SHADOW CREDIT AND THE DEVOLUTION OF CONSUMER CREDIT REGULATION

by
Nathalie Martin & Lydia Pizzonia***

Shadow credit is trending. Shadow credit has all the essential attributes of regular credit except that it is unregulated. It operates in a world in which products and services that look, act, and feel like credit products are deemed to be something that is not actually credit. This legal sidestep is accomplished either by passing industry-friendly legislation or by tweaking the shadow credit product just enough to not be defined as credit, but "something else." That "something else" is often called a "lease," an "advance," or in the case of Afterpay, simply a "service." At its essence, however, it is still credit. More and more shadow credit products are popping up to take the place of actual credit products.

The purpose of avoiding being "credit" is to avoid consumer credit regulation. We see this trend among purveyors of rent-to-own household goods, rent-to-own real estate, employer payday advances, buy-now-pay-later services like Afterpay, income sharing agreements in higher education finance, and even bail bonds, all of which seek to avoid complying with usury laws or interest rate caps, Article 9 of the Uniform Commercial Code (U.C.C.), the federal Truth in Lending Act, and all other consumer credit protection laws.

While some of these products are helpful to consumers, or at least not particularly harmful, some are deeply predatory. They can operate outside the law.

* Frederick M. Hart Chair in Consumer and Clinical Law, University of New Mexico School of Law. The author thanks Stewart Paley, Adam Levitin, Bob Lawless, and colleagues Ernesto Longa, Joe Schremmer, George Bach, Reed Benson, Jennifer Moore, Jen Laws, and Fred Hart for their research and comments on earlier drafts; Clair Gardner and Jarrod Greth for their fine research assistance; and the University of New Mexico School of Law for its generous financial assistance. The authors are also grateful to the Lewis & Clark Law Review, particularly Lead Article Editor John Mayer, Executive Editor Alexandra Giza, Submissions Editor Colin Bradshaw, and Editor in Chief Connor B. McDermott.

** J.D. 2019, University of New Mexico School of Law. The author thanks her husband and children for their constant encouragement and support, and Professor Kenneth Bobroff for being a sounding board, providing insight and new ideas, and supporting her desire to initiate change in this area.

For example, classic rent-to-own contracts that were historically used for household goods are now being used in housing contracts in vulnerable Native American communities.

Emerging shadow credit products are testing the limits of what should be permitted in rent-to-own contracts and similar financing tools. The trend toward shadow credit has the capacity to derail our entire consumer credit regulation system.

I. INTRODUCTION

As we say in the law, if it looks like a duck and it quacks like a duck it is a duck.[1] Sometimes products in the consumer credit market look very similar to other products, but by tweaking that product in a tiny way, a provider of credit can avoid a great deal of regulation, including consumer protection regulation. In this Article, we identify a dangerous trend in consumer protection law, namely the expansion of shadow credit. Shadow credit is credit disguised as something else. Sometimes the disguise is unintended. Other times, it is designed to avoid consumer protection laws.

When it comes to defining what constitutes credit, what is old is suddenly new again. If one were to find the perfect designer, Covid-19 facemask on the internet, like my family just did, the shopper would be told to add one more thing to the shopping cart in order to qualify for Afterpay. Afterpay is a financing service that claims *not* to be financing.[2] Similarly, education finance Income-Sharing Arrangements (ISAs) allow lenders to advance funds to students for tuition/living expenses in exchange for a percentage of that student's future income. Again, these financiers claim *not* to be financers and thus *not* to be providing credit.

Over 50 years ago, leading up to the passage of the Truth in Lending Act (TILA) in 1968, what counted as "credit" and was thus subject to TILA was a big question. At the time, many states had statutorily enacted the time-price differential doctrine.[3] Under this doctrine, if a retailer sold goods for future payment, the differential between the price of a cash sale and that of credit sale was not interest for usury law purposes.[4] State retail installment loan acts eventually held these fees to be finance charges that had to be disclosed in a certain way,[5] but as we discuss in Part III.B below, some retailers found their way around these regulations. Fifty years later, the dance continues. Indeed, these shadow credit products are proliferating and putting our entire consumer credit regulation system at risk.[6]

---

[1] Joe Campbell & Richard Campbell, *Why Statutory Interpretation Is Done as It Is Done* 11–12 (Sydney Law School, Legal Studies Research Paper No. 14/79, 2014), http://ssrn.com/abstract=2484315.

[2] David Chan, *Afterpay: Consumer Advocates Fear 'Instant Approvals' Will Cause Serious Financial Hardship*, ABCNEWS (Sept. 26, 2017), https://www.abc.net.au/news/2017-09-26/afterpay-consumer-debt/8988394.

[3] Adam Levitin, *What Is "Credit"? Afterpay, Earnin', and ISAs*, CREDIT SLIPS (July 16, 2019, 1:31 PM), https://www.creditslips.org/creditslips/2019/07/what-is-credit-afterpay-earnin-and-isas.html#more.

[4] *Id.*

[5] Mourning v. Family Publ'ns Serv., Inc., 411 U.S. 356, 361(1973).

[6] In his blog on the renewed importance of defining what constitutes "credit," Adam Levitin notes that products like payday advances, income sharing agreements for higher education finance, and buy-now-pay-later products like Afterpay all claim not to be credit and not subject to the

While we discuss several modern examples as evidence of the rise of shadow credit, we focus on rent-to-own transactions to demonstrate how an entire industry can legislate itself out of consumer credit laws and restrictions. If one industry can accomplish this, so can others. Before we know it, our entire system of protecting consumers could disappear. Moreover, we have identified a small segment of the rent-to-own industry that is taking advantage of consumers, raising the question of whether it is time to revisit the entire framework for regulating consumer credit.

We start our inquiry by asking about the nature of credit, and then whether rent-to-own transactions are essentially credit, or just leases as the rent-to-own industry claims. The implications of this question are far-reaching. If the transaction is essentially a sale or purchase, the transaction is a credit transaction regardless of what you call it. In that case, the transaction is subjected to many state and federal laws regarding disclosures, default requirements, remedies, and so on.[7] If the main point is to rent, but never to own, that is a lease that need not be regulated as credit.[8]

Long ago, the rent-to-own industry passed enabling legislation to state explicitly that its transactions were outside the realm of credit.[9] This legislation removes rent-to-own transactions from all state consumer credit regulation, TILA, all other federal regulations, and state commercial law such as Article 9 of the U.C.C.[10] This Article explores this industry-sponsored legislation in the context of a complex set of consumer needs. It asks whether rent-to-own contracts are indeed outside of Article 9 and outside all of the protections that loan products have under both state and federal law.[11] It further asks whether we need to revisit the nature of all rent-to-

Truth in Lending Act, as well as a slew of other federal and state regulations. Levitin, *supra* note 3.

[7] *See infra* Part II.A.

[8] *Id.*

[9] *See infra* notes 168–81 and accompanying text; *see also* James M. Lacko, Signe-Mary McKernan & Manoj Hastak, *Survey of Rent-to-Own Customers*, FED. TRADE COMM'N ES-4 (April, 2000), https://www.ftc.gov/reports/survey-rent-own-customers/.

[10] *Id.* at ES-4, 12–13.

[11] Michael G. Bridge et al., *Formalism, Functionalism, and Understanding the Law of Secured Transactions*, 44 MCGILL L.J. 567, 599 (1999). As these scholars explain, from a functionalist perspective:

> a lease operates as a form of purchase money financing to the extent that it allows a lessee who lacks the wherewithal to buy the leased goods to nonetheless obtain their possession and use. The economic function of the transaction from the point of view of the lessor and the purchase money secured party is similar: both obtain the right to a stream of payments during the currency of the transaction and both can claim an *in rem* right to priority as against other creditors in the event of insolvency.

Id. at 599; *see also, e.g.*, Margaret Howard, *Equipment Lessors and Secured Parties in Bankruptcy: An Argument For Coherence*, 48 WASH. & LEE L. REV. 253, 253–54, 279–83 (1991); John D. Ayer, *On the Vacuity of the Sale/Lease Distinction*, 68 IOWA L. REV. 667, 668, 681 (1983) (discussing functionalist arguments in favor of the identity of leases and security).

own contracts or simply find protections in situations in which the abuses seem most egregious.[12]

While our focus is rent-to-own, and ultimately a small niche market within rent-to-own, the question of what constitutes credit has far-reaching implications for the future of consumer credit regulation. We are watching a trend in which more and more industries carve themselves out of the credit definition, further eroding what consumer protection remains.

In Part II of this Article, we explore the essence of credit transactions, discuss the goals of the consumer credit protection scheme, and examine the specific laws through which these goals are met.[13] We then discuss the difference between recourse and non-recourse credit and describe relevant portions of Article 9 of the U.C.C., one of the main laws rent-to-own companies and other shadow credit providers seek to avoid.[14] In Part III, we describe the taxonomy of rent-to-own transactions, how they work, how the industry regulated itself, and what these industry regulations provide.[15] We then describe the demographics of a typical rent-to-own customer and the goals of most rent-to-own customers in rent-to-own relationships.[16]

In Part IV we describe another form of the rent-to-own contract, those relating to rent-to-own real estate.[17] We explore various predatory practices in these shadow

---

[12] While many scholars have dabbled in rent-to-own scholarship, two have studied this industry extensively: Professor Michael Anderson and Professor Jim Hawkins. Professor Anderson has dedicated his career to studying rent-to-own. *See, e.g.*, Michael H. Anderson & Raymond Jackson, *A Reconsideration of Rent-to-Own*, 35 J. CONSUMER AFF. 295, 298 (2001), http://www.thefreelibrary.com/A+Reconsideration+of+Rent-to-Own.-a080805982. Anderson has deep ties to industry, but nevertheless is an honest scholar. In one article, he critiques a scholar who shortens rental periods and inflates the value of rented goods in order to reduce the annual percentage rate on typical rent-to-own transactions. *Id.* Professor Hawkins is a leading consumer law scholar, who has written on many consumer products, including fertility treatment financing, title lending, payday lending, rent-to-own, and most recently, employer payday advances. *See, e.g.*, Jim Hawkins, *Financing Fertility*, 47 HARV. J. LEGIS. 115, 116 (2010) (fertility treatment financing); Kathryn Fritzdixon, Jim Hawkins, & Paige Marta Skiba, *Dude, Where's My Car Title?: The Law, Behavior, and Economics of Title Lending Markets*, 2014 UNIV. ILL. L. REV. 1013, 1016 (2014) (title lending); Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. Rev. 855, 857 (2007) (payday lending); Jim Hawkins, *Renting the Good Life*, 49 WM. & MARY L. REV. 2041, 2046 (2008) (rent-to-own). Hawkins views rent-to-own from an extremely practical point of view, expressing the desire to see the transactions as hybrids between typical credit transactions and basic rental agreements. *Id.* at 2052–53. His goal is to avoid overly-paternalistic regulation in order to maintain the rent-to-own option for consumers, and regulate with fee caps, lifetime reinstatement polices, and other regulatory "light touches." *Id.* at 2047, 2117. These are valuable contributions.

[13] *See infra* notes 24–123 and accompanying text.

[14] *See infra* notes 124–49 and accompanying text.

[15] *See infra* notes 150–205 and accompanying text.

[16] *See infra* notes 206–22 and accompanying text.

[17] *See infra* notes 223–44 and accompanying text.

credit transactions, sometimes called land sale contracts or contracts for deed.[18] In Part V, we describe a recent trend that combines the classic rent-to-own contract with the shadow housing market. More specifically, we explore predatory practices in Native communities involving rent-to-own sheds used for housing.[19] These practices are largely unknown and thus have not been explored by previous scholars. These rent-to-own shed transactions provide an opportunity to describe these unknown practices and to examine the real dangers of shadow credit at its worst.[20]

In Part VI, we discuss the greater implications of the credit/no credit dichotomy, focusing on the societal implications of sheltering shadow credit products from regulation.[21] We provide a number of examples from other areas of the law in which society elevates substance over form to protect various regulatory frameworks in our complex legal system.[22] In Part VII, we conclude that the rent-to-own industry, particularly as it morphs into areas beyond household goods, demonstrates the harm that all shadow credit products can impart on the consumer credit regulatory system, and perhaps even the entire credit regulatory system.[23]

II. THE ESSENCE OF CONSUMER PROTECTION AND CREDIT TRANSACTIONS

The purpose of this Part is to determine what our consumer credit regulation system is designed to do for consumers, to which transactions it should apply, and why. We discuss what makes a product or service "credit" as opposed to something else. We explore why and how our legal system regulates consumer credit products and briefly review some of the most important federal and state consumer credit laws. We then describe the distinction between recourse and non-recourse credit, which relates to the rent-to-own industry's argument that rent-to-own contracts are not credit because customers can terminate the contracts at any time without owing more debt. We end with a Section describing Article 9 of the U.C.C. and the ways it has been amended regarding what actually constitutes credit.

A. *What is Shadow Credit?*

As lawyers, we are comfortable with unsettled or grey areas in the law.[24] Indeed,

---

18 *Id.*

19 *See infra* notes 245–95 and accompanying text.

20 *Id.*

21 *See infra* notes 296–315 and accompanying text.

22 *Id.*

23 *See infra* notes 315–18 and accompanying text.

24 Raúl Jáuregui, *Rembrandt Portraits: Economic Negligence In Art Attribution*, 44 UCLA L. REV. 1947, 1959–61, 2011–12 (1997); W. Bradley Wendel, *Autonomy Isn't Everything: Some Cautionary Notes On Mccoy v. Louisiana*, 9 ST. MARY'S J. LEGAL MAL. & ETHICS 92, 111–13

interpreting gray areas of the law is one of the skills lawyers bring to society.[25] This interpretive process is also what makes our work interesting, more art than science.[26] Gray areas can either arise from the world at large or be created by law and lawyers themselves, but however they arise, the law aspires to elevate substance over form and to recognize reality rather than contort it.[27]

Shadow credit operates much like regular credit but differs in small ways.[28] Shadow credit operates in the grey areas or shadows of the finance industry. When we charge an item on a credit card, or take out a mortgage or a payday loan, we know we are entering into a credit relationship.[29] Since creditors tend to have more power in credit relationships than borrowers, a host of laws protect borrowers, particularly consumer borrowers.[30]

What makes something credit? Starting with a basic dictionary definition, credit is "the provision of money, goods, or services with the expectation of future payment."[31] Under this definition, credit is borrowing money and promising to pay it back at a later time. Credit is a service, not a good,[32] and as Ayn Rand once proclaimed, credit transactions include the vast majority of economic transactions in a complex industrial society.[33] Most of us have instincts about what constitutes credit

---

(2018). Our own experiences with rent-to-own come from a lifetime of interacting with low-income consumers and first-hand knowledge of their experiences with consumer credit products. Our experiences with actual consumers allow us to see not just the law, though that is critically important, but also the effect of the law on human beings. Some of our reactions come from a gut reaction, developed over three decades of teaching, writing, and law practice, about what does and does not constitute credit.

[25] Jáuregui, *supra* note 24, at 1963, 1986–87, 1990.

[26] *Id.* at 1958–59, 1963, 1990, 2012.

[27] *See, e.g.*, Frank Lyon Co. v. United States, 435 U.S. 561, 581–82 (1978) (the Supreme Court held that the title owner that acquired depreciable real estate, rather than a mere conduit or agent, had the legal right to take tax deductions associated with depreciation on the building).

[28] By shadow credit, we do not mean "shadow banking," a phrase used during the Great Recession of 2008 to mean activities that involved high-risk financing outside that provided by traditional banks. *See* Stijn Claessens & Lev Ratnovski, *What Is Shadow Banking?* 3 (International Monetary Fund, Working Paper No. 14/25, 2015), https://ssrn.com/abstract=2559504.

[29] Elizabeth Renuart & Diane E. Thompson, *The Truth, The Whole Truth, and Nothing but the Truth: Fulfilling the Promise of Truth in Lending*, 25 YALE J. REG. 181, 184–85 (2008).

[30] *Id.* at 185, 196–97; *see also* Anderson & Jackson, *supra* note 12, at 305 (describing rent-to-own transactions and stating that "[d]ue to asymmetry in experience and depth of information, the salesperson is at an advantage to the ordinary consumer regarding not only the product but also, even more importantly, the legal and financial provisions of the contract.").

[31] *Credit*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/credit (last visited Dec. 20, 2020).

[32] Alexei Alexandrov, Daniel Grodzicki & Özlem Bedre-Defolie, *Consumer Demand for Credit Card Services* 2 (Consumer Financial Protection Bureau Office of Research, Working Paper No. 2018-03, 2018), https://ssrn.com/abstract=3135421.

[33] AYN RAND, THE VIRTUE OF SELFISHNESS: A NEW CONCEPT OF EGOISM 111 (1961).

as opposed to something else. Some of the less tangible attributes of credit include transactions that get reported on a credit report,[34] transactions in which the consumer puts down a deposit, transactions in which the item being paid for can be repossessed, and so on. None of these attributes are determinative, however.

Federal consumer credit regulations contain numerous technical definitions of credit. We discuss the substance of these laws later, but under Regulation Z,[35] which regulates most consumer credit transactions including home mortgages, home equity lines of credit, reverse mortgages, credit cards, installment loans, and certain kinds of student loans,[36] credit means "the right to defer payment of debt or to incur debt and defer its payment."[37] The Consumer Financial Protection Act of 2010 (CFPA), that created the Consumer Financial Protection Bureau, defines credit as "the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purchase."[38] The Equal Credit Opportunity Act (ECOA) and the Fair Credit Reporting Act (FCRA) track this CFPA definition,[39] except that ECOA and the FCRA limit a "creditor under these Acts to those who regularly extend credit, not those do so only occasionally."[40] The Fair Debt Collection Practices Act (FDCPA) lacks a definition of credit but broadly defines a creditor as "any person who offers or extends credit creating a debt or to whom debt is owed."[41] Debt is defined by the Fair Debt Collection Practices Act as:

> any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or house-

---

34 Alexandra P. Everhart Sickler, *The (Un)Fair Credit Reporting Act*, 28 LOY. CONSUMER L. REV. 238, 243 n.21 (2016).

35 Regulation Z, 12 C.F.R. § 1026.1 (2019).

36 *Id.*

37 *Id.* at § 1026.2(a)(14); *see also* Levitin, *supra* note 3. Regulation Z, section 1026.2(b)(3) also states that "[u]nless defined in this part, opportunity words used have the meanings given to them by state law or contract." This means more transactions might fall within TILA/Reg Z than it appears at first glance. Levitin, *supra* note 3.

38 Consumer Financial Protection Act (CFPA) of 2010 § 1002, 12 U.S.C. § 5481(7) (2018) (definitions). Oddly, there is no definition of debt. *Id.*

39 Under ECOA, credit is defined as, "the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefor." Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691a(d) (2018); Fair Credit Reporting Act (FCRA), 15 U.S.C. § 1681a (r)(5) (2018) (defining "credit" and "creditor" as having the same meaning as in the ECOA).

40 Equal Credit Opportunity Act (ECOA) §§ 1692(a)–(e); *see also* Fair Credit Reporting Act (FCRA) § 1681a(r)(5).

41 Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. § 1692a(4) (2018).

> hold purposes, whether or not such obligation has been reduced to judgment.[42]

While TILA's definition of "credit" is similar to that of the CFPA and ECOA/FCRA, providing that "*the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment*,"[43] its definition of "creditor" is entirely different:

> The term 'creditor' refers only to a person who both (1) regularly extends, whether in connection with loans, sales of property or services, or otherwise, consumer credit which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required, and (2) is the person to whom the debt arising from the consumer credit transaction is initially payable on the face of the evidence of indebtedness or, if there is no such evidence of indebtedness, by agreement.[44]

In describing all of these various definitions of debt and credit, Professor Adam Levitin explains:

> Credit is generally defined as the right to defer payment of an obligation. But sometimes it has to be granted by a "creditor," and "creditor" is defined substantially differently by statute. In particular, TILA requires either a possible finance charge or payment in more than four installments.[45]

Needless to say, much of this language is in conflict, even though many of these federal laws apply to the same transaction.

When it comes to rent-to-own, many consumer law scholars and legislators instinctively believe that rent-to-own transactions are credit transactions.[46] In his discussion of whether rent-to-own is regulated by the Consumer Financial Protection Bureau, Jim Hawkins catalogues a list of congresspersons who assumed rent-to-own was credit.[47] Many consumers also assume they are using credit to buy something when they enter into rent-to-own transactions, because they are not paying

---

42 *Id.* at § 1692b(5).

43 Truth in Lending Act (TILA), 15 U.S.C. § 1602(f) (2018).

44 *Id.* at § 1602(g).

45 Levitin, *supra* note 3.

46 Jim Hawkins, *The Federal Government in the Fringe Economy*, 15 CHAPMAN L. REV. 23, 31–32 (2011).

47 "For instance, consider this exchange between Senators Dodd and Schumer when discussing the differences between the bill the House and Senate passed:

> DODD: Could we try, I'm not going to—as I said I'm not going to offer the amendment now but could we try to deal with the non-bank payday lenders and the non-bank rent to own type people who escape regulation here?
>
> DODD: Well, we've raised that with the other side . . .
>
> SCHUMER: The House put it in. No, the House is OK with it. The House has it in their bill.

the full price at the moment of the purchase.[48] Even atypical rent-to-own customers often assume that rent-to-own is credit.[49] So why aren't rent-to-own transactions credit? Primarily because the industry passed laws proclaiming that rent-to-own was not "credit,"[50] as described in Part III.B below.

B. The Protections Consumers Need and Businesses Seek to Avoid

The point of being "not credit" is to avoid consumer credit regulation, but why do we regulate consumer credit in the first place? Concerns include high fees, disguised fees, repossession without notice, unfair default provisions, and unequal bargaining power.[51]

Consumer protection laws come in two types: disclosures and substantive regulations.[52] Various federal and state laws protect consumers from harm, including inaccurate, misleading, or deceptive practices engaged in to gain an advantage over consumers.[53] The policy behind disclosure is that consumers are less sophisticated than businesspeople, but that if sufficient information is provided to consumers,

---

Testimony from people supporting the Military Lending Act (MLA) also assumes rent-to-own is credit. In support of an amendment to the MLA, Senator Jack Reed stated:

> Rent-to-own loans. This is where you go to a shop and you say I would like to rent a TV for 30 days because you am [sic] deploying in 45 days . . . then you don't deploy so you keep it, and in some cases, you end up paying two to three times the retail price of the appliance. At least individual soldiers have to be informed of those practices and know about it. We have to be sure they are getting that information . . . . That is what we want to do – coordinate these activities through a military liaison at a consumer financial protection agency. We want to do that because it is the right thing to do and because if we cannot protect the men and women who are protecting us, then we have to ask seriously whether we are doing our job. I know they are doing their job.

Id. at 30–31.

[48] Lacko, *supra* note 9, at ES-4.

[49] One friend, a law professor, was renting a piano and it ultimately was taken back by its owner. She sought Professor Martin's advice as a consumer. She assumed that once she had paid the fair market value of the sued piano, she would own it. This was without any additional interest or fees.

[50] *See infra* notes 168–81 and accompanying text.

[51] Lacko, *supra* note 9, at 3.

[52] According to scholar Scott Burnham, consumer law serves three primary functions: "(1) the *disclosure function* to provide consumers with essential information, (2) the *representation function* to act as the bargaining agent for the consumer by mandating substantive provisions consumers would otherwise be unable to obtain, and (3) the *bargaining function* to offer consumers a choice." Scott J. Burnham, *The Regulation of Rent-to-Own Transactions*, 3 LOY. CONSUMER L. REV. 40, 41 (1991).

[53] Federal Trade Commission Act (FTCA), 15 U.S.C. §§ 41–77 (2019) (prohibiting "unfair methods of competition and unfair or deceptive acts or practices"); Truth-in-Lending Act (TILA), 15 U.S.C. § 1602(a) (2018) (having among its goals to protect consumers against inaccurate and unfair billing).

this can help level the playing field.[54] We also want to ensure that consumers have a way to compare the cost of credit being offered by various credit service providers.[55] Disclosure can be appealing because, theoretically, it encourages consumers to be free agents and limits paternalism.[56] If it works, and consumers can read and understand the disclosures, the disclosures can help market forces operate more efficiently.[57]

In contrast, substantive protective regulation limits free choice, including the choice to make bad decisions. Even if substantive regulation does limit free will, where bargaining power is imbalanced, substantive regulation may be necessary to achieve fairness.[58] In reality, substantive versus disclosure regulation is a false dichotomy because disclosures are critical to enforcing substantive regulations and because most consumer protection laws contain both.

The rent-to-own industry has been clear in its desire to avoid most consumer credit regulation schemes. In describing the development of the industry, James Nehf explains:

> 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. 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. A market for the [rent-to-own] service was quickly established.[59]

If a product is not debt or credit, it escapes compliance with TILA,[60] the

---

54 Susan Lorde Martin & Nancy White Huckins, *Consumer Advocates vs. the Rent-To-Own Industry: Reaching a Reasonable Accommodation*, 34 AM. BUS. L.J. 385, 388 (1997).

55 Renuart & Thompson, *supra* note 29, at 184, 187.

56 Hawkins, *supra* note 12, at 2115.

57 *Id.* at 2116.

58 *Id.* at 2092–93; *see also* New Mexico *ex rel.* King v. B & B Inv. Grp., Inc., 329 P.3d 658, 669–70 (N.M. 2014) (decision of the New Mexico Supreme Court discussing substantive and procedural unconscionability).

59 James P. Nehf, *Effective Regulation of Rent-to-Own Contracts*, 52 OHIO ST. L.J. 751, 755 (1991).

60 Truth-in-Lending Act (TILA), 15 U.S.C. §§ 1601–1667f (2018).

FDCPA,[61] and numerous other federal and state laws applicable to the extension of credit.

Some of the products in the marketplace that currently claim to not be credit include rent-to-own contracts,[62] bail bonds,[63] employer loans,[64] buy-now-pay-later services like Afterpay and education finance ISAs. These last two are modern cutting-edge examples of the expansion of shadow credit.

Afterpay works with retailers to provide financing for relatively small purchases, by breaking up the purchase price into four equal installments.[65] In the same breath, Afterpay claims that "[u]nlike some typical finance businesses, Afterpay relies on and only benefits from customers not going into default, paying off their orders in full and on time," but also that "[a]fterpay charges a flat $10 late fee per payment and a further late fee of $7 if the payment is not made within 7 days."[66] On a small purchase, these fees represent thousands of percentage points per annum if stated as interest rates. The first YouTube video to pop up to help consumers understand Afterpay calls this service interest-free, which is scary.[67] The capacity to use essentially unregulated services like this to overspend is breathtaking, especially for younger consumers.[68]

Likewise, with education finance ISAs, lenders advance funds to the consumer

---

[61] *Id.* § 1692a.

[62] Hawkins, *supra* note 12, at 2051.

[63] California felt the need to clarify that bail bonds are indeed credit after the industry claimed they were not and thus claimed they did not need to state an APR in their contracts. S. 318, 2019-20 Leg., Reg. Sess. (Cal. 2019).

[64] Jim Hawkins, *Earned Wage Access and the End of Payday Lending*, B.U. L. REV. (forthcoming 2020) (manuscript at 36–41), https://ssrn.com/abstract=3514856.

[65] *Afterpay Fact Sheet*, AFTERPAY, https://www.afterpay.com/attachment/44/show (last visited Dec. 21, 2020).

[66] *Id.*

[67] Destinyc06, *What is afterpay??? Afterpay pros and cons!! How to use afterpay.*, YOUTUBE (Mar. 23, 2019), https://www.youtube.com/watch?v=GFw1-klb7-s.

[68] As Levitin explains in his blog:

> This finance charge or four-installments provision is key for buy-now-pay-later products like Afterpay. Afterpay allows the consumer to purchase goods now and pay over 4 equal installment payments. So it's within the 4-installment part of the "creditor" definition. And Afterpay does not have a charge if you pay on time. It only has a late fee. Late fees are excluded from the finance charge if it is for "actual, unanticipated late payment." So if borrowers are anticipated to pay off the Afterpay advance within the four installments, no problem—no finance charge, and not a "creditor" for TILA, and therefore not subject to TILA disclosure rules, TILA error resolution rules, or TILA unauthorized transaction liability limitation rules. Of course, if most consumers are paying late, then Afterpay's late fee would be a finance charge, so it would be a creditor, extending credit and subject to TILA. (I have no reason to believe that this is the case).

Levitin, *supra* note 3. Note, however, that even though Afterpay is not subject to TILA, it is still subject to ECOA, FCRA, FDCPA, and CFPA.

for tuition/living expenses in exchange for the consumer's promise to pay a percentage of his or her future income, over and above a minimum amount, to the lender.[69] While the total number of payments, payment time, and/or amount of payment may be capped, generally speaking, "the more you earn, the more you pay."[70]

While these ISAs are clearly used to finance an education, they claim to be "not credit."[71] Similar to buy-now-pay-later arrangements like Afterpay, and like Paycheck advances, the financiers claim that they do not issue credit.[72] Like the rent-to-own industry, ISA providers claim that only unconditional promises to repay constitute credit,[73] belying the existence of non-recourse credit. Indeed, in one law firm's analysis of ISAs, the firm explains in detail, law by law, why all of the usual consumer protection laws do not apply to ISAs.[74] We can see that many creditors would indeed want "more of that please." Below we describe some of the laws these entities seek to avoid.

---

69 Levitin, *supra* note 3.

70 *Id.*; *see also* Robert Farrington, *Be Careful with Income Sharing Agreement (ISAs) to Pay for College*, FORBES (Apr. 12, 2019), https://www.forbes.com/sites/robertfarrington/2019/04/12/income-sharing-agreements-to-pay-for-college/#70fc4d1052e0.

71 Levitin describes them as more like "participating preferred shares, in that if there's enough to pay the common equity (the consumer) a dividend, then the preferred shares must be paid a dividend. While we often call preferred shares equity, they're really a hybrid of equity and debt features." Levitin, *supra* note 3.

72 *Regulatory Treatment of Educational ISAs Under Federal and Select State Consumer Credit Statutes*, MORRISON & FOERSTER LLP (Mar. 2019), https://media2.mofo.com/documents/190408-regulatory-educational-consumer-credit-statutes.pdf.

73 *Id.* at 1–2. As Levitin explains in his blog:

> Whether ISAs are credit is critical to their viability. ISAs are priced differently depending on school and/or major. A computer science major is likely to have to pay a lower percentage than an anthropology major. One might imagine a pricing differential between students at an HBCU or minority-serving institution and at other schools. If ISAs are credit for ECOA purposes, there's likely, therefore, to be major disparate impact issues.
>
> . . .
>
> For CFPA purposes, there are two possible ways [ISAs could be credit]. First, for ISAs provided by the school itself (such as Perdue University), the answer is clearly yes. "Credit" is "the right granted by a person to a consumer to . . . purchase . . . services [education] and defer payment for such purchase." If a school is the ISA provider, it's definitely credit for the CFPA, which means UDAAP prohibitions apply. I think the answer is also the same if the provider is affiliated with the school, as the CFPA has an anti-evasion provision in its definition of "financial product or service".
>
> Second, for ISAs provided by third-parties, the question is whether the ISA is a "right granted by a person to a consumer to defer payment of a debt" or to "incur debt and defer its payment." (To be sure, the language about "purchase property or services and defer payment for such purchase" does not necessarily refer to a purchase from the person . . .).

Levitin, *supra* note 3.

74 MORRISON & FOERSTER LLP, *supra* note 72, at 2, 6–21.

1. The Truth in Lending Act

The granddaddy of all consumer protection laws is TILA, passed by Congress in 1968.[75] TILA requires all credit providers to disclose all fees and charges in one number, an annual percentage rate (APR) comprised of the sum of the amount financed and the finance charge, as well as the number, amount, and due dates of all scheduled payments and the amount of any late payment charge.[76] Congress' purpose in enacting TILA was to allow consumers to more readily compare the various credit terms available, to avoid the uninformed use of credit, and to protect the consumer against "inaccurate and unfair credit . . . practices."[77] As explained by Elizabeth Renuart and Diane Thompson:

> The drafters of TILA understood that without uniform disclosure, interest calculations are forbiddingly complex. The APR is meant to be a simplifying heuristic that allows borrowers to decide between options that are otherwise overwhelmingly complex. Many consumers stumble when confronted with even basic computational problems. Lenders can compound those missteps through marketing that distracts consumers from the salient points.[78]

Congress designed the APR to be the single number for consumers to focus on when shopping for credit, and thus the APR has become the touchpoint for consumers comparing the cost of credit.[79] The purpose of TILA is to allow consumers to compare fees, or the total cost of goods or housing, by comparing the annual percentage rate on credit costs.[80] Moreover, TILA has been remarkably effective at getting consumers to pay attention to interest rates and the cost of credit.[81] TILA's familiar and tidy TILA text box makes easy an otherwise daunting math task.[82]

TILA applies to credit sales, which include "any contract in the form of a bailment or lease in which the bailee or lessee contracts to pay a sum substantially equivalent to or in excess of the aggregate value of the property and services involved and 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."[83] Barring industry legislation to the contrary, this language certainly covers rent-to-own transactions.

---

[75] Truth in Lending Act (TILA), Pub. L. No. 90-321, 82 Stat. 146 (1968) (current version at 15 U.S.C. § 1601 (2018)).

[76] *Id.* at § 1638(a)(6).

[77] *Id.* at § 1601(a); *see also* Martin & Huckins, *supra* note 54, at 388–89.

[78] Renuart & Thompson, *supra* note 29, at 190.

[79] *Id.* at 217.

[80] *Id.* at 190.

[81] *Id.* at 189–90.

[82] *Id.*

[83] Martin & Huckins, s*upra* note 54, at 389; Truth in Lending Act (TILA), 15 U.S.C. § 1602(g) (2018).

Retail sales stores like Conn's or Best Buy, who sell items on credit, must comply with TILA, but rent-to-own stores in states with industry-sponsored legislation do not. Yet there is no doubt that the market substitute for rent-to-own contracts are installment sales contracts offered through retailers like Conn's. Conn's is a national appliance, furniture, and electronic store which makes most of its sales from the credit it offers to consumers who have difficulty getting credit elsewhere.[84] It is required to include an APR in all its contracts which puts it at a disadvantage compared to rent-to-own companies.

To help consumers compare the cost of their goods and credit services to those offered by typical rent-to-own companies, Conn's offers a side-by-side comparison on their web site.[85] For an LG 43" television, their cash price is $699.99 and their financed price over 24 months is $1,173.52. They compare this to a typical rent-to-own transaction for the same television in which the cash price is $1,046.05 and the financed price is $2,092.09.[86]

The point of all this is not the exorbitant cost, but the fact that Conn's and rent-to-own are not on a level playing field because Conn's is required to be honest and transparent in its disclosure of the total costs of its products and services and rent-to-own is not, despite that these transactions are market substitutes.[87]

---

[84] Lawrence Meyers, *A Case Study in Capital Preservation: Conn's (Part 1)*, WYATT INV. RESEARCH (Sept. 22, 2014), https://www.wyattresearch.com/article/capital-preservation/.

[85] *YES MONEY vs. Rent To Own*, CONNS HOMEPLUS, https://www.conns.com/yes-money-financing-vs-rent-to-own-texas, (last visited on Aug. 27, 2020).

[86] *Id.* This is a saving of $918 over roughly two years. *Id.* They do the same math for an LG French door refrigerator, which they sell for $1,699.97 cash or $2,515.12 financed. With rent-to-own, one would pay $2,500.53 for the same refrigerator in cash or $3,846.96 financed, a $1331 savings. Finally, they offer a sofa set for $1,979.99 in cash or $2,890.96 financed, whereas these same items would cost roughly $2,080 in cash or $4,160 over time from a rent-to-own establishment.

[87] A few courts have considered whether rent-to-own companies must disclose an APR and comply with TILA. Some have found that rent-to-own contracts fall within TILA, given that in substance they are the same as a credit transaction and that in most cases the customer intends to buy the item, not merely rent it. *See* Clark v. Rent-It Corp., 685 F.2d 245, 248 (8th Cir. 1982); Davis v. Colonial Sec. Corp., 541 F. Supp. 302, 305 (E.D. Pa. 1982); Waldron v. Best T.V. & Stereo Rentals, Inc., 485 F. Supp. 718, 719 (D. Md. 1979); Murphy v. McNamara, 416 A.2d 170, 177 (Conn. Super. Ct. 1979). Most courts, however, have found that TILA does not apply to rent-to-own contracts, on the reasoning that in a rent-to-own transaction, the customer does not promise to pay the full value of the goods he or she is acquiring. *See, e.g.*, Ortiz v. Rental Mgmt., Inc., 65 F.3d 335, 342 (3d Cir. 1995); *In re* Hanley, 135 B.R. 311, 314 (C.D. Ill. 1990); Clark v. Rent-It Corp., 511 F. Supp. 796, 799 (S.D. Iowa 1981); LeMay v. Stroman's, Inc., 510 F. Supp. 921, 923 (E.D. Ark. 1981); Dodson v. Remco Enters., Inc., 504 F. Supp. 540, 543 (E.D. Va. 1980); Smith v. ABC Rental Sys. of New Orleans, Inc., 491 F. Supp. 127, 397 (E.D. La. 1978), *aff'd*, 618 F.2d 397 (5th Cir. 1980); Stewart v. Remco Enters., Inc., 487 F. Supp. 361, 363 (D. Neb. 1980); Remco Enters., Inc. v. Houston, 677 P.2d 567, 573 (Kan. App. 1984). Moreover, in 1981, the Federal Reserve Board, empowered by Congress to issue implementing

Some scholars insist that providing an APR in rent-to-own transactions will only confuse customers. For example, Michael Anderson claims that APRs do not help consumers understand rent-to-own transactions and that they "neither convey sufficient information to enable a consumer to rationally choose the most efficient alternative nor can they be cited as evidence of exploitation of either [rent-to-own] or laundromat customers."[88] Similarly, Professor Jim Hawkins has argued that APRs should not be required in rent-to-own transactions, in part because consumers do not understand APRs and cannot calculate them,[89] and in part because the industry has indicated in the strongest possible way that if it has to disclose an APR, it will leave the marketplace.[90]

On the other hand, consumers need not be able to calculate an APR as long as they can compare two TILA boxes, which many apparently can do.[91] APR disclosures are still relevant in contracts shorter than one year in duration. After all, one need not travel a mile to go a certain number of miles per hour. If rent-to-own dealers were required to disclose the APR, this interest rate might shock consumers into reconsidering signing on the dotted line. Then, on the other hand, it may not, but at least consumers could compare the cost of a rent-to-own transaction to an installment purchase agreement if they wanted to.

2. The Fair Debt Collection Practices Act

The FDCPA sets limits on the ways in which debt collectors can contact consumers to collect a debt. For example, debt collectors may not call before 8 am or after 9 pm,[92] call a consumer at work,[93] employ any unfair practices in an attempt to collect a debt,[94] or conceal his or her identity on the phone.[95] Moreover, if the consumer asks to never be contacted again, the debt collector must cease all contact

---

regulations for the TILA, clarified the scope of the act by amending its Regulation Z to define a credit sale as including "a bailment or lease (*unless terminable without penalty any time by the consumer*)." Martin & Huckins, *supra* note 54, at 389–90. Rather, he or she has an option to keep paying and own the item at the end of a certain term. *But see* Perez v. Rent-a-Ctr., Inc., 892 A.2d 1255, 1257–58 (N.J. 2006).

[88] As Anderson explains:

> Requirements that rent-to-own agreements disclose implicit APRs merely cloud the issue for consumers because they are not simply disguised installment contracts any more than are layaway plans or the long-term use of coin-operated washing machines and photocopiers.

Anderson & Jackson, *supra* note 12 , at 304–05.

[89] Hawkins, *supra* note 12, at 2107.

[90] *Id.* at 2103–04.

[91] *See* Renuart & Thomas, *supra* note 29, at 217–18.

[92] Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. § 1692c (a)(1) (2018).

[93] *Id.* § 1692c (a)(3).

[94] *Id.* § 1692f.

[95] *Id.* § 1692d (6).

with that consumer.[96] The FDCPA also dictates how a debt collector must act when communicating with a third party about the consumer being collected upon, and dictates that debt collectors cannot even share information pertaining to a debt to anyone but the consumer, a spouse, or a parent if the consumer is underage.[97] Debt collectors cannot communicate with consumers by postcard or in any other way that invades privacy about the debt, nor can they publish any kind of listing of consumers that have not paid a debt, except to a consumer bureau.[98]

If a consumer hires an attorney and tells the debt collector he or she is represented, the debt collector can no longer communicate with the consumer directly.[99] Debt collectors are prohibited from using any form of harassment or abuse while attempting to collect.[100] They cannot lie or falsely imply that the consumer has committed a crime.[101] While these rules do not generally apply to companies collecting on their own debts, if the creditor collects under a slightly different name than the one they otherwise operate under, the FDCPA rules do apply.[102] If the FDCPA is violated, the consumer can recover statutory and actual damages plus attorney's fees, an important remedy when seeking a lawyer.[103]

The FDCPA does not apparently apply to rent-to-own transactions, yet fair debt collection in rent-to-own transactions is a problem. According to the National Consumer Law Center (NCLC), the rent-to-own industry has used the threat of arrest and criminal sanctions to obtain payments from customers.[104] In many states, if a customer misses a single payment and does not promptly return the merchandise, the rent-to-own dealers pursue criminal charges against the customer.[105] The industry, enabled by state criminal statutes and prosecutors' offices, has pursed criminal theft charges against renters of property, which the NCLC likens to the resurgence of debtor's prison and the criminalization of poverty.[106] In other consumer transactions, failure to make a payment would be considered a breach of contract, a civil matter, but, because in rent-to-own contracts, the dealers retain title to the property, dealers base their criminal claims on "theft of services" or "theft of rental

---

96 *Id.* § 1692c (c).

97 *Id.* §§ 1692c (b), (d).

98 *Id.* §§ 1692b (4)–(5), 1692d (d), 1692f (7).

99 *Id.* §§ 1692b (6), 1692c (a)(2).

100 *Id.* § 1692d.

101 *Id.* §§ 1692e (7)–(8), (10).

102 *Id.* § 1692a (6).

103 *Id.* § 1692k (a).

104 Brian Highsmith & Margot Saunders, *The Rent-To-Own Racket: Using Criminal Courts to Coerce Payments from Vulnerable Families*, NAT'L CONSUMER L. CTR. 2 (Feb. 2019), https://www.nclc.org/images/pdf/criminal-justice/report-rent-to-own-racket.pdf.

105 *Id.* at 3.

106 *Id.* at 4. In these situations, dealers use intimidation tactics on customers struggling to make payments on their rent-to-own contracts. *Id.* at 3, 9.

property."[107]

NCLC attorneys also describe how state agencies such as prosecutors' offices and the police are being used by the rent-to-own dealers.[108] State theft laws vary widely. Some explicitly apply to rent-to-own contracts, while others are silent on whether they apply to rent-to-own transactions.[109] Some state statutes base the severity of the offense on the value of the property (i.e., misdemeanor versus felony) and are particularly concerning because of the high mark-up on the property being rented in these contracts.[110] For example, someone arrested for theft of a TV worth $200 at retail might be charged with stealing property worth $1200 if that's what the inflated "cash price" of the TV is in the rent-to-own agreement.[111] Thus a simple failure to pay a consumer debt, a civil collection suit, becomes first a criminal misdemeanor charge that can then be inflated to a felony conviction which carries all of the consequences of serious criminal behavior, including inability to vote, obtain employment, etc.

3. Other Federal Laws

The Consumer Leasing Act, enacted by Congress in 1976, applies to consumer leases that obligate the consumer for more than four months.[112] The Act requires lessors to disclose the initial payment, any official fees or other incidental charges, and the number, amount, total amount, and due dates of the periodic payments, but does not require the disclosure of a finance charge or an annual percentage rate

---

[107] *Id.* at 3. Only three states specifically exclude RTO transactions from their theft statutes: Connecticut, South Carolina, and Virginia. *Id.* at 12.

[108] *Id.* at 11.

[109] *Id.* at 12.

[110] *Id.* at 13.

[111] Advocates suggest that state laws be passed to protect consumers from being targeted by rent-to-own dealers. Some suggested provisions explicitly excluding rent-to-own contracts from theft statutes, requiring specific proof that the defendant intended to steal the property, establishing a civil legal process through which rent-to-own deals and consumers can resolves disputes, and regulating coercive collection strategies by imposing legal liability for threatening arrest with no reasonable basis. *Id.* at 3; *see also* Shannon Najmabadi & Jay Root, *New Texas Law Protects Rent-to-own Customers Against Criminal Prosecution*, TEXAS TRIBUNE (June 21, 2019, 9:00 AM), https://www.texastribune.org/2019/06/21/new-texas-law-protects-rent-own-customers-against-criminal-prosecution/ (describing the passage of this kind of state law). There is also the FCRA, but this act is used by creditors and non-creditors alike. KaydenPhoenix2011, *Credit Advice*, CREDIT KARMA (May 19, 2011), https://www.creditkarma.com/question/does-leasing-furniture-and-other-items-help-boost-a-credit-score/. Rent-to-own establishments send mixed signals on whether they do or do not report credit, but one thing is clear: if they do not, that does not help one's credit, and taking out a regular loan does. Ciaran John, *Does Rent to Own Help Your Credit?*, THE NEST, https://budgeting.thenest.com/rent-own-credit-23222.html (last visited Oct. 21, 2020).

[112] Truth in Lending Act (TILA), 15 U.S.C. § 1667 (1) (2018).

because the lessor is not extending credit.[113] These requirements are extremely minimal,[114] yet the rent-to-own industry need not even comply with these laws because rent-to-own contracts do not obligate the consumer beyond the one week or one month rental.

The ECOA prohibits a creditor from discriminating against an applicant on the basis of race, color, religion, national origin, sex, marital status, age, or receipt of public assistance.[115] Since rent-to-own deals are allegedly not credit, rent-to-own dealers are allowed to discriminate. The FCPA requires those who collect payments on debts to report on such activity in a fair and accurate manner,[116] but these requirements do not apply of course if rent-to-own transactions do not involve the extension of credit.[117]

4. State Usury Laws

Another set of laws that rent-to-own dealers seek to avoid is usury laws, or laws that cap the interest rates that a lender can charge on loans.[118] To establish a usury claim at common law, a plaintiff must ordinarily prove the following: (i) a loan of money or forbearance of debt, (ii) an agreement that the principal shall be repayable absolutely, (iii) the exaction of a greater amount of interest than is allowed by law, and (iv) an intention to evade the law at the inception of the transaction.[119]

Sixteen states plus the District of Columbia have usury caps ranging from 12%

---

113 *Id.* at § 1667a (9).

114 *See* Martin & Huckins, *supra* note 54, at 391 n.42, stating that:

> The industry has recognized that because the provisions of the Consumer Leasing Act are so "benign," some RTO dealers might attempt to conform their agreements to its requirements. Ed Winn III, *Looking at Leasing*, PROGRESSIVE RENTALS, Dec. 1994/Jan. 1995, at 10. Legal counsel to the Association of Progressive Rental Organizations, a RTO trade group, advises caution to dealers considering such action for the following reasons: 1) advertising "no obligation," a particular attraction of RTO, might subject them to charges of false advertising; 2) RTO customers are quite likely to return the merchandise during the initial four-month rental period; if dealers, to avoid expenses, do not take default judgments, they may be viewed as not really being in the leasing business, but they would no longer be in compliance with state RTO statutes; 3) the availability of a purchase option becomes an issue because, if one is offered, it has to be for a price greater then [sic] "nominal" or the transaction may be characterized as a sale, subjecting the transaction to the TILA and state installment sales statutes.

Id. at 12–13; FED. DEPOSIT INS. CORP., CONSUMER COMPLIANCE EXAMINATION MANUAL V-7.1 (Sep. 2015), https://www.fdic.gov/regulations/compliance/manual/5/v-7.1.pdf.

115 Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691 (2018).

116 Fair Credit Reporting Act (FCRA), 15 U.S.C. § 1681(a) (2018).

117 Rent-to-own agencies surely use the credit reporting system to check on customer's creditworthiness, so they are using the system and they should also report to it.

118 Miller v. Colortyme, Inc., 518 N.W.2d 544, 549–50 (Minn. 1994).

119 *Id.* at 549.

to 36% per annum. Minnesota is one of those states.[120] As a result, in *Miller v. Colortyme*, the Minnesota Supreme Court had to decide if a rent-to-own transaction was a credit transaction because if so, the transaction involved an interest rate well above the Minnesota interest rate cap.[121] The court ultimately held that rent-to-own transactions were credit sales and thus subject to general usury laws.[122]

Naturally, being able to get out from under usury caps is a tremendous benefit for a creditor. For example, payday lenders, which charge 300% per annum or more, cannot operate in states with usury caps.[123] If rent-to-own transactions are not credit, they need not comply with usury laws and can charge whatever they want.

C. Recourse Versus Non-recourse Debt, Article 9, and the Scope and Legislative History of Article 9

Secured debt comes in two types: recourse debt, in which the creditor can pursue the debtor for the full amount even if the collateral doesn't cover it, and non-recourse debt, where the creditor can only realize on the collateral for the debt, once the debtor stops paying.[124] Article 9 covers all security interests, whether the debt is recourse or non-recourse.[125] Several industries that look like they are providing secured credit are claiming that their products are not credit at all but something else. This Section describes these different types of secured credit and why we care if a vendor is providing secured credit.

1. Rent-to-Own Debt is Non-recourse Debt, but Debt Nevertheless

The industry's most consistent and compelling argument for why rent-to-own is not credit is that customers can end the relationship at any time, surrender the rented goods, and not be liable for the remaining lease payments. As the New Jersey Supreme Court noted in *Perez v. Rent-A-Center*, however, this one fact is not determinative on the issue of whether something is credit or something else.[126] Functionally, rent-to-own transactions involve non-recourse debt, a type of debt for which the creditor does not seek additional payment after default, but relies solely on its collateral post-default.

---

[120] *Payday Loan Consumer Information*, CONSUMER FED'N AMERICA, https://paydayloaninfo.org/state-information (last visited Dec. 21, 2020).

[121] *Miller*, 518 N.W.2d at 546.

[122] *Id.* at 548.

[123] Nathalie Martin, *Public Opinion and the Limits of State Law: The Case for Federal Usury Caps*, 34 N. ILL. U. L. REV. 259, 266, 268–71 (2014).

[124] Julia Kagan, *Defining Limited Recourse Debt*, INVESTOPEDIA, https://investopedia.com/terms/l/limitedrecoursedebt.asp (last visited Dec. 20, 2020).

[125] U.C.C. § 1-901(a) (AM. LAW. INST. & UNIF. LAW COMM'N 2019) (". . . [T]his article applies to . . . a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract . . .").

[126] Perez v. Rent-a-Ctr., Inc., 892 A.2d 1255, 1270 (N.J. 2006).

Non-recourse or limited recourse debt is debt for which the creditor agrees not to pursue the borrower for any additional payments once it repossesses its collateral.[127] With recourse debt, the lender has the legal right to collect not just from the collateral, but also from the debtor's other assets upon default.[128] Recourse debt can either be full recourse or limited recourse.[129] Full recourse debt allows the lender to seize and sell the debtor's assets, through the state execution and collections process.[130]

Limited recourse or non-recourse debt contracts forbid the lender from collecting except from limited assets, typically just its collateral.[131] This type of debt "gives the lender a limited amount of recourse to the borrower's other assets in the event of default."[132] If the borrower defaults on his or her payments, the lender can exercise its rights to repossess its collateral, but that's it. If the collateral is insufficient to cover the entire debt, the borrower is not personally liable for the deficiency or shortfall between the amount of unpaid debt and the amount realized on the collateral.[133]

Non-recourse loans are not limited to home loans.[134] Any time the lender relies solely on the value of its collateral for collection, the debt is non-recourse debt. Rent-to-own contracts create just that, non-recourse debt. It is not that the transactions are leases, as both parties prefer that the customer ultimately own the property and in most cases that is what happens.[135] Rather, rent-to-own transactions create debt for which the lender intends to rely solely on its collateral for repayment. Rent-to-own contracts in which the customer can end the relationship at any time by just returning the goods have all of the attributes of non-recourse debt. Non-recourse debt is debt, nevertheless.

2. The Side-Step Around Article 9

As we have seen, creditors extending credit on a secured or unsecured basis benefit in many ways by calling their products something other than "credit." One

---

127 Kagan, *supra* note 124.

128 *Id.*

129 *Id.*

130 *Id.*

131 *Id.*

132 *Id.*

133 *Id.*

134 For example, "[a]uction houses and art specialists, on the other hand, provide non-recourse loans and their decisions are based solely on the value of the art and its risk. The borrower's guarantee is not required in order to approve a non-recourse loan, and the main criterion is the art itself, not the creditworthiness of the borrower." William N. Goetzmann & Milad Nozari, *Art as Collateral* 5 (Yale ICF, Working Paper No. 2018-01, 2020), https://ssrn.com/abstract=3099054.

135 Lacko, *supra* note 9, at ES-2.

benefit is escaping the purview of Article 9 of the U.C.C., which governs repossessions, forfeiture, and creditor liability. In the first scholarly article on rent-to-own, Professor James Nehf noted the industry's particular interest in avoiding Article 9's repossession provisions.[136]

The scope of Article 9 has always been broad, to keep lenders from disguising their transactions as leases for the purpose of escaping the protections of the U.C.C. As one court explained:

> [Article 9 was drafted, in part,] [t]o avoid the dismal history under which legislatures drafted laws to govern security arrangements and clever lawyers routinely escaped the grasp of such laws by devising ingenious documents that suited their clients' needs . . . . [The Code instructs that, with limited exceptions, Article 9 applies regardless of] whether title in collateral is in the secured party or the debtor . . . . The drafters . . . took this step with the intention "that its provisions should not be circumvented by manipulation of the locus of title."[137]

Ensuring that Article 9 applies to disguised security interest is critical to, among other things, avoiding forfeitures of equity similar to that which occurred in the infamous *Walker Furniture* case, in which a low-income woman made most of her installment payments on various household goods, but defaulted at the end and lost everything.[138] The drafters of Article 9 also sought to avoid unfair collection and repossession.[139]

---

[136] Nehf, *supra* note 59, at 752.

[137] *In re* Jeff Benfield Nursery, Inc., 565 B.R. 603, 613 (Bankr. W.D.N.C. 2017).

[138] Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 447 (D.C. Cir. 1965).

[139] As Nehf explains:

> 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. 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. 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. 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 for any surplus realized from the sale or lease above the amount owed. Because the percentage of RTO contracts that result in repossessions is relatively high, 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.

Nehf, *supra* note 59, at 789–90.

As explained below, the original U.C.C. distinguished between leases and contracts by looking at the economic realities of the transaction. The customer's option to get out of the deal before the end of the lease was one factor, but not determinative.[140] Under former section 1-201(37), courts balanced many factors to determine if a lease was a true lease or a security interest.[141] Under most of these analyses, rent-to-own transactions were deemed disguised security interests, which were covered by Article 9 and were thus subject to all of the protections of both the U.C.C. as well as all other credit-related laws.[142] Courts focused on a variety of objective facts related to the leasing transaction, such as the terms of the lease and any option, the

---

140 If a "lease" includes a purchase option for nominal or no consideration, then it is presumed to be intended as a security agreement and not a lease, unless the option price bears a resemblance to the fair market value of the property. *In re* Phoenix Pipe & Tube, L.P., 38 U.C.C. Rep. Serv. 2d 28, *2 (E.D. Pa. June 8, 1993). A purported lease is actually a secured sales contract and therefore does not constitute a true lease when the parties apparently intended the lease as security, as demonstrated by the debtor's option to purchase the "leased" equipment at the end of the lease term. Although the lease may not contain explicit language granting a security interest, the practical effect of the lease is to create a security interest if the lease is intended as security. *In re* Village Import Enters., 126 B.R. 307, 308 (Bankr. E.D. Tenn. 1991). The Code recognizes that a secured sale may be veiled in lease terms. The lease need not contain specific language granting the security interest. The drafters of the U.C.C. "expected a lease intended as security to use only lease terms. They did not expect a party to disguise a secured sale as a lease and then give away the disguise by including words granting the lessor a security interest." *Id.* at 308–09; *see also* Sutton v. Ryder Truck Rental, Inc., 807 S.W.2d 905, 906–07 (Ark. 1991). An equipment lease is in reality a secured transaction if the lessee has the right to purchase the equipment for $1.00 at the end of the lease period. *In re* McDaniel, 127 B.R. 132, 134 (Bankr. N.D. Tex. 1991).

141 *See In re* Price, 577 B.R. 643, 653–54 (Bankr. E.D.N.C. 2017) (holding that a purported lease agreement was a disguised security agreement when the "lessee's" obligations were not subject to termination, the "lessee" was obligated for the initial term of the lease, and the option to purchase the equipment for $1.00 constituted nominal consideration); *see also In re* Johnson, 571 B.R. 167 (Bankr. E.D.N.C. 2017); *In re* Ajax Integrated, L.L.C., 554 B.R. 568, 578–79 (Bankr. N.D.N.Y. 2016); *In re* Johnson, 86 U.C.C. Rep. Serv. 2d 207, *6–8, *12–13 (S.D. Miss. Mar. 27, 2015); *In re* Purdy, 763 F.3d 513, 519–21 (6th Cir. 2014); Gib. Fin. Corp. v. Prestige Equip. Corp., 949 N.E.2d 314, 321 (Ind. 2011); *In re* Lash, 73 U.C.C. Rep. Serv. 2d 292, *15–16 (Bankr. M.D.N.C. Dec. 9, 2010); *In re* Bailey, 326 B.R. 156, 161 (Bankr. W.D. Ark. 2005); *In re* Super Feeders, Inc., 236 B.R. 267, 269–70 (Bankr. D. Neb. 1999); *In re* Eagle Enters., 237 B.R. 269, 274–75 (E.D. Pa. 1999).

142 More specifically, former section 1-102(37), which later became section 1-203, provided that:

> Unless a lease or consignment is intended as security, reservation of title thereunder is not a "security interest." 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.

In re Super Feeders, Inc., 236 B.R. at 269–70.

amount of equity, if any, that the lessee was acquiring in the leased property, the amount of rent under the lease compared to the purchase price for the goods if sold rather than leased, which party insured the property, whether the lessor had disclaimed warranties, the value of the property at the end of the lease, and the nature of the lessor's business.[143] One very significant factor was whether the lease agreement required that the transferee pay consideration for the use of the goods for a term that was equal to their economic life, although this one factor was by no means determinative.[144] Rent-to-own transactions meet many of these fluid factors.

Later, the lease versus security interest provision in Article 9 was moved to section 1-203 and amended to make it absolutely necessary for the customer to be bound to the entire lease term for the full useful life of the leased goods, in order for a transaction to be a security interest.[145] This new definition created a sea change in

---

[143] The test focused on whether, at the time the lease was executed, it was reasonably predictable that the "lessor" will have retained more than a nominal residual interest in the goods. If it had not, the transaction is in fact a secured transaction because the transferee has received the full economic ownership, and presumably value, in the goods. A thorough discussion of the difference between a lease and a security interest can be found in COOGAN ET AL., SECURED TRANSACTIONS UNDER THE UCC § 30.02 (2020). *See also In re* Pillowtex, Inc., 349 F.3d 711, 717–18 (3d Cir. 2003); *In re* Our Secret, Ltd., 282 B.R. 697, 701–04 (Bankr. D.N.M. 2002); Leasing One Corp. v. Caterpillar Fin. Servs. Corp., 776 N.E.2d 408, 407, 409–11 (Ind. Ct. App. 2002); *In re* Hoskins, 266 B.R. 154, 158–59 (Bankr. W.D. Mo. 2001); Citipostal, Inc. v. Unistar Leasing, 724 N.Y.S.2d 555, 558 (N.Y. App. Div. 2001); Burkhart v. U.S. Commerce Equip. Fin. LLC., 2001 WL 984915, at *4 (Tenn. Ct. App. Aug. 28, 2001).

[144] Some factors deal with an option exercisable by the transferee to renew the lease or to purchase the goods. An option to purchase the goods does not convert the lease to a sale and security interest so long as the transferee must pay more than a nominal consideration. The reason is that the transferee might not exercise the option and thus the transferor has a residual value. If the lessee does exercise the option to purchase, at that point its purchase of goods is a separate transaction from the original lease. On the other hand, if the transferee must pay no consideration or only nominal consideration, the transferee at the time the lease is executed acquires the total interest in the goods. Hence, the nominal lease is a disguised security interest. Whether a lease is a lease or a security interest turns most critically, therefore, on whether the additional consideration paid by the transferee is nominal. COOGAN, *supra* note 143, at § 30.03[1][c].

[145] U.C.C. § 1-203 (AM. LAW. INST. & UNIF. LAW COMM'N 2017). Specifically, section 1-203 was amended as follows:

> § 1-203. Lease Distinguished from Security Interest.
>
> (a) Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.
>
> (b) A transaction in the form of a lease creates a security interest *if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee*, and: (1) the original term of the lease is equal to or greater than the remaining economic life of the goods; (2) 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; (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or (4) the lessee has an option to become

the definition by providing that there was no need to balance any factors and no security interest at all, if the lease was "subject to termination by the lessee."[146] Before this, whether the lessee could terminate was just one factor.[147] Suddenly, if the customer did not have to pay the entire lease, then it was no longer a secured transaction, but a lease regardless of the rest of the economics. Prior to the enactment of this amendment, courts used at least sixteen different factors, but the one factor that was determinative to many courts was whether the "lease" granted the "lessee an option to become the owner of the property for no additional or nominal consideration at the end of the lease."[148] Rent-to-own transactions by definition contain the very option upon which former Article 9 and these cases relied.

It is remarkable that this little-talked-about sea change turned the existing test on its face and made the absolute promise to pay the one determining factor, eliminating intent entirely, along with the previously used economic realities test. By focusing solely on the absolute promise to pay rather than the economic realities, our U.C.C. also moved away from international standards on the lease/sale distinction, which focus primarily on whether the lessee has the option to become the owner of the goods upon full compliance with the terms of the contract.[149] In any case, before this U.C.C. amendment, the rent-to-own industry got busy passing the industry-friendly legislation described in the next Part, perhaps just in case the U.C.C. changed again.

> the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

Id. (emphasis added).

146 *Id.*

147 *See, e.g.*, *In re* Village Import Enters., 126 B.R. at 308.

148 *See* Nehf, *supra* note 59, at 793. As Nehf explains, where the lessee can automatically become 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." *Id.* Some courts disagreed, however. "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 consumer undertakes no obligation to repay a debt." *Id.* at 793–94.

149 *See, e.g.*, *Conditional Sales Act*, R.S.N.S. 1989, c 84, § 2(1)(b); *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*, [1995] 2 S.C.R. 187 (Can.) (in which the Supreme Court of Canada confirmed that this wording did not limit the scope of the registration provisions of the Nova Scotia Act, first enacted in 1930, to "disguised conditional sales agreements"—i.e., lease-option agreements—where it is plain that the lease payments in reality are going toward the purchase of the leased goods).

III. THE ANATOMY OF RENT-TO-OWN

This Part describes how rent-to-own works. It helps put these contracts in context by comparing them to pure lease transactions, in which a person rents an item for a limited period of time with no expectation of ownership. A good example is a car rented at an airport. The consumer never plans to own the car and is using it for a short time. "Rent-to-own" or "rental-purchase" transactions are something of a hybrid.[150] These contracts are typically written as short-term, weekly or monthly, obligations, but automatically renew for an extended period.[151] Typically, the consumer becomes the owner on completion of payments over that span.[152]

Rent-to-own companies fall within the broad category of lenders who provide "loans" to low-income consumers at high costs.[153] Other lenders in this category include payday lenders, tax-refund-anticipation loan providers, traditional check cashers, foreign remittance shops, auto-title pawn stores, and traditional pawn shops, all of which share certain predatory characteristics.[154] For the most part, these lenders are clustered in low-income neighborhoods or outside military bases, their products are poorly regulated, often with triple-digit interest rates, they sometimes operate under safe-harbor laws drafted by the industry itself, they sometimes use threatening bullying tactics to collect debts and late payments, and their products are often designed to keep consumers in perpetual debt.[155]

The name "rent-to-own" says it all. Rent-to-own contracts offer the allure of renting in order to someday own. Indeed, the majority of rent-to-own customers hope to someday own the item outright.[156] The cost of these transactions is three or four times the cash price for the item.[157]

---

[150] Martin & Huckins, *supra* note 54, at 385–86 (discussing typical rent-to-own transactions); David L. Ramp, *Renting to Own in the United States*, 24 CLEARINGHOUSE REV. 797, 797 (1990) (discussing rent-to-own contracts).

[151] *Id.* at 797, 809.

[152] *Id.* at 797.

[153] Ed Mierzwinski, *The Poor Still Pay More: The Small-Loan Industry Preys on Low-Income Americans Who Often Have No Choice but to Accept Their Outrageous Payment Terms. But This Big Business May Be Facing Trouble*, 44 TRIAL 40, 42 (2008).

[154] *Id.*

[155] *Id.* (noting that the "mom-and-pop lenders" of the 1960s are now called rent-to-own stores, and "sell the American dream of ownership of furniture, appliances, computers, jewelry, automobile wheel sets, and wide-screen TVs. *Business Week* said rent-to-own businesses have 8% (about $20 billion) of the $250 billion 'poverty business.'").

[156] Lacko, *supra* note 9, at ES-2.

[157] *Id.* at ES-3.

A. Rent-to-Own Fundamentals

Rent-to-own contracts are highly popular and have been since the 1960s.[158] In 2016, the Association of Progressive Rental Organizations reported revenue of $8.6 billion in the United States and also reported an estimated customer count of 4 million between brick and mortar stores and e-commerce.[159] Rent-to-own agreements enable a consumer to rent a product for a set time period without a credit check or substantial down payment.[160] The consumer is then given the option to purchase that product by either paying a substantially higher purchase price, or by completing all self-renewing payments for the set time period.[161] The consumer can also terminate the agreement at any point with no penalty.[162] According to the contract terms, by just stopping the agreed upon payments, the contract ceases and the vendor will come and pick up the product.[163]

Rent-to-own transaction rates are undeniably high.[164] For example, consider a typical transaction involving a $300 television. The rent-to-own agreement listed a seemingly reasonable weekly payment of $16 and after 52 payments, the consumer would own the television for the total cost of $832.[165] This transaction amounts to an APR of 254%, though APRs are not provided to customers as we discussed above in connection with the truth-in-lending analysis.[166] For comparison purposes, the average APR for credit cards in the United States in 2019 was 15.05% for all accounts.[167]

B. Unprecedented Self-Regulation

While rent-to-own transactions appear to us to be disguised security interests,[168] due to enabling statutes lobbied into law by the rent-to-own industry, they

---

158 *Id.* at 2.

159 Richard May, *The Shape of Rent-to-Own by the Numbers*, ASS'N OF PROGRESSIVE RENTAL ORG. (Aug. 7, 2017), https://www.rtohq.org/2017/08/shape-rent-numbers/.

160 Lacko, *supra* note 9, at ES-3.

161 *Id.*

162 *Id.*

163 *Id.* at 4.

164 Nehf, *supra* note 59, at 752.

165 *The Consumer Rental Purchase Agreement Act: Hearing on H.R. 1701 Before the Subcomm. on Fin. Inst. and Consumer Credit of the H. Comm. on Fin. Servs.*, 107th Cong. 99 (2001) (statement of Margot Sanders, Managing Attorney, National Consumer Law Center).

166 *See supra* notes 75–91 and accompanying text.

167 *Consumer Credit - G.19*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (Aug. 7, 2020, 3:00 PM), https://www.federalreserve.gov/releases/g19/current/g19.pdf.

168 A disguised security interest has been defined by the Fifth Circuit as a transaction labeled as a lease, but where the agreement is not subject to cancellation by the lessee, and the lessee is

are regulated under their own industry-written laws. Few purveyors of credit services have organized as relentlessly as the rent-to-own industry. Considering payday lenders, mortgage lenders, debt collectors, rent-to-own landlords, credit-reporting agencies, and every other purveyor of credit, none have sought so hard to pass their own extensive regulatory framework, on both a state and national level.

> In the 1980s, the rent-to-own industry convinced more than forty-five state legislatures 'to adopt its preferred safe-harbor legislation—treating week-to-week contracts as renewable leases, not as purchases over time—thus exempting the business from state small-loan usury ceilings, retail installment sales acts, and other credit sale laws.'[169]

According to many, the industry regulation is toothless and, essentially, non-regulation.[170]

According to James Nehf, the industry sprang up once federal disclosure laws, like TILA, made it more expensive to lend to low-income individuals.[171] By arguing that this service was not credit at all, but rather merely renting an item one might ultimately own, companies could avoid all the new (at the time) federal regulation.[172] They could also avoid Article 9.[173] Avoiding these two regulatory schemes seemed to be the primary goal of the legislation.[174]

As we explained in Part II.B.2 above, the current Article 9 does not cover the transactions in any case, so the rush to legislate out of it is mysterious. Perhaps the industry feared that the law would change back, and they would then be subject to Article 9 as they were under prior U.C.C. law. The primary obligations of Article 9 are to provide notice of default before repossession, to not breach the peace when

---

bound to become the owner of the goods. *In re* Pioneer Health Servs., Inc., 759 F. App'x. 240, 243–44 (5th Cir. 2018).

[169] Mierzwinski, *supra* note 153, at 42.

[170] See H.R. REP. NO. 107-590, pt. 1, at 37 (2002) (testimony of Hon. Maxine Waters), stating that:

> [t]he Consumer Rental Purchase Agreement Act is special interest legislation at its very worst. The bill is falsely presented by its industry proponents as pro-consumer and as not pre-emptive of state law. Neither is true. The bill has one purpose and one purpose only: to circumvent stronger consumer protections in the Federal Truth-in-Lending Act and in the statutes of a handful of States that the rent-to-own industry has not been able to overturn.

Id.; *see also The Consumer Rental Purchase Agreement Act: Hearing on H.R. 1701 Before the Subcomm. on Fin. Inst. and Consumer Credit of the H. Comm. on Fin. Servs.*, 107th Cong. 38 (2001) (statement of Hon. Julia Carson); *Consumer Credit Protection Act: Hearing on S. 1152 Before the Subcomm. on Consumer Affairs of the S. Comm. on Banking, Housing, and Urban Affairs*, 98th Cong. 1 (1983) (statement of Sen. Paula Hawkins, Chairman, Subcomm. on Consumer Affairs).

[171] Nehf, *supra* note 59, at 754–55.

[172] *Id.*

[173] *Id.*

[174] *Id.* at 821–22.

repossessing, to provide notice of sale of the collateral, to return any surplus back to the borrower after the sale, if there is one, and to allow the borrower to reclaim the goods before a sale.[175] One goal of Article 9 is to avoid a forfeiture if there is value in a repossessed item, and rent-to-own transactions necessarily permit such a forfeiture.[176] Since the companies also can re-rent the same repossessed items to other customers, forfeiture can be more nefarious. Forfeiture of equity deprives customers of their right to the benefit from the companies' normal, contractual mitigation of damages.[177]

The industry is also deeply opposed to compliance with TILA, the law that requires lenders to state the APR on a loan so that customers can compare the cost of various forms of credit and the credit offered by various providers.[178] In his empirical study of rent-to-own companies, Professor Jim Hawkins found that rent-to-own companies uniformly reported that, if they had to comply with the obligations to state an APR for their products, they would leave that market or stop operating in that state.[179] This extreme desire to not disclose the cost of credit is also mysterious.

The desire to avoid all forms of consumer credit regulation has been articulated often. According to Martin and Huckins:

> The industry is very concerned with maintaining its unique position in the marketplace, neither sale nor lease, in order to keep its favorable legal treatment. For example, APRO has counseled its members to avoid marketing techniques that bring it too close to retail sales. . . . Under a flex-term plan, for example, the store offers to rent an item for, perhaps, $40 a month, in which case the customer would become the owner in two years, or for $70 a month, in which case it would take only one year to own. APRO legal counsel explains that such a plan makes the term "fair rental value" meaningless and suggests that the customer is doing something other than merely renting the item for a month. If the customer merely rents for one month on the $70 plan, he has not gotten anything for his extra $30 a month, creating an unfair, deceptive transaction.[180]

The industry wants to have it both ways. Both they and their customers intend for the transaction to be an outright sale, and hope that it will be, but they want to

---

175 *Id.* at 789–90.

176 *Id.* at 790–91.

177 *See id.* at 789–90.

178 The rent-to-own industry likes to call itself a "service," as if this will preclude the transaction from being credit. The fact that this is a service, does not make it not credit. All credit is a service. *See* Alexandrov, Grodzicki & Bedre-Defolie, *supra* note 32, at 2 (describing credit as a service).

179 Jim Hawkins, *supra* note 12, at 2103–05.

180 Martin & Huckins, *supra* note 54, at 412 n.187.

avoid regulation by being governed by lease, rather than credit laws. [181]

C. Rent-to-Own Regulation

All but four U.S. states passed industry-sponsored regulation in some form or another.[182] This Part briefly reviews some of the primary provisions of most of these laws, typically called Rental Purchase Agreement Acts ("Acts").[183] The key provisions are that rent-to-own transactions are not "credit transactions" and that rent-to-own transactions are not covered by either Article 9 or Article 2 of the U.C.C.[184] Given that the transactions are deemed not to be "credit transactions" under these statutes, they are regulated to a far lesser degree,[185] to the detriment of their typically disadvantaged customers. The regulations mandate minimum disclosures but few "substantive limits on the transaction in areas consumer representatives deem most abusive."[186]

1. The Substance (or Lack Thereof) of Rental Purchase Agreement Acts

To fall within these Acts, the contract must be an agreement for the "use of goods by an individual for personal, family or household purposes, for an initial period of four months or less, that is automatically renewable with each payment after the initial period, that does not obligate or require the consumer to continue renting or using the goods beyond the initial period and that permits the consumer to become the owner of the goods."[187] The first key is to make sure the transactions are four months long or less, even though they can be renewed as long as it takes to purchase the item.[188]

The meat of the Acts are the disclosures. The primary disclosures require a description of the goods and whether they are new or used;[189] a statement of the cash price of the goods, which is illusory;[190] disclosure of periodic payments and due dates and a total of these payments due in order to own the item; along with an explanation of how to purchase items at the end of the "lease" or in an early purchase option. There also must be a disclosure about who must maintain the items; whether

---

[181] Anderson & Jackson, *supra* note 12, at 304.

[182] *Id.*

[183] *See, e.g.*, Rental-Purchase Agreement Act, N.M. Stat. Ann. § 57-26-1 (1995).

[184] Anderson & Jackson, *supra* note 12, at 304.

[185] *Id.*

[186] Nehf, *supra* note 59, at 815.

[187] N.M. Stat. Ann. § 57-26-2G (1995).

[188] *See id.* The statute also exempts mobile homes and a few other transactions like safety deposit boxes. N.M. STAT. ANN. §§ 57-26-A (3), (5) (1995).

[189] N.M. STAT. ANN. § 57-26-5A(4) (1995).

[190] Disclosure of the cash price is meaningless, though, because no one goes into a rent-to own establishment to buy outright and stores can set the cash price at any level they want. Nehf, *supra* note 59, at 822–23.

the consumer is liable for loss or damage to the goods and who must insure the goods;[191] a statement that the consumer will not own the goods until the consumer has paid the total amount necessary to acquire ownership,[192] and a statement that the consumer may terminate the rental-purchase agreement without penalty by voluntarily surrendering the goods "in good repair, reasonable wear and tear excepted, along with any past due rental payments upon expiration of any rental period."[193]

While lessee rent-to-own companies are provided with explicit damages under the Act, there is no section providing damages for lessor consumers. One could read the Act as providing no right to sue by a consumer lessor, but the Act also says that "[t]his subsection does not bar a consumer then in default on an obligation from asserting a violation of the Rental-Purchase Agreement Act as an original action or as a defense or counterclaim to an action brought by a lessor against the consumer."[194] As for lessee damages,[195] lessees can recover the greater of actual damages for breach or 25% of the total payments required to owns the item, but only between $100 and $1,000.[196] Consumers are also liable for costs and attorneys' fees,[197] and cannot offset their own damages.[198] Regarding the statute of limitations, all suits must be filed within one year of the last rental payment or within one year of the rental-agreement violation.[199] Given that a consumer is not likely to know he or she must sue within a year, this is incredibly short, especially for a contract. Contracts statute of limitations are usually four years.[200] Lessees also have a few defenses, none particularly generous.[201]

This disclosure-based Act falls far short of the protections one gets with other credit products, such as disclosure of interest rates under TILA, recovery of surpluses, and notice of repossession under Article 9.

---

191 *See* N.M. STAT. ANN. §§ 57-26-5A(3), (9) (1995).

192 *Id.* § 57-26-5A(2).

193 *Id.* § 57-26-5A(10).

194 N.M. STAT. ANN. § 57-26-11B (1995).

195 *Id.* § 57-26-11A.

196 *Id.* § 57-26-11A(1).

197 *Id.* § 57-26-11A(2).

198 "A consumer may not take any action to offset the amount for which a lessor is potentially liable under subsection A of this section against any amount owed by the consumer unless the amount of the lessor's liability has been determined by judgment of a court of competent jurisdiction in an action in which the lessor was a party." *Id.* at § 57-26-11B.

199 *Id.* § 57-26-11D.

200 U.C.C. § 2-725 (AM. LAW. INST. & UNIF. LAW COMM'N 2017).

201 *See* Brian Highsmith & Margot Saunders, *The Rent-To-Own Racket: Using Criminal Courts to Coerce Payments from Vulnerable Families*, NAT'L CONSUMER L. CTR. 1, 14–15 (Feb. 2019), https://www.nclc.org/images/pdf/criminal-justice/report-rent-to-own-racket.pdf.

2. Case Law on Rent-to-Own

In Minnesota, New Jersey, North Carolina, and Wisconsin, the industry-sponsored legislation did not pass due to fairness concerns for consumers.[202] Under the existing consumer credit statutes of these states, rent-to-own contracts are credit transactions,[203] and therefore, in those states, the transactions are considered credit transactions.[204] The cases rely on each state's definition of a consumer credit sale.[205]

---

[202] Bruce Speight & Greg Hart, *Rent-to-Own Ripoff: Why Wisconsin Shouldn't Exempt the Predatory Rent-to-Own Industry from Consumer Protection Laws*, WIS. PUB. INT. RES. GROUP (May 13, 2013), https://wispirg.org/sites/pirg/files/reports/The%20Rent-to-Own%20Ripoff.pdf. Speight & Hart state that:

> While some 46 states have enacted industry-friendly laws with these and other weak provisions, a few states, including New Jersey, Wisconsin, Minnesota and Vermont, enforce tough consumer protection laws. Unable to win in all state legislatures, the RTO industry has also asked Congress to preempt, or over-ride, these strong state consumer protection laws and replace them with a weak industry-friendly federal law; thus far, that effort has failed.

Id.; *see also* Highsmith & Saunders, *supra* note 201 (observing, in Appendix: State Laws Authorizing RTO Transactions and Criminalizing Failure to Rental Property, that all states have laws authorizing RTO transactions except Minnesota, New Jersey, North Carolina, and Wisconsin).

[203] Minnesota, New Jersey, and Wisconsin both require APR disclosures because judicial decisions have held that the transactions fall within each state's respective Consumer Credit Sales Act. *See* Miller v. Colortyme, Inc., 518 N.W.2d 544, 548, 549 (Minn. 1994) (concluding that rent-to-own transactions were credit sales under Minnesota's Consumer Credit Sales Act); *see also* Perez v. Rent-a-Ctr., Inc., 892 A.2d 1255, 1270 (N.J. 2006); Rent-A-Ctr., Inc. v. Hall, 510 N.W.2d 789, 795 (Wis. Ct. App. 1993) (holding that Wisconsin's consumer credit sale act covered rent-to-own transactions). Also, Vermont requires disclosure but does not call these "credit." VT. STAT. ANN. tit. 9, § 41b(a) (2015); VT. C.P.R. 115.04(b)(4) (1997) (requiring disclosure on price tag); VT. C.P.R. 115.04(b)(1) (1997) (requiring disclosure in contract). Nine other states impose statutory limits on the total costs that rent-to-own firms may charge customers: Connecticut, Hawaii, Iowa, Maine, Michigan, New York, Ohio, Pennsylvania, and West Virginia. *See* Hawkins, *supra* note 12, at 2108 n.319 (citing Ed Winn III, APRO's Legal Counsel, *Mem* http://www.rtohq.org/rent-to-own/wp-content/uploads/LegUpdate_2006.pdf (last visited Mar. 29, 2019)).

[204] *See, e.g.*, Perez, 892 A.2d at 1270; Miller, 518 N.W.2d at 549.

[205] For example, the Wisconsin statute reads:

> (9) "Consumer credit sale" means a sale of goods, services or an interest in land to a customer on credit where the debt is payable in installments or a finance charge is imposed and includes any agreement in the form of a bailment of goods or lease of goods or real property if the bailee or lessee pays or agrees to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the goods or real property 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 goods or real property upon full compliance with the terms of the agreement.

WIS. STAT. § 421.301 (2020). Minnesota's statute reads as follows:

> Subd. 2. Consumer credit sale. — "Consumer credit sale" means a sale of goods or services in which:

D. The Demographics of the Typical Rent-to-Own Customer

The best available data on rent-to-own usage and demographics, as well as customer intentions at the time of contracting, comes from a 2000 FTC study involving interviews with over 500 randomly selected rent-to-own customers.[206] The rent-to-own industry insists that a large part of its customer base is comprised of well-heeled customers that rent-to-own to fill a temporary need, such as a large-screen TV for the Super Bowl.[207] In reality, most rent-to-own consumers are disadvantaged.[208] Compared to households that had never used rent-to-own, rent-to-own customers were more likely to be African-American, were younger and less educated, and had lower incomes.[209] Rent-to-own customers are far more likely to come from

> (a) credit is granted by a seller who regularly engages as a seller in credit transactions of the same kind;
> (b) the buyer is a natural person; and
> (c) the goods or services are purchased primarily for a personal, family or household purpose, and not for commercial, agricultural, or business purpose.

MINN. STAT. § 325G.15 (2019).

[206] Lacko, *supra* note 9, at 1. The major findings of the FTC staff survey included that 2.3% of United States households had used rent-to-own transactions in the last year, and 4.9% had done so in the last five years. *Id.* at 25. This is lower than the usage of payday loans by comparison, which run 5.5% nationwide. PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 4 (2012), https://www.pewtrusts.org/-/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf.

[207] *See* APRO, THE RENT-TO-OWN INDUSTRY: AN OVERVIEW, https://www.rtohq.org/wp-content/uploads/2019/06/APRO-Flipbook-About-Us.pdf (last visited Dec. 20, 2020) ("What all customers have in common is that they have immediate needs for consumer household goods . . .").

[208] *See* Eligio Pimentel, *Renting-to-Own: Exploitation or Market Efficiency?*, 13 LAW & INEQ. 369, 370 (1995); Lee M. Breslau, *A Study of Appliance Rental Practices: Appliance Rentals and Purchases by Low-Income Consumers*, 20 CLEARINGHOUSE REV. 1515, 1516–17 (1987); *see also Rent-To-Own: Providing Opportunities or Gouging Consumers?: Hearing Before the Comm. on Banking, Fin. and Urban Affairs*, 103rd Cong., 1st Sess. 121–22 (1993) [hereinafter "Hearings"] (testimony of William Leibovici, Assistant Attorney General of Maryland). In these hearings, William Leibovici stated that:

> Everybody seems to agree that the customers of rent-to-own centers are primarily low-income consumers. . . . In addition to being low-income, a significant number of rent-to-own customers are seniors. In 1990, the American Association of Retired Persons (AARP) produced a Senior Consumer Alert in which it stated 'Older Persons are prime targets of these [rent-to-own] come-ons.

Id.

[209] Lacko, *supra* note 9, at 1. The report found that:

> Thirty-one percent of rent-to-own customers were African American, 79 percent were 18 to 44 years old, 73 percent had a high school education or less, 59 percent had household incomes less than $25,000, 67 percent had children living in the household, 62 percent rented their residence, 53 percent lived in the South, and 68 percent lived in non-suburban areas.

Id.

communities of color, as African-Americans and Hispanics appear to be overrepresented in rent-to-own transactions.[210] According to a report written for Rent-A-Center itself, 38.6% of its rent-to-own customers are African-American and 10.9% are Hispanic despite that at the time of that report, African-Americans constituted 12.1% of the total population and Hispanics, 9%.[211] These rent-to-own customers also were more likely to have children at home, rent their homes, and live in the South.[212] They also were more likely to live in the inner city or the country. [213]

Regarding economic condition, most consumers who entered into a rent-to-own agreement made less money than those who had never entered into a rent-to-own agreement.[214] They also had less education.[215] Of the customers who returned their rent-to-own item, 24% did so for financial reasons.[216] Almost half of rent-to-own customers surveyed reported making late payments.[217] Fifteen percent of late customers reported poor treatment from the lessee, and 11% reported quasi-abusive techniques from collections departments.[218]

E. What Do Customers Really Want in Rent-to-Own Transactions?

A common claim by industry is that many of their customers are not interested in buying the item they are renting; rather, most just want to use it for a while.[219] This is largely untrue. Seventy percent of customers buy the item they are renting and this purchasing rate applies across all demographics.[220] The reason the industry focuses on customers that do not wish to buy is that it makes the transaction look more like a true, short-term lease than a lease purchase agreement or a credit transaction. Continuing with this charade, the industry claims that, at the moment of

---

[210] Pimentel, *supra* note 208, at 370–71 n.7 (citing Carl C. Hoffmawn & Robert L. Lovler, *Rent-A-Center Final Report* (1994) (prepared for the Board of Directors of Thorn Emi Plc, the Parent Company of Rent-A-Center)).

[211] U.S. DEP'T. OF COMMERCE, 1990 CENSUS OF POPULATION GENERAL POPULATION CHARACTERISTICS UNITED STATES 3 (1990).

[212] Lacko, *supra* note 9, at 1.

[213] *Id.*

[214] *Id.*

[215] *Id.*

[216] *Id.* at 62.

[217] *Id.* at 74.

[218] *Id.*

[219] See Anderson & Jackson, *supra* note 12, at 302, stating that:

> The rental phase of RTO is well suited to consumers who find themselves in personal, financial, or employment situations that are seen as temporary or unpredictable. For this consumer group of renters, the embedded put option is highly valued while the option to secure an installment agreement at a later date increases in value through time.

Id.

[220] Lacko, *supra* note 9, at ES-1.

entering into the transaction, most customers do not wish to purchase the item.[221] This is also untrue. "Sixty-seven percent of customers intended to purchase the merchandise when they [entered] the . . . transaction, and 87 percent of the customers intending to purchase actually did [so]."[222] The name of these transactions says it all: the average person "rents" to "own."

IV. RENT-TO-OWN HOUSING AND SHADOW CREDIT

A close cousin to the rent-to-own transaction for consumer goods is another shadow credit transaction, the land sale contract, or contract for deed.[223] These transactions fall somewhere along the continuum of property rights between owners and renters and classic home mortgage transactions.[224] Buyers purchase their homes with installment payments and the seller holds on to title to the land and home until that last payment is made.[225]

These transactions allow people with bad credit or no credit to purchase a home, at least in theory.[226] In practice, they don't work as well.[227] In many ways, these transactions combine the worst aspects of traditional home buying, with the worst aspects of leasing real estate. The buyers often are responsible for repairs and also fail to build equity.[228]

Due to imbalances of power between buyers and sellers, many of these rent-to-own home buyers never end up owning the home they pay on for several years.

Rent-to-own homebuyers do not typically become homeowners for several reasons: First, the transactions are often not recorded, so there is no paper trail proving the buyers have actually purchased anything.[229] Second, even in an honest deal,

---

221 *Id.* at 10–11.

222 *Id.* at ES-2.

223 Genevieve Hébert Fajardo, *"Owner Finance! No Banks Needed!" Consumer Protection Analysis of Seller-Financed Home Sales: A Texas Case Study*, 20 GEO. J. POVERTY L. & POL'Y 429 (2013); *cf.* Grant S. Nelson, *The Contract for Deed as a Mortgage: The Case for the Restatement Approach*, 1998 BYU L. REV. 1111, 1112 (1997); Elizabeth M. Provencio, *Moving from Colonias to Comunidades: A Proposal for New Mexico to Revisit the Installment Land Contract Debate*, 3 MICH. J. RACE & L. 283, 293–95 (1997); Grant S. Nelson & Dale A. Whitman, *The Installment Land Contract-A National Viewpoint*, 1977 BYU L. REV. 541, 541–42 (1977).

224 Nelson, *supra* note 223, at 1112.

225 Nelson & Whitman, *supra* note 223, at 541.

226 *See* Eric T. Freyfogle, *The Installment Land Contract as Lease: Habitability Protections and the Low-Income Purchaser*, N.Y.U. L. REV. 293, 304–05 (1987).

227 *See* Provencio, *supra* note 223, at 293–95 (describing the debate surrounding installment land contracts).

228 *See* Freyfogle, *supra* note 226, at 295–96 n.12; *see also* Nelson, *supra* note 222, at 1113.

229 *See* Hébert-Fajardo, *supra* note 223, at 429 (stating that "[t]here are many examples of families who pay under a contract for deed for years, only to find out that the home has existing

there is the problem of forfeiture of equity when a buyer fails to complete the transaction—a particularly common and significant problem if the buyer has paid for a long time.[230] Consumers lose their homes and their equity.[231]

Third, unlike outright purchases, the properties do not get inspected before the transaction begins, so they often have serious defects that the buyer does not know about and must fix.[232] These defects would be remedied by the landlord in a traditional rental relationship.[233] Buyers typically pay a significant down payment, so walking away is expensive. Finally, the effective interest rates on these deals can be breathtakingly high, especially when compared to traditional bank loans. Rates of 9 to 18% are not uncommon,[234] compared to current mortgage rates of 2.5 to 4%.[235] Over 30 years, these interest rate differentials can amount to hundreds of thousands of dollars. [236]

Typical installment land contract buyers resemble typical household goods rent-to-own customers. Contracts for deed are often referred to, fittingly, as a "poor man's mortgage."[237] Buyers are typically low-income and more often persons of color.[238] Buyers seldom request or even know about inspections, appraisals, and title

---

liens or that the seller plans to evict them and start over with new buyers."). Professor Hébert Fajardoa, tells this story from one of her clinic cases:

> Selling to a second buyer then trying to evict: Ms. Alvarado lives with her family in Eagle Pass, Texas, on the border with Mexico. She signed a contract for deed, making a down payment of $1500 and paying $400 per month for at least three years. The seller never recorded the contract for deed. In 2011, Ms. Alvarado received an eviction notice saying she would need to leave the property at the end of the month. The seller had sold the property to another buyer using another contract for deed.

Id. at 431 (emphasis omitted).

230 *See* Provencio, *supra* note 223, at 285; *see also* Freyfogle, *supra* note 226, at 312.

231 Provencio, *supra* note 223, at 287.

232 Freyfogle, *supra* note 226, at 296 n.12.

233 *Id.* at 296.

234 *See* Hébert Fajardo, *supra* note 223, at 429; Shelayne Clemmer, *Texas's Attempt to Mitigate the Risks of Contracts for Deed—Too Much for Sellers—Too Little for Buyers*, 38 ST. MARY L.J. 755, 799 (2007) (describing rates as high as 18% for contracts for deed, contracts in which seller provides financing to the buyer for the purchase of real property—similar to rent-to-own).

235 BANKRATE, LLC, https://www.bankrate.com (last visited Oct. 21, 2020).

236 *Id.*

237 Hébert Fajardo, *supra* note 223, at 429.

238 See Stacy Purcell, *The Current Predatory Nature Of Land Contracts And How To Implement Reforms*, 93 NOTRE DAME L. REV. 1771, 1774 (2018), stating that:

> In the first half of the twentieth century, land contracts were largely used by members of minority groups who were shut out of the traditional home buying market. Racist lending practices prevented African Americans from receiving bank-financed mortgages, so they turned to land contracts. For example, in Chicago an estimated eighty-five percent of African-American homeowners purchased their home with a land contract. These sales heavily favored the sellers and were often unjust. As is still the case, buyers rarely completed the contract term and obtained legal title. Instead, they fell behind on payments and lost their

policies.[239] Buyers rarely know to check title records, or to ensure that their deed is held in escrow until all payments are made. [240]

The New York State Department of Financial Services (DFS) claims that rent-to-own, lease-to-own, or land installment contracts have become new forms of predatory mortgage lending, noting that they are marketed to vulnerable consumers, promising a path to homeownership, but having them sign agreements that do not lead to that coveted result.[241] The state of Wisconsin agrees and is suing Vision Property Management for "misleading and deceiving business practices [that] induce[s] Wisconsin consumers to lease, rent, or purchase uninhabitable properties."[242] Wisconsin claims that the company requires tenants to bear the costs of rehabilitating the property, curing building code violations and paying back taxes, and if they do not do so, they are evicted in short order.[243] Even more so than rent-to-own appliance and electronics transactions, an imbalance of power is a defining feature of rent-to-own real estate contracts.[244]

V. RENT-TO OWN HOUSING SHEDS AND NATIVE AMERICAN PREDATION

As we have explained, the rent-to own industry has successfully created its own regulation system in most states. This system defines the rent-to-own business as one that does not provide credit and thus is not bound by the large suite of laws applicable to consumer credit transactions. As we have also seen, rent-to-own housing and real estate contracts have the potential to be particularly harmful to con-

---

> homes. The practice "stripped wealth from African-American communities and led to 'debt peonage or impoverishment for many black contract buyers, and . . . decay of the communities in which such sales were concentrated.'"

Id.

239 See Freyfogle, *supra* note 226, at 305, stating that:

> The typical installment contract home buyer has long appeared to courts as a poorly advised, poorly protected, often lower-income purchaser . . . Because they do not obtain outside financing, they do not benefit from the precautions demanded by typical mortgage lenders: inspections, appraisals, title reports, termite certificates, and other evidence of a property's value.

Id.

240 *Id.*

241 *Mortgage Markets: Regulators Look at Rent-to-Own*, 51 MORTGAGE & REAL EST. EXECS. REP. 6 (2018).

242 Ben Lane, *Wisconsin Accuses Rent-to-Own Operator Vision Property Management of Harming Consumers*, HOUSINGWIRE (June 5, 2017), https://www.housingwire.com/articles/40339-wisconsin-accuses-rent-to-own-operator-vision-property-management-of-harming-consumers.

243 *Id.*

244 *Cf.* Provencio, *supra* note 223, at 305–06.

sumers as they capitalize on the strong desire to become homeowners. These transactions frequently result in a forfeiture of equity and all the contract terms are colored by a significant imbalance of power. These same characteristics are present in a new form of rent-to-own housing that has the potential to be even more predatory than classic rent-to own contracts or rent-to-own real estate contracts. This Part describes this new development: rent-to-own shed deals in Native American communities.

A. Native Americans are a Vulnerable Target for Rent-to-Own Shed Deals

Native Americans are particularly vulnerable in terms of financial stability. Less than 50% of all Native people graduate from high school each year.[245] Conversely, an average of 93% of non-Native students in the United States obtained a high school diploma.[246] Poverty and unemployment rates are also higher for Native Americans than other ethnic groups across the nation.[247] In 2017, only 14.7% of all Native Americans across the nation had a bachelor's degree.[248] Over 20% of Native American families live below the poverty line, which is the highest poverty rate among all ethnic groups.[249] By comparison, the national poverty level was 11.8% in 2018.[250] Compounding the problem, many Native people lack understanding of credit reports and credit scores, which is exacerbated by language barriers and inadequate access to technology that could otherwise be used to facilitate financial education and consumer research.[251] Many have also taken out high-cost predatory credit and have compromised credit histories and high rates of loan defaults.[252]

---

[245] *Education*, NAT'L CONGRESS OF AM. INDIANS, http://www.ncai.org/policy-issues/education-health-human-services/education (last visited Dec. 21, 2020); *see also* Gaby Galvin, *Tribal Housing Reveals Inequalities in Indian Country*, U.S. NEWS & WORLD REP. (Sept. 23, 2017, 12:00 AM), https://www.usnews.com/news/best-states/articles/2017-09-23/across-the-us-disparities-in-indian-country-emerge-through-tribal-housing (discussing inequalities between different Native groups).

[246] U.S. DEP'T OF EDUC., NAT'L CTR. FOR EDUC. STAT. ET AL., 2017 STATUS AND TRENDS IN THE EDUCATION OF RACIAL AND ETHNIC GROUPS 66 (July 2017).

[247] Galvin, *supra* note 245.

[248] U.S. CENSUS BUREAU, *Table S1501: 2017 ACS 1-year Estimate Subject Tables-Educational Attainment*, https://data.census.gov/cedsci/table?q=s1501&g=0100000US&y=2017&tid=ACSST1Y2017.S1501&hidePreview=true (last visited Dec. 21, 2020).

[249] U.S. CENSUS BUREAU, *Table S1702: Poverty Status in the Past 12 Months of Families*, https://data.census.gov/cedsci/table?q=S1702&tid=ACSST1Y2019.S1702 (last visited Dec. 21, 2020).

[250] Jessica Smega, et al., *Income and Poverty in the United States: 2018*, U.S. CENSUS BUREAU (Sept. 10, 2019), https://www.census.gov/library/publications/2019/demo/p60-266.html.

[251] Megan Horning, *Border Town Bullies: The Bad Auto Deal and Subprime Lending Problem Among Navajo Nation Car Buyers*, 73 NAT'L LAW. GUILD REV. 193, 205–06 (2016).

[252] Valentina Dimitrova-Grajzl, et al., *Consumer Credit on American Indian Reservations* (Mar. 26, 2014) (unpublished manuscript at 1–4), https://ssrn.com/abstract=2408747. This may

Higher than average rates of poverty, limited education, and a lack of financial literacy make Native Americans more vulnerable to risky sales contracts such as rent-to-own agreements. While rent-to-own agreements involving goods such as appliances and electronics can be harmful, rent-to-own housing transactions are exponentially worse for consumers, especially in Native communities.

B. Housing Crisis in Indian Country

Lack of housing in Indian country makes tribal members especially vulnerable to alternative housing options.[253] "'Housing needs are very extreme on tribal lands,' says Housing and Urban Development (HUD) spokesperson Ed Cabrera. 'They face a lot of challenges with sanitation, structural deficiencies, homelessness and other things we take for granted. There's been improvement in the past couple of decades, but there are still major problems.'"[254] The importance of affordable housing is crucial to lifting tribal members out of poverty, obtaining employment, and improving overall quality of life.[255] Tribal nations rely heavily on federal funding to support housing development.[256] HUD allocates blocks of grants and loan guarantee programs to the tribes that, in turn, are used by tribal authorities to increase, improve, and maintain housing.[257] Unfortunately, this leaves tribal members at the mercy of the tribal housing authorities to utilize insufficient funding to provide housing.[258]

---

be due a general lack of financial literacy that is certainly not confined to the Native American sector of consumers.

[253] This was the case for one Tribal Member in New Mexico who, as an adult, lived in her childhood, three-bedroom home with her parents, two brothers, and niece. Space was tight, privacy was non-existent, and she was eager to get out on her own. Tina had a high school diploma. She worked full time as a cashier but only made minimum wage. There were not many options in her community for housing and what little she found, she couldn't afford. A relative offered to rent her his 16'x 24' shed for $150 per month. To her, 384 square feet for $150 per month was heaven, compared to the cramped quarters in her family's home. The shed was insulated, but had no electricity. Extension cords were run from the relative's main home out to the shed so that Tina could plug a couple lights in at night, a fan in the summer, and a small heater in the winter. Eventually, they installed a window A/C unit and plugged that into the extension cord as well. Tina lived there for six years despite having no running water or plumbing. Tina, a Tribal member in New Mexico whose name has been changed for this Article, describes the reasons why she chose to live in a shed cabin for 6 years, and the experience of living in a shed cabin. *See* personal communication with Tina, Mar. 3, 2019.

[254] Galvin, *supra* note 245.

[255] *Id.*

[256] *See generally Addressing the Housing Crisis in Indian Country: Leveraging Resources and Coordinating Efforts: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 112th Cong. (2012) (discussing federal programs to support housing development in tribal nations).

[257] Galvin, *supra* note 245.

[258] *See, e.g.*, *id.* (describing housing crisis in Navajo Nation).

The Senate Indian Affairs Committee described the crisis in detail in 2015.[259] An earlier HUD report explained:

> Decent housing is not readily available in Indian Country; decent and *affordable* housing is even harder to obtain. Overall, 18.4 percent of homeowners in Native American areas are cost burdened. This means they are spending more than 30 percent of their income for housing each month. Affordability problems are even more common for those who do not own their homes: 31.6 percent of renters on Native American lands are cost burdened."[260]

In the same 2009 evaluation, HUD reported that overcrowding affected 16% of Native American and Alaska Native households in tribal areas.[261] Seventeen percent of these households had one or more people staying with them solely due to a lack of housing alternatives.[262] Six percent of the homes in the study had incomplete plumbing and 7% had incomplete kitchens, compared to less than 2% of all United States households.[263] The researchers concluded that 68,000 housing units would be required to eliminate the problem of overcrowding in Native communities.[264] This partly explains why Native communities have been so hard hit by the 2020 Coronavirus pandemic. For example, the largest tribe in the United States, the Navajo Nation, has a higher infection rate than anywhere else in the nation, including New York and New Jersey.[265]

The difficulty of obtaining a mortgage in Indian Country further compounds the problem. Land in Indian Country is held in trust by the federal government as a result of the General Allotment Act of 1887.[266] Tribal trust land may not be encumbered by a lien without overcoming substantial hurdles.[267] While section 184 of the Indian Home Loan Guarantee Program was designed to assist lenders in overcoming these hurdles and providing mortgages to Tribal members, the barriers are

---

[259] *Addressing the Housing Crisis in Indian Country*, *supra* note 256.

[260] S. REP. NO. 114-117, at 2 (2015).

[261] *The Native American Housing Needs Study*, U.S. DEP'T OF HOUSING & URBAN DEVELOPMENT, https://www.huduser.gov/portal/pdredge/pdr-edge-research-022117.html (last visited Dec. 21, 2020).

[262] *Id.*

[263] *Id.*

[264] *Id.*

[265] Alexandra Sternlicht, *Navajo Nation Has Most Coronavirus Infections Per Capita In U.S., Beating New York*, FORBES (May 19, 2020, 4:04 PM), https://www.forbes.com/sites/alexandrasternlicht/2020/05/19/navajo-nation-has-most-coronavirus-infections-per-capita-in-us-beating-new-york-new-jersey/#3e78f0908b10.

[266] U.S. DEP'T OF HOUSING & URBAN DEVELOPMENT, OFFICE OF POLICY DEVELOPMENT & RESEARCH, MORTGAGE LENDING ON TRIBAL LAND: A REPORT FROM THE ASSESSMENT OF AMERICAN INDIAN, ALASKA NATIVE, AND NATIVE HAWAIIAN HOUSING NEEDS 1 (2017).

[267] *Id.* at 19.

still such that lenders are reluctant to engage in the process.[268] Lending through the section 184 program typically takes six to eight months to close because of the steps required to overcome the trust status of the land.[269] Despite section 184 providing a 100% guarantee on the loan, lenders often lack the knowledge and/or desire necessary to take on the process.[270]

With inadequate housing available, limited financial resources, and often, compromised credit, tribal members look outside of the reservation for housing possibilities. For example, shed dealers recognize this opportunity. Many have situated themselves near New Mexico pueblos in order to offer rent-to-own shed deals to tribal members. Many of the sheds marketed look more like welcoming cabins than what you might use for tool storage. They can be equipped with electricity once delivered and insulated to provide a livable space. Most appealing, the rent-to-own contracts require no credit check, no commitment, and little down payment, making them appear to be a viable option for financially strapped tribal members. Unfortunately, like many consumer credit products, they sound better than they actually are.

C. Rent-to-Own Shed Dealers: The New Predator of New Mexico's Native Americans

Native Americans have historically been targeted by various predatory institutions in search of the poorest, most vulnerable communities. High interest loan stores physically surround the Navajo Nation, saddling this particular Native American community with more high interest loans than any other community in the United States.[271] Likewise, the Navajo Nation is also surrounded by car dealerships notoriously known for upselling vulnerable customers into a vehicle the salesman knows they cannot afford.[272] After pressuring the consumer into an expensive car, the salesperson may inflate the consumer's stated income to qualify the customer for financing.[273] The FTC investigated these dealers and ultimately sued them for violations of the FTC Act, TILA, Regulation Z, and the Consumer Leasing Act, among

---

[268] *Id.*

[269] *Id.* at viii.

[270] *Id.* at 19–20. Lenders also note that the lack of established credit among Tribal members provides yet another obstacle preventing them from engaging in offering mortgages in Indian Country. *Id.* at 24.

[271] *Endless Debt: Native Americans Plagued by High-Interest Loans*, NBC NEWS: IN PLAIN SIGHT (Oct. 31, 2014), https://www.nbcnews.com/feature/in-plain-sight/endless-debt-native-americans-plagued-high-interest-loans-n236706.

[272] Horning, *supra* note 251, at 206–08.

[273] *Id.* at 205 (explaining the sales practices of dealerships surrounding the Navajo Nation, including misrepresenting buyer's stated income, knowingly selling vehicles to customers unable to afford the monthly payment, and relying on repossessions as a second stream of revenue for a single vehicle).

other laws, for preliminary and permanent injunctive relief, rescission or reformation of contracts, restitution, and damages.[274]

In these car deals, after getting Native American customers into their dealerships, dealers keep the customers there for extended periods of time, hide crucial parts of the contracts, lie about reported income, and fraudulently qualify buyers for cars the dealership knows they will never be able to afford,[275] because, in the end, the dealership knows that car will be repossessed and then be resold for a second stream of revenue.[276] These dealerships also extensively market their most overpriced and, in some cases, fraudulent deals to Native communities alone. This type of targeted marketing has been found to be illegal discrimination due to disparate treatment and disparate impact.[277]

We see similar targeted, discriminatory marketing in the rent-to-own shed industry. For example, one company has 18 shed dealer locations within New Mexico.[278] See Image 1.

---

[274] *FTC Charges Auto Dealerships in Arizona and New Mexico with Falsifying Consumers' Information on Financing Documents*, FED. TRADE COMM'N (Aug. 1, 2018), https://www.ftc.gov/news-events/press-releases/2018/08/ftc-charges-auto-dealerships-arizona-new-mexico-falsifying; *see also* Fed. Trade Comm'n v. Tate's Auto Ctr. of Winslow Inc., 2019 WL 1130006, at *1 (D. Ariz. Mar. 13, 2019).

[275] Horning, *supra* note 251, at 206–08.

[276] *Id.*

[277] Creola Johnson, *The Magic of Groups Identity: How Predatory Lenders Use Minorities to Target Communities of Color*, 17 GEO. J. ON POVERTY L. & POL'Y 165, 197–99 (2010); *see* LastWeekTonight, *Payday Loans: Last Night with Jon Oliver*, YOUTUBE (Aug. 10, 2014), https://www.youtube.com/watch?v=PDylgzybWAw.

[278] GRACELAND PORTABLE BUILDINGS, Addendum B-New Mexico Map, https://graceland.worldsecuresystems.com/states/new-mexico.html (last visited Oct. 21, 2020) (Graceland locations identified by the letter "G" on the map). This dealer has extremely poor customer reviews. *Graceland Portable Buildings Reviews and Complaints*, PISSEDCONSUMER, https://graceland-portable-buildings.pissedconsumer.com/review.html, (last visited Dec. 20, 2020).

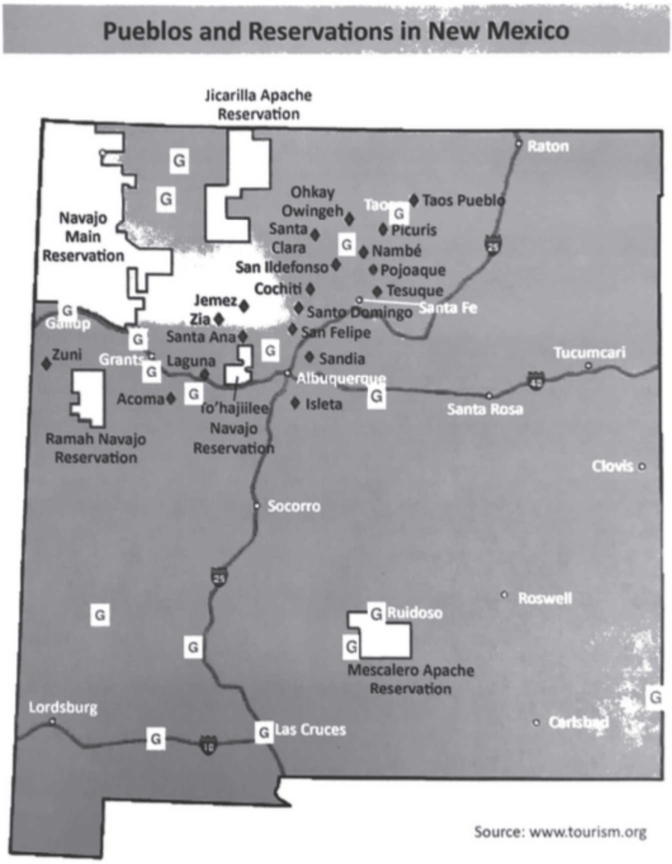

Image 1.

All but four locations, located primarily in rural southern New Mexico,[279] are surrounded by tribal lands. At the Mescalero Nation, there are two dealers, one located at each entrance to the reservation. Similar to the car dealerships facing charges by the FTC, this dealer surrounds tribal land with rent-to-own sales locations. Just as the Navajo Nation depends on transportation to survive day-to-day life in rural America, Native communities in New Mexico seek affordable housing. Dealers sell Native consumers on costly rent-to-own shed deals, knowing that many will not be able to afford the monthly payments.[280] Eventually, the sheds can be repossessed

[279] These southern border locations target another highly vulnerable population: recent immigrants.

[280] NATIONAL BARN & STORAGE RENTAL ASSOCIATION, NBSRA, http://www.nbsra.com/ (last visited Dec. 21, 2020).

and sold for a second stream of revenue.[281] Indeed it is not uncommon in our clinical law program to hear stories of repossession or to actually see sheds being repossessed. It is difficult to get information about the status of a "repossession"[282] or to even get an accounting. The fee structures are opaque and at times impossible for even lawyers to understand. Given the complete lack of governmental oversight, the potential for abuse is limitless.[283]

D. An Insider's View of Rent-to-Own Predation

The website of the National Barn and Storage Rental Association (NBSRA), the trade association for the shed industry, explains the industry practices.[284] The organization's mission is to "[p]rotect the industry's future against legislation."[285] The benefits of being a rent-to-own dealer include that "[t]here is no increased risk to the [dealer] since the rent-to-own company assumes the risk . . . the dealer receives full retail price for the structure and frees up capital to allocate in other areas or build more sheds."[286] Moreover, as for shed repossessions, these are actually good for business. According to the website:

> Returns are not necessarily a financial loss. The returned shed will attract new customers since there is a segment of shed buyers looking for a bargain. A rental return brings customers to the sales lot eager to buy, sometimes this leads to the sale of a new storage shed or barn.[287]

While the NBSRA elucidates the benefits of rent-to-own dealerships, some veterans in the industry disagree, going so far as to warn consumers to beware of rent-to-own shed deals. Sheds Unlimited has dedicated an entire page of its website to

---

281 *Id.* For example, John, from a centrally located Pueblo in New Mexico, used to build sheds for his community. This was his side job and how he supported his family during his off season from work. Once Graceland came to town however, he had to close that side business. "Nobody wanted to wait for me to build a shed, when they could buy one, rent-to-own, for a few hundred dollars a month." He was happy for his community until he began to see the negative impact Graceland was having. "I had to buy my brother-in-law's shed from him when he got behind on payments. They were about to come take it and would have if I hadn't paid it off. Everyone thinks it's just a couple hundred dollars until they are making that payment month after month and then they realize they can't afford it." When you inundate a sector of consumers who are financially vulnerable and in desperate need of housing options, your shed sales are going to increase. Interview with John, Tribal Member in New Mexico (Feb. 10, 2019) (a Tribal Member in New Mexico, discussing experiences in Native communities with regards to shed deals).

282 Telephonic Interview with Kenneth Bobroff, President, UNM School of Law (June 21, 2019).

283 *Id.*

284 NBSRA, *supra* note 280.

285 *Id.*

286 *Why Rent To Own?*, NBSRA (Apr. 4, 2018), http://www.nbsra.com/why-rent-to-own.

287 *Id.*

educating consumers on the dangers of these transactions.[288] They educate consumers that rent-to-own sheds will cost consumers 25–65% more than buying outright.[289] The site goes on to warn consumers that, if at any time they stop making monthly payments, they will lose the shed, even if they have paid 99% of the contract price.[290]

Michael W. Mathis, a shed dealer for over 20 years, is so opposed to rent-to-own shed sales that he created his own blog on the topic.[291] As he explains:

> [w]e have been [i]n the storage shed business for almost 20 years, I have personally taken the time to investigate the possibility of tapping into this additional market myself, and have been approached by lenders who are more than willing to work with me in this endeavor, but I have a problem with offering this mainly my conscience . . . my real problem with Rent to Own is that I feel we are taking advantage of people. Let's face it anyone with any financial insight can see this for what it is A RIP OFF . . . Rent to Own shed business preys on people who have made poor choices, don't know better or unfortunate circumstance [has] put them in bad financial situations.[292]

Some larger players in the industry, such as "Tuff-Shed," seemingly agree with this opinion of rent-to-own shed agreements. While "Tuff-Shed" did begin offering rent-to-own options in 2015, they limited rent-to-own contracts to sheds 10x16 and smaller.[293] Sheds sized at 10x16 or smaller are significantly less likely to be used as homes, thereby reducing the chance of a consumer losing their home to the rent-to-own agreement.

Rent-to-own agreements for shed dealers are undoubtedly profitable for the industry. If they weren't profitable, no shed dealer would offer these types of agreements. However, when those positioned to receive a large cut of that profit publicly acknowledge the unethical nature of the transaction and refuse to take part, it sends a powerful message of extraordinary predation.

---

[288] *Why NOT to choose a Rent-A-Shed Option*, SHEDS UNLIMITED LLC, https://shedsunlimited.net/why-not-to-choose-a-rent-a-shed-option (last visited Dec. 21, 2020).

[289] *Id.* Our view of rent-to-own customer contracts show that this is an incredibly conservative estimate based on contracts on file with authors, scrubbed of identifying data.

[290] *Id.*

[291] Michael W. Mathis, *Rent to Own Storage Sheds - Why You Should Think Twice*, EZINEARTICLE (Feb. 20, 2010), https://ezinearticles.com/?Rent-to-Own-Storage-Sheds—-Why-You-Should-Think-Twice&id=3798258.

[292] *Id.*

[293] *Introducing Rent-To-Own with Tuff Shed*, TUFF SHED (Feb. 25, 2016), https://www.tuffshed.com/introducing-rent-to-own-with-tuff-shed.

E. Comparing the Cost of Credit in Shed Homes to Rent-to-Own Land Sale Contracts and Mortgages

Interest rates on housing are lower than interest rates on other types of loans. For example, a credit card rate might average 18–24%, while a home loan in 2020 averages 2.75–3.125%.[294] A very high-interest land sale contract, or mobile home loan, can run 18%, though rates of 9–10% are currently more common. The interest rate in a typical rent-to-own shed is roughly 40% per annum, 10 times the average home mortgage rate.[295] These rates are incredibly high, particularly given that forfeiture of equity is so likely. Clearly additional regulation is needed to ensure that those on the low end of the economic scale do not pay so much more than the rest of us for basic shelter.

VI. THE GREATER IMPLICATIONS OF THE CREDIT-NO CREDIT DISTINCTION ON THE FUTURE OF CREDIT REGULATION

In this Part, we discuss the greater implications of the credit/no credit dichotomy, focusing on large-scale societal implications of sheltering shadow credit products from regulation. In considering the narrowest problems we have raised here, many solutions are viable. For example, if we focus narrowly on the abuses occurring in the rent-to-own shed industry, we could regulate the rent-to-own shed industry in the same way we regulate mobile home rent-to-own transactions. In some states, for example, rent-to-own mobile home transactions are treated as credit because the stakes are large and the personal property is being used as a home.[296] If one wanted to think a bit more broadly, one could similarly regulate rent-to-own real estate to require all the consumer protections of other consumer credit.[297]

We could think even more broadly and regulate the entire rent-to-own household goods industry right back into the consumer credit scheme, where it once sat before Article 9 was amended and before the rent-to-own industry passed its own regulatory scheme. In so doing, we would treat rent-to-own like any other consumer credit transaction. Rent-to-own dealers would be legally required to comply with interest rate caps, TILA, and Article 9. Consumers could compare the cost of this credit to market alternatives like retail installment sales contracts, could be free of

---

294 BANKRATE, *supra* note 235.

295 *Id.*

296 *See, e.g.*, N.M. STAT. ANN. § 57-26-3(A)(5) (1995).

297 *See, e.g.*, Nelson, *supra* note 223, at 1116. Nelson argues that courts should take the Restatement Third of Property's approach which treats contracts for deed as mortgages. *See id.* Nelson acknowledges that in states where these types of contracts are regulated by statute, it might be unfeasible to implement this judicial solution. *Id.* at 1166–67. By adopting the Restatement's approach, however, he argues that both buyers and sellers will have their interests protected under the broad confines of mortgage law. *Id.*

unfair debt collection practices by collection agencies, and could get the repossession and other protections of Article 9. Lawyers could sue for violations of these laws, keeping the credit providers honest and the consumers protected. While this may constrict the availability of rent-to-own transactions, there would likely still be plenty of players and market alternatives to fill consumer need.

Shadow credit, however, creates concerns broader than just rent-to-own transactions. As one commentator explained as to all of these newer shadow creditor products, but particularly ISAs in education:

> I suspect what is going on is an attempt by the ISA industry to get the camel's nose under the tent and become too-big-to-fail. If the ISA industry gets large enough before facing the regulatory question, the industry will be able to push back against any regulatory attempts by pointing to potential disruption and reliance of consumers upon the product. Frankly, this is an issue the CFPB should be getting out ahead on. The Bureau should be issuing regulatory guidance on ISAs as part of its regulation of the private student lending market. Alternatively, the Bureau could undertake a rule making defining "debt" under the CFPA.[298]

As we have mentioned, payroll advance loans are growing fast, and while they could be a good market alternative to payday loans,[299] this industry's claim to be outside consumer credit regulation is also troubling. The industry's refusal to comply with usury laws or TILA make the products and their regulation unpredictable going forward. Indeed, New York State is leading a multi-state investigation into whether payroll advance companies are, by claiming to be "not credit," violating usury laws and other consumer protections.[300] Similarly, bail bonds, buy-now-pay-later services, and employer payday advances are all credit transactions, though they claim not to be bound by TILA or other credit laws.[301]

The cost of not catching the shadow credit trend before it really takes hold could be significant. The benefits of non-compliance, charging whatever interest rates one wants, not disclosing an interest rate, and not complying with repossession and forfeiture rules are incredibly remunerative. As a result, there is no reason to believe the growth in shadow credit will not continue to morph, perhaps enough to deregulate consumer credit.

This issue also has broader implications for the legal system as a whole. There are endless examples of situations in which form could be elevated over substance,

---

[298] Levitin, *supra* note 3.

[299] Hawkins, *supra* note 12, at 2112.

[300] Suzanne Barly, *New York State Regulator Leads Probe into Payroll Advance Industry*, REUTERS (Aug. 6, 2019, 10:47 AM), https://www.reuters.com/article/us-new-york-loans/new-york-state-regulator-leads-probe-into-payroll-advance-industry-idUSKCN1UW218.

[301] Alex Kornya et al., *Crimsumerism: Combating Consumer Abuses in the Criminal Legal System*, 54 HARV. C.R.-C.L. L. REV. 107, 127, 138 (2019).

to the detriment of our legal system. In these other areas of the law, we are careful to elevate substance over form, so we can treat all fact patterns, products, and situations with authenticity, fairness, and consistency under the law. While formalism and procedural distinctions have their place, we need to be careful how those rules affect people in practice, and aware of unintended consequences.[302]

The substance-over-form doctrine is a major tenet of tax law.[303] Placing form over substance creates a distressing tendency to mangle basic economic concepts.[304] In both taxation and employment contexts, courts and the IRS routinely look beyond labels to determine the true nature of the legal relationship between employers and employees/independent contractors.[305] Allowing employers to mislabel an employee as an independent contractor would lead to all kinds of mischief and undermine laws intended to protect employees from wage theft and overreaching.[306] There are many, many more examples from the area of taxation.[307]

In the area of tribal payday lending, we see another example of how form cannot be elevated over substance.[308] A lender cannot simply partner with a tribe on a very minimal level, and then get the sovereign immunity that tribes receive as governments.[309] Similarly, minority-owned businesses get certain benefits when applying for and bidding on government contracts, but one cannot simply form a loose partnership with one minority group, who has very little control or ownership, and

---

302 *See* Edward J. Schnee, *Substance-Over-Form Doctrine: The Past, Present and Recommended Future*, 127 J. TAX'N 82, 82 (2017) (stating that the "Supreme Court has created numerous doctrines to implement the Internal Revenue Code. These doctrines have been applied many times. They have also changed over time. One of these major doctrines is the substance-over-form doctrine."); *see also* David Dyzenhaus, *Constituting the Rule of Law: Fundamental Values in Administrative Law*, 27 QUEEN'S L.J. 445, 450 (2002). Another example of the substance over form doctrine comes from administrative court decisions:

> Formalism is formal in that it requires judges to operate with categories and distinctions that determine results without the judges having to deploy the substantive arguments that underpin the categories and distinctions. Since those categories and distinctions must take on a life of their own in order to operate in this detached way, they are capable of determining results that contradict the very arguments for these categories and distinctions.

Id.

303 *See generally* Bryan Camp, *Form Over Substance in Fifth Circuit Tax Cases*, 34 TEX. TECH. L. REV. 733 (2003).

304 *Id.* at 736.

305 *Id.* at 745.

306 *Id.* at 744.

307 *Id.* at 742.

308 *See generally* De La Torre v. Cashcall, Inc., 422 P.3d 1004, 1009 (Cal. 2018); Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?*, 69 WASH. & LEE L. REV. 751, 753 (2012).

309 *Id.* at 753, 755.

get those benefits.[310]

Finally, in the area of securities regulations, federal and many state statutes regulate "investment contracts" as well as the traditional categories of securities, like shares of stock, to avoid gamesmanship in the form of transactions.[311] Under the analysis of the Supreme Court in *Howey*, what matters is what the transaction really is, not what it purports to be.[312]

The examples above are all from commercial law, but there are many more examples of items in which we are careful to elevate substance over form in our legal system. In the area of environmental law, for example, the Environmental Protection Agency regulates pesticides under the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA).[313] Under section 18 of FIFRA,[314] all pesticides must be registered and under FIFRA's implementing rules.[315] These products include all products used as a pesticide, even if the manufacturer never advertised the product for this use or even intended that use when the product was produced.[316] In other words, throughout our legal system, substance beats form, classification matters, and meaningful regulatory schemes protect both honest businesses and consumers.

VII. CONCLUSION

As some of the examples above show, classification is not just about money. The legitimacy of the entire legal system rests on honest classification and characterization, calling a spade a spade. As our Supreme Court has noted numerous times, "[t]he exaltation of form over substance is to be avoided."[317] Lawyers specialize in categorizing fact patterns, transactions, and products. How we do this affects much more than we may realize. Rent-to-own transactions are but one example of transactions that look, act, and clearly are credit, but have been misclassified by the law

---

310 *Id.*; *see also id.* at 753, 757.

311 *What is the Howey Test*, FINDLAW, https://consumer.findlaw.com/securities-law/what-is-the-howey-test.html (last visited Dec. 21, 2020).

312 Securities Exchange Comm'n v. W. J. Howey Co., 328 U.S. 293, 300–01 (1947). Under the *Howey* Test, a transaction is an investment contract if: "1. It is an investment of money, 2. There is an expectation of profits from the investment, 3. The investment of money is in a common enterprise, and 4. Any profit comes from the efforts of a promoter or third party. Although the *Howey* Test uses the term "money," later cases have expanded this to include investments of assets other than money." FINDLAW, *supra* note 311.

313 Federal Insecticide, Fungicide, and Rodenticide Act, 7 U.S.C. § 136(b) (2018).

314 *Id.* § 136a(a).

315 40 C.F.R. § 152.15 (2019); *see also Why Pesticide Certification?*, N.D. ST. UNIV., https://www.ag.ndsu.edu/pesticide/WhyPesticideCertification.pdf (last visited Oct. 21, 2020).

316 *See, e.g.*, *id.* (the substance over form rule causes Avon to need to register Skin So Soft as a pesticide); *see also* 40 C.F.R § 152.15 (2019).

317 United States v. DiFrancesco, 449 U.S. 117, 142 (1980).

to be something else, at the behest of the rent-to-own industry. As we have demonstrated, as rent-to own has morphed into areas beyond household goods, we can see the harm that shadow credit can impart on individuals, the consumer credit system, or perhaps even the credit system as a whole.[318] What happens with one credit product can happen with others. More critically, what happens in the credit and financial world can happen in the rest of the legal system. We can watch the legal system weaken through false classifications. Alternatively, we can stay vigilant in calling a spade a spade and regulating credit as credit, for the sake of the entire system.

[318] Erik F. Gerding, *The Subprime Crisis and the Link between Consumer Financial Protection and Systemic Risk*, 5 FIU L. REV. 93, 93 (2009) (arguing that consumer financial protection can, and must, serve a role not only in protecting individuals from excessive risk, but also in protecting markets from systemic risk and that strong "consumer financial regulations can mitigate these risks in three, non-exclusive ways: (1) by reducing the level of defaults on consumer loans, (2) by making defaults more predictable, and (3) by reducing the correlation of defaults."). Professor Gerding testified before Congress on this same topic in 2019. *Emerging Threats to Stability: Considering the Systemic Risk of Leveraged Lending: Hearing before the H. Comm. on Fin. Servs., Subcomm. on Consumer Protection and Fin. Inst.*, 116th Cong. 2–15 (2019) (statement of Erik F. Gerding, Professor of Law and Wolf-Nichol Fellow, University of Colorado Law School).