created by an RTO lease.³⁰¹ State legislatures have been more responsive to the concerns of RTO customers, and given the accelerating trend to enact RTO legislation in the

³⁰⁰ The Consumer Lease and Rental Purchase Agreement Act, S.1152, 98th Cong., 1st Sess., 129 CONG. REC. S5402 (daily ed. Apr. 27, 1983). *See also* S.2181, 98th Cong., 1st Sess., 129 CONG. REC. S17031 (daily ed. Nov. 18, 1983) (similar to S.1152). The bills would have comprehensively amended the entire CLA and would have added separate RTO regulation. The effort was a culmination of FRB efforts to simplify the CLA after Congress neglected the leasing provisions in the 1980 simplification of TILA. *See* 45 Fed. Reg. 80, 648, 80, 689 (1980); Cooluris & Winn, *supra* note 282, at 1167. The House subsequently introduced RTO legislation, H.R. 2537, 100th Cong., 1st Sess. (May 28, 1987).

³⁰¹ S.1152 would have required disclosure of the following information in RTO contracts: (1) the number, timing amounts, and total of rental payments necessary to acquire ownership, (2) a statement that the consumer will not own the property until the end of the lease, (3) a statement that the total payment does not include late fees, pick-up fees, or other charges, and that the consumer should read the contract to understand these charges, (4) a statement that the consumer is responsible for the fair market value of the property if it is lost, stolen, or damaged, and (5) a statement whether the property is new or used. S.1152, 98th Cong., 1st Sess., § 114; *see Senate RTO Hearing, supra* note 2, at 14-15. H.R. 2537 would have imposed the same Senate disclosures plus disclosure of (1) service and maintenance responsibilities of the parties, (2) a statement summarizing terms of the consumer's option to purchase, (3) any applicable manufacturer's warranty, (4) cash price of the goods, (5) a description of any security interest retained by the lessor, (6) a statement that the consumers may terminate at any time without penalty, and (7) a description of any insurance provided by the lessor and its cost. H.R. 2537, 100th Cong., 1st Sess. §§ 114, 116(b)(2) (May 28, 1987). The bill also contained price tag disclosures, *id.* § 115, and required disclosure of a consumer's reinstatement rights, *id.* § 116(b)(3). *See also* H.R. 5636, 99th Cong., 2d Sess. §§ 114, 115, 116 (Oct. 2, 1986) (similar to H.R. 2537).

states, the likelihood of effective federal legislation being enacted seems remote.³⁰²

B. State Legislation as a Regulatory Solution

RTO legislation enacted in twenty-nine states³⁰³ over the past five years has followed an atypical pattern. In a reversal of their customary roles, industry has been pressing for regulatory legislation, and consumer representatives have been opposing.³⁰⁴ The resulting compromise

³⁰² The RTO industry continues to press for a federal bill to preclude a "patchwork" of state regulation and inconsistent court decisions in various jurisdictions. See *Senate RTO Hearing*, *supra* note 2, at 116 (statement of J. Samuel Choate, Jr.); *RTO Network News*, Vol. 2, No. 6, p. 1 (June 1990) (House had scheduled hearing on RTO legislation set for June 26, 1990; hearing postponed).

³⁰³ ALA. CODE §§ 8-25-1 to 8-25-6 (1990); ARK. STAT. ANN. §§ 4-92-101 to 4-92-107 (1990); COLO. REV. STAT. §§ 5-10-101 to 5-10-1001 (1990); 1991 Conn. Acts 91-162 (Reg. Sess.) §§ 1 to 18; DEL. CODE. ANN., tit. 6, §§ 7601 to 7616 (1991); FLA. STAT. §§ 559.9231-559.9241 (1990); GA. CODE ANN. §§ 10-1-680 to 10-1-689 (1991); ILL. REV. STAT. ch. 121½, paras. 1801-1805 (1989); IND. CODE §§ 24-7-1-1 to 24-7-9-7 (1990); IOWA CODE §§ 537.3601 to .3624 (1989); 1991 Kan. Sess. Laws 336 §§ 1-12; KY. REV. STAT. ANN. §§ 367.976 to .985 (Michie/Bobbs-Merrill 1991); 1991 La. Acts 204, §§ 3351-3362; MD. COM. LAW CODE ANN. §§ 12-1101 to 12-1112 (1990); MASS. ANN. LAWS ch. 93, §§ 90-94 (Law. Co-op. 1991); MICH. COMP. LAWS ANN. §§ 445.951-445.970 (West 1989); MINN. STAT. §§ 325 F.84 to 325 F.98 (1991); MO. REV. STAT. §§ 407.660 to .665 (1990); NEB. REV. STAT. §§ 69-2101 to 69-2115 (1989); 1991 Nev. Stat. 196, §§ 1-12; N.Y. PERS. PROP. LAW §§ 500-507 (McKinney 1991); OHIO REV. CODE ANN. §§ 1351.01-1351.09 (Anderson 1990); OKLA. STAT. tit. 59, §§ 1950-1957 (1990); R.I. GEN. LAWS §§ 6-44-1 to 6-44-10 (1990); S.C. CODE ANN. §§ 37-2-701 to 37-2-714 (Law. Co-op 1991); S.D. CODIFIED LAWS ANN. §§ 54-6A-1 to 54-6A-10; TENN. CODE ANN. §§ 47-18-601 to 47-18-614 (1990); TEX. BUS. & COM. CODE ANN. §§ 35.71-35.74 (Vernon 1991); and VA. CODE ANN. §§ 59.1-207.17 to 59.1-207.27 (1991).

³⁰⁴ Historically, the typical pattern for enacting consumer legislation has been first, public disclosure of circumstances considered harmful to consumers; second, proposed legislation to remedy the perceived abuses; third, opposition by business interests. See Feldman, *supra* note 1, at 16. Business interests often prevail in these confrontations, in large part because industry trade organizations generally have greater financial resources, better organized political action groups, and more powerful lobbyists. *Id.* at 30. This has been particularly true in RTO legislative efforts. See Winn, *State Rent-To-Own Statutes Revisited*, PROGRESSIVE RENTALS, June/July 1987, at 30, 37 (through mid-1987, RTO industry spent over \$350,000 promoting federal legislation; state legislative efforts cost between \$25,000 and \$40,000 each, not including campaign contributions by individual dealers to legislators running for office).

enactments generally insulate RTO transactions from attack under usury laws³⁰⁵ and other credit-related statutes but contain a variety of substantive limits on the RTO transaction and some combination of over thirty required contract disclosures. Overall, the laws are a positive development for consumers³⁰⁶ because they purport to address the issues most likely to be important to RTO customers, but the laws contain serious flaws. This section examines the more significant aspects of these statutes.

1. Price Controls

Perhaps the most pressing issue facing legislatures is whether the high price of RTO contracts should be limited. Consumer advocates who see low-income families spending a large part of their monthly budgets on RTO products urge price controls as a substitute for usury limits, but have succeeded in only four states.³⁰⁷ Those successes are largely illusory, however, because in each state the law limits the total RTO price to approximately twice the disclosed "cash price."³⁰⁸ If there were a limit on cash prices, this approach might be effective. But the statutes do not control

³⁰⁵ RTO dealers believe that the most important aspect of RTO legislation is the statutory recognition of RTO contracts as transactions distinct from credit sales. Dealers have, for the most part, adjusted to any substantive restrictions imposed by the laws and view the "safe harbor" of regulation as a key factor in the industry's growth. See Winn, *supra* note 304, at 44; Winn, *Rent-To-Own Statutes: A Comparison and Analysis*, PROGRESSIVE RENTALS, Feb. 1986, at 20.

³⁰⁶ Many consumer representatives would disagree. They view RTO legislation as merely legitimizing an industry that exploits the poor. See Winn, *Rent-To-Own Statutes: 16 States and Counting*, PROGRESSIVE RENTALS, June/July 1988, at 28.

³⁰⁷ 1991 Conn. Acts 91-162 (Reg. Sess.) § 9; IOWA CODE ANN. § 537.3608 (West 1991); MICH. COMP. LAWS ANN. § 445.954 (West 1989); N.Y. PERS. PROP. LAW § 503 (McKinney 1991); OHIO REV. CODE ANN. § 1351.06 (Anderson 1990). The Minnesota RTO law does not regulate prices directly but authorizes the Commissioner of Commerce to adopt rules imposing price limits. MINN. STAT. ANN. § 325 F.91(2) (West 1991).

³⁰⁸ 1991 Conn. Acts 91-162 (Reg. Sess.) § 9(b) (50% of total lease payments cannot exceed cash price); IOWA CODE ANN. § 537.3608(2) (West 1991) (50% of total lease payments cannot exceed cash price); MICH. COMP. LAWS ANN. § 445.954(2) (West 1989) (if 45% of payments made equals the cash price, the lessee owns property); N.Y. PERS. PROP. LAW § 503 (McKinney 1991) (50% of total payments cannot exceed cash price; if 50% of the payments exceed the cash price, the consumer owns goods); OHIO REV. CODE ANN. § 1351.06 (Anderson 1990) (as soon as 50% of lease payments equals the cash price, the lessee owns property).

cash prices,³⁰⁹ and because RTO dealers generally target lower-income consumers and seldom compete in the market for cash sales, there are no effective market controls. An RTO dealer can disclose a cash price at virtually whatever level it chooses, subject only to the generous limits of unconscionability.³¹⁰

Assuming that price limitations are desirable in theory,³¹¹ effective controls would be difficult to achieve in practice because the RTO industry leases a wide variety of differentiated products. With fungible products like corn, heating oil, and gasoline, the government could conceivably set and monitor price controls by fixing a uniform retail or wholesale price per bushel, barrel, or gallon. In contrast, it would be virtually impossible to set a price for every type of television, stereo, washer, dryer, or item of furniture available to an RTO dealer. One alternative to specific product controls would be to limit the dealer mark-up from a benchmark amount such as dealer cost or manufacturer's suggested retail price (e.g., limit total RTO prices to twice dealer cost). Such benchmarks are less manipulative than cash prices and thus could be more effective, but they create other problems. Purchasers of new automobiles realize that a dealer's "cost" for a product is not easily determined or verified. Discounts, rebates, and buy-back arrangements offered by manufacturers can obscure the true cost of an item to the retailer.³¹² The problem is compounded by the difficulty of tracing a dealer's cost for a shipment of goods to a particular item offered for rent to the public. Once the goods are warehoused or displayed, matching prices of specific products with purchase order prices would be a cumbersome task. Manufacturer's suggested retail price might be a more easily verified benchmark for a particular product, but manufacturers do not suggest selling prices for all products, and when prices are suggested they can be rather arbitrary and do not necessarily reflect market conditions.³¹³ In addition, while not directly manipulative by RTO dealers, rates could be indirectly

³⁰⁹ The laws typically define cash price as "the price at which a lessor in the ordinary course of business would offer the property that is the subject of a lease-purchase agreement to the lessee for cash on the date of the lease-purchase agreement" OHIO REV. CODE ANN. § 1351.01(B) (Anderson 1990).

³¹⁰ See *supra* note 138.

³¹¹ See generally Slawson, *Price Controls for a Peacetime Economy*, 84 HARV. L. REV. 1090 (1971).

³¹² This practice is most common in the sale of automobiles, where dealers often cite their "cost" during negotiations on a final sale price. See L. SACHS, *HOW TO BUY YOUR NEW CAR FOR A ROCK-BOTTOM PRICE* 101-02 (1987). If "cost" became statutorily related to price in RTO contracts, similar practices could be expected.

³¹³ *Id.* at 103.

controlled by dealers preferring to do business with manufacturers offering the most generous suggested prices. Since the manufacturer's suggested retail price has no necessary relationship to the wholesale price, manufacturers would have little economic incentive to suggest low retail prices.

Even if a suitable benchmark could be found, a more fundamental question is whether price limits are advisable. While RTO prices are unquestionably high, there is no evidence that profits are unreasonable or that monopoly power (or collusion) inhibits price competition among RTO dealers.³¹⁴ Prices presumably are high because the cost of providing merchandise under an RTO plan to this class of consumers is also high.³¹⁵ Effective price controls would probably serve, like interest rate ceilings in general, only to exclude some super-high risk consumers from the RTO market. If a legislature is already prepared to find, however, that RTO leasing is a tolerable alternative for high risk consumers, it would seem inconsistent to impose a pricing restriction that excludes some consumers. Moreover, even if base rental prices are effectively limited, their benefit can be undermined by a dealer adding extra fees for incidental services to increase overall income. For those concerned with the high price of RTO products, a better approach may be to permit the market to set base prices, impose rules that ensure timely and adequate disclosure of those prices, and then limit some of the more common add-on charges, discussed below, that can substantially increase the ultimate cost of an RTO contract well beyond the price indicated by the base rate.

2. *Limits on Other Charges*

RTO contracts often authorize the dealer to assess miscellaneous charges that can significantly increase the cost to the consumer. These include fees for contract processing, late payments, reinstatement of the contract after default, home collection of payments, delivery of the goods, termination of the contract, security deposits, and personal property insurance. In some instances these charges can be the most offensive aspects of RTO contracts because even an astute customer who has read the contract may find it difficult to predict their cumulative effect. In unregulated states, and even in

³¹⁴ RTO dealers maintain that profits average only five to eight percent of revenues. See *Senate RTO Hearing*, *supra* note 2, at 133; PROGRESSIVE RENTALS, June/July 1987, at 43.

³¹⁵ See *supra* note 1.

some states where RTO bills recently have been enacted, these charges can add over a hundred dollars to the total price.³¹⁶

While add-on fees are purportedly imposed to recover costs otherwise borne by the dealer, separate assessments for several types of fees, even if conspicuously disclosed in the contract, may not be warranted. Fees added to the base price can be justified only if they serve to recoup costs resulting from some action or request by a customer beyond what is contemplated by the basic transaction. The traditional justification for allowing a fee for late payments, for example, is that delays in payment increase the creditor's cost of doing business and the increased cost should be borne by those who cause it, rather than shared by all customers (including punctual payors) through a general increase in the base price. Conversely, allowing additional fees for costs common to all or nearly all transactions can only surprise and mislead customers about the true price of the transaction.

Processing fees. Processing fees, which are permitted under at least twenty-eight RTO statutes,³¹⁷ are nothing more than extra charges assessed

³¹⁶ For example, in South Carolina, where the RTO statute authorizes specific levels of several types of fees, an RTO customer who leases a television under a 78-week contract, and who makes 15 late payments, could easily end up paying \$106 more than the total rent called for in the contract: \$30 in late payment fees (\$2 per late payment); \$56 in home collection fees (assuming only 8 home collections—18 is the maximum allowed); \$5 processing fee; and \$15 delivery charge. *See* S.C. CODE ANN. § 37-2-705, -706 (Law. Co-op 1991). This would not include any reinstatement fees or redelivery fees that could be assessed if the consumer defaulted and later reinstated the contract, *see id.* § 37-2-714, nor would it include any property insurance required by the lessor as a condition to consummating the transaction.

³¹⁷ ALA. CODE § 8-25-2(d)(3) (1990) (must explain other charges for which lessee may be liable; does not expressly forbid processing fees); ARK. STAT. ANN. § 4-92-105(b)(4) (1989) (same); COLO. REV. STAT. § 5-10-601 (1990) (no more than \$10 per contract but not in addition to a delivery charge); 1991 Conn. Acts 91-162 (Reg. Sess.) (cannot exceed \$10); DEL. CODE ANN., tit. 6, § 7603(a)(6)(1991) (must disclose total of initial payments; also does not expressly forbid processing fees); FLA. STAT. § 559.9233(4)(d),(f) (1990) (must disclose any initial payment including any advance payment, delivery charge, or any trade-in allowance to be paid by the lessee at or before completion of the agreement; must disclose all other charges not included in rental payments); GA. CODE ANN. §§ 10-1-682(a)(2),(4) (1991) (same); ILL. ANN. STAT. ch. 121½, para. 1802(g)(4), (e)(1) (1989) (must disclose amount and purpose of any fee or charge not included in periodic payment; a charge in addition to periodic payments must reasonably relate to the service performed); IND. CODE §§ 24-7-5-1, 24-7-5-3(B) (1990) (\$10 charge both processing and delivery fee); IOWA CODE § 537.3612(2) (1989) (cannot exceed \$10; if delivery charges are applied, then no processing fee is allowed); 1991 Kan. Sess. Laws 336 § 5(7) (must disclose total initial payments); KY. REV. STAT. ANN. § 367.977 (Michie/Bobbs-Merrill 1991) (must disclose initial payments required to be

for entering into the RTO transaction. While there are costs involved in processing customer orders, the costs are more or less uniform among customers and should be incorporated into the RTO pricing structure and not tacked on at the inception of the contract. Customers who rely upon advertised monthly payments or price tag disclosures in making purchasing decisions can be surprised to find a processing fee added to their bill.

Late fees. All twenty-three RTO statutes allow the collection of fees for late periodic payments. Most states place limits on the amount of such fees, typically four or five dollars per late payment.³¹⁸ The fees can accumulate

paid before consummation of the agreement; must disclose the total of all initial and periodic payments and other charges to acquire ownership; does not forbid processing fees); 1991 La. Acts 204 § 3355(b) (must disclose all payments required at or before consummation or agreement); MD. COM. LAW CODE ANN. § 12-1104(a)(5) (1990) (disclosure of initial payments required to be made); MASS. ANN. LAWS ch. 93, § 91(b),(d) (Law. Co-op 1991) (must disclose the amount of any payment required by lessee at or before the execution of the lease); MINN. STAT. § 325F.86(d) (1990) (disclosure of any initial or advance payment); MO. REV. STAT. § 407.662(6) (1990) (must disclose amount and purpose of any payment, charge, or fee in addition to the regular periodic payments; does not expressly forbid processing fees); 1991 Nev. Stat. 196 § 4(g) (must disclose total payments required to be paid before consummation of agreement); N.Y. PERS. PROP. LAW § 501(5)(1), (7)(e) (McKinney 1991) (must disclose amount and purpose of any fee or charge not included in periodic payment; a charge in addition to periodic payments must be reasonably related to the service performed); NEB. REV. STAT. § 69-2110(1), (2) (1989) (no more than \$10; if contract has delivery charge, cannot have initial fee); OKLA. STAT. tit. 59, § 1954(c)(8) (1990) (initial fee cannot exceed \$10); R.I. GEN. LAWS § 6-44-3(b) (1990) (must disclose the amount of any payment required by lessee at or before the execution of the lease); S.C. CODE ANN. § 37-2-706(1) (Law. Co-op 1990) (initial fee not to exceed \$5); S.D. CODIFIED LAWS ANN. § 54-6A-5(7) (must disclose total payments required before consummation of agreement); TENN. CODE ANN. § 47-18-601(a)(9) (1990) (must disclose initial payments required to be paid before consummation of the agreement or delivery of the property, whichever is later); TEX. BUS. & COM. CODE ANN. § 35.72(g)(4) (Vernon 1991) (must disclose amount and purpose of any fee or charge not included in periodic payment; does not forbid processing fee); VA. CODE ANN. § 59.1-207.21(A)(7) (1991) (must disclose total of initial payments required to be paid before consummation of the agreement or delivery of the property, whichever is later).

Only Michigan expressly prohibits processing fees. *See* MICH. COMP. LAWS ANN. § 445.957(d) (West 1989).

³¹⁸ ALA. CODE § 8-25-4 (1990) (does not specifically mention or limit); ARK. STAT. ANN. § 4-92-106(b) (1990) (does not limit); COLO. REV. STAT. § 5-10-601(4)(a) (1990) (if monthly payment, \$5 maximum; if weekly or bi-weekly payment, \$3); 1991 Conn. Acts 91-162 (Reg Sess.) § 4(3) (5% of payment or \$5; \$1 minimum); DEL. CODE ANN., tit. 6, § 7608(4) (10% of payment or \$3). FLA. STAT. § 559.9237 (1990) (cannot exceed \$5); GA. CODE ANN. § 10-1-685(e) (no express fee allowed but does allow reinstatement

to large sums, however, over a contract calling for seventy-eight weekly payments by a person with uncertain income.³¹⁹ Late fees are justified because late payments cost dealers money and, if the fees are not allowed, all customers would pay higher prices, which would be unfair to those who timely make their payments. Late fees are only justified, however, to the extent that they cover the added cost created by the delay in receiving payment.³²⁰ The cost has two components. The first is the opportunity cost

fee); ILL. REV. STAT. ch. 121½, § 1802(c)(5) (1989) (cannot exceed \$5); IND. CODE § 24-7-5-5(a)(1) (1990) (if monthly payment, cannot exceed \$5; weekly payment, \$3); IOWA CODE § 537.3612(3)(4)(a) (1989) (not more than \$5; home collection charge in lieu of delinquency charge); 1991 Kan. Sess. Laws 336 § 7(3) (allows late fee upon payment); KY. REV. STAT. ANN. § 367.977(1)(e) (Michie/Bobbs-Merrill 1991) (must disclose the amount and purpose of any payment, charge, or fee in addition to the regular periodic payments; does not expressly forbid late fee); 1991 La. Acts 204 § 3357(A)(3) (allows for fee upon reinstatement); MASS. ANN. LAWS ch. 93, § 91(j) (Law. Co-op 1991) (must disclose amount and method for determining); MD. COM. LAW CODE ANN. § 12-1104(a)(13) (1990) (must disclose any other charges; does not expressly forbid late fees); *cf.*; MINN. STAT. § 325 F.91(1)(4) (1990) (charge shall not exceed the greater of 5% of payment or \$3); MO. REV. STAT. § 407.662(2)(5) (1991) (cannot exceed \$5 per default); NEB. REV. STAT. § 69-2110(3)(a), (b) (1989) (\$5 monthly payments; \$3 weekly); 1991 Nev. Stat. 196 § 8(1)(c) (allows late fee upon reinstatement); N.Y. PERS. PROP. LAW § 501(3)(e) (McKinney 1991) (not more than the greater of 10% of the payment or \$5 monthly, \$3 weekly); OHIO REV. CODE ANN. § 1351.02(A)(6) (Anderson 1990) (must disclose late fees); OKLA. STAT. tit. 59, § 1954(c)(5) (1990) (cannot charge late fee in excess of \$5 when added to the reinstatement fee; \$3 if weekly payments); R.I. GEN. LAWS § 6-44-5(b) (1990); S.D. CODIFIED LAWS ANN., § 54-6A-7(3)(1991) (allows late fee upon reinstatement); TENN. CODE. ANN. § 47-18-607(a)(2)(A) (1990) (allows late fee upon reinstatement); TEX. BUS. & COM. CODE ANN. § 35.72(c)(5) (Vernon 1990) (fee cannot exceed 5% of payment or \$5, and not less than \$2); VA. CODE ANN. § 59.1-207.21(A)(8) (1990) (allows late fees); *cf.* MICH. COMP. LAWS ANN. §§ 445.970, 445.953(1)(d), 445.958 (West 1989) (must disclose the amount of all other charges, individually itemized which are not included in periodic payment; § 445.970 sample form indicates late fees not allowed; reinstatement fee may be charged in lieu of late fee).

³¹⁹ *Cf.* 16 C.F.R. § 444.4 (1991) (FTC Rule prohibiting "pyramiding" of late charges when subsequent delinquencies are attributable to an unpaid late fee on earlier installment).

³²⁰ Late fees have historically been upheld by courts as penalties designed to encourage prompt payment, rather than hidden interest charges. *See* Comilla Cotton Oil Co. v. Spencer Kellogg & Sons, 257 F.2d 162 (5th Cir. 1958); Bunn v. Weyerhaeuser Co., 268 Ark. 445, 598 S.W.2d 54 (1980); Barbour v. Handlos Real Estate & Bldg. Corp., 393 N.W.2d 581 (Mich. Ct. App. 1986). With low income consumers, however, late payment may not be a voluntary decision, or matter of neglect, as much as an economic necessity. *See* Begelfer v. Najarian, 409 N.E.2d 167, 172 (Mass. 1980). Caution should therefore be exercised in regulating late fees in RTO contracts; the likelihood of late

of money that should be in the dealer's pocket but is delayed. Over a long term or for large amounts, the loss can be high, but the cost to the dealer of a twenty dollar payment being a few days late, in terms of perhaps lost interest in a bank account, is negligible. The other, and more substantial component, is the added collection expenses that may result from late payments.³²¹ Phone calls, visits to residences and legal recourse all take time and money, and only those who cause them should be expected to pay. But these expenses are not likely to be incurred until payment is at least a few days late. An RTO statute thus could reasonably allow collection of late fees but only if a grace period, roughly equivalent to the time when significant collection efforts begin, is mandated. The imposition of late fees without any grace period, which more than half of the RTO statutes permit, can generate a windfall for the dealer.³²²

Reinstatement fees. Reinstatement is a concept perhaps unique to RTO transactions. An RTO lessee can terminate the contract at any time, but he may, at a later time when disposable income allows, wish to begin renting the same or similar property again and receive "credit" for prior rentals toward ownership. Both lessee and lessor benefit from this opportunity because the lessee can more easily obtain ownership upon resuming payments and the lessor is less likely to lose the customer to another dealer. Consequently, even before RTO statutes began mandating reinstatement rights for RTO customers, many dealers offered them but charged a fee for reinstating the agreement.³²³ All RTO statutes mandate reinstatement

payment is high over a long weekly or bi-weekly contract.

³²¹ See K. BROWN & K. KEEST, *supra* note 23, at § 5.2.4.2.

³²² Grace periods for late payments are required in COLO. REV. STAT. § 5-10-601(4)(a) (1990) (5 days on monthly contracts; 3 days, weekly); 1991 Conn. Acts 91-162 (Reg. Sess.) § 4(3) (5 days on monthly contracts; 3 days weekly); DEL. CODE ANN., tit. 6, § 7608(4) (1991) (2 business days); ILL. REV. STAT. ch. 121½, para. 1802(c)(5) (1990) (3 days); IND. CODE § 24-7-5-5(a)(1) (1990) (5 days, monthly; 3 days, weekly); IOWA CODE § 537.3612(4)(a), (b) (1991) (5 days, monthly; 3 days, weekly); MINN. STAT. § 325F.91(1)(4) (1990) (3 days, monthly; 2 days, weekly); NEB. REV. STAT. § 69-2110(3)(a), (b) (1989) (5 days monthly, 3 days weekly); N.Y. PERS. PROP. LAW § 501(3)(e) (McKinney 1991) (3 days, weekly; seven days, monthly); OHIO REV. CODE ANN. § 1351.05(D) (Anderson 1990) (2 days, weekly; 5 days, monthly); S.C. CODE ANN. § 37-2-705 (Law. Co-op 1991) (5 days, monthly; 3 days, weekly); S.D. CODIFIED LAWS ANN., § 54-6A-7(3) (1991) (5 days monthly; 3 days weekly); TEX. BUS. & COMM. CODE ANN. § 35.72(c)(5) (Vernon 1991) (7 days); VA. CODE ANN. § 59.1-207.23 (1990) (5 days, monthly; 2 days, if more frequent).

³²³ See *Hawkes Television v. Bureau of Consumer Protection*, No. CV 82-686, slip op. at 4 (Me. Super. Ct. 1982), *rev'd*, 462 A.2d 1167 (Me. 1983).

rights,³²⁴ but only nine allow imposition of a separate reinstatement fee.³²⁵ The majority view is the more defensible. A reinstatement fee is similar to an initial processing fee in that it is intended to cover the cost of starting (or restarting) the transaction. It differs from a processing fee, however, because the expense is not caused by all customers but only those who first terminate an agreement and later renew. Nevertheless, a reinstatement fee is difficult to justify in most circumstances. Processing the reinstatement order is not likely to involve substantial additional work because the customer's application, original order, and account will be a matter of record, perhaps on a computer, and the process may require little more than a new entry and redelivery of the property. If a redelivery fee is allowed, as is the case in most states,³²⁶ a separate fee for reinstatement largely duplicates reimbursement for any added expense to the dealer. More importantly, the likelihood of reinstatement for low-income RTO customers, whose income and expenses may be unpredictable over a seventy-eight week contract, is rather high. Since reinstatement is generally good for all concerned, sound policy would recommend removing barriers to the process. Imposing a fee may discourage reinstatement, penalize the customer for taking an action that benefits not only himself but also the dealer, and may increase the dealer's income beyond any additional costs.

Home collection fees. Although RTO contracts typically require payments to be made at the dealer's store weekly or monthly in advance of the next rental period, irregular streams of income and lack of transportation contribute to a high rate of delinquency. Not surprisingly, a common practice among RTO dealers to encourage prompt payments is to collect overdue rent at the customer's home and charge a fee for each trip. No RTO statute

³²⁴ See *infra* note 341.

³²⁵ In many RTO statutes, reinstatement fees are treated as equivalent to late fees because each time a payment is late the agreement is deemed "terminated" and late payments serve to "reinstate" the terminated agreement. See statutes cited *supra* note 318. In nine states a separate charge for reinstatement appears to be authorized even if late fees have already been assessed. See COLO. REV. STAT. § 5-10-602 (1990) (\$5 limit); 1991 Conn. Acts 91-162 (Reg. Sess.) § 7(b) (\$5 limit); DEL. CODE ANN. tit. 6, § 7607(b) (\$5 limit); IOWA CODE ANN. § 537.3613 (West 1991) (\$5 limit); IND. CODE § 24-7-5-6 (1990) (\$5 limit); MINN. STAT. § 325 F.90(2) (1990) (\$5 limit); OHIO REV. CODE ANN. § 1351.05(B) (Anderson 1990) (\$5 limit); R.I. GEN. LAWS § 6-44-5(b) (1990) (\$5 limit).

³²⁶ See *infra* note 329. Of the seven states permitting separate reinstatement fees, only Colorado appears to prohibit redelivery charges. COLO. REV. STAT. § 5-10-601(2) (1990) (authorizing *initial* delivery fee; silent on redelivery fees).

prohibits collection of such fees.³²⁷ Like late payment fees, home collection fees can be viewed as an expense that should be paid by those who cause the problem. Several factors, however, may counsel against allowing the charge. First, since a trip to a customer's residence is part of the collection process for late payments, and indeed may be the principal expense resulting from a late payment, the expense should probably be subsumed in the late fee

³²⁷ See COLO. REV. STAT. § 5-10-601(3) (1990) (\$10 maximum in lieu of late fees; may not be assessed more than three times in a six-month period if monthly payments; six times in six months if weekly or bi-weekly); 1991 Conn. Acts 91-162 (Reg. Sess.) § 4(2) (cannot charge unless express agreement; cannot exceed \$5; may not be assessed more than three times in six months); DEL. CODE ANN. tit. 6, § 7603(a)(1) (1991) (must disclose all changes in contract; statute does not prohibit fee); FLA. STAT. § 559.9234(6) (1990) (cannot charge unless express agreement and disclosure); GA. CODE ANN. § 10-1-685(c) (1991) (prohibits fee unless expressly agreed to and amount disclosed); IND. CODE § 24-7-5-4 (1990) (\$10 or as adjusted under § 24-7-7-4); IOWA CODE § 537.3612(3) (1989) (\$7 maximum; home collection charge in lieu of delinquency charge); 1991 Kan. Sess. Laws 336, § 5(a)(1) (must disclose all charges; fee not prohibited); MD. COM. LAW CODE ANN. § 12-1111 (1990) (form agreement ¶ 5 appears to authorize fee; statute otherwise silent); MICH. COMP. LAWS ANN. § 445.957(e) (West 1989) (prohibits fee unless express agreement and disclosure); MINN. STAT. § 325F.91(3) (1990) (for payments more frequent than monthly, fee may be assessed no more than three times in three-month period; if at least monthly, no more than three times in six months; charge cannot exceed \$7; in lieu of late charge for the period); NEB. REV. STAT. § 69-2104(e) (1989) (required disclosure of all charges in contract; statute does not prohibit the fee); 1991 Nev. Stat. 196 § 4(I) (must disclose all fees; fee not prohibited); OHIO REV. CODE ANN. § 1351.04(E) (Anderson 1990) (cannot charge unless disclosed and expressly agreed); OKLA. STAT. tit. 59, § 1954(c)(9) (1990) (cannot exceed \$10; no more than three charges in six months if monthly; or six in six months if more often); S.C. CODE ANN. § 37-2-706(3) (Law. Co-op. 1991) (no more than \$7; may not be assessed more than three times in six-month period if payments are monthly or less frequent; six times in six months if more frequent than monthly); TENN. CODE ANN. § 47-18-604(a)(5) (1990) (must include statement that the total payments does not include other charges; does not prohibit home collection fee); VA. CODE ANN. § 59.1-207.21(A)(8) (1990) (same). Eleven states have laws similar to Tennessee's. See also ALA. CODE § 8-25-2(d)(3) (1990) (same as Tenn.); ARK. STAT. ANN. § 4-92-105(b)(4) (1990); ILL. REV. STAT. ch. 121½, para. 1802(g)(4) (1989); KY. REV. STAT. ANN. § 367.977(2)(1)(e) (Michie/Bobbs-Merrill 1991); 1991 La. Acts 204, § 3355(7); MASS. ANN. LAWS ch. 93, § 91(d) (Law. Co-op 1991) (same); MO. REV. STAT. § 407.662(3)(6) (1990); N.Y. PERS. PROP. LAW § 501(7)(e) (McKinney 1991); R.I. GEN. LAWS § 6-44-3(d) (1990); S.D. CODIFIED LAWS ANN. § 54-6A-5(8) (1991); TEX. BUS. & COM. CODE ANN. § 35.72(g)(4) (Vernon 1991).

charge.³²⁸ Second, allowing a separate home collection fee (up to ten dollars per trip in some states) can substantially increase the RTO cost largely at the discretion of the dealer. When a payment is late, the dealer has several available collection options. Some customer's homes may be visited (perhaps those which are conveniently located), while others will merely receive phone calls or letters. Third, and perhaps most importantly, allowing the fee may encourage personal contact between collectors and consumers, which can lead to confrontation and perhaps intimidation. Legislators should strive to minimize these opportunities, or at least not provide an incentive.

Delivery/redelivery fees. Every RTO statute allows a charge for delivering the leased property to the customer's home.³²⁹ The justification

³²⁸ Several statutes do provide that either late fees or home collection fees can be assessed, but not both. *See* COLO. REV. STAT. § 5-10-601(3) (1990); IOWA CODE § 537.3612(3) (1989); MINN. STAT. § 325F.91(3) (1990).

³²⁹ In several states, a delivery fee or initial processing fee may be charged, but not both. *See* COLO. REV. STAT. § 5-10-601(2) (1990) (not to exceed \$15 for five or fewer items or \$45 if more than five; delivery fee in lieu of initial processing fee); 1991 Conn. Acts 91-162 (Reg. Sess.) § 2(a)(3) (must disclose all initial payments, including delivery fees); DE. CODE ANN. tit. 6, § 7603(a)(6) (1991) (must disclose all payments due at delivery or consummation of contract); FLA. STAT. § 559.9233(4)(f) (1990) (must disclose all other charges not included in the rental payments; does not prohibit delivery fees); GA. CODE ANN. § 10-1-686 (1991); IND. CODE § 24-7-5-3(a), (b) (1990) (allows reasonable fee; in lieu of processing charge); IOWA CODE § 537.3612(2) (1989) (delivery charge not to exceed \$10; \$25 for more than five items; in lieu of initial charge); 1991 Kan. Sess. Laws 336, § 5(a)(7) (must disclose all payments due at delivery or consummation of contract); KY. REV. STAT. ANN. § 367.977(1)(e) (Michie/Bobbs-Merrill 1991) (must disclose all initial payments to be paid before delivery or consummation whichever is later; must disclose other charges not included in the rental payments); 1991 La. Acts 204, § 3355(6), (7) (same); MICH. COMP. LAWS ANN. § 445.958(2) (West 1989); MINN. STAT. § 325F.90(2) (1990) (may not charge delivery charge greater than \$15 for five items or less; \$30 for more than five items); MO. REV. STAT. § 407.662(3)(6) (1990) (must disclose amount and purpose of other charges for which lessee may be liable; does not prohibit delivery fees); NEB. REV. STAT. § 69-2110(2) (1989) (not more than \$10; \$25 for more than five items; in lieu of initial fee); 1991 Nev. Stat. 196 § 4(1)(G) (must disclose all payments due at delivery or consummation of contract); OHIO REV. CODE ANN. § 1351.02(2) (Anderson 1990) (must disclose any initial payment including any delivery charge); OKLA. STAT. tit. 59, § 1954(C)(6) (1990) (cannot exceed \$15 within 15 miles or \$30 if more than 15 miles; if more than five items, cannot exceed \$45 regardless of distance); S.C. CODE ANN. § 37-2-706(2) (Law. Co-op. 1991) (not to exceed \$15 or \$45 for more than 5 items; in lieu of initial charge); TENN. CODE ANN. § 47-18-607(a)(2)(A) (1990); *see also* ALA. CODE § 8-25-2(d)(3) (1990) (must disclose other charges for which lessee may be liable); ARK. STAT. ANN. § 4-92-105(b)(4) (1990) (same); ILL. REV. STAT. ch. 121½, para. 1804(g)(4) (1989) (same); MD. COM. LAW CODE ANN. § 12-1104(a)(5), (13) (1990)

for allowing delivery charges depends, to a large extent, on whether delivery is a real option that can be readily declined by the consumer. If the contract or business practice requires delivery or if, due to the size of the product or the complexity of installation, nearly all RTO customers receive delivery rather than take the product home from the store, the cost of the initial delivery is virtually indistinguishable from other general business expenses and should be incorporated into the base price.³³⁰ If consumers have a real option to decline delivery, and that option is adequately disclosed, a reasonable charge to cover the additional expense should be allowed. The justification for redelivery fees on reinstated contracts is slightly stronger. Redelivery expenses are not common to all customers and should not be shared by all through increased rental prices. Customers who reinstate agreements cause multiple deliveries and cost the dealer more than those who continue leasing uninterrupted. Unless a separate reinstatement fee is also being assessed, these consumers should pay a reasonable fee to cover this added expense.³³¹

(must disclose any initial payments to be made at or before consummation, and any other charges not included in rental payments; § 12-111 example form shows delivery charge); MASS. ANN. LAWS ch. 93, § 91(b), (d) (Law. Co-op. 1991) (must disclose any payment required at or before the execution of the lease; must disclose the amount of other charges not included in the payment); N.Y. PERS. PROP. LAW § 501(7)(e) (McKinney 1991) (must disclose amount and purpose of other charges for which lessee may be liable); R.I. GEN. LAWS § 6-44-3(d) (1990) (same); S.D. CODIFIED LAWS ANN. § 54-6A-5(7) (must disclose all payments due at delivery or consummation of contract); TEX. BUS. & COM. CODE ANN. § 35.72(g)(4) (Vernon 1991) (same); VA. CODE ANN. § 59.1-207.21(A)(7), (8) (1990) (same).

³³⁰ Dealers, of course, would like to collect the delivery fee at the outset of the contract (when the costs are incurred) rather than spreading the fee out among installment payments and collecting it over time. So long as the delivery fee is included in the disclosed total RTO price, the dealer should be permitted to collect a larger initial payment to cover the delivery expense. The problem to be remedied here is one of surprise, e.g., when the RTO price tag says \$500 at \$25 per month, but the consumer later learns that the price is really \$530, with \$55 due at the outset to cover the first month rental plus delivery charges.

³³¹ Redelivery fees appear to be allowed in all states except, perhaps, Colorado and Oklahoma. *See* 1991 Conn. Acts 91-162 (Reg. Sess.) § 7(b) (allows redelivery charge upon reinstatement); DEL. CODE ANN. tit. 6, § 7607(b) (1991) (reasonable redelivery fees permitted); FLA. STAT. § 559.9235(2) (1990); GA. CODE ANN. § 10-1-686 (1991) (allows redelivery charges not to exceed delivery charge); IND. CODE § 24-7-6-2 (1990) (redelivery charge can be equal to delivery charge); IOWA CODE § 537.3616(2) (1989) (redelivery charge equal to delivery charge); 1991 Kan. Sess. Laws 336, § 7(a)(2) (reasonable redelivery fees permitted); KY. REV. STAT. ANN. § 367.980(1)(b) (Michie/Bobbs-Merrill 1991) (reasonable costs of redelivery upon reinstatement); 1991

Termination or pick-up fees. Only fourteen RTO statutes prohibit a dealer from charging a fee when a customer terminates a lease and causes the dealer to pick up the leased property.³³² The justification for this fee is to compensate for the time and effort expended by the dealer retrieving goods and preparing them for possible re-rental to someone else. At first glance, it may seem fair to charge a fee to customers who generate these extra costs. Incorporating the costs into the general pricing structure would result in some RTO customers (those who rent to the end of the contract) to subsidize those who rent for shorter periods. Nevertheless, the charge seems unwarranted in contracts that expressly allow the customer to terminate without penalty. In light of evidence that up to eighty percent of RTO customers terminate the agreement at some point,³³³ termination is an eminently foreseeable event

LA. ACTS 204, § 3357 (A)(2) (same); MD. COM. LAW CODE ANN. § 12-1106(a)(2) (1990); MICH. COMP. LAWS ANN. § 445.958(2) (West 1989) (redelivery charge cannot exceed delivery charge); MINN. STAT. § 325F.90(2) (West 1990) (redelivery charge not to exceed \$15 for five items or \$30 for more than five items); MO. REV. STAT. § 407.664(2) (1990) (allows redelivery charges on reinstatement); NEB. REV. STAT. § 69-2108(2)(a) (1989) (same); 1991 Nev. Stat. 196, § 8(1)(B) (reasonable redelivery fees permitted); OHIO REV. CODE ANN. § 1351.05(B) (Anderson 1990) (same); R.I. GEN. LAWS § 6-44-5(b) (1990) (same); S.C. CODE ANN. § 37-2-714(2) (Law. Co-op. 1989) (redelivery equal to delivery charge); S.D. CODIFIED LAWS ANN. § 54-6A-7(2) (reasonable redelivery fees permitted); TENN. CODE ANN. § 47-18-607(a)(2) (1990) (reasonable delivery and redelivery fees); VA. CODE ANN. § 59.1-207.23(A) (1990) (allows redelivery charges on reinstatement); *see also* ALA. CODE § 8-25-2(d)(3) (1990) (must disclose other charges for which lessee may be liable; does not prohibit redelivery fees); ARK. STAT. ANN. § 4-92-105(b)(4) (1990) (same); ILL. REV. STAT. ch. 121½, para. 1804(g)(4) (1989) (same); MASS. ANN. LAWS ch. 93, § 91(b),(d) (Law. Co-op. 1991) (same); N.Y. PERS. PROP. LAW § 501(7)(e) (McKinney 1991) (same); TEX. BUS. & COM. CODE ANN. § 35.72(g)(4) (Vernon 1991) (same); *cf.* COLO. REV. STAT. § 5-10-601(2) (1990) (allows initial delivery fee per contract; redelivery charges are specifically prohibited after "repair or maintenance;" does not mention redelivery upon reinstatement); OKLA. STAT. tit. 59, § 1954(C)(6) (1990) (does not specifically mention redelivery, but does not define conditions under which "delivery" charge may be assessed other than for actual "delivery" of merchandise; otherwise, § 1954(C)(10) prohibits additional charges other than those specified).

³³² *See* COLO. REV. STAT. § 5-10-504(1)(b) (1990); 1991 Conn. Acts 91-162 (Reg. Sess.) § 4(5); FLA. STAT. § 559.9234(5) (1990); GA. CODE ANN. § 10-1-685(b) (1991); IND. CODE § 24-7-4-12 (1990); IOWA CODE § 537.3611(2) (1989); KY. REV. STAT. ANN. § 367.980(1)(a) (Michie/Bobbs-Merrill 1991); MD. COM. LAW CODE ANN. § 12-1104(a)(11) (1990); MICH. COMP. LAWS ANN. § 445.957(c) (West 1989); MINN. STAT. § 325 F.91(1)(1)(6) (1990); NEB. REV. STAT. §§ 69-2108(1), 2109 (1989); OHIO REV. CODE ANN. § 1351.04(D) (Anderson 1990); TENN. CODE ANN. § 47-18-607(a)(1) (1990); VA. CODE ANN. § 59.1-207.21(A)(12) (1990).

³³³ *See supra* note 170.

at the outset of every contract. But perhaps more importantly, termination is a basic right provided in the contract and is the one aspect of RTO agreements that purportedly sets them apart from retail sales. Assessing a termination fee essentially constitutes a penalty for exercising the very contract right that allows RTO agreements to escape regulation under other credit laws.³³⁴

Security deposits. All states except Minnesota allow an RTO dealer to collect a security deposit at the start of the transaction.³³⁵ The deposit

³³⁴ See Regulation Z, 12 C.F.R. § 226.2(a)(16) (1990) ("credit sale" would include RTO leases if they were not "terminable without penalty at any time by the consumer").

³³⁵ See MINN. STAT. § 325F.91(3) (1990) (prohibits the retention of RTO security deposits). Other statutes either expressly authorize security deposits or have provisions authorizing any charge or fee if properly disclosed. See COLO. REV. STAT. § 5-10-601(1) (1990) (must disclose security deposit and conditions for return); 1991 Conn. Acts 91-162 (Reg. Sess.) § 2(a)(3) (must disclose all initial payments); DEL. CODE ANN. tit. 6, § 7603(a)(6) (1991) (same); IND. CODE § 24-7-3-3(5) (1990) (must disclose if a security deposit is required and conditions for return); IOWA CODE § 537.3605(3) (1989) (must disclose if a security deposit is required); 1991 Kan. Sess. Laws 336 § 5(a)(7) (must disclose all initial payments); 1991 La. Acts 204 § 3355 (same); MASS. ANN. LAWS ch. 93, §§ 92(a)(3), 91(b) (Law. Co-op. 1991) (must disclose in advertisements if security deposit is required; must disclose in contract the amount of any payment required at or before execution); NEB. REV. STAT. § 69-2110(1) (1989) (must disclose if a security deposit is required and requirements for return); OKLA. STAT. tit. 59, § 1954(B)(6) (1990) (must disclose the amount of any required security deposit); R.I. GEN. LAWS § 6-44-8(a)(3) (1990) (must disclose in advertisement if security deposit is required); S.C. CODE ANN. § 37-2-706(1) (Law. Co-op. 1991) (if security deposit is required, must disclose amount and condition for return); see also ALA. CODE § 8-25-2(d)(3) (1990) (must disclose any other charges); ARK. STAT. ANN. § 4-92-105(b)(4) (1990) (same); FLA. STAT. § 559.9233(4)(d) (1990) (must disclose total of initial payments to be paid at or before consummation); GA. CODE ANN. § 10-1-682(a)(2) (1991) (same); ILL. REV. STAT. ch. 121½, para. 1802(g)(4) (1989) (must disclose amount and purpose of any other payment, charge, or fee not included in periodic payments); KY. REV. STAT. ANN. § 367.977(1)(i) (Michie/Bobbs-Merrill 1991) (must disclose total of initial payments to be paid at or before consummation or delivery, whichever is later); MD. COM. LAW CODE ANN. § 12-1104(a)(5) (1990) (must disclose total of initial payments to be paid at or before consummation); MICH. COMP. LAWS ANN. § 445.953(1)(b) (West 1989) (must disclose any initial payments to be paid at or before consummation or delivery, whichever is later); MO. REV. STAT. § 407.662(3)(6) (1990) (must disclose amount and purpose of any other payment, charge, or fee not included in periodic payments); 1991 Nev. Stat. 196 § 4(1)(G) (must disclose all initial charges); N.Y. PERS. PROP. LAW § 501(7)(e) (McKinney 1991) (same); OHIO REV. CODE ANN. § 1351.02(A)(2) (Anderson 1990) (must disclose total amount of initial payment to be paid at or before consummation); S.D. CODIFIED LAWS ANN. § 54-6A-5(7) (1991) (must disclose all initial charges); TENN. CODE ANN. § 47-18-604(5) (1990) (must disclose amount and purpose of any

creates a fund to reimburse the dealer for damage to leased property or lost rentals resulting from the lessee's retention of goods beyond the period for which he has paid. If the customer promptly makes the goods available to the dealer upon termination of the agreement and the goods are in satisfactory condition, the deposit would be returned. The deposit thus can be an effective way of allowing the dealer to receive money from a lessee who has breached the agreement. If properly disclosed and not abused, requiring a security deposit as "insurance" against such losses seems fair. Problems arise when disclosure is incomplete or misleading as, for example, when an advertisement promises a ten dollar rate for the first week but fails to mention a required twenty dollar security deposit. Unfairness can also result if a dealer retains the security deposit without justification after termination or delays unreasonably in returning the money to the lessee. The former concern can be addressed by requiring pertinent disclosure of security deposits in the contract and advertisements.³³⁶ The latter practice can, and should, be prohibited by statute, perhaps in a state's unfair trade practices law, but its discouragement in practice is largely left to the marketplace and the hope that maintaining customer goodwill is more important to the dealer than retaining security deposits without cause. As an added assurance, an RTO statute could reasonably mandate a deadline for returning deposits and impose severe penalties for noncompliance. No state currently imposes such a deadline.

Property insurance. Under several consumer credit laws, including TILA and the Uniform Consumer Credit Code, a creditor can insist that, as a condition of entering into the transaction, the buyer must either purchase property insurance from the seller or provide proof that the collateral is adequately insured.³³⁷ Creditors naturally would like some assurance that,

other payment, charge, or fee not included in periodic payments); TEX. BUS. & COM. CODE ANN. § 35.72(g)(4) (Vernon 1991) (same); VA. CODE ANN. § 59.1-207.21(A)(7) (1990) (must disclose total amount of initial payment to be paid at or before consummation or delivery, whichever is later).

³³⁶ Two states expressly require disclosure of security deposits in advertisements. MASS. ANN. LAWS ch. 93, § 92(a)(3) (Law. Co-op. 1991); R.I. GEN. LAWS § 6-44-8(a)(3) (1990). All states that permit security deposits require such disclosure in the RTO contract. See *supra* note 335.

³³⁷ Under TILA, the creditor can require the consumer to purchase property insurance from the creditor, but any mandatory insurance premiums so paid must be included in the disclosed finance charge. See 12 C.F.R. § 226.4(d)(ii) (1990). TILA does not prohibit a creditor from requiring proof of insurance as a condition to consummating the transaction. *Id.* The U.C.C.C. authorizes a creditor to collect property insurance premiums if the costs are conspicuously disclosed and if the consumer is allowed to choose the insurer. U.C.C.C. § 2.501(2)(a) (1974 version); see also *id.* at § 4.301.

if the property is destroyed or stolen, a fund to cover the loss exists in addition to the buyer's promise to reimburse the seller out of his own pocket. The issue is important to RTO dealers because incidents of theft and damage may occur at relatively high rates in the neighborhoods where they operate. The question is whether RTO dealers should be permitted to impose special fees to cover such losses, or whether the cost should be incorporated into the basic RTO rates.

Currently most RTO statutes prohibit a dealer from requiring an RTO customer to purchase property insurance from the dealer,³³⁸ but most do allow imposition of a separate fee if the lessee does not have insurance from another source.³³⁹ This may be misguided. Unlike many more affluent consumers, low income RTO customers are not likely to own their homes or carry renter's insurance against loss of personal property, and consequently in most cases they will be required to pay the extra periodic insurance fee to cover the risk. If there is no real option for RTO customers to avoid paying insurance premiums to the dealer, it may make sense to incorporate the fee into the RTO basic rates. The result would be slightly higher rental rates for all, but those rates would more accurately reflect the actual cost of the contract. Most RTO customers would benefit from the more accurate upfront disclosure, and dealers should suffer no loss in revenue. A viable alternative would be to allow a dealer to charge for property insurance, but only if the contract discloses the lessee's right to reject the coverage and assume personal responsibility for loss or damage to the goods even if he does not have personal property insurance. No RTO statute currently takes this approach, which would allow lessees to decide whether the risk is worth the added fee.

³³⁸ See ALA. CODE § 8-25-3(4) (1990); ARK. STAT. ANN. § 4-92-105(a)(4) (1990); COLO. REV. STAT. § 5-10-504(1)(a) (1990); 1991 Conn. Acts 91-162 (Reg. Sess.) § 4(1); FLA. STAT. § 559.9234(4) (1990); GA. CODE ANN. § 10-1-685(a) (1991); ILL. REV. STAT. ch. 121½, para. 1802(2)(c)(4) (1989); IND. CODE § 24-7-4-12(1) (1990); KY. REV. STAT. ANN. § 367.979(5) (Michie/Bobbs-Merrill 1991); 1991 La. Acts 204 § 3356(7); MICH. COMP. LAWS ANN. § 445.957(a) (West 1989); MINN. STAT. § 325F.86(h) (1990); MO. REV. STAT. § 407.662(2)(4) (1990); NEB. REV. STAT. § 69-2107(5) (1989); N.Y. PERS. PROP. LAW § 501(3)(d) (McKinney 1991); OHIO REV. CODE ANN. § 1351.04(A) (Anderson 1990); OKLA. STAT. tit. 59, § 1954(c)(4) (1990); TENN. CODE ANN. § 47-18-606(5) (1990); TEX. BUS. & COM. CODE ANN. § 35.72(c)(4) (Vernon 1991). *But see* MASS. ANN. LAWS ch. 93, § 91(g) (Law. Co-op. 1991) (must disclose any insurance "required of the lessee"); R.I. GEN. LAWS § 6-44-3(g) (1990) (same).

³³⁹ Oklahoma may be the only exception. OKLA. STAT. tit. 59, § 1954(c)(10) (1990) prohibits the charging of any fee "other than those specified" in the statute. Property insurance is not expressly authorized in the act.

3. Restrictions on Repossession

Repossessing merchandise from lessees who have stopped paying rent is an unavoidable part of the RTO business. Unfriendly confrontations between customer and dealer have led to allegations of unfair collection efforts and have contributed to the poor image of RTO dealers in some communities.³⁴⁰ Two issues typically arise: (1) whether RTO customers should have some way of protecting "equity" in goods that are repossessed after a substantial amount of rent has been paid, and (2) whether certain types of collection tactics should be prohibited.

With the exception of Massachusetts, all RTO statutes deal with the first issue by mandating reinstatement rights which allow the lessee to relinquish possession of rented property and resume payments at a later date without losing credit for earlier rentals. This right can be valuable to low-income individuals who may find it difficult to make continuous rental payments for twelve or eighteen months. The statutes take two approaches, each of which has some merit. In several states the reinstatement period (usually thirty to sixty days) is offered only to lessees who make the property available to the dealer "promptly" after default or within a grace period (two to seven days) after the last prepaid rental term expires.³⁴¹ This, of course, benefits

³⁴⁰ See *supra* notes 161-64 and accompanying text.

³⁴¹ See ALA. CODE § 8-25-4 (1990) (five days if monthly payment; two days if less than monthly; if merchandise is returned, the period is extended to thirty days after the return); ARK. STAT. ANN. § 4-92-106(a), (d), (e) (1990) (right to reinstatement extended to thirty days if property is returned other than by judicial process); FLA. STAT. § 559.9235(1) (1990) (right to reinstate if prompt surrender of property and lessee tenders reinstatement fees within 60 days of expiration of last rental period for which timely payment is made); GA. CODE ANN. § 10-1-686(a) (1991) (right to reinstatement if no more than three periodic payments missed and lessee surrendered the item to lessor); ILL. REV. STAT. ch. 121½, para. 1802(e)(2) (1989) (must take required action before the later of one week or one-half payment period); IND. CODE § 24-7-6-1 (1990) (right to reinstate if (1) prompt surrender of goods after failure to make payment and (2) not more than 60 days after surrender); IOWA CODE § 537.3616(1) (1989) (reinstatement rights if property is surrendered (when requested by lessor) and not more than 60 days have passed since the return of the property); KY. REV. STAT. ANN. § 367.980(1)(b) (Michie/Bobbs-Merrill 1991) (lessee must pay all past due rental charges, reasonable costs of pickup, redelivery, and refurbishing and any applicable late fee within five days of the renewal date if monthly, within two days if more frequently; if lessee returns the property, extend period for additional thirty days from the date of return); MICH. COMP. LAWS ANN. § 445.958 (West 1989) (if lessee missed not more than three periodic payments and item surrendered); MO. REV. STAT. § 407.664(1) (1990) (if asserted within three rental terms of last timely payment, lessor may require payment of unpaid payments, delinquency charges, reinstatement fee, and redelivery charge); OHIO REV. CODE ANN. § 1351.05

dealers by encouraging prompt return of property after payments have ceased, because a lessee who retains property without paying rent beyond the grace period forfeits future reinstatement rights. So long as the lessee is made aware of the grace period after termination of the agreement, this approach seems reasonable. The second approach also requires prompt return of property but provides a graduated reinstatement period depending on how many payments have been made. A lessee who stops paying near the end of the RTO contract may have up to 180 days in which to reinstate the agreement and obtain ownership.³⁴² Lessees who terminate after only a few

(Anderson 1990) (right extends to three lease terms after expiration of last lease term timely paid if lessee surrendered property at lessor request; lessor may require payment of any unpaid lease payments, delinquency charges, reasonable reinstatement fee, and redelivery charge; grace period not less than two days for weekly payment period or not less than five days if monthly; not entitled to more than three monthly grace periods per year); OKLA. STAT. tit. 59, § 1954(D) (1990) (reinstatement rights when lessee makes past due payments and returns property within two days of request; right extends for not less than thirty days after the return); R.I. GEN. LAWS § 6-44-5(a) (1990) (right for three lease terms if lessee surrenders property upon request; may require payment of unpaid lease payments, late charges, and reasonable reinstatement fees); S.C. CODE ANN. § 37-2-714(1), (2) (Law. Co-op. 1991) (right to reinstatement if not more than sixty days in default, only one periodic payment has been missed, and lessee has surrendered the item during the time in which payments were missed; lessor may charge the outstanding balance of payments and delinquency charges, plus delivery charges); TEX. BUS. & COM. CODE ANN. § 35.72(e)(2), (f) (Vernon 1991) (lessee must take proper action by the later of one week or one-half the number of days in a regular payment period after due date of payment; if merchandise is returned, the right to reinstatement must be extended for thirty days).

³⁴² See COLO. REV. STAT. § 5-10-701(1) (1990) (60 days; if lessee paid more than 60% of payments required for ownership, extend period for 120 days); 1991 Conn. Acts 91-162 (Reg. Sess.) § 7(a) (reinstatement period can be extended depending on percentage of contract completed); DEL. CODE ANN. tit. 6, 7607(a)(2) (1991) (60 days; if lessee paid more than 60% of total payments, extend to 180 days); 1991 Kan. Sess. Laws 336, § 7(b) (within five days of renewal date for monthly payments or two days if weekly payment, lessee must pay: (1) past due rental charges, (2) reasonable cost of pick-up and redelivery, and (3) reinstatement fee; if lessee paid less than two-thirds of ownership amount, the right extends not less than twenty-one days from the return of the property; if paid more than two-thirds of ownership amount, the right extends not less than forty-five days from return of property); MD. COM. LAW CODE ANN. § 12-1106(a) (1990) (same); 1991 La. Acts 204, § 3357(B), (C) (same); MINN. STAT. § 325F.90(1)(2) (1990) (if after failing to make timely payment, lessee surrenders the property within seven days of request and if lessee paid less than 60% of total payments necessary to acquire ownership, reinstatement period is 60 days; if lessee paid more than 60%, period is 180 days); NEB. REV. STAT. § 69-2108(2) (1989) (thirty days if lessee pays reasonable cost of pick-up, redelivery, and refurbishing and late fees within five days of renewal

weeks may have shorter reinstatement periods. This approach is potentially difficult to monitor, but if followed it offers an equitable solution that recognizes the increased value of reinstatement as an RTO customer nears the end of a contract. Again, so long as the consumer is made aware of his rights after termination, the approach seems fair.

The second issue—discouraging abuses in the collection process—is sparingly treated in RTO statutes,³⁴³ perhaps because other state laws of general applicability may address similar concerns. Minnesota is the only state to include comprehensive collection protections in its RTO statute.

date for monthly payment or three days for more frequent payments; extended to ninety days if lessee returned property and 60-80% of ownership already paid; extend to 180 days if more than 80%); 1991 Nev. Stat. 196 § 8(2), (3), (4) (same as Kansas); N.Y. PERS. PROP. LAW § 501(5)(c) (McKinney 1991) (if property returned within the later of seven days or one-half rental period, thirty days; if lessee paid one-half of payments required for ownership, sixty days; if three-fourths of payments are paid, 180 days); S.D. CODIFIED LAWS ANN. § 54-6A-7(3) (same as Kansas); TENN. CODE ANN. § 47-18-607(a)(2) (1990) (lessee must pay past due rental charges and reasonable cost of pick-up, redelivery, and refurbishing and any applicable late fee within five days of renewal date for monthly rentals or within two days if more frequent period; reinstatement period is then extended depending on percentage of payments made); VA. CODE ANN. § 59.1-207.23(A)-(C) (1990) (can reinstate upon payment of past due rental charges, reasonable costs of pick-up, and redelivery and applicable late fees, within five days of renewal date if monthly or two days if more frequently; if property returned, the right extends to twenty-one days if lessee has paid less than two-thirds of amount to acquire ownership; if paid two-thirds or more, extend right to forty-five days).

³⁴³ Several RTO statutes provide some collection protection to consumers, typically prohibitions against the lessor's breaching the peace, requiring that the lessee waive defenses or counterclaims, imposing confession of judgment remedies, garnishing wages or taking a security interest in goods other than the subject of the transaction. *See* ALA. CODE § 8-25-3 (1990); ARK. STAT. ANN. § 4-92-105(a)(1) to (3) (1990); COLO. REV. STAT. §§ 5-10-103, 5-10-502 (1990); 1991 Conn. Acts 91-162 (Reg. Sess.) § 3(a), (b); DEL. CODE ANN. tit. 6, 7608 (1991); FLA. STAT. § 559.9234 (1990); GA. CODE ANN. § 10-1-684 (1991); ILL. REV. STAT. ch. 121½, para. 1802(c) (1989); IND. CODE §§ 24-7-4-5 to 24-7-4-7 (1990); 1991 Kan. Sess. Laws 336, § 6; KY. REV. STAT. ANN. § 367.979(4) (Michie/Bobbs-Merrill 1991); 1991 LA. ACTS 204, § 3356; MD. COM. LAW CODE ANN. § 12-1105 (1990); MICH. COMP. LAWS ANN. § 445.956(b), (c), (e) (West 1989); MINN. STAT. § 325F.91 (1990); MO. REV. STAT. § 407.662(2)(2) (1990); NEB. REV. STAT. § 69-2107 (1989); 1991 Nev. Stat. 196, § 7; N.Y. PERS. PROP. LAW § 501(3)(a)-(c) (McKinney 1991); OHIO REV. CODE ANN. § 1351.03(A) (Anderson 1990); OKLA. STAT. tit. 59 § 1954(c) (1990); R.I. GEN. LAWS § 6-44-4 (1990); S.C. CODE ANN. §§ 37-2-708 to 37-2-710 (Law. Co-op. 1991); S.D. CODIFIED LAWS ANN. § 54-6A-6 (1991); TENN. CODE ANN. § 47-18-606(1)-(4) (1990); TEX. BUS. & COM. CODE ANN. § 35.72(c) (Vernon 1991); VA. CODE ANN. § 59.1-207.22 (1990).

Modeled after the federal Fair Debt Collection Practices Act ("FDCPA"),³⁴⁴ the law limits the frequency and timing of contacts with a delinquent customer, prohibits contacts with employers and third parties except in limited circumstances, and permits the customer to cut off further collection efforts by giving written notice to the dealer.³⁴⁵ The FDCPA provides limited benefits to consumers because it applies only to third party collection agencies and not to businesses, like RTO companies, that collect debts owed directly to themselves.³⁴⁶ The Minnesota law, one of the most recent RTO statutes to be enacted, fills a gap in this area and should be a model for future legislation. Congress' stated reason for limiting the federal act to third party collectors was that local banks and retailers are not likely to engage in abusive collection tactics because they are concerned about protecting their business reputations in the community.³⁴⁷ The same rationale would counsel against regulating the collection efforts of the RTO industry, whose dealers must also be concerned about their reputations,³⁴⁸ but RTO dealers have more frequent contact with delinquent customers than do most other businesses, and the RTO industry has a relatively poor record in some regions where abuses have occurred.³⁴⁹ Protections like those in Minnesota would set reasonable ground rules that many RTO dealers probably already follow. Those who do not abide by such guidelines should suffer a penalty.

4. *Contract Disclosures*

The consumer complaints about the RTO industry discussed in this article have largely occurred in unregulated environments where opportunities for deception were abundant. Rational spending decisions often were inhibited

³⁴⁴ 15 U.S.C. § 1692-1692m (1991).

³⁴⁵ See MINN. STAT. § 325F.92 (West 1990).

³⁴⁶ The FDCPA governs the activities of "debt collectors," defined as persons whose principal business is the collection of "debts owed or due or asserted to be owed or due another." 15 U.S.C. § 1692a(6) (1991).

³⁴⁷ See SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, CONSUMER CREDIT PROTECTION ACT, S. REP. NO. 187, 95th Cong., 1st Sess., reprinted in 1977 U.S. CODE CONG. & ADMIN. NEWS 1697.

³⁴⁸ See 1990 Not 'Easy,' But it Did Mean Success, RTO NETWORK NEWS, Jan. 1991, at 1-2 (improved relationships with consumer groups and media).

³⁴⁹ See *supra* note 170 and accompanying text.

because consumers did not realize the total costs of an RTO transaction.³⁵⁰ If consumers are given meaningful disclosures and substantive protections where overreaching is most common, exploitation of the unwary should decrease and informed decisions are more likely to be made. With the market working more efficiently, consumers should be able to assess the economic consequences of their choices and spend their money according to their individual preferences.³⁵¹

RTO contract disclosures should apprise the typical RTO customer of the overall nature of the transaction, the expected costs of the agreement including any fees that could be assessed during the contract term,³⁵² and the customer's rights against the dealer during the lease and after the relationship has terminated.³⁵³ For the most part, the RTO statutes enacted

³⁵⁰ See, e.g., *Hawkes Television v. Maine Bureau of Consumer Credit*, No. CV 82-686, slip op. at 4 (Maine Sup. Ct., Oct. 19, 1982), *rev'd*, 462 A.2d 1167 (Me. 1983) (dealer prominently advertised and disclosed weekly rent but not total RTO cost).

³⁵¹ See generally Koefele-Kale, *supra* note 30, at 141; Schwartz & Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 656 (1979) (discussing the effects of disclosure on the operation of efficient market). Virtually all disclosure legislation is subject to criticism. Disclosure in the written contract often has minimal impact on consumer behavior since the consumer usually makes the purchasing decision before the contract terms are examined. See *infra* note 362. Even when a consumer reviews contract disclosures, often the sheer number of disclosures can be overwhelming, diluting their effect. See *infra* note 356. Critics have contended that disclosure laws provide little benefit but satisfy the political demand for some legislation without producing strong opposition from industry. See Davis, *supra* note 134, at 843 n.10; Whitford, *supra* note 119, at 436. Indeed, the RTO disclosure legislation enacted to date has been sponsored by RTO dealer associations and has had relatively little adverse effect on business. See *States Enacting Rent-to-Own Laws Still on the Increase During 1990*, PROGRESSIVE RENTALS, June-July 1990, at 23, 47; Winn, *Rent-to-Own Statutes: A Comparison and Analysis*, PROGRESSIVE RENTALS, Feb. 1986, at 20, 21.

³⁵² The RTO industry believes that the periodic rental rate and duration of the contract are the terms most closely scrutinized by RTO customers. See Winn, *State Rent-to-Own Statutes Revisted*, PROGRESSIVE RENTALS, June-July 1990, at 30.

³⁵³ Disclosure of a consumer's rights upon default will have little impact on the consumer's decision whether to consummate the transaction. Most consumers do not expect default and for many it is an unlikely event. Some critics of TILA have therefore concluded that disclosure of default rights is not useful in the decisionmaking process. See Koefele-Kale, *supra* note 30, at 127-28; Landers, *supra* note 30, at 684. While not necessarily helpful in the decisionmaking process, disclosure of some default information to RTO consumers, particularly grace periods for late payments and conditions for reinstatement rights, can be important. For RTO consumers, the likelihood of default is high and valuable rights can be lost if the consumer does not comply with contract

to date serve these functions by requiring conspicuous disclosure of virtually every aspect of the RTO transaction,³⁵⁴ which in some states means as many as seventeen items of required information.³⁵⁵ Disclosure of reinstatement rights, late fee amounts and grace periods, permissible uses of security deposits, lessee's responsibility for loss or damage to property and insurance options, in addition to basic periodic payment, amounts, and total RTO costs, can aid the consumer in understanding the legal relationship.

Disclosure of too much information, however, can dilute the effectiveness of all disclosures and inhibit consumer understanding of the most important aspects of the transaction, particularly among consumers with substandard educational backgrounds.³⁵⁶ TILA disclosures were simplified in 1980

conditions. *See supra* notes 340-49 and accompanying text.

³⁵⁴ Required contract disclosures are set forth in ALA. CODE § 8-25-2(d) (1990); ARK. STAT. ANN. § 4-92-105(b) (1990); COLO. REV. STAT. § 5-10-401 (1990); 1991 Conn. Acts 91-162 (Reg. Sess.) § 2; DEL. CODE ANN. tit. 6, § 7603 (1991); FLA. STAT. § 559.9233(4)(a)-(n) (1990); GA. CODE ANN. § 10-1-682 (1991); ILL. REV. STAT. ch. 121½, para. 1802(f)-(g) (1989); IND. CODE § 24-7-3-3 (1988); IOWA CODE § 537.3605 (1989); 1991 Kan. Sess. Laws 336 § 5(a); KY. REV. STAT. ANN. § 367.977 (Michie/Bobbs-Merrill 1991); 1991 La. Acts 204, § 3355; MD. COM. LAW CODE ANN. § 12-1104 (1990); MASS. ANN. LAWS ch. 93, § 91 (Law. Co-op 1991); MICH. COMP. LAWS ANN. § 445.953 (West 1989); MINN. STAT. § 325F.86 (1990); MO. REV. STAT. § 407.662(3) (1990); NEB. REV. STAT. § 69-2104 (1989); 1991 Nev. Stat. 196, § 4(1); N.Y. PERS. PROP. LAW § 501(7) (McKinney 1991); OHIO REV. CODE ANN. § 1351.02(A) (Anderson 1990); OKLA. STAT. tit. 59, § 1954(A), (B), (D)(2) (1990); R.I. GEN. LAWS § 6-44-3 (1990); S.C. CODE ANN. § 37-2-702(1) (Law. Co-op. 1991); S.D. CODIFIED LAWS ANN. § 54-6A-5 (1991); TENN. CODE ANN. § 47-18-604(a) (1990); TEX. BUS. & COM. CODE ANN. § 35.72(g) (Vernon 1991); VA. CODE ANN. § 59.1-207.21 (1990).

³⁵⁵ *See* OHIO REV. CODE ANN. § 1351.02, .04 (Anderson 1990) (requiring the following disclosures: (1) description of goods, (2) whether new or used, (3) initial payment, (4) amount and timing of periodic payments, (5) amount of "other charges," (6) explanation of risk of loss, (7) explanation of reinstatement rights, (8) service or maintenance responsibilities, (9) statement explaining how agreement can be terminated, (10) total cost of obtaining ownership, (11) early purchase options, (12) manufacturer's warranty coverage after ownership transfers, (13) "cash price" of the goods, (14) statement that the transaction is regulated under state law, (15) statement that lessee is not required to purchase insurance from lessor, (16) in home collection fee (must be separately agreed to), and (17) method of computing and amount of delinquency charges).

³⁵⁶ Following the enactment of TILA in 1968, a consensus emerged that information overload had a deleterious effect on comprehension of disclosed information. Confronted with too much information, the typical consumer response is to ignore disclosure entirely. *See* T. STICHT, LEARNING & LISTENING IN LANGUAGE COMPREHENSION AND THE ACQUISITION OF KNOWLEDGE 285 (Carrol & Fredle eds. 1972); Koefele-Kale, *supra* note 30, at 128, 128 n.64; Landers & Rohner, *A Functional Analysis of Truth in Lending*, 26

following findings that consumers typically digest only a few bits of information in one sitting.³⁵⁷ RTO disclosure statutes are subject to similar criticism as they often bombard the consumer with more information than can reasonably be comprehended.³⁵⁸ Nevertheless, the peculiar circumstances of an RTO transaction may justify the detailed disclosures. The RTO transaction embodies a unique variety of rights and obligations not common to other types of buying arrangements, and the best realistic hope of apprising consumers of the salient characteristics of the arrangement may be to set them all out in the contract. At least if the consumer receives a copy of an agreement laden with information, he or she can refer to the document later if a dispute arises. Moreover, as the statutes promote uniformity in disclosed terms and language, consumers are in a better position to shop comparatively among RTO dealers.

Some relatively painless steps can be taken, however, to improve consumer understanding. RTO contracts should be drafted in plain language that a person with below average education can understand.³⁵⁹ Customers could be required to initial each disclosure, or at least the more important ones, to increase the likelihood of reading and understanding.³⁶⁰ Oral disclosures of key provisions, such as the periodic rate, total cost, amount of

U.C.L.A. L. REV. 711, 727-28 (1979). This is especially true when the consumer receives the disclosures under stressful circumstances not suited to careful study. Koefele-Kale, *supra* at 129-30, 130 n.68; Landers & Rohner, *supra*, at 725 (description of typical setting for contract disclosures). The problems associated with detailed disclosure schemes occur in leasing transactions as well as credit sales. See *Senate RTO Hearing*, *supra* note 2, at 31 (Statement of Nancy H. Teeters, FRB).

³⁵⁷ See Koefele-Kale, *supra* note 30, at 128-29, 145 (consumers have accurate recall of two items of information—amount borrowed and monthly payments); Mandell, *Consumer Perception of Incurred Interest Rates: An Empirical Test of the Efficacy of the Truth-in-Lending Law*, 26 J. FIN. 1146, 1146-48 (1971); Bettman, *Consumer Information Acquisition and Search Strategies*, THE EFFECT OF INFORMATION ON MARKET BEHAVIOR (A. Mitchell ed. 1978) (typical consumer can digest 8 “bits” of information before overload).

³⁵⁸ See *supra* note 355 (Ohio disclosures); MD. COM. LAW CODE ANN. § 12-1111 (1990) (form RTO agreement containing 13 paragraphs of disclosures, including complex reinstatement rights and formula for early purchase option).

³⁵⁹ The likelihood of information being understood depends in part on the readability of the information. Low income, undereducated individuals stand to benefit most from simple contract disclosures. See Davis, *supra* note 134, at 846-47, 872; Koefele-Kale, *supra* note 30, at 130, 132 (advocating clear writing style and use of familiar language).

³⁶⁰ See, e.g., OHIO REV. CODE ANN. § 1351.04(E) (Anderson 1990) (in-home collection disclosure must be separately signed).

late fees and grace periods, could be mandated.³⁶¹ Perhaps most importantly, certain fundamental information about the cost of an RTO contract should be made before the contract is signed and during the shopping activity.³⁶² All but seven of the RTO statutes allow dealers to make the enumerated disclosures at the time they present the contract to the customer for signature.³⁶³ A dealer is thus able to display an item in the

³⁶¹ The principal problem with requiring oral disclosures is the difficulty of enforcement. Businesses could be subject to numerous complaints that oral disclosures were not given and might find such allegations difficult to refute. Even if the consumer signed a form acknowledging that the oral disclosures were made, the consumer could maintain that he did not know what he was signing. *See* *Cole v. Lovett*, 672 F. Supp. 947 (S.D. Miss. 1987), *aff'd*, 883 F.2d 1008 (5th Cir. 1987). Legislatures could ameliorate these problems by, for example, providing no private remedy for a dealer's failure to give oral disclosures or providing that the consumer's signature creates a presumption that disclosures were made. *Cf.* 15 U.S.C. § 1635(c) (1991) (consumer's written acknowledgment of receipt of TILA disclosures creates rebuttable presumption).

³⁶² For the vast majority of consumers, contract disclosure is too late. The "sale" is usually made, at least in the consumer's mind, before he ever sees a contract. *See* *Jordan & Warren*, *supra* note 119, at 1320. Dealers in states where price tag disclosures are mandated report that the disclosures are not unduly burdensome. *See* PROGRESSIVE RENTALS, June-July 1988. In addition to price tag disclosures, discussed *infra* note 363 and accompanying text, 27 states require disclosures in RTO advertisements. The laws parallel TILA's advertising guidelines, *see supra* note 299, and require disclosure of information (e.g., total RTO cost) only if the advertisement refers to a specific item for lease. The laws vary widely in their scope. *See* ALA. CODE § 8-25-5 (1990); ARK. STAT. ANN. § 4-92-107 (1990); COLO. REV. STAT. § 5-10-1001(2) (1990); 1991 Conn. Acts 91-162, § 11(a); DEL. CODE ANN. tit. 6, § 7606(a) (1991); GA. CODE ANN. § 10-1-683(b) (1991); ILL. ANN. STAT. ch., 121½, para. 1803 (1989); IOWA CODE § 537.3615(2) (1989); 1991 Kan. Sess. Laws 336 § 10(a); KY. REV. STAT. ANN. § 967.982(1) (Michie/Bobbs-Merrill 1991); 1991 La. Acts 204, § 3360(A); MD. COM. LAW CODE ANN. § 12-1109 (1990); MASS. ANN. LAWS ch. 93, § 92 (Law. Co-op. 1991); MICH. COMP. LAWS ANN. § 445.955(3) (West 1989); MINN. STAT. § 325F.88(2)(a) (1990); MO. REV. STAT. § 407.663 (1990); NEB. REV. STAT. § 69-2112 (1989); 1991 Nev. Stat. 196, § 10(1); N.Y. PERS. PROP. LAW § 505 (McKinney 1991); OHIO REV. CODE ANN. § 1351.07 (Anderson 1990); OKLA. STAT. tit. 59, § 1954(E) (1990); R.I. GEN. LAWS § 6-44-8 (1990); S.C. CODE ANN. § 37-2-704(1) (Law. Co-op. 1991); S.D. CODIFIED LAWS ANN. § 54-6A-10(1)-(3) (1991); TENN. CODE ANN. § 47-18-610(a) (1990); TEX. BUS. & COM. CODE ANN. § 35.73 (Vernon 1991); VA. CODE ANN. § 59.1-207.26 (1990).

³⁶³ Disclosures on price tags for displayed merchandise are required in 1991 Conn. Acts 91-162 (Reg. Sess.) § 11(b) (cash price, amount and number of periodic payment; total cost); DEL. CODE ANN. tit. 6, § 7606(c) (cash price, amount and number of periodic payments, total cost); MD. COM. LAW CODE ANN. § 12-1104 (1990) (number and amount of payments; total RTO price; new or used); MICH. COMP. LAWS ANN. §

store for, say, ten dollars per week rental and the customer may not learn that the item is used merchandise, that the total cost of ownership is \$800, or that he must also pay a delivery fee or security deposit, until the contract is presented for signature. Unlike traditional retail credit sales, in which merchandise is presumed to be new and the ultimate credit cost of an item can be estimated from the stated cash price, RTO merchandise is sometimes used and the approximate ownership price cannot be determined from observing the periodic rental price without also knowing the length of the contract, performing some multiplication and noting what other charges are being assessed. Meaningful price tag disclosure should include, at a minimum, the number and amount of periodic payments, the total RTO cost of ownership, including any mandatory fees or security deposits, and a statement whether the leased property is new or used. Only with this information can a consumer engage in comparison shopping at other RTO dealers and, for those with other alternatives, at local retailers offering similar goods for cash or on credit.

V. CONCLUSION

The RTO industry has become a nationwide alternative to retail credit sales for a large number of our poorer citizens. Early efforts to characterize the transaction as an illegal evasion of usury laws and other consumer credit statutes have largely failed to gain widespread support. While attacks on the industry continue, the trend appears to favor a realization that RTO offers something of value to low income consumers who have been previously unprotected by other laws. The movement toward accepting the transaction as a legal option for consumers should ultimately benefit RTO customers by mandating uniform, meaningful disclosures tailored to their concerns and by eliminating some of the unfair practices and charges that have existed in the past. Although there may be no effective way to reduce substantially the cost of an RTO transaction, if legislatures focus on the peculiar circumstances of the RTO customer, laws can be enacted that allow consumers to make better informed, and more equitable, purchasing decisions.

445.955(3) (West 1989) (cash price, amount and number of periodic payments); MINN. STAT. § 325F.88(2)(b) (1990) (cash price, amount of lease payment, total cost); N.Y. PERS. PROP. LAWS § 505(3) (McKinney 1991) (cash price, amount and number of payments, total cost); OHIO REV. CODE ANN. § 1351.07(C) (Anderson 1990) (cash price, amount and number of payments, total cost).

