

Introduction to Rent-To-Own
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Overview of RTO Regulation and Legislation

Rent-to-own transactions are generally defined as an agreement for the use of personal property for personal, family, or household purposes, for an initial period of 4 months or less, that is automatically renewed with each rental payment and permits (but does not require) the consumer to acquire ownership. The lease must be terminable without penalty.

How the transaction is defined has been the key battle for the industry over the last 20 years. The battle has been largely about what the transaction is or is not. Opponents have sought to define the transaction as a credit sale and subject the industry to interest or time-price limits and requires APR disclosures. The industry has been successfully in shaping this debate and carving the transaction out of key regulatory schemes, including:

- **It's not a "security interest" and "retail installment sale":** The consumer has no obligation to renew the agreement beyond the initial period (usually a weekly initial term). Accordingly, the transaction generally does not fall within the statutory definitions of "security interest" and "retail installment sale." In addition, most of the RTO statutes specifically provide that the transaction does not create a "security interest" or "retail installment sale."
- **It's not a "Consumer Lease":** Because the lease is terminable before the expiration of four months, the transaction is not covered by the Consumer Leasing Act. *Givens v. Rent-A-Center, Inc.* 720 F. Supp. 160 (S.D. Ala. 1988), *aff'd without op.*, 885 F.2d 879 (11th Cir. 1989).
- **It's not a "credit sale under TILA":** TILA definition of "credit sale" specifically excludes leases that are terminable without penalty. *Reg. Z § 226.2(a)(16)*.

Opponents argued that the "economic reality" of the transaction required that it be treated like a credit sale—that is—the consumer's "built-up equity" in the goods is forfeited if a payment is missed and dealer repossess the property without the protections afforded in a credit sale. Secondly, opponents argued that RTO cost too much. Indeed, the transaction is an expensive way to acquire consumer goods if the consumer pays all of the payments. To counter these arguments, the industry agreed to substantive consumer protections:

- **Reinstatement Rights:** Many of the state statutes passed require that the dealer permit the customer to "reinstate" an agreement if they miss a payment and the dealer picks-up or repossess the goods. The consumer must pay all past due amounts owed in order to reinstate. The dealer is required to redeliver either the same or comparable goods. In some cases the reinstatement rights can extend as long as 180 days.

- **Early Purchase Option Rights:** Many state statutes mandate early purchase option formulas. Early purchase option rights allow the consumer to purchase the goods, at anytime during the agreement, by paying a discounted amount of the “cash price.” For example, the “cash price” minus 50% of the rent paid.

Presently, forty-seven states¹ and Puerto Rico have passed legislation defining the transaction as a lease and providing for appropriate disclosures. Three states, New Jersey, North Carolina and Wisconsin, do not have RTO legislation. Vermont does not regulate RTO transactions as credit sales, but requires an “effective APR” disclosure.

Keys to Legislative Success

- **Debate focused largely on the Definition:** The primary issue was whether the transaction was a sale subject to retail installment sales acts and the requirements of a secured transaction or a lease. The clearly terminable nature of the transaction made definition question relatively easy to explain and win support for. Also, the ability to terminate the lease at anytime, with reinstatement rights, means that no one is “economically trapped.” The secondary attack on the cost of the transaction could then be dealt with through substantive consumer protections, such as early purchase options, that were acceptable to the industry.
- **Unified Industry:** The “lease v. sale” question was life or death for industry members both large and small. It provided a single unifying issue that industry members rallied around.

¹ The Minnesota Supreme Court effectively negated the Minnesota Rental-Purchase Agreement Act by holding that the transactions were credit sales and subject to the states usury limits. *Miller v. Colortyme*, 518 N.W.2d 544 (1994).