1-1-1989

Equipment Leases--Warranty Rights and Remedies of Lessees

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Articles

Equipment Leases - Warranty Rights and Remedies of Lessees

Claude D. Rohwer*

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This article analyzes the warranty rights and remedies available to a lessee of goods in a jurisdiction that has adopted Article 2A of the UCC. California has adopted Article 2A designating it Division 10 of the California Uniform Commercial Code. The California enactment made numerous revisions and additions to the uniform text which will be noted where relevant to the discussion.

1. Unless otherwise noted, all section references herein are to the UNIFORM COMMERCIAL CODE, 1988 Edition. This article does not deal with specific statutory enactments relating to warranty rights and remedies under consumer leases. The author expresses his appreciation for research assistance from Gregory Richardson and Josh Shinnick, class of 1990, and to the numerous faculty colleagues who provided helpful comments. Particular appreciation is expressed to Richard A. Elbrecht, Supervising Attorney, California Department of Consumer Affairs, for sharing his ideas and concerns about this topic.


The California modifications have been substantially followed in the draft under consideration in Massachusetts and this enactment is coming to be known as the “California-Massachusetts” or “Cal-Mass” modifications. This version of Article 2A is also being proposed for adoption by bar groups in New York, New Jersey, Illinois and other states and may become the basis for discussion of a new draft of Article 2A in the near future. At least three states have adopted the uniform version of Article 2A without substantial modification. These include Oklahoma (1988 OKLA STAT. tit. 12A, §§ 2A-101-531 (West 1989)), South Dakota (1989 S.D. STAT. tit. 57A-2A 101-531 (Michie 1989)), and Minnesota (Minn. Stat. Ann. § 336.2A-101-336.2A-531 (West Supp. 1989)).

In a lease transaction, the lessee may have different warranty rights against various parties. These parties can include the lessor, the supplier who is the party that either sold the goods to the lessor or who sold goods to the lessee that were the subject of a sale and lease back between the lessee and the lessor, and in some cases the manufacturer or other remote seller of the goods. Under Article 2A, a determination of warranty rights may be dependent upon the classification of the lease as a finance lease, a term of art defined in the code. The following is a list of the various potential warranty rights which a lessee might be able to assert against one or more of these parties.

I. Warranty Rights

A lessee has at least seven different sources for warranty rights relating to leased goods.5

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4. "Finance lease" is defined in section 2A-103(g) and includes leases in which:
   (i) the lessor does not select, manufacture or supply the goods, (ii) the lessor acquires
   the goods or the right to possession and use of the goods in connection with the
   lease, and (iii) either the lessee receives a copy of the contract evidencing the lessor's
   purchase of the goods or before signing the lease contract, or the lessee's approval
   of the contract evidencing the lessor's purchase of the goods is a condition to
   effectiveness of the lease contract.

California has modified this uniform text by adding alternative methods of complying with the third requirement.

The California version of the third requirement reads as follows:

(iii) either (A) the lessee receives a copy of the contract evidencing the lessor's
     purchase of the goods on or before signing the lease contract, (B) the lessee's
     approval of the contract evidencing the lessor's purchase of the goods is a condition
     to effectiveness of the lease contract, (C) the lessor (aa) informs the lessee in writing
     of the identity of the supplier unless the lessee has selected the supplier and directed
     the lessor to purchase the goods from the supplier, (bb) informs the lessee in writing
     that the lessee may have rights under the contract evidencing the lessor's purchase
     of the goods, and (cc) advises the lessee in writing to contact the supplier for a
     description of any such rights, or (D) the lease contract discloses all warranties and
     other rights provided to the lessee by the lessor and supplier other than those disclosed in the
     lease contract.

CAL. COX. CODE § 10103(9) (effective Jan. 1, 1990) (This addition to the uniform version of
the Code is not one of California's better contributions to the jurisprudence of leases).

Where a finance lease exists, the contract by which the lessor purchases or leases the goods is termed a “supply contract,” (2A-103(y)), and the person from whom the lessor acquired
the goods by purchase or lease is termed the “supplier,” (2A-103(x)). A finance lease can be
found in a sale and lease back to seller as described in section 2A-103 comment (g).

5. The terms “lease” or “leases” as used herein refer to leases of goods. Whether a
transaction is a true lease or is in fact a sale with a reserved security interest is governed by
1-201(37). This section has been amended in conjunction with the proposed Article 2A to
bring more certainty to the resolution of the question of what is a true lease.
A. Express Warranty Rights Against the Lessor

In all types of leases the lessee may enforce any express warranty made by his lessor. Section 2A-210 which relates to the creation of express warranties in leases is substantively identical to section 2-313 pertaining to express warranties in the sale of goods. Section 2A-214 contains warranty disclaimer provisions comparable to those found in section 2-316.

B. Warranty of Quiet Possession

In all types of leases, there is a warranty by the lessor that protects the lessee from claims of third persons "that arose from any act or omission of the lessor" which will interfere with the lessee's enjoyment of its leasehold interest, "other than a claim by way of infringement or the like." See § 2A-211 (providing for a warranty of quiet possession with respect to leases that is not given to a buyer under article 2). See also § 2A-211 (comment) ("the scope of the protection is limited to claims or interests that arose from acts or omissions of the lessor").

C. Warranty Against Infringement

If the lease is not a finance lease and if the lessor is a merchant who regularly deals in goods of that kind, there is an implied warranty that "the goods are delivered free of rightful claims of any person by way of infringement or the like." See § 2A-212.

D. Implied Warranty of Merchantability by Lessor

If the lease is not a finance lease and if the lessor is a merchant with respect to goods of that kind, there is an implied warranty of merchantability given by the lessor.

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6. The pronoun "he" or "his" refers to both genders.
7. Unlike section 2-316, section 2A-214 specifically requires that all disclaimers be in writing and adds in subsection (4) provisions relating to exclusion or modification of warranties against interference or infringement.
8. See § 2A-211 (providing for a warranty of quiet possession with respect to leases that is not given to a buyer under article 2). See also § 2A-211 (comment) ("the scope of the protection is limited to claims or interests that arose from acts or omissions of the lessor").
9. § 2A-211(2).
10. § 2A-212.
E. **Implied Warranty of Fitness for a Particular Purpose by Lessor**

If the lease is not a finance lease, the lessee may have an implied warranty of fitness for a particular purpose against the lessor.\(^\text{11}\) The elements which must exist in order to give rise to this warranty are identical to those which give rise to the warranty of fitness for a particular purpose in a contract for the sale of goods.\(^\text{12}\)

F. **Warranty Rights Against a Supplier**

If the lease is a finance lease, the lessee may enforce against the supplier of the goods all promises made by the supplier to the lessor and all warranties that accompany the supply contract between the supplier and the lessor.\(^\text{13}\) Assuming the lessor acquired the goods by purchase, these warranties could include warranties of title and warranties against infringement,\(^\text{14}\) express warranties,\(^\text{15}\) implied warranty of merchantability\(^\text{16}\) and implied warranty of fitness for a particular purpose.\(^\text{17}\)

G. **Rights Against Manufacturers or Other Remote Sellers Independent of Article 2A**

In any lease, a lessee can assert any rights recognized under common law or Article 2 against remote sellers,\(^\text{18}\) whether it be a supplier, as that term is defined in section 2A-103(x), or a manufacturer or other remote seller of the goods. Such rights could include actions founded upon express warranties or tort.\(^\text{19}\) Such direct warranty rights of the lessee against the supplier are expressly preserved

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11. § 2A-213.
12. § 2-315.
13. § 2A-209. See infra notes 46-54 and accompanying text.
14. § 2-312.
15. § 2-313.
16. § 2-314.
17. § 2-315.
18. The term "remote seller" is used to identify any party, including a manufacturer, who has owned and sold the goods in question and with whom the lessee has no direct contractual relationship.
19. See infra notes 83-98 and accompanying text.
under a California addition to the provisions of section 2A-209.\(^{20}\)

The warranty or tort rights which might be asserted independent of Article 2A may be crucial to a lessee for various reasons. Aside from the possibility that one party may not be able to respond to judgment thus making multiple theories against different defendants advantageous, it is also possible that warranty rights independent of Article 2A may be enforceable even in situations where Article 2A warranties were effectively disclaimed.\(^{21}\)

II. THE FINANCE LEASE

A basic question in many warranty actions brought by lessees under Article 2A will be whether or not the lease in question was a finance lease. This category of lease is a creation of the new Article 2A and is specifically defined in section 2A-103(g). To find that a lease is a finance lease, the three requirements in subsection (g) must be satisfied:

(i) the lessor must not select, manufacture or supply the goods;
(ii) the lessor must acquire the goods or the right to possession and use of the goods in connection with the lease; and,
(iii) the lessee must receive a copy of the lessor's purchase contract prior to signing the lease, or the lease contract must be expressly conditioned upon the lessee's approval of the terms of the lessor's purchase contract.\(^{22}\)

The purpose behind this statutory definition is readily apparent. The lessor who maintains an inventory of merchandise from which he leases goods gives his own warranties to the lessee. Assuming that the lessee has no relationship to the party from whom the lessor purchased the goods, the lessee may have no warranty rights against that remote seller.\(^{23}\) Conversely, a lessor who does not select goods or maintain any inventory in goods for lease but simply purchases goods selected by the lessee for the purpose of leasing them to the

\(^{20}\) CAL. COM. CODE § 10209(4) (West Supp. 1989) providing that:
In addition to the extension of the benefit of the supplier's promises and warranties to the lessee under subdivision (1), the lessee retains all rights and remedies which the lessee may have against the supplier that arise from any agreement between the lessee and the supplier or from any other law.

\(^{21}\) See infra notes 95-96, and accompanying text.

\(^{22}\) § 2A-103(g). California modifications to the third requirement for a finance lease are detailed in note 4, supra.

\(^{23}\) The exception would be found in cases that come within item I (G), supra. See infra notes 83-98 and accompanying text.
lessee has warranty liability only in the unusual circumstance where that lessor has given an express warranty or committed some act or omission that permits a third person to assert a claim to the goods.\(^{24}\) In this situation, the lessee is only given the right to enforce the warranties made by the supplier. The first two requirements in the definition of a finance lease are designed to distinguish these two kinds of transactions.\(^{25}\)

The third requirement in the definition of a finance lease, that giving lessee the right to examine the supply contract, is designed to serve a different purpose. It is exclusively for the protection of the lessee, giving the lessee some opportunity to exercise control over the terms of the supply contract by which the goods move from the supplier to the lessor.\(^{26}\) Since this element is present in the code for the sole purpose of protecting the lessee, it should be subject to being waived by the lessee where such a waiver would suit the lessee’s purposes.

Assume that a hypothetical lessee selects goods manufactured by X and negotiates with X concerning the price and other contract terms. The lessee then signs a lease contract with a lessor who thereafter acquires the goods by lease or purchase from X and leases them to lessee. This transaction complies with the first two requirements for finding a finance lease because the lessor has not selected, manufactured or supplied the goods and the lessor has acquired the goods in connection with the lease. It does not comply with the third requirement for a finance lease because the lessee has not been afforded an opportunity to review the terms of the supply contract before the lease became effective. Should the failure of the lessor and lessee to comply with this third provision, a requirement inserted in the law solely to protect the lessee, serve to deny to the lessee the rights which he would otherwise have against X?\(^{27}\)

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24. The only warranty rights which a lessee can assert against a lessor in a finance lease are express warranties made by the lessor and the limited warranty of quiet enjoyment. See supra text accompanying notes 6 & 8. Given the nature of a finance lease, it would be a very unusual fact situation in which a lessor in such a transaction would make any express warranties or engage in any act which would interfere with the lessee’s quiet enjoyment. For all practical purposes, a lessee will have no warranty rights against a lessor in a finance lease.

25. See § 2A-103 and comment (g) thereto.

26. See § 2A-103, comment (g).

27. It is clearly to the advantage of the lessor to comply with the third criteria. Depending upon the nature of the lessee’s claim, it may also be to lessee’s advantage that the transaction be treated as a finance lease. Compliance with the requirements of a finance lease makes X a supplier against whom the lessee will have a direct right of action on the supply contract under section 2A-209. Failure to comply prevents the creation of a finance lease which may subject
If the lessee is permitted to waive the third requirement of subsection (g), then the lease in question would be a finance lease. Such a waiver by the lessee does not prejudice X who sold the goods to the lessor. As the transaction occurred, X had every reason to believe that he was a "supplier" as that term is defined in section 2A-103(x) and that the resulting lease which X believed would be negotiated between lessor and lessee would be a finance lease. The technical defect in the transaction which would prevent the creation of a finance lease occurred in the transaction between the lessor and lessee. X was neither aware of nor privy to this transaction. If the lessee is permitted to treat the resulting lease as a finance lease and assert warranty rights contained in the supply contract directly against X, this will come as no surprise to X. In fact, X would be surprised if it were otherwise.

It is concluded that where the first two requirements of a finance lease have been met, a lessee seeking to maintain an action against a supplier under section 2A-209 may waive the third requirement of a finance lease.

III. Lessee's Warranty Rights in a Finance Lease

In a finance lease, the lessee has a direct right of action against the supplier for breach of any warranties found to exist in the supply contract in addition to whatever common law rights he may have against the supplier. That by no means resolves all of the potential the lessor to possible warranty liability that would otherwise not exist (2A-211(2) and 2A-212). Failure to comply with the third criteria would obviously be the result of an oversight by lessor.

28. The Official Comments to section 2A-103(g) indicate that the parties to the transaction have discretionary control over whether it is to be treated as a finance lease. The second paragraph of this comment provides: "Unless the lessor is comfortable that the transaction will qualify as a finance lease, the lease agreement should include provisions giving the lessor the benefits created by the subset of rules applicable to the transaction that qualifies as a finance lease under this Article." The fifth paragraph of this comment provides: "If a transaction does not qualify as a finance lease, the parties may achieve the same result by agreement; no negative implications are to be drawn if the transaction does not qualify."

Thus, the statutory definition of a finance lease is subject to agreement by the parties. This being the case, the right of a party (here the lessee) to waive a condition to the finding of a finance lease should be controlled by general principles of contract law. Since the third criterion of subsection (g) is a condition imposed exclusively for the protection and benefit of the lessee, the lessee should have the right to waive it. See E.A. Farnsworth, Contracts, at 560-565. The right to waive a statutory provision created for the protection of a party is recognized in the law. Courts have long permitted a party against whom an oral contact is being enforced to waive the writing requirement of the statute of frauds.
issues. It is only the beginning. This article will utilize a hypothetical lease transaction to explore some of these problems. The facts for this hypothetical lease will be taken from *A&M Produce Co. v. FMC Corporation,*29 (hereinafter referred to as the *A&M* case). While the *A&M* case involved a direct sale of goods, the same basic transaction could take place in the context of a finance lease.

The complex facts of the *A&M* case can be summarized as follows. FMC is a large manufacturer of farm equipment including equipment used for the purpose of sizing tomatoes destined for the fresh produce market. A&M conducted a rather large farming operation but had never grown tomatoes for market. A&M negotiated with another company for a sizing machine and was given a price of $60,000 to $68,000 for the necessary equipment, including a hydro cooler to lower the temperature of the fruit while it was being processed. Thereafter, A&M discussed its needs with field representatives of FMC who gave A&M a capacity chart indicating the speed at which the machine would sort tomatoes. The FMC representatives advised that the machine worked with such speed that no cooling equipment would be necessary. A&M signed a "field order" on a form furnished by the F.M.C. representatives with a preliminary price of $15,300 and paid $5,000 down. The documents were sent to the FMC home office where engineers worked out a design for the A&M operation and the detailed list of necessary equipment.

FMC sent A&M a final contract with full equipment list reflecting a total price in excess of $32,000. The "back side" of the contract contained certain limited express warranties together with a provision excluding all other warranties. There was also a provision disclaiming liability for consequential damages. An A&M officer signed the contract without reading it. A&M paid an additional $5,680 on the contract price and proceeded to expand its packing shed to accommodate the new equipment.

The FMC equipment did not work at the represented speed. The slow rate of processing together with the absence of cooling equipment caused fruit to spoil. A&M could not sell its tomatoes for canning because they were the wrong variety, and most of the crop was lost. A&M offered to settle the dispute by returning the equipment and recovering its down payments. This offer was rejected. A&M sued on theories of express warranty, implied warranty of

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fitness for a particular use and misrepresentation. The misrepresentation action was dropped at trial.

The trial court judge ruled that both the exclusion of warranties and the disclaimer of liability for consequential damages were unconscionable contract provisions under the facts of this case.30 The jury returned a verdict for A&M in an amount in excess of $281,000. The trial court entered judgment for damages in the amount of $269,000 plus attorneys’ fees of $45,00031 and prejudgment interest.32

The appellate court affirmed the judgment and the supreme court denied hearing.33 It is not the purpose of this article to engage in critical analysis of the A&M decision.34 Rather, this article assumes that the issues in A&M were properly resolved and focuses upon the question of whether and how a similar result might be reached if A&M had been a lessee rather than a purchaser of the equipment in question. The facts of the A&M case will serve as the basis for discussion of a hypothetical situation in which the manufacturer, FMC, is a supplier who actually sells the goods to a leasing company and the farmer, A&M, is a lessee who leases those goods from the leasing company.

IV. A HYPOTHETICAL LEASE TRANSACTION

Assume that A&M negotiated directly with FMC as it did in the A&M case, after which FMC sold the equipment to a hypothetical

30. California did not adopt section 2-302 of the UCC relating to unconscionability. Subsequent to the transaction in question, California adopted Civil Code section 1670.5 which is applicable to all contracts and contains provisions identical to section 2-302. The A&M decision relating to unconscionability was based upon common law. The opinion contains a substantial review of cases dealing with the procedural aspects and substantive aspects of unconscionability. A&M, 135 Cal. App. 3d 473, 483-88, 186 Cal. Rptr. 114, 120-23 (1982).

31. Since the contract provided for attorneys’ fees for FMC, the court applied California Civil Code section 1717 which provides for reciprocal attorneys’ fees to the prevailing party where the contract provides for attorneys’ fees for either. This result was reached despite the argument by FMC that the warranties in this case arose “outside” the contract (because they were not contained in the signed writing) and did not constitute an action “on the contract.” A&M, 135 Cal. App. 3d at 494-95, 186 Cal. Rptr. at 127.

32. The court followed California Civil Code section 3287(b) which gives the trial court discretion to award prejudgment interest on unliquidated claims. A&M, 135 Cal. App. 3d at 493-497, 186 Cal. Rptr. at 129. The exercise of discretion to award such interest in this case was sustained by the appellate court in part on the grounds that by rejecting a reasonable settlement offer, FMC was placing at risk interest on any resulting judgment. Id. The court also noted that the statutory rate of interest which was then only seven percent, was far lower than prevailing rates of interest during the period in question. Id.

33. See supra note 29.

34. See generally, Comment, Unconscionability and the Enforcement of Standardized Contracts in Commercial Transactions, 16 Pac. L.J. 247 (1984) for a comment on this decision and the impact of the law of unconscionability upon commercial transactions.
company called Lease Co and Lease Co entered into a finance lease with A&M. The purpose of leasing rather than purchasing would presumably be for financing or tax planning or both. The transaction is otherwise identical in its economic effect to the actual facts of the A&M case.

Further, assume that all negotiations concerning the price and performance characteristics of the equipment occurred between A&M and FMC and that representations by FMC were all made to A&M, not to the actual buyer, Lease Co. A&M relied upon FMC's skill and judgment to select and furnish goods suitable to the particular purpose which A&M sought to accomplish. However, the sales contract was between FMC and Lease Co. Lease Co is the party that "agreed" to the contract terms excluding warranties and disclaiming liability for consequential damages, and unlike A&M, Lease Co is probably quite familiar with sales contract forms and terms.

It is doubtful whether Lease Co would have grounds for asserting that the exclusion and disclaimer provisions are unconscionable and should not be enforced. Under the uniform version of UCC Article 2A, A&M must have had the opportunity to review and approve this sales contract, either before the lease was signed, or before the lease became legally enforceable, in order for the lease to constitute a finance lease. However, as in the actual case where A&M did not even read the sales contract, it can be assumed that this right of review may not have been exercised by A&M in any meaningful way. The opportunity to review would be sufficient to satisfy the requirement.

Analyzing the issues presented in the A&M case in this hypothetical lease situation raises several problems. Assuming for the moment that A&M is attempting to enforce warranties contained in the supply contract between FMC and Lease Co as set forth in I (F) above, A&M must contend with the actual terms of the FMC-Lease Co sales agreement including the provision excluding warranties beyond the limited express warranty contained therein.

35. Under the California modifications of section 2A-103(g), this opportunity may not have been available to A&M. Unfortunately, California has seen fit to allow a finance lessor to avoid showing the supply contract to the lessee or obtaining the lessee's approval of its terms. See supra note 4.
36. See supra notes 22 and 26 and accompanying text.
37. See supra note 13 and accompanying text. As an alternative theory, A&M might seek to enforce against FMC express warranties made directly by FMC to A&M as described I (G). See supra note 19 and accompanying text. This alternative theory of liability is discussed in the text beginning at note 83, infra.
A. Exclusion of Warranties in the Supply Contract

The preliminary question in the A&M case was whether the exclusion of warranties was operative. The sales contract clause excluding warranties was found to comply with UCC section 2-316 requirements with respect to language and conspicuousness. Therefore, this disclaimer would be effective unless it was found to be unconscionable. In finding the disclaimer to be unconscionable, the court placed heavy emphasis upon the status and experience of both the seller and the buyer. In the hypothetical lease situation, the buyer is Lease Co which presumably has more experience and knowledge relating to business practices and to contract documents and terms and is presumably aware of the opportunity to negotiate better terms with FMC if it chooses to do so. A question which must be resolved is whether the court would focus upon the buyer, Lease Co, or upon the party who actually negotiated the contract, A&M, in determining such questions as unequal bargaining power, meaningful choice, surprise, and taking unfair advantage - factors frequently considered in deciding unconscionability questions.

The A&M opinion quotes various sources for the following statements: "commercial practicalities dictate that unbargained-for terms only be denied enforcement where they are also substantively unreasonable," and "[U]nconscionability turns not only on a 'one-sided' result, but also on an absence of 'justification' for it." The opinion notes that "a businessman usually has a more difficult time establishing procedural unconscionability in the sense of either 'unfair surprise' or 'disequal bargaining power.'" The court relied in part upon the California Supreme Court opinion in Graham v. Scissor-Tail, Inc. in which the court refused to enforce on behalf of Scissor-Tail, a performing group, an arbitration clause in which the Musicians' Union of which Scissor-Tail was a member had the right to select the arbitrator. Appointment of an arbitrator by an agent of

one of the parties was viewed as "fundamentally unconscionable."\textsuperscript{42} By contrast, an exclusion of warranty clause is a contract provision expressly authorized by the UCC and by some consumer protection legislation\textsuperscript{43} and is recognized and permitted in most legal systems of the world.\textsuperscript{44} It is commonly used in the sale of durable goods in the United States. While exclusion of warranties is subject to strict judicial scrutiny, one can conclude that such a contract term will not be found to be unconscionable in a commercial transaction unless aspects of both procedural and substantive unconscionability are found to be present.

A\&M's ability to convince a court that the disclaimer of warranties is unconscionable in the hypothetical lease situation may depend upon whether the court considers the status, experience and bargaining power of the lessee, A\&M, rather than that of the actual buyer, Lease Co. The justifications for a court looking to the bargaining power of the lessee rather than the lessor in a finance lease for purposes of determining the issue of unconscionability in the supply contract are several: the lessee is the party that actually negotiated the terms of the contract to the extent that any negotiation took place; Article 2A of the UCC gives the right of enforcement of this warranty to the lessee; Article 2A gives the lessee the opportunity to review the sales agreement before a finance lease can become effective, thus recognizing that the lessee is the party primarily concerned with the terms of that purchase contract. Further, while the lessor may have experience in reviewing and understanding contracts of sale and certainly has an interest parallel to that of the lessee in obtaining the best warranty rights possible,\textsuperscript{45} its interest in specific

\textsuperscript{42} \textit{Graham,} 28 Cal. 3d at 821, 623 P.2d at 173, 171 Cal. Rptr. at 612. Graham was an experienced promoter, and as such, was certainly not surprised by this contract clause which was standard in the industry, \textit{Id.} The court none-the-less applied the concept of unconscionability to deny enforcement of that contract provision. However, the objectionable contract term in \textit{Graham} and disclaimer of warranties in our hypothetical lease situation are not closely analogous.

The contract term in \textit{Graham} was viewed by the Court as having the effect of denying to Graham any hope of an impartial party to resolve disputes arising under the contract, and was thus fundamentally unconscionable in a substantive sense. \textit{Id.} at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615.

\textsuperscript{43} See \textsc{Cal. CIV. Code} §§ 1790-179.75 (warranties can be disclaimed under California's Song-Beverly Consumer Warranty Act). \textit{But see} 15 U.S.C. 2301-2312, (Magnuson-Moss Warranty Act, which permits limitation but not total disclaimer of warranties).

\textsuperscript{44} See \textsc{British Sale of Goods Act} (1979) § 55; \textsc{German CIV. Code} (BGB) § 476; United Nations Convention on the International Sale of Goods (Vienna Convention 1980) Art. 35 (for examples of foreign and international legislative recognition of the right of parties to disclaim warranties).

\textsuperscript{45} A lessor clearly has an economic interest in getting the best possible warranty rights.
warranty terms is certainly not as immediate as the interests of the lessee.

In passing upon questions relating to the unconscionability of contract terms in a supply contract, a court should look to the finance lessee, not the lessor, as the party immediately affected by the contract terms. The relevant inquiry concerning aspects of procedural unconscionability should be the experience and sophistication, or lack thereof, of the finance lessee as distinguished from the lessor.

B. Identification of Warranty Rights in the Supply Contract

If A&M successfully challenges the enforceability of the disclaimer of warranties provisions, the court will have to determine what warranty rights are actually contained in the purchase contract between FMC and Lease Co. With respect to express warranties, one question presented is whether the express representations made by FMC agents to A&M employees become part of the basis of the bargain between FMC and Lease Co. 46

The contract of sale is between Lease Co and FMC, and Lease Co could have negotiated the terms of this contract. For various practical and commercial reasons, Lease Co left the specific selection of the goods and the negotiation of contract terms to A&M. All three parties to the transaction were fully aware of this situation and recognized that while Lease Co could not be oblivious to the terms of the purchase contract, Lease Co was nevertheless willing to leave the terms and details of the transaction to be worked out by its

While the lessee has the immediate right of possession, the lessor must have a reversionary interest in the goods if the transaction is in fact a lease under section 1-201(37). Thus the lessor may also be harmed by a breach of warranty and could have a right to recover under section 2-714. See text following note 74, infra. Further, the equipment serves as security for the lease payments due to the lessor, and the practical fact is that voluntary payment of the rent due is easier to obtain if the lessee receives satisfaction for defects in the goods. It is however, a fact that in most finance leases, the transaction is completely "spec'd out" by the supplier and the lessee, and the finance lessor typically does not become involved in matters relating to performance of the goods and warranty rights relating thereto.

46. Section 2-313 was not written to accommodate the transaction in question involving, as it does, three parties instead of two. Section 2-313 refers to express warranties being created by "Any affirmation of fact or promise made by the seller to the buyer . . ." which is not likely to occur in a finance lease where the lessee, not the buyer, negotiates with the supplier concerning the acquisition of the goods.

47. See supra note 45. Lease Co owns the equipment and has the reversionary interest in it. Particularly in the event of default on the lease, the lessor is concerned with the terms of its purchase. If the sales price is too high or the terms too onerous, this impacts negatively upon Lease Co's economic position.
lessee and the supplier. Under these circumstances, it is not unreasonable to conclude that A&M was acting as an agent of Lease Co for the purposes of negotiating the contract. While A&M did not have authority to bind Lease Co to a contract of purchase, it was understood by all parties that Lease Co would agree to be bound to any reasonable or generally acceptable contract terms that A&M negotiated on its behalf.

The lessee need not rely exclusively upon this "agency" theory. In Odell v. Frueh, a building contractor was allowed to maintain an action against one of its suppliers based upon an express warranty made by the supplier not to the contractor but to the architect who designed the building and specified the use of the supplier's product. The court stated: "[t]his representation was an affirmation of fact by the seller relating to the goods sold; the natural effect thereof was to induce reliance by the buyer; the goods were purchased because of such representations; the (goods) thereby (were) warranted . . . ." This case provides authority for finding that an express warranty made not to the buyer but to a person other than the buyer can become part of the contract between seller and buyer. The situation is analogous to a representation made not to the lessor but to the lessee in a finance lease transaction.

In a finance lease where the lessee conducts the negotiations with the supplier regarding the specific goods to be purchased and the

48. See W. Seavey, Law of Agency at 3 (1977) (a classic definition of agency is "a consensual, fiduciary relation, created by law by which one, the principal, has a right to control the conduct of the agent, and the agent has a power to affect the legal relations of the principal."). However, the term "agent" has come to be used in a more expansive fashion. Thus, state officials are designated agents for purposes of service of process upon out-of-state motorists who drive the state in and corporations that do business in the state. Realtors who do not possess power to contract can still be empowered to communicate messages and make representations that can be binding upon their principals. Employees who do not have authority to execute contracts can be empowered to negotiate agreements that are subsequently approved by their superiors. Promises and representations made to these negotiating employees can be enforced by their employer.

The lessee negotiating for the purchase of goods to be bought by the lessor does not have power to create a contract, but does have power to negotiate terms which lessee and supplier both understand the lessor will likely accept without question. In fact, the lessor will not agree to be bound to any purchase contract that the lessee does not approve because the lessor is purchasing the goods only in connection with the lease.

The contract ultimately concluded between the lessor and the supplier should be found to include express warranties as well as other promises concerning such matters as manner of delivery or the furnishing of technical expertise to assist in assembly that are properly admissible under the parol evidence rule. The lessee probably does not have authority to bind the lessor to contract commitments, but the lessee is authorized to receive representations or promissory commitments from the supplier which can become part of the purchase contract.

50. Id. at 508, 304 P.2d 45, 48.
contract terms, a court may find that the lessee is acting as the agent for the purchaser-lessee during those negotiations. Any representations or promises made by the supplier which would be recognized as part of the basis of the bargain, and thus become express warranties,\(^{51}\) if the lessee were in fact the purchaser, should be found to have been made to the purchaser-lessee as the principal in the negotiations. Thus the express warranties found to have been made in the actual A&M case should be found to be a part of the purchase contract in the hypothetical lease situation even though they were not included in the written supply contract.

C. Finding an Implied Warranty of Fitness for a Particular Purpose in a Supply Contract

The second warranty issue that could arise in litigation between A&M and FMC concerns an implied warranty of fitness for a particular purpose. The language of section 2-315 clearly contemplates a buyer depending upon the seller's skill and judgment to provide goods suitable to the buyer's specific purposes. At first blush, this section appears difficult to apply where it is the lessee that relies upon the supplier's skill and judgment based upon knowledge of the lessee's particular purpose which allegedly gives rise to the warranty.

The "purpose" for which Lease Co is buying the equipment in question is to have equipment satisfactory for A&M's tomato sizing needs. By the very nature of a finance lease, Lease Co is not buying the equipment to hold as inventory for lease to future customers. It is buying the equipment only "in connection with the lease" to A&M.\(^ {52}\) The fact of this intended use together with the fact that the buyer/lessor is looking to the supplier's skill and judgment to select equipment appropriate to the lessee's particular needs is known to FMC. Thus the factors required for this implied warranty are present\(^ {53}\) and a warranty for fitness for the lessee's particular use should be found to be present in a finance lease where the facts are similar to the hypothetical FMC-Lease Co sales contract.\(^ {54}\)

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52. § 2A-103(g).
53. For a discussion of the factors necessary to find an implied warranty of fitness for a particular purpose see section 2-315 and cases such as Lewis v. Mobile Oil Corp., 438 F.2d 500 (8th Cir. 1971) and Lewis & Sims, Inc. v. Key Indus., Inc., 16 Wash. App. 619, 557 P.2d 1318 (1976).
54. An alternative analysis might proceed on the theory that "the particular purpose for
V. RIGHTS AND REMEDIES AVAILABLE TO THE LESSEE

Analysis of the rights and remedies available to a lessee of goods for any breach including breach of warranty may be most easily accomplished by comparing them with the analogous rights and remedies of an aggrieved buyer under Article 2. In abbreviated summary, a buyer may:

1. Before goods have been accepted, reject a non-conforming tender of goods or, in the case of an installment contract, reject goods where the non-conformity substantially impairs the value of the installment and cannot be cured.

2. After the goods have been accepted, revoke acceptance under section 2-608 by meeting the requirements of that section and section 2-607.

3. In cases involving non-delivery, proper rejection or proper revocation of acceptance, available remedies include:
   a) Cancellation of the contract under section 2-711(1);
   b) Damages based upon cover purchase price minus contract price;
   c) Damages based upon market price less contract price;
   d) Incidental or consequential damages;
   e) Specific performance in appropriate circumstances.

4. In case of defective goods which have been accepted and retained, the buyer may recover:
   a) damages reflecting the diminished value of the goods or proximate damages of a different amount arising from special circumstances; or,

which the goods are required” (section 2-315) by Lease Co is to have goods that will perform the required tasks and fill the needs of Lease Co’s lessee. Thus the lessee’s needs and purposes are in fact Lease Co’s needs and purposes.

55. § 2-601.
56. § 2-612.
57. § 2-712.
58. § 2-713.
59. § 2-715.
60. § 2-716 permits specific enforcement “where the goods are unique or in other proper circumstances.” This has been interpreted to permit specific enforcement of a contract in various circumstances where the goods involved are not in fact unique but cover is not reasonably available to the buyer. For examples, see: Laclede Gas Co. v. Amco Oil Co., 522 F.2d 33 (8th Cir.1975); Iowa Electric Light & Power Co. v. Atlas Corp., 467 F. Supp. 129 (1978) rev’d on other grounds 603 F.2d 1301 (8th Cir. 1979); Copylease Corp. of Am. v. Memorex Corp., 408 F. Supp. 758 (1976); Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429 (1975); Kaiser Trading Co. v. Associated Metals & Minerals Corp., 321 F. Supp. 923 (1970); Ace Equip. Co., Inc. v. Aqua Chem, Inc., 73 Pa. D. & C.2d 300 (1975).

61. § 2-714(2).
b) the loss resulting in the ordinary course of events from seller's breach;\textsuperscript{62} plus,
c) Incidental or consequential damages in proper circumstances.\textsuperscript{63}

The purpose of this section is to examine the comparable rights of a lessee under Article 2A. The right of a lessee to reject goods is set forth in section 2A-509 if the leased goods are to be delivered in a single lot, or in section 2A-510 if the lease is an installment lease.\textsuperscript{64} These two sections track the "perfect tender" rule of section 2-601 in the case of single lot leases and the "substantial impairment of value and cannot be cured" test of section 2-612 in the case of installment leases. The right of the lessor or supplier to cure is set forth in section 2A-513 which parallels the cure provisions in section 2-508. The section 2-605 and 2-606 provisions relating to the requirement of stating defects and defining acceptance find their parallels in sections 2A-514 and 2A-515 with some revisions relating to what conduct constitutes acceptance.

The effect of acceptance of leased goods and the possibility of revoking that acceptance are covered in sections 2A-516 and 2A-517. In the case of a finance lease, the right to revoke acceptance is very narrow. It can exist only where "acceptance was reasonably induced \ldots by the lessor's assurances." Thus in a finance lease, there is no right to revoke acceptance for the other "usual" reasons including acceptance with knowledge of nonconformity induced by promises of cure and acceptance which resulted from the difficulty in discovering of the defect.\textsuperscript{65}

This limitation upon the power to revoke acceptance in a finance lease is consistent with section 2A-407 requiring that once a lessee in

\begin{itemize}
  \item[62.] § 2-714(1).
  \item[63.] § 2-715.
  \item[64.] This term is defined in section 2A-103(i) which parallels the definition of an installment contract in sections 2-307 and 2-612.
  \item[65.] See §§ 2A-516(2) and 2A-517(1). In comparing the rights of lessees under finance leases with the rights of buyers of goods, one profound difference is the inability of the lessee to revoke acceptance except where acceptance was induced by assurances made by the lessor. For a very different analysis of the issue, see Comment, A Unified Treatment of Finance Revocation for Acceptance Under the Uniform Commercial Code, 137 U. PA. L. REV. 967, 990-1001 (1989).
  \item California modified section 2A-516(2) to give to consumers in certain consumer leases the right to revoke acceptance in certain circumstances not permitted under Article 2A. California Commercial Code section 10516(2) provides in part: "In the case of a finance lease, other than a consumer lease in which the supplier assisted in the preparation of the lease contract or participated in negotiating the terms of the lease contract with the lessor, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it." California also modified the definition of consumer leases removing the $25,000 cap contained in section 2A-103(e). CAL. COM. CODE § 10103(e) (West Supp. 1989).
\end{itemize}
a finance lease has accepted the goods, he must perform his obligations under the lease contract "come hell or high water." This provision imposing upon the lessee the absolute duty to make lease payments for accepted goods has commonly been inserted in similar leases before the adoption of article 2A. It is designed to accomplish the result that once goods are accepted by the lessee, the lessee's liability on the lease is absolute. From that point forward, the lessee's remedies against the supplier under section 2A-209 are the exclusive remedies that the lessee can exercise. Only where acceptance of defective goods resulted from assurances by the lessor, which would be a rare fact situation, does the lessee have any remedy which would affect liability on the lease.\(^{66}\)

In cases of breach by a lessor where the lessee has not accepted the goods,\(^{67}\) the lessee's rights parallel those given to a buyer in Article 2.\(^{68}\) In the case of breach of warranty by the lessor, the lessee

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\(^{66}\) In a case where revocation of acceptance is permitted due to assurances by the lessor, "a lessee who so revokes has the same rights and duties with regard to the goods involved as if the lessee had rejected them." (§ 2A-517(3)). Since the "hell or high water" provisions of section 2A-407 apply only to goods that are "accepted," liability on the lease can be avoided by a lessee who can revoke acceptance because of the assurance given by the lessor. This interpretation is substantiated in the first paragraph of the comments under section 2A-407. In this regard, California modified 2A-407 adding a third subsection which provides: "This section shall not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods." Cal. Com. Code § 10407(3) (West Supp. 1989).

\(^{67}\) Section 2A-508 lists the possibilities which include simple non-delivery (2A-509), repudiation by the lessor (2A-402), proper rejection by the lessee (2A-509 and 510), and proper revocation of acceptance (2A-517). Section 2A-402 does not apply to consumer leases in California. California Commercial Code section 10402 inserts this exception and adds a second subsection which provides: "The rights and remedies of the parties to a consumer lease in connection with a repudiation of that lease shall be determined under other laws, and this section shall not affect the applicability or interpretation of those laws."

\(^{68}\) These rights are listed in section 2A-508(1) and (2) and can include:
   (a) cancelation of the lease and recovery of anything paid thereon (2A-505 and 2A-508(1) which parallel buyer's rights under 2-711(1));
   (b) cover and obtain the difference between the present value of the lease payments to be made under the cover lease and the present value of the lease payments which would have been due under the cancelled lease together with any incidental and consequential damages (2A-518 and 2A-520);
   (c) recover "damages for non-delivery" amounting to the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable, together with incidental and consequential damages (2A-519 and 520 roughly paralleling 2-713 and 2-715);
   (d) recovery of goods within 10 days of payment of rent or security deposit in the event of lessor's insolvency (2A-522 paralleling rights of buyer under 2-502);
   (e) obtain specific performance or replevin (2A-521 paralleling 2-716);
   (f) exercise any rights and remedies provided in the lease contract or other rights granted by article 2A (2A-508(3)).

California has made several modifications to the sections cited in this footnote. California
may recover damages under section 2A-519(4). This subsection parallels section 2-714 providing for damages based on the difference between the "value of the use of the goods accepted" and the "value if they had been as warranted for the lease term." The lessee is permitted to show proximate damages resulting from special circumstances and may also recover incidental and consequential damages which are defined in section 2A-520 which parallels section 2-715.

In a finance lease, there are no warranty rights available against the lessor except express warranties made by the lessor and limited warranties relating to title and infringement. The intent and purpose of Article 2A is to require the lessee in a finance lease to look to the supplier for most warranty claims. These warranty rights are found in Article 2 and arise under the supply contract, a contract of sale between the supplier and the lessor.

While the Code does not expressly cover the question, it is evident that the lessee in a finance lease will also look to Article 2 rather than Article 2A to determine the measure of damages for breach of warranty by the supplier. This conclusion is indirectly supported by several clues in Part 5 of Article 2A which contains default provisions.

The first section of Part 5, section 2A-501, refers repeatedly to default by the lessor or lessee with no mention of default by the supplier. Section 2A-502 also refers to "lesser or lessee in default," and sections 2A-503 and 2A-504 refer to stipulated remedies and liquidated damages in the lease agreement with no mention of terms of the supply contract. Section 2A-506 sets forth the statute of limitations provisions for "action for default under the lease contract."

The Article 2A remedies for lessees begin with section 2A-508 under the heading "Default By Lessor." All references in that section

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Commercial Code section 10508(3) provides: "If a lessor is otherwise in default under a lease contract, the lessee may exercise any right or remedy provided in this division except to the extent that this division makes the right or remedy available only upon the occurrence of a default described in subdivision (1) or (2)." Section 10518 provides that damages measured by a cover purchase shall be computed "as of the date of commencement of the term of the new lease agreement" rather than as of the date of default. Section 10518(3) provides that a lessee can elect to proceed under section 10519(2) (difference in market rent) even if the lessee has entered into a cover lease that qualifies under section 10518. Section 10519 has been modified to allow its remedy to be used by a lessee without regard to whether a qualified cover lease was entered. See generally CAL. COMM. CODE §§ 10508-10519 (West Supp. 1989).

69. The lessor in a finance lease gives no implied warranties of merchantability (2A-212) or fitness for a particular purpose (2A-213), and the warranty of the lessor relating to claims or interests of other persons in the goods is quite limited in a finance lease (2A-211). See supra notes 8-11 and accompanying text.

70. See supra notes 13-17 and accompanying text and note 27.
are to lessee's failure to perform. Sections 2A-518, 2A-519, and 2A-520 all conspicuously refer to "lessor's default" and do not mention "supplier's default."

The sections dealing with rejection refer to tender or delivery by the lessor or the supplier but these references to the supplier do not take away from the conclusion that all of the provisions of sections 2A-501 et. seq., apply only to actions brought by the lessee for default by the lessor rather than for breach of promise or warranty by the supplier in the supply contract. Finally, the comment to 2A-508 contains the somewhat ambiguous statement: "There is no special treatment of the finance lease in this section."

The remedy provisions in Article 2 were structured to measure the loss suffered by a buyer, not a lessee. With the promulgation of Article 2A, it would have been appropriate to propose conforming amendments to the remedies sections of Article 2. Since no party can validly claim benefit of the bargain damages beyond those actually suffered, a finance lessee bringing action against a supplier under section 2-714, for example, will be limited to damages attributable to the reduced value of the use of the goods during the term of the lease. A court might properly look to section 2A-519(4) for a formula to apply.

In cases where a supplier has breached a warranty given in a finance lease, there will ordinarily also be damage to the lessor. While the breach does not cause the lessor to lose its right to enforce the lease, a breach of warranty will ordinarily diminish the value of the lessor's reversionary interest in the goods. Thus where the lessee has a breach of warranty action against the supplier, the lessor could ordinarily be expected to join in that action to recover that portion

71. § 2A-514.
72. § 2A-511.
73. For example, section 2-714 measures damages on the basis of the diminished value of the goods. This is appropriate for a buyer but would ordinarily overcompensate a lessee who has the right to use of the goods for only the period of the lease which must be less than their useful life (1-201(37)). By contrast, the formula found in section 2A-519(4) measures the lessee's damages on the basis of diminished value of use during the lease term which is one appropriate measure of the lessee's damages whether the lease be a finance lease or a non-finance lease.
74. Such conforming amendments were proposed in the official critique of Division 10 of the California UCC prepared by the California Department of Consumer Affairs but were not included in the California legislation. R. Elbrecht, Should The Lessee Have Better Remedies Against The Supplier in A UCC "Finance Lease"?, Division of Consumer Services, Legal Services Unit (1988) (on file at the Pacific Law Journal).
of the diminished value of the goods not recoverable by the lessee. The lessor's recovery, for instance, could be the section 2-714 measure of damages based upon the diminished value of the goods, reduced by that portion of the diminished value attributable to the lessee's loss of the value of their use during the lease term as computed using the formula in section 2A-519(4). The supplier would be liable for the full diminished value under section 2-714 and this amount would be shared by the lessee and the lessor as their respective interests in the goods dictate.

There remain additional remedy issues which a lessee may face. These will be explored in the next section.

VI. THE HYPOTHETICAL LEASE REVISITED

A. Liability for Consequential Damages

Returning to the hypothetical lease based upon the facts of the A&M case, there remain remedy issues to be resolved to determine damages recoverable by the lessee against the supplier in a finance lease. To begin, assume that the supply contract between FMC and Lease Co contains a disclaimer of liability for consequential damages as was the fact in the A&M case.

In A&M, the contract provision disclaiming liability for consequential damages was not enforced on the grounds that it was unconscionable under the circumstances of that case. The factors relating to procedural unconscionability have been noted. One must once again face the question whether the court will focus upon A&M with its purported lack of experience and expertise, or that of Lease Co to determine whether procedural unconscionability exists. With respect to substantive unconscionability, the main thrust of the court's

75. See supra notes 29-32 and accompanying text.
76. Among other things, these include the nature of the contract, whether it is a contract of adhesion, the identity of the parties and their relative sophistication and bargaining power, the history of the bargaining process including the extent to which terms were called to the attention of the adhering party and whether these terms were actually negotiated, the physical location in the contract of the provisions in question and such matters as the size of the type in which they were printed, and any other relevant factors relating to the bargain other than the fairness and propriety of the contract terms themselves. The fairness and effect of the contract terms themselves relates to the matter of substantive unconscionability. See supra notes 38-45 and accompanying text.
opinion in the A&M case seems to be reflected in its statement: “If the seller’s warranty was breached, consequential damages were not merely ‘reasonably foreseeable;’ they were explicitly obvious.” As was done with the issue relating to the unconscionability of the warranty disclaimer, the court relied in the A&M case upon the fact that the transaction did not involve an experimental process with specially designed equipment. The case involved a “standardized mass-produced product from an industry seller” which is a leader in the manufacture of such equipment.

The elements of substantive unconscionability of the consequential damage disclaimer clause are the same in the hypothetical lease situation as they were in the A&M case. However, the disclaimer of liability for consequential damages is a standard practice in many industries and in many situations is not so substantively unconscionable or even unfair that enforcement will be denied in the absence of accompanying elements of procedural unconscionability. Denial of enforcement of this contract term will not be likely in a situation involving a commercial lease unless the court looks to the circumstances relating to A&M rather than Lease Co to determine whether procedural unconscionability exists.

In a finance lease, the court should look to the status and circumstances of the lessee rather than those of the buyer/lessor in determining all questions relating to the application of the doctrine of unconscionability to contract terms. As stated in the comments to section 2A-209: “The function performed by the lessor in a finance lease is extremely limited.” Commercial realities dictate that the court recognize the supply contract in a finance lease transaction as being

77. A&M, 135 Cal. App. 3d 473, 492, 186 Cal. Rptr. 114, 126. The court also stated: When non-negotiable terms on preprinted form agreements combine with disparate bargaining power, resulting in the allocation of commercial risks in a socially or economically unreasonable manner, the concept of unconscionability as codified in the Uniform Commercial Code sections 2-302 and 2-719, subdivision (3), furnishes legal justification for refusing enforcement of the offensive result. Id. 135 Cal. App. 3d at 493, 186 Cal. Rptr. at 126. Interestingly, the court cites and apparently relies upon section 2-302 which is conspicuously absent from the California Commercial Code. See supra note 30.

78. A&M, 135 Cal. App. 3d 473, 491, 186 Cal. Rptr. 114, 125. A contractual provision allocating the risk of consequential damages to a buyer would be less “socially or economically unreasonable” if the subject of the contract were specially designed goods or experimental equipment in which case a seller might reasonably wish to shift to the buyer the risk of consequential damages resulting from failure of the goods to perform in the intended fashion. See, S.M. Wilson & Co. v. Smith Int'l, 587 F.2d 1363 (9th Cir. 1978).

a contract negotiated by the supplier and the lessee, the terms of which are of primary concern to the lessee rather than to the actual buyer.

Assuming that a court does determine that consequential damages are not effectively disclaimed in the hypothetical lease, the consequential damages for which the supplier is liable are those of the lessee and not the purchaser-lessee. The evident sense and purpose of section 2A-209 makes this clear. The lessee is given the right to enforce against the supplier warranties contained in the supply contract. The lessee would have no right to collect damages resulting to the purchaser-lessee as these would not constitute an economic loss suffered by the lessee.  

The foreseeability of the consequential damages sustained by the lessee would be governed by an analysis of the facts disclosed during the negotiations between the lessee and the supplier and any other facts which bring to the attention of the supplier the circumstances of the lessee and the foreseeable consequences of a failure of the equipment to conform to contract warranties.  

B. Recovery of Attorneys' Fees

The question of reciprocal attorneys' fees should also be resolved in favor of the lessee in the hypothetical lease transaction if the lessee is the prevailing party. Under section 2A-209, the lessee is permitted to maintain an action against the supplier on the supply contract, thus recovery is a "upon the contract" as required by the California Civil Code section 1717.

VII. DIRECT TORT OR WARRANTY RIGHTS OF A LESSEE AGAINST A SUPPLIER OR OTHER REMOTE PARTY (WARRANTY RIGHTS INDEPENDENT OF ARTICLE 2A)

Article 2A may provide appropriate warranty rights satisfactory to the needs of a lessee in some situations. In a finance lease, the right
to assert against a supplier warranties contained in the supply contract
may give the lessee the remedy he seeks. In a non-finance lease, the
lease contract may provide adequate remedies against the lessor.
However, in other cases the best remedy for a lessee may involve an
action against a manufacturer, seller or other remote person based
upon theories other than those enunciated in Article 2A.

Established case law permits lessees to bring action on various tort
and warranty theories against manufacturers or other remote sellers
of the goods leased. The central historical problem which a plaintiff
must surmount to maintain such actions has been the absence of
privity between the plaintiff and defendant. This is still a concern in
certain types of actions. Assuming this privity problem can be over-
come, it should not matter whether the party bringing the action is
in fact a buyer of the goods in question or a lessee of those goods.

An action against a remote seller might be founded in tort under
a theory of products liability.83 To the extent that such actions involve
personal injury or accidental damage to other property, they are
beyond the scope of this article. However, various jurisdictions have
recognized a tort action in products liability for economic loss
involving the destruction of the goods themselves84 or loss of use.85
Where such an action is permitted, a lessee of goods can have a
direct right of action in tort against the seller without regard to
whether the lease is a finance lease or not.86

Rptr. 697 (1963); RESTATEMENT OF TORTS § 402A.
84. For example, see Gherna v. Ford Motor Co., 246 Cal. App. 2d 639, 55 Cal. Rptr.
94 (1966), where a cause of action for strict liability was recognized despite the fact that the
defect in the automobile caused a fire that resulted only in damage to the automobile itself.
A lessee of goods which were destroyed or damaged in like fashion could assert such a cause
of action against a manufacturer without regard to requirements or limitations contained in
the UCC.
85. Santor v. A&M Karagheusian, Inc., 44 N.J. 52, 207 A.2d 305 (1965), is a prominent
case permitting a buyer to maintain an action against a manufacturer for economic damage
resulting from loss of use of a defective product. The application of this case has been
narrowed in New Jersey. See Fashion Novelty Corp. of New Jersey v. Cocker Machine &
Foundry Co., 331 F. Supp. 960 (1971) applying New Jersey law. For a review of state decisions
on this subject, see East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986).
To the extent that state law may permit a tort action in products liability for economic damage
resulting from loss of use of a product, this theory
would be available to a lessee without regard to the restrictions or requirements of the UCC.
86. All jurisdictions also recognize a tort action for fraud or misrepresentation which is
not based upon any privity of contract. For a case allowing this action against a manufacturer
based upon allegations of tortious misrepresentation in advertising, see Ford Motor Co. v.
Taylor, 60 Tenn. App. 271, 446 S.W.2d 521 (1969). Where the elements of this tort can be
established, that theory of liability against a remote seller of goods will also be available to a
lessee without regard to whether the lease is a finance lease.
Many jurisdictions have also recognized a right of action based upon express warranty despite the absence of privity between plaintiff and defendant.\textsuperscript{87} Such warranties may be found in advertisements,\textsuperscript{88} in statements contained in labels or otherwise attached to goods\textsuperscript{89} or in written warranties or other written or oral statements given or made directly to the plaintiff.\textsuperscript{90} The representations by the remote seller are found to be a part of the basis of the bargain despite the fact that there is no direct contract or "bargain" between these parties.\textsuperscript{91} While it is generally stated that the plaintiff must establish that he relied upon the express warranty, some cases find liability despite the absence of evidence of such specific reliance.\textsuperscript{92} There are also cases which permit actions against manufacturers and other remote sellers on a theory of implied warranty.\textsuperscript{93}


Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of Section 2-318 on third party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of this Act may offer useful guidance in dealing with further cases as they arise.


\textsuperscript{91} In Flory v. Silvercrest Indus., Inc., 129 Ariz. 574, 633 P.2d 383 (1981), the court denied enforcement of an express warranty given by a remote manufacturer to a purchaser under Article 2 of the UCC because it was not the basis of the bargain between a buyer and seller, but remanded for retrial on the theory that the express warranty might create a separate contract of warranty between manufacturer and buyer.

\textsuperscript{92} Seeley, 63 Cal.2d 9, 403 P.2d 145, 45 Cal. Rptr. 17; Massey-Ferguson, Inc. v. Laird, 432 So.2d 1259 (1983); Rodrigues v. Campbell Indus., 87 Cal. App. 3d 494, 151 Cal. Rptr. 90 (1978).

\textsuperscript{93} See Manheim v. Ford Motor Co., 201 So.2d 440, 201 So.2d 909 (1967) and cases collected in Annotation, \textit{Products Defect - Privity}, 16 A.L.R. 3d 683 (1967). Some of these cases are based upon state statutes which dispense with the requirement of privity. For example, see L.A. Green Seed Co. of Ark. v. Williams, 246 Ark. 453, 438 S.W.2d 717 (1969).
As an alternative to enforcing, under section 2A-209, rights flowing from the supply contract between the supplier and the lessor, the lessee may assert a direct warranty action and other common law rights against the supplier for breach of representations and promises made by the supplier to the lessee which induced the lessee to select and lease the equipment in question.\textsuperscript{94} In such an action, the lessee is asserting rights arising from its own relationship with the supplier. Case authority indicates that the lessee’s rights are not affected by exclusion of warranties in the transaction between the supplier and the lessor.\textsuperscript{95} For the same reasons, the disclaimer of liability for consequential damages contained in the supply contract are not available to the supplier in an action by the lessee based upon express warranties made to the lessee.

One concern with this conclusion—that the lessee might have rights unaffected by any disclaimers in the supply contract—arises from the fact that under section 2A-103(g) the lessor will have shown the supply contract to the lessee for its approval before the lessee became bound to the lease.\textsuperscript{96} This raises a question of the reasonableness of the reliance of the lessee upon express warranties made by the supplier directly to the lessee when the lessee has reason to know that the supplier has sought to disclaim both the warranties themselves and liability for consequential damages for their breach. The answer may be that in business transactions people do regularly rely upon statements made by those with whom they deal, and it is thus appropriate to recognize that reliance as reasonable.

VIII. Ramifications of Article 2A

The adoption of Article 2A,\textsuperscript{97} will provide statutory guidance for resolution of some of the problems relating to leases of goods which


\textsuperscript{95} Randy Knitwear, Inc. v. American Cyanamid Co., 11 N.Y.2d 5, 181 N.E.2d 399, 226 N.Y.S. 363 (1962), Dobias v. Western Farms Ass’n, 6 Wash. App. 194, 491 P.2d 1346 (1971).. This need not be the case under California law given the California modification of 2A-103(g) (CAL. COM. CODE § 10103(g)) which provides alternative methods for fulfilling this third requirement of a finance lease. See supra note 4. In practice, a lessee in California may not have the opportunity to approve the supply contract unless the lessee specifically negotiates for this right.

\textsuperscript{96} See supra note 3.
were not addressed in the earlier versions of the Uniform Commercial Code. Unfortunately, while Article 2A does provide a new framework for resolution of warranty issues, it fails to recognize or deal with several problems. This creates a challenging task for the courts with little existing case law to serve as guidance. However, courts have found imaginative ways to interpret and expand upon the warranty sections in Article 2, and it can be anticipated that a similar common law expansion upon the literal terms of Article 2A will take place.

Since codification of sales warranties began, courts have not treated the express provisions of legislative enactments such as the British Sale of Goods Act, the Uniform Sales Act or the Uniform Commercial Code as the sole source of guidance in determining warranty rights and obligations. Court interpretation of and expansion upon the statutory enactments has played a major part in supplementing the literal language of these acts and codes. Perhaps more importantly, in several instances courts have found warranty rights arising from situations other than those provided for in the statutes.98

In interpreting the language of Article 2A as well as the new applications of certain parts of Article 2, courts will be well advised to employ the realist philosophy of Karl Llewellyn and recognize that this approach is an appropriate tool not just for the interpretation of those articles of the code for which Professor Llewellyn bore overall responsibility, but also for Article 2A and the new interpretations which will have to be made to implement its apparent purposes.99 The practices of the marketplace and the manner in which people manage and conduct transactions involving the leasing of goods must be recognized and given due consideration in resolving the questions that will no doubt arise.

Courts must also continue to recognize their proper role in developing warranty law and remedies in situations not expressly considered or addressed in the code. This includes finding express warranties outside the literal parameters of the code. It also includes continuing the process of judicial recognition of warranty rights of lessees, a process which was begun before Article 2A or any other legislation expressly provided statutory authorization for finding such rights.100

98. See supra notes 87-94 and accompanying text.
100. See Farnsworth, Implied Warranties of Quality in Non-Sales Cases, 57 Colum. L. Rev. 653 (1957). See generally cases cited in note 94, supra.
Article 2A has been subjected to criticism on various grounds, and one might anticipate that revisions may be proposed in the near future. The numerous modifications made by California and being considered in Massachusetts and other jurisdictions, suggest such a possibility. Whether the warranty and remedy sections become leading candidates for early revision may depend in large part upon the imagination with which lessees' counsel develop appropriate theories and the willingness of courts to implement warranty rights and remedies which place the lessee in a position comparable to that of the purchaser of goods.
