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Ohio Rev. Code Ann. Ch. 1351 (Anderson 1988): Ohio's Rent-to-Own Legislation: Adequate or Ineffective?

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LEGISLATION NOTE

OHIO REV. CODE ANN. ch. 1351 (Anderson 1988):* Ohio's Rent-to-Own Legislation: Adequate or Ineffective?

I. INTRODUCTION

The United States is a nation on credit.[1] Consumer debt in this country rose from one hundred fifteen billion dollars in 1969 to nearly six hundred billion dollars in 1987.[2] Consumers no longer want to wait for goods, and therefore, seek alternative means to obtain desired goods.[3] This pattern is also prevalent among the poor of the nation, as even low-income consumers strive for possessions.[4]

A study of low-income families conducted in 1963[5] indicates that low-income consumers purchase large quantities of durable goods.[6] According to the study, low income consumers lack the cash to buy outright, however, and rarely are able to obtain traditional forms of credit.[7] Entrepreneurs have recognized that a market exists among low-income members of society and, despite risks involved, have elected to

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* Chapter 1351, formerly H.B. 421, became effective in 1988.

1. Caplovitz, *The Social Benefit and Social Costs of Consumer Credit*, AM. COUNCIL ON CONSUMER INTERESTS 119 (V. Hampton ed. 1987). "Today, being in debt is the American way of life and a person's credit rating is a major asset. . . ." *Id.*

2. Bottorff, *Cry of 'Charge!' Unleashes Bankruptcy As More Consumers Do Battle With Debt*, NEW ENG. BUS., June 1, 1987, at 37. Similar statistics were reported by David Caplovitz in 1987. Caplovitz stated that the installment debt grew from $150 billion in 1975 to $620 billion in 1987. *See* Caplovitz, *supra* note 1, at 119. That figure represents more than $7,000 in installment debt per American household, excluding mortgage debt and non-installment debts such as medical bills. *Id.*

3. Vavoso, *Consumers Want the Easy Life*, BOTTOMLINE, June 1987, at 13.

4. D. CAPLOVITZ, THE POOR PAY MORE 14 (1963).

5. D. CAPLOVITZ, THE POOR PAY MORE (1963). The Caplovitz book is the result of a study of low income families in three New York City settlements. The study has been cited by several authors with one author referring to it as "a classic study" of low income consumers. R. NADER, THE CONSUMER AND CORPORATE ACCOUNTABILITY 255 (1973); *accord* A. GRIFFIN, THE CREDIT JUNGLE 138 (1971).

6. D. CAPLOVITZ, *supra* note 4, at 12. The study noted that families who bought on credit own more durable goods than those who did not. *Id.* at 96–97.

7. *Id.* at 14. Another author noted that problems concerning buying power of low income individuals are prevalent in all areas of the country, not just New York City. ROSE, THE BETRAYAL OF THE POOR 1 (1972).

conduct business with low-income consumers.[8] These transactions are popular and the willingness by both parties to enter into such contracts has created a national multi-billion dollar rent-to-own industry in the United States.[9]

Through the rent-to-own industry, primarily low to middle income consumers gain possession of television sets, refrigerators and other home appliances, as well as entertainment equipment,[10] applying weekly or monthly payments toward ultimate ownership of the goods.[11] There are generally no credit checks in rent-to-own transactions and the consumer has no obligation to continue renting or to ultimately purchase.[12] Thus, a consumer who is unable to establish credit can obtain goods he could not otherwise afford.

However, this convenience is offset by high prices.[13] Although payments are low, they are spread across a long period of time. When these payments are added together, the total cost of the goods can easily become two or three times the value of the item.[14] Further, as one

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8. D. CAPLOVITZ, *supra* note 4, at 15. These merchants cater to low income people who cannot obtain credit anywhere else but in their neighborhood. *Id.*; *accord* A. GRIFFIN, *supra* note 5, at 121.

9. DeCourcy Hinds, *Rent-and-Own Plans: Handy but Costly*, N.Y. Times, June 4, 1988, at 25, col. 1. In the last five years, the sales in the rent-to-own industry have doubled to over two billion dollars annually. *Id.* Nationwide, approximately 3,000 rental companies exist with about 6,000 outlets. *Id.*

10. A television set, which may not be a necessity to most people, is in fact a necessity item to low income individuals who rely on it as a link with the outside world and possibly their only source of entertainment. G. LEINWAND, THE CONSUMER 25 (1970). "Television sets account for nearly one half of all revenue generated by rent-to-own programs. . . . [and] [h]ome appliances represent the second largest category." Swagler, *Rent-to-Own Programs: Is Consumer Protection Adequate?*, AM. COUNCIL ON CONSUMER INTERESTS 267, 267 n.3 (K. Schnittgrund ed. 1986).

11. Henry, *Lender of Last Resort*, FORBES, May 18, 1987, at 73.

12. *Id.*

13. Swagler, *supra* note 10, at 267–68. A survey of nine rent-to-own agencies in the Atlanta area revealed that the cost to purchase a 19-inch portable color television set with a retail value of approximately $325 ranged from $878 to $1,170 on a weekly payment plan and $828 to $972 on a monthly payment schedule. *Id.* Swagler's research indicated that if the rental fees of rent-to-own consumers were treated as installment sale payments, an annual percentage rate (APR) for financing could be calculated. *Id.* at 268. The APR for the payments ranged from 162%–206% for weekly payment customers and 117%–168% for monthly customers. *Id.* Technically, however, the consumer is a renter and his payments are lease payments, not installment sale payments. *Id.* Therefore, APR is inapplicable to rent-to-own agreements, and laws regulating maximum APR figures do not help regulate such contracts. *Id.* Another article stated that APR, if calculated for these types of transactions, would run about 89%. *See* Henry, *supra* note 11, at 73.

14. Henry, *supra* note 11, at 73. In St. Louis in 1987, a 19-inch portable color television set could be bought from an electronics discounter for approximately $229, plus 6 per cent sales tax. *Id.* A credit card customer could go to a major department store and bring home the same television model for $500, including a two-year maintenance agreement, delivery charge, sales tax, and 18% credit card finance charge. *Id.* Without any credit, a rent-to-own consumer can take home that television set for about $9.95 per week, which usually includes maintenance fees. *Id.* Multiply comments@udayton.edu/ulr/vol14/iss2/11 consumer will pay about $776 for the same television a

industry leader noted, customers do not own the property until all payments are made.[15] If the customer misses payments or defaults prior to making the final payment, the customer retains no interest in the merchandise, while the merchant repossesses the property and keeps the past payments.[16]

State legislatures were alerted to the potential hazards these rent-to-own agreements pose to consumers. In order to combat the problem, the Ohio General Assembly recently enacted Chapter 1351 of the Revised Code, which regulates lease-purchase agreements, commonly referred to as rent-to-own transactions.[17] Opponents of the new law contend it does not adequately protect consumers and still allows merchants to charge more than twice the fair value of the goods purchased.[18] Proponents, however, maintain that the law is reasonable and contend that further regulation by the government would amount to paternalism.[19]

First, this note will briefly examine the history of installment sales agreements which ultimately led to the creation of the now common rent-to-own transaction. Second, it will examine past legislative and judicial attempts to regulate such transactions and the difficulties associated with these efforts. Third, the purpose and provisions of the Chapter 1351 "rent-to-own" statute will be examined. Finally, this note will consider the success of the statute in achieving its objectives.

II. BACKGROUND

Installment sales agreements have existed since before the turn of the century.[20] In 1889, Belle Caldwell purchased a new Singer sewing machine for fifty-five dollars on an installment payment plan.[21] The plan required Mrs. Caldwell to make low routine monthly payments on

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cash customer bought for $229. *Id.*

15. *Id.*

16. *Id.* As Henry notes, "the customer isn't really buying the goods until he has bought them." *Id.*; *see also* Henderson, *Rent-Own Bill Ok's 125% Charges*, Clev. Plain Dealer, Dec. 28, 1987, at 1B, col. 1.

17. OHIO REV. CODE ANN. § 1351 (Anderson 1988).

18. *Rent-to-Own: Hearings on Amended HB 421 before the Senate Comm. on Financial Institutions and Insurance*, Ohio Senate (1988) [hereinafter *Hearings*] (testimony of Paul Herdeg, Staff Attorney, Cleveland Legal Aid Society).

19. Telephone interview with Samuel Choate, attorney representing the rent-to-own industry (Oct. 26, 1988) [hereinafter Choate Interview] (Mr. Choate said his office wrote most of OHIO REV. CODE ANN. § 1351).

20. *See, e.g.*, Caldwell v. Singer Mfg. Co., 4 Ohio C.C. Dec. 680 (1892), *aff'd*, 55 Ohio St. 638, 48 N.E. 1118 (1896). In fact, installment sales were conceived by Singer Manufacturing Company in 1856. *See* Caplovitz, *supra* note 1, at 119.

21. *Caldwell*, 4 Ohio C.C. Dec. at 680.

the machine. In exchange, she gained immediate possession of it.[22] The title, however, remained with the vendor until Caldwell completed the payments. After making several payments, she failed to pay according to the exact terms of the contract.[23] Without refunding any portion of her installment payments, the company repossessed the machine.[24] This case, *Caldwell v. Singer Manufacturing Co.*,[25] illustrates the potential for the buyer/lessee to lose all he has invested in the merchandise purchased on an installment sales plan.

In the more recent case of *Jones v. Star Credit Corp.*,[26] the high cost of this credit method is illustrated. In *Jones*, the plaintiffs, who were welfare recipients, agreed to purchase a home freezer unit for nine hundred dollars.[27] Additional costs, including sales tax and time credit charges, increased the cost of the unit to $1,234.80.[28] At trial, the court determined that the maximum retail value of the freezer was only three hundred dollars.[29] The *Jones* court held that the contract was unconscionable because the price was more than four times the retail value of the item.[30]

Although the *Jones* court determined that the contract was unconscionable, such a remedy is not a reliable tool to cure abuses in the area of retail installment sales because courts are often unwilling to invalidate contracts between individuals based on price alone.[31] Therefore, other measures became necessary to protect consumers in cases in which the abuses are excessive. Special care, tempered with a degree of deference, is required to regulate contractual agreements between merchants who were willing to conduct business on an installment basis, and the low-income consumer who was a willing participant, but may not have been aware of the pitfalls of such a transaction.[32]

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22. *Id.*

23. *Id.*

24. *Id.* After paying $36 in installment payments on the machine, her payments became late and the company repossessed the machine. Caldwell filed suit, seeking return of the $36 plus costs. *Id.*

25. *Id.* The *Caldwell* court also noted that "whenever they could get a party in default on any of the payments of the installments, whether of $1.00 or more, they took possession of the property and held it as their own, and filched from the people their machines and all they had paid on them." *Id.* at 682.

26. 59 Misc. 2d 189, 298 N.Y.S.2d 264 (Sup. Ct. 1969).

27. *Id.* at 190, 298 N.Y.S.2d at 264.

28. *Id.* at 190, 298 N.Y.S.2d at 265.

29. *Id.*

30. *Id.* at 192, 298 N.Y.S.2d at 265.

31. FARNSWORTH, CONTRACTS § 4.28 (1982).

32. The *Jones* Court noted:

> On the one hand it is necessary to recognize the importance of preserving the integrity of agreements and the fundamental right of parties to deal, trade, bargain, and contract. On the other hand there is the concern for the uneducated and often illiterate individual who is

Due to his economic status, the low-income consumer is at a considerable disadvantage in the marketplace. He lacks the cash necessary for purchases and is usually unable to obtain credit.[33] These facts, coupled with a high degree of job insecurity, contribute to his reputation as a poor credit risk.[34] He is a member of a "captive" class who has neither the means nor sufficient knowledge of the marketplace necessary to price shop.[35] He "is less psychologically mobile, less active, [and] more inhibited in his behavior than the well-to-do consumer. The radius of stores he considers for possible purchases is always smaller."[36] Before the rent-to-own companies catered to these low-income consumers, the consumers' options were limited. Their choices were to do without durable goods or buy within the scope of the installment sales market.[37] However, that market presents great risks to the inexperienced consumer.

In contrast, the merchants who were willing to sell on credit to low-income consumers inherited sizeable risks that their customers would be unable to afford the payments and would ultimately default.[38] Further, usury statutes prohibited merchants from charging the interest rates they contended were necessary to make such transactions profitable.[39]

In order to protect low-income consumers and relieve the economic burden on merchants who were willing to cater to this high-risk group,[40] state legislatures began passing retail installment sales acts. The Ohio Retail Installment Sales Act[41] became effective August 10, 1949.[42] The act is designed to allow retail installment purchases to be conducted in a manner fair to both merchants and consumers.[43] It authorized higher interest rates on installment sales transactions while establishing rigid requirements regarding the substance and form of such

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the victim of gross inequality of bargaining power, usually the poorest members of the community.

Jones, 59 Misc. 2d at 190, 298 N.Y.S.2d at 265.

33. G. LEINWAND, *supra* note 10, at 24. "It has been said that 'the curse of the poor is their poverty.' This means that they are cursed not only with a lack of money but also with an inability to get the most for the limited money they do have." *Id.*

34. D. CAPLOVITZ, *supra* note 4, at 14.

35. *Id.*

36. *Id.* at 49 n.1 (quoting M. JAHODA, P. LAZARSFELD & H. ZEISEL, THE UNEMPLOYMENT OF MARIENTHAL (1960)).

37. A. GRIFFIN, *supra* note 5, at 121.

38. Note, *Consumer Credit: The Ohio Retail Installment Sales Act and Its Abuses*, 20 CASE W. RES. L. REV. 621 (1969).

39. *Id.* at 621–22.

40. D. CAPLOVITZ, *supra* note 4, at 15–16.

41. OHIO REV. CODE ANN. §§ 1317.01–99 (Anderson 1988).

42. Note, *supra* note 38, at 622.

43. *Id.* at 632.

contracts.[44] Retail installment sales are defined as "every retail installment contract to sell specific goods, every consumer transaction in which the cash price may be paid in installments over a period of time, and every retail sale of specific goods to any person in which the cash price may be paid in installments over . . . time."[45] This type of sales method is a special credit transaction which presents difficulties to consumers. As one author noted, "[t]he institution of credit introduces special complex requirements for intelligent consumption. Because of the diverse and frequently misleading ways in which charges for credit are stated, even the highly educated consumer has difficulty knowing which set of terms is most economical."[46]

A. Regulating Retail Installment Sales Contracts

The Retail Installment Sales Act (RISA) fixed the per-year interest rate which could be charged on an installment contract[47] and required the contract to be in writing.[48] Under RISA, the contract must recite the following: cash price;[49] amount of down payment; unpaid balance; cost of insurance, if any, to the buyer/lessee; principal balance owed; finance charges and time balance owed and number of payments.[50]

The finance charge provision is especially attractive because it limits the amount a merchant can charge in an installment transaction.[51] The section establishes a maximum base finance charge of eight dollars per one hundred dollars a year on the principal balance of the contract.[52] This section also establishes a service charge maximum of fifty cents per month for the first fifty dollars and twenty-five cents per month for the next five fifty dollar units.[53] Therefore, on a three hundred dollar unpaid balance, the maximum base finance charge would be twenty-four dollars per year and the maximum service charge would

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44. *Id.* at 622.

45. OHIO REV. CODE ANN. § 1317.01(A) (Anderson 1988).

46. D. CAPLOVITZ, *supra* note 4, at 14 (footnote omitted).

47. OHIO REV. CODE ANN. § 1317.06 (Anderson 1988).

48. *Id.* § 1317.02. "Every retail installment sale shall be evidenced by an instrument in writing. A copy of said instrument shall be delivered to the retail buyer by the retail seller at the time of its execution." *Id.*

49. *Id.* § 1317.04. Cash price is defined as the price measured in dollars, agreed upon in good faith by the parties as the price at which the specific goods which are the subject matter of any retail installment sale would be sold if such a sale were a sale for cash to be paid upon delivery instead of a retail installment sale.
Id. § 1317.01(K).

50. *Id.* § 1317.04.

51. *Id.* § 1317.06.

52. *Id.* § 1317.06(A)(1).

53. *Id.* § 1317.06(A)(2).

be twenty-one dollars per year.

In *Teegardin v. Foley*,[54] the Supreme Court of Ohio noted that the purpose of the RISA was to prevent common abuses existing in the installment purchase system.[55] In that case, the court held that the RISA should be applied to actions involving automobile sales conducted on an installment basis.[56]

B. Regulating Rent-to-Own Contracts

The Retail Installment Sales Act is not effective for cases involving rent-to-own contracts. By its very nature, a retail installment sales contract (RISK) is different from a rent-to-own contract because a RISK involves the sale of an item on an installment payment plan.[57] A RISK is a sales contract. Therefore, it contains payments that a buyer is obligated to make. On the other hand, a rent-to-own contract is a lease-purchase agreement for an initial period of four months or less, which is automatically renewable at the end of each lease period.[58] Although a lease-purchase agreement also permits the lessee to ultimately acquire ownership of the item,[59] a lessee is neither obligated to make all of the payments, nor obligated to ultimately purchase.[60] In a lease purchase contract, the obligation exists only to the extent of each payment.[61] Therefore, the lessee can terminate the contract at any time. Since the lease-purchase agreement is not technically a sale, the consequences of the transactions are different and cannot be regulated in a like manner.[62] Thus, the RISA, which governs installment sales, is not adequate to directly address the problems of the rent-to-own industry.[63]

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54. 166 Ohio St. 449, 143 N.E.2d 824 (1957).

55. *Id.* at 453, 143 N.E.2d at 827.

56. *Id.*

57. Note, *supra* note 38, at 632; *see also supra* note 45 and accompanying text.

58. Lease-purchase agreement is defined as an agreement for the use of personal property by an individual primarily for personal, family, or household purposes for an initial period of four months or less that is automatically renewable with each lease payment after the initial period and that permits the lessee to acquire ownership of the property. OHIO REV. CODE ANN. § 1351.01(F) (Anderson 1988).

59. *Id.*

60. *Id. See generally* DeCourcey Hinds, *supra* note 9.

61. *See* Henry, *supra* note 11, at 74. Under a rent-to-own contract, the buyer has no obligation to continue renting or to purchase. *See id.* at 73.

62. *See supra* notes 57–60 and accompanying text. However, the State of Pennsylvania amended its RISA to include lease-purchase agreements. That legislation sets a maximum interest rate of 25% for rent-to-own transactions. PA. STAT. ANN. tit. 69 § 1101 (Purdon 1988).

63. Existing federal laws, specifically the Truth in Lending Act, 15 U.S.C. §§ 1601–1613, 1631–1641, 1661–1665 (1982), and the Consumer Leasing Act, 15 U.S.C. § 1667 (1982), also are inadequate to regulate lease-purchase transactions. *See* 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). The Consumer Leasing Act regulates leases "for a period of time exceeding four months." 15 U.S.C. § 1667(1) (1982). The Truth in Lending Act regulates transactions in which the lessee is obligated to pay a

Other jurisdictions have addressed this same problem. In *State v. Action TV Rentals, Inc.*,[64] the Court of Appeals of Maryland held that week-to-week or month-to-month rental agreements are not governed by the RISA.[65] That court noted that jurisdictions are split in their interpretation of the character of such contracts.[66] Some courts have ruled that these contracts are leases intended as security,[67] while others have determined that these transactions are true leases.[68]

1. Security Interest

In Ohio, a judge recognized the confusion created by rent-to-own contracts, noting that, "this Court [sic] has little guidance from Ohio courts on what they deem to be the proper construction to be given to

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sum at least as great as the value of the property. *Id.* § 1602(g). Since rent-to-own transactions are usually week-to-week or month-to-month and offer low weekly or monthly rental fees, neither federal act will regulate rent-to-own transactions. *See, e.g.*, Davis v. Colonial Sec. Corp., 541 F. Supp. 302, 304 (E.D. Pa. 1982), *appeal dismissed mem.*, 720 F.2d 660 (3d Cir. 1983); Lemay v. Stroman's, Inc., 510 F. Supp. 921, 922–23 (E.D. Ark. 1981); Stewart v. Remco Enter., 487 F. Supp. 361, 362–63 (D. Neb. 1980); Dodson v. Remco Enter., 504 F. Supp. 540, 542–43 (E.D. Va. 1980); *Smith*, 491 F. Supp. at 127.

64. 297 Md. 531, 467 A.2d 1000 (1983).

65. *Id.* at 555, 467 A.2d at 1012.

66. *Id.* at 549, 467 A.2d at 1009.

67. *See In re* Merrit Dredging Co., 839 F.2d 203 (4th Cir. 1988) (twelve monthly rental payments with no additional consideration to purchase created a security interest and thus the parties intended a conditional sale), *cert. denied*, 108 S. Ct. 2904 (interim ed. 1988); *In re* Thompson & Son, 665 F.2d 941 (9th Cir. 1982) (considering intent of the parties as an important factor, the court determined that the lease of heavy construction equipment which provided an option to purchase for little consideration was a security interest); *In re* Tillery, 571 F.2d 1361 (5th Cir. 1978) (under an automobile lease, the court determined than an option to purchase for no or nominal consideration created a security interest); Sight & Sound of Ohio, Inc. v. Wright, 36 Bankr. 885 (S.D. Ohio 1983) (lease of a refrigerator for a low weekly rate with an option to purchase created a security interest because such a large amount of money had accrued in prior payments); Waldron v. Best TV & Stereo Rentals, Inc., 485 F. Supp. 718, 719 (D. Md. 1979) (a rental agreement in which lessee had an option to terminate the contract at anytime was a credit sale and such termination clause did not alter the essential nature of the contract); *In re* Standard Fin. Management Corp., 79 Bankr. 100 (Bankr. D. Mass. 1987) (the court applied a 16-part test to determine if the lease is a true lease or was a lease intended as security and thus a conditional sale); Palacios v. ABC TV & Stereo Rental of Milwaukee, Inc., 123 Wis. 2d 79, 365 N.W.2d 882 (Ct. App. 1985) (lease of a television set determined to be a conditional credit sale under the Truth in Lending Act).

68. Clark v. Rent-It Corp., 511 F. Supp. 796 (S.D. Iowa 1981) (rental agreement for a television set with $17 per week payments and an option to own after 78 weeks did not create a security interest and is not a conditional sale); Stewart v. Remco Enter., 487 F. Supp. 361 (D. Neb. 1980) (agreement is not a credit sale when the buyer/lessee is only required to pay one week's rent); 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); *In re* Armstrong, 84 Bankr. 94, 97 (Bankr. W.D. Tex. 1988) (agreement in which debtor has no obligation to continue renting was held to be a true lease rather than a lease intended as security); *In re* Peacock, 6 Bankr. 922 (Bankr. N.D. Tex. 1980) (an agreement to lease which included an option for the buyer/lessee to terminate the agreement at anytime is a true lease because there exists no obligation to pay).

these provisions in determining whether an agreement, such as that at issue in this case, is in fact a lease or was intended to create a security interest."[69] The agreement at issue in the case *Sight & Sound of Ohio, Inc. v. Wright* was a transaction in which the plaintiff leased a refrigerator for a weekly rate but retained an option to purchase after making the requisite payments.[70] The court held that the contract created a security interest, even though the plaintiff had no obligation to continue renting.[71] In doing so, the *Sight & Sound* court explained two provisions that are relevant to its analysis.[72] The first is section 1309 of the Ohio Revised Code,[73] which regulates secured transactions in Ohio. That provision applies to contractual arrangements that intend to create a security interest.[74] The court noted that the substance of the transaction, not its form, will determine whether it is a secured transaction that is governed by section 1309[75] of the code.

Another provision, section 1301 of the Ohio Revised Code,[76] states:

> 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 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.[77]

The *Sight & Sound* court focused on the statutory language which states that, upon completing all payments, the lessee shall become or has the option to become the owner of the property.[78] The *Sight & Sound* court concluded that upon completing the requisite payments, the lessee had no plausible alternative but to exercise the option to purchase. Thus a security interest was created.[79]

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69. 36 Bankr. 885, 888 (S.D. Ohio 1983).

70. *Id.* at 887.

71. *Id.* at 891. After 72 consecutive weekly terms, the debtor could elect to terminate the agreement or purchase the refrigerator for the then fair market value which was not to exceed $69.75. *Id.* By the terms of the agreement, if the option to purchase were exercised, the total amount of payments would not exceed $1,551.15. *Id.* at 888.

72. *Id.*

73. OHIO REV. CODE ANN. § 1309 (Anderson 1988).

74. *Id.* § 1309.02(A)(1). In *Sight & Sound*, the court considered intent of the parties an important factor in deciding whether an agreement represents a true lease or a lease intended as a security. 36 Bankr. at 890.

75. *Sight & Sound*, 36 Bankr. at 888.

76. OHIO REV. CODE ANN. § 1301 (Anderson 1988).

77. *Id.* § 1301.01(KK); *see also Sight & Sound*, 36 Bankr. at 888.

78. *Sight & Sound*, 36 Bankr. at 888.

2. True Lease

Other courts, however, interpreted these transactions differently and concluded that similar contracts did not create security interests.[80] Rather than focus on the option to purchase as the court did in *Sight & Sound of Ohio, Inc. v. Wright*,[81] the court in *In re Armstrong*[82] focused on the lessee's right to terminate the contract at will and concluded that a security interest does not exist in such a contract. Therefore, the *Armstrong* court concluded that the contract was a simple lease.[83] The apparent confusion courts have experienced in interpreting lease-purchase agreements appears[84] to be one reason the Ohio legislature chose to follow the national trend toward creating a separate regulation for rent-to-own transactions.[85] Another reason to follow the trend was the fact that rent-to-own companies have managed to sidestep regulation by convincing state lawmakers that rent-to-own customers can get out of the contracts at anytime.[86] Therefore, some regulation of the industry was necessary.

III. SUMMARY OF RENT-TO-OWN PROVISIONS

Ohio's rent-to-own statutes, Chapter 1351 of the Ohio Revised Code,[87] is designed to regulate lease-purchase agreements on personal property leased for four months or less.[88] It also provides for a crackdown on companies that harass customers or use illegal means to repossess merchandise.[89] The law, which became effective June 30, 1988, is described as a compromise between the Ohio Rental Dealers Association, the Ohio Legislative Commission and the Ohio Attorney General's Consumer Protection Division.[90] Authored by Washington D.C. lobbyist Samuel Choate[91] of the Rental Dealers Association, the legis-

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80. *See supra* note 68.

81. 36 Bankr. at 885.

82. 84 Bankr. 94 (Bankr. W.D. Tex. 1988).

83. *Id.*

84. *See supra* notes 67–68 and accompanying text.

85. Telephone interview with Paul Herdeg, staff attorney for the Cleveland Legal Aid Society (Oct. 19, 1988) [hereinafter Herdeg Interview].

86. Henry, *supra* note 11, at 73.

87. OHIO REV. CODE ANN. § 1351 (Anderson 1988).

88. *Id.*

89. Henderson, *supra* note 16, at 1B, col. 1.

90. Address by Representative Jane Campbell (Democrat-Clev.), floor of the Ohio House of Representatives (June 24, 1987) [hereinafter Campbell Address] (Campbell introduced the H.B. 421 legislation).

91. Choate has written laws regulating the rent-to-own industry for numerous states. "When asked whether having a lobbyist for an industry write a set of regulations was a conflict of interest, Choate replied: 'Who knows more about the industry?' " Henderson, *supra* note 16, at 1B, col. 3.

lation has stirred considerable debate. The following discussion addresses the effectiveness of three significant provisions of the statute which proponents claim are designed to protect consumers: the disclosure provision,[92] the reinstatement provision,[93] and the ceiling on payment provision.[94]

IV. ANALYSIS

A. Disclosure Provision

The Ohio rent-to-own legislation was introduced to provide meaningful disclosure of the terms in lease-purchase agreements concerning costs, liabilities and responsibilities of the consumer.[95] Thus, the legislation attempts to establish a comprehensive disclosure provision.[96] The disclosure provision is detailed. According to one proponent of the legislation, the disclosure provision is the most comprehensive in Ohio's consumer law.[97] "Many of the hidden terms which historically caused problems for consumers may no longer be buried in agreements. The bill required clear and conspicuous disclosures of the type of information vital to allow consumers to make an informed choice as to whether to rent the goods."[98]

Information required in the disclosure includes: A brief description of the property (including a statement denoting whether the property is new, used or previously leased); a calculation of the total amount of all payments (including advance payments and delivery charges); the amount and timing of payments; the amount of all other charges, individually itemized; a statement concerning maintenance and liability for damages or loss; a termination provision; a disclosure of the total lease payments and all other charges necessary to acquire ownership of the property; the option to buy, detailing the price for purchase; and the cash price of the property that is the subject of the lease purchase agreement.[99] The bill also requires that rent-to-own merchants provide notice of the following: cash price, amount of the lease-rental payment and the total number of payments required to obtain ownership.[100]

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92. OHIO REV. CODE ANN. § 1351.02.
93. *Id.* § 1351.05.
94. *Id.* § 1351.06.
95. Campbell address, *supra* note 90.
96. *Id.*
97. *Hearings, supra* note 18 (testimony of James T. Stremanos, Chief Investigator for Attorney General Anthony J. Celebrezze's Consumer Protection Division) (Stremanos testified in support of the legislation).
98. *Id.*
99. OHIO REV. CODE ANN. § 1351.02 (Anderson 1988).
100. *Id.* Further, the lessor must clearly and conspicuously disclose in a prominent place and in specified type that the lease purchase agreement is regulated by state law and may be

Although the disclosure provision is a comprehensive one, its ability to assist the low-income consumer in making an educated purchase is limited.[101] The disclosure provisions require statements in the contract which detail all obligations and payments necessary for the lessee to gain ownership.[102] However, the disclosure is very complex. Consequently it is difficult for the average rent-to-own consumer to comprehend.[103] As noted above, typical rent-to-own customers are not skilled consumers.[104] Their financial status and lack of experience in comparative shopping and credit purchasing often leaves them unprepared to adequately question the figures stated.[105]

Also, as one recent study suggests, being aware of the alternatives available to the high costs of rent-to-own agreements is of little value if one is not in a position to take advantage of the alternative.[106] Rent-to-own programs target low-income groups who generally have poor credit histories and who may be fearful of applying for credit.[107]

Finally, since individuals who use installment plans or lease-purchase services often are low-income individuals or welfare recipients, they may not know that the buyer must beware of the terms.[108] In *Murphy v. McNamara,*[109] a welfare recipient with four children brought action against a company that rents and sells television and stereo sets.[110] The plaintiff made routine payments on the equipment until she learned the actual cost she would pay for the unit.[111] In order to acquire ownership of the equipment, she would have to pay $1,268. Retail value of the unit was four hundred ninety-nine dollars.[112] The court determined that the unequal levels of understanding and ability to negotiate created unequal bargaining power that voided the contract.[113] Had the plaintiff known the terms of the contract, she may not have entered into the agreement.[114]

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enforced either by the state attorney general or private legal action. § 1351.02(A)(14).

101. *See generally* Swagler, *supra* note 10, at 269.

102. OHIO REV. CODE ANN. § 1351.02(A)(9).

103. *See supra* note 46 and accompanying text.

104. *See supra* notes 33–37 and accompanying text.

105. *Id.*

106. Swagler, *supra* note 10, at 270.

107. *Id.* at 269. One industry leader noted that he intends next to lure a more upscale clientele and "rent to 'people who have credit but are borrowed to the hilt.' " Henry, *supra* note 11, at 74 (quoting Tom Devlin, founder of Rent-A-Center, one of the nation's largest rent-to-own chains).

108. Herdeg Interview, *supra* note 85.

109. 36 Conn. Supp. 183, 416 A.2d 170 (Super. Ct. 1979).

110. *Id.* at 184, 416 A.2d at 173.

111. *Id.* at 185, 416 A.2d at 173.

112. *Id.*

113. *Id.* at 184, 416 A.2d at 177.

114. *Id.* at 185, 416 A.2d at 173.

Under circumstances similar to those in *Murphy*, provisions such as the disclosure provision of Ohio's rent-to-own legislation are insufficient, in and of themselves, to help individuals who do not understand what is disclosed and who are not in a position to overcome their disadvantage.[115] Thus, in order to adequately protect consumers, further measures must be utilized.

B. Paternalism

Courts and commentators who have examined this area have questioned the judiciary's role in providing excessive protection to consumers.[116] For example, some courts have addressed the question by noting that the judiciary is fearful of interfering with the rights of parties to freely contract.[117] In *Jones v. Star Credit Corp.*,[118] the court summarized the dilemma, noting:

> On the one hand it is necessary to recognize the importance of preserving the integrity of agreements and the fundamental right of parties to deal, trade, bargain, and contract. On the other hand there is the concern for the uneducated and often illiterate individual who is the victim of gross inequality of bargaining power, usually the poorest members of the community.[119]

There is legitimate concern that governmental paternalism could backfire.[120] Laws already have been enacted to protect consumers from creditors.[121] Some laws achieve the desired consumer protection but make risky accounts unprofitable for merchants. Consequently, television sets, appliances, furniture and other items are no longer available to consumers who can not afford to pay by traditional means.[122] As one consumer law attorney notes, "[t]his was not the first time that reformers hurt the folks they meant to help."[123] In the rent-to-own industry,

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115. *See supra* notes 33–37 and accompanying text.

116. *See* Toker v. Westerman, 113 N.J. Super. 452, 274 A.2d 78 (Dist. Ct. 1970); Jones v. Star Credit Corp., 59 Misc. 2d 189, 298 N.Y.S.2d 264 (Sup. Ct. 1969); *see also* Shapiro, *Courts, Legislatures, and Paternalism*, 74 VA. L. REV. 519 (1988).

117. *See, e.g., Toker*, 113 N.J. Super. at 456, 274 A.2d at 81 (1970). The *Toker* case involved the retail installment sale of a refrigerator freezer. The court noted that courts continue to recognize that they should not unnecessarily restrict the freedom to contract, but added that courts will invalidate unconscionable contracts that hurt the public. *Id.* Here, a welfare recipient contracted to pay cash price of $1,229.76 for the refrigerator freezer. *Id.* at 453, 274 A.2d at 79. The court estimated that the retail price of the item was between $350 and $400. *Id.* at 454, 274 A.2d at 79.

118. 59 Misc. 2d at 189, 298 N.Y.S.2d at 264 (Sup. Ct 1989).

119. *Id.* at 190, 298 N.Y.S.2d at 265.

120. Shapiro, *supra* note 116, at 573.

121. *See generally* OHIO REV. CODE ANN. §§ 1317, 1351 (Anderson 1988); *supra* note 63.

122. Henry, *supra* note 11, at 73.

123. *Id.*

should laws become too restrictive by requiring a substantial effort by the merchants, while providing them with little return, the merchants will be unable to deal with high-risk rent-to-own consumers.[124] Thus, low income consumers with no means of credit will have no ability to obtain the items they desire or need.

Democratic theorists and practitioners, however, still do not appreciate excessive legislative or judicial paternalism.[125] The majority of courts remain reluctant—at least when acting without legislative guidance or mandate—to interfere with the private sales agreements people consider to be in their best interests. This view endures despite the fact that given a more equitable society, people might not feel compelled to enter into such "bargains".[126]

One court's willingness to act, however, was apparent when it considered the issue and concluded:

> The law is beginning to fight back against those who once took advantage of the poor and illiterate without risk of either exposure or interference. . . . This body of laws recognizes the importance of a free enterprise system but at the same time will provide the legal armor to protect and safeguard the prospective victim from the harshness of an unconscionable contract.[127]

C. *Reinstatement Provision*

Another provision of the legislation, chapter 1351 of the Ohio Revised Code,[128] which was hailed as a benefit to consumers, is the statute's reinstatement provision.[129] This provision is the result of a compromise between government, the rent-to-own industry and other concerned parties.[130] Its proponents claim that the section allows the customer to reinstate the agreement after he fails to make timely payments, without the loss of his "equity" acquired prior to default.[131] However, the provision is insufficient to assist most rent-to-own customers. While it does provide for reinstatement without loss of accrued benefits, it only provides this option for three lease terms.[132] Because many rent-to-own contracts are week-to-week, under the new law, a customer with financial difficulties has only three weeks to reinstate

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124. Choate Interview, *supra* note 19.
125. Shapiro, *supra* note 116, at 519.
126. *Id.* at 536 (footnote omitted).
127. *Jones*, 59 Misc. 2d at 190, 298 N.Y.S.2d at 265.
128. OHIO REV. CODE ANN. § 1351 (Anderson 1988).
129. *Id.* § 1351.05.
130. Campbell Address, *supra* note 90.
131. *Id.*
132. OHIO REV. CODE ANN. § 1351.05(A) (Anderson 1988).

without losing credit for all prior payments.[133] For individuals who are injured on the job, seriously ill or laid off, three weeks is an inadequate amount of time to realistically reinstate the lease. This could be a severe detriment for consumers who have made several payments and for some reason have defaulted. If the Ohio legislature intended the reinstatement provision to be effective, the law would list the provision as a sixty or ninety-day reinstatement period, so that customers on week-to-week contracts would have time to regain sound financial footing before reinstating. As it stands, the reinstatement provision does little for the people who need it most. These individuals in need are people who cannot afford to purchase outright and elect to lease with the option to purchase. However, their finances become strained, and they need a statutory provision that will realistically accommodate their situation. This provision does not give them this ability. Consequently, they lose all they have invested in the transaction.

D. Price Ceiling Provision

Although the above two provisions[134] raise concern among consumer advocates, the provision of the bill that has stirred the most controversy is the section which purports to place a ceiling on the amount that a lessor can charge for the leased items.[135] The price ceiling provision states that a lessor may not charge the lessee more than double the "cash price" of the property when all payments are totaled.[136]

While the provision does eliminate the previous problems of lease-purchase consumers paying four or five times the value of the product in order to obtain ownership,[137] Robert Hobbs of the National Consumer Law Center argues that the legislation does not go far enough to eliminate the gross price inflation that occurs in the rent-to-own industry.[138] The problem is compounded because many of the terms in the

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133. *Id.*

134. *Id.* §§ 1351.02, 1351.05.

135. *Id.* § 1351.06.

136. *Id.* Subsection (A) states:

> No lessor shall offer a lease-purchase agreement in which fifty per cent [sic] of all lease payments necessary to acquire ownership of the leased property exceed the cash price of the leased property. When fifty per cent [sic] of all lease payments made by a lessee equals the cash price of the property disclosed to the lessee pursuant to division (A)(11) of section 1351.02 of the Revised Code, the lessee shall acquire ownership of the leased property and the lease-purchase agreement shall terminate.

Id. § 1351.06(A).

137. *Hearings, supra* note 18 (testimony of Robert J. Hobbs, an attorney for the National Consumer Law Center, Inc.) (Hobbs has been involved since 1969 in representing low-income consumers who have used the services of the rent-to-own industry).

138. *Id.* An amendment to the Ohio rent-to-own legislation which would have allowed a 50% markup over retail price was rejected by the Senate. *See* Agenda for the Financial Institu-

bill are confusing and misleading. For example, the "cash price" of an item is the basis for the cost ceiling.[139] While the cash price is disclosed to consumers, they cannot be expected to realize and comprehend legal terminology that distinguishes the cash price from the retail price. Therefore, consumers will not know exactly what they are paying when they agree to the terms. Such a minor difference likely goes unnoticed by many people, but its impact can be costly.[140]

For example, a set of used furniture may retail for four hundred fifty dollars at a regular appliance store, whereas, at a rent-to-own company, the cash price may be set at a level higher than retail value, five hundred dollars, for example. Under section 1351.06, the rent-to-own merchant can then charge up to double the cash price of the item, or one thousand dollars in this example, regardless of whether the cash price is a true reflection of the retail price or value.

Ohio is not the only state to allow such excessive rates. In Michigan, a consumer who rents a five hundred dollar appliance for eighteen months with the option to buy, could pay $1,267 or one hundred percent above the fair value of the goods.[141] In New York, the rate can be as high as approximately one hundred twenty-five percent.[142]

One industry advocate attempts to justify the costs, stating that expenses are high for rent-to-own merchants.[143] Samuel Choate of the Rental Dealers Association states emphatically that rent-to-own merchants would go out of business if the maximum amount they could charge were lower.[144] Statistics, however, do not support the notion that retail installment sales companies have higher losses.[145] For example, an industry spokesperson, in a statement before the Congressional Subcommittee on Consumer Affairs of the Senate Committee on Banking, Housing and Urban Affairs in 1983, disclosed loss figures for the industry that were less than the delinquency rate on credit cards.[146] Also, one of the leading national rent-to-own companies, Rent-A-Center, has made considerable profit. For the last five years, the company's revenues have been growing by forty-four percent annually.[147] The chain's market value is four hundred thirty million dollars—over thirty times

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tions and Insurance Committee of the Ohio Senate (January 19, 1988).

139. OHIO REV. CODE ANN. § 1351.06 (Anderson 1988).

140. Rent-to-own consumers could pay more than two times the retail value of the item.

141. DeCourcey Hinds, *supra* note 9, at 25, col. 3.

142. *Id.* at 25, col. 4.

143. Letter from Samuel Choate to Rep. Jane Campbell (Dec. 8, 1987) (discussing H.B. 421) (Choate is the attorney representing the rent-to-own industry).

144. Choate Interview, *supra* note 19.

145. Herdeg Interview, *supra* note 85.

146. *Id.*

147. Hardy, *supra* note 11, at 31.

the anticipated earnings.[148] These figures do not support the notion that the industry would dissolve if other alternatives were sought to reduce the price ceiling the lessor can charge for leased items.

V. CONCLUSION

The rent-to-own industry has for years succeeded in projecting itself as the answer to the low-income individual's prayers. With creative advertising and promotion, these companies have lured consumers into a confusing tangle of disclosure provisions and exorbitant pricing. A spokesperson for the state Attorney General's office noted, "[r]egulation of this industry is a positive step, something which is clearly in the best interests of consumers, since there is no uniformly recognized regulatory scheme by which abuses can be readily addressed."[149]

While it is agreed that regulation is a positive step, chapter 1351 of the Ohio Revised Code[150] may not be the best solution. Although the statute mandates comprehensive disclosure of terms in an agreement, the law ignores the true danger of the rent-to-own method. The industry caters to a sector of the market that is most likely unable to obtain goods any other way.[151] Therefore, merchants act as lenders of last resort who are legally able to charge prices well above those allowed in either loan or sales transactions.[152] Paul Herdeg of the Cleveland Legal Aid Society, who opposed the legislation, commented that if the legislature had set a more realistic ceiling upon the total purchase price in rent-to-own transactions, he likely would have supported the bill.[153] The Ohio State Legal Services Association proposed an amendment which would have allowed rent-to-own companies a 50% mark-up over retail prices.[154] However, that amendment was rejected.[155]

Herdeg notes that a better solution to the price ceiling dilemma would be an amendment to the Retail Installment Sales Act[156] to include lease-purchase agreements.[157] Pennsylvania amended its RISA to include these transactions.[158] The legislation in that state set a maximum interest rate of 25% for rent-to-own transactions under the retail

148. *Id.*

149. *Hearings, supra* note 18 (testimony of James T. Stremanos).

150. OHIO REV. CODE ANN. § 1351 (Anderson 1988).

151. *See supra* notes 33–37 and accompanying text.

152. The maximum finance charge for small loans in Ohio is 28%, while sellers are allowed a maximum of 25%. Herdeg Interview, *supra* note 85.

153. Herdeg Interview, *supra* note 85.

154. Agenda for the Financial Institutions and Insurance Committee of the Ohio Senate (January 19, 1988).

155. *Id.*

156. OHIO REV. CODE ANN. §§ 1317.01–.99 (Anderson 1988).

157. Herdeg Interview, *supra* note 85.

158. PA. STAT. ANN. tit. 69, § 1101 (Purdon 1988).

installment sales provision.[159] Had Ohio amended its RISA to include rent-to-own transactions, the disclosure provision would have been similar to that of the rent-to-own statute and added charges would not be excessive. Instead, the Ohio law favors the industry at the expense of consumers because it allows the merchants to capitalize on the low income consumer's inability to go elsewhere for the goods.

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[159] *Id.*