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Consider the parable of Ben and Lee, two hopeful sojourners in the wonderland of consumer automobile finance. Ben has just bought a new car. He may have made a bad deal, but at least the law provides some minimal standards to protect him. Lee has just acquired a new car—perhaps from the same dealer. But Lee has almost none of the protections which the law extends to Ben. Worse yet, he probably doesn't even know he doesn't have them. Rather, to the contrary, he probably thinks he is better off than Ben.

The reason why Lee is in a jam is that Lee has just signed a "lease." The ordinary consumer probably thinks of a "lease" as being different from a "sale"—and it is. The consumer probably sees a lease as less risky and less binding than a sale—and it is nothing of the sort. Rather, under the law as it stands today, the consumer who "leases" a car from a California dealer frequently bears substantially all the risks that fall on a "buyer." What advantages does he get in return? So far as I can tell, none. But he does get one great disadvantage. It is this: the "lessee" is an orphan of the law. He is expressly excluded from the coverage of California's basic automobile installment sales act. Other statutes, while they do not clearly exclude him, are sketchy or vulnerable to misinterpretation. The practical result is that the lessee normally operates outside the pro-

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tective scheme that has been erected to protect consumers in the marketplace.

There is no justification for this disparity. It persists because very few people understand the situation except, presumably, the people who profit from it. The area is overdue for reform.

It is time for some examples. Ben has just picked out a New Blue Volcano that he wants to own. The dealer says that it will cost Ben (after down payment) a total of $4,000, plus perhaps $1,500 in finance charges. Ben can't pay it all at once, of course. Perhaps he agrees to pay it off in 48 monthly installments; this would be $114.58 each month (rounded off).[1]

Of course, if part way through the term Ben defaults on his promise to pay, the dealer may be able to retake the car and resell it. If there is any difference between the amount collected from Ben plus the amount received from the new buyer (on the one hand) and the sum due the dealer on the contract, then the dealer can collect the difference from Ben. This is the "deficiency judgment" that so often arises to haunt the person who can't keep up his car payments.

That is one deal. Here is a variation. Maybe Ben can't pay $114.58 a month. Maybe he can pay only $75 a month. Very well then; the dealer may write up the contract for the same car so that Ben pays only $75 a month—for the first 47 months. Of course, the catch is that the 48th payment will have to be $1,975, which means that Ben will have to refinance or default at that time.[2] But the 48th payment is a long way away and the deal may look sweet enough now to make Ben forget about the sour ending.

Now, consider Lee. He goes to the same car dealer and looks at the same New Blue Volcano. But the dealer does not offer to sell. He says, "I can lease it to you for $75 a month," and Lee accepts. They draw up a form that includes the following information (the language is tricky, so watch carefully). The car has a "value" (not a "price") of $4,000, and Lee will pay $75 a month. The contract lists "the total amount of periodic payments to be credited to the lessee in the establishment of any liability at the end of the lease period"—set that at $2,025. Then it lists

1. This would be an effective annual percentage rate of 16.5 percent. *See* COMMERCE CLEARING HOUSE, TRUTH-IN-LENDING, REGULATION Z, ANNUAL PERCENTAGE RATE TABLES (1969).

2. This would be an effective annual percentage rate of 13.25 percent. *See* COMMERCE CLEARING HOUSE, TRUTH-IN-LENDING, REGULATION Z, ANNUAL PERCENTAGE RATE TABLES FOR IRREGULAR TRANSACTIONS (1969). Note that the total of payments—$5,500—is the same here as in the previous example, but that the annual percentage rate is lower. The explanation is that the consumer has the use of the principal sum for a longer period of time. To take a simple example: Suppose creditor borrows $100 from

"the total amount of period payments not to be so credited"—call that $1,500. Finally, it lists "the maximum for which the lessee could be liable at the end of the lease period."—that would be $1,975. What's going on here? In fact, Lee has just entered into exactly the same deal as Ben. He has agreed to make 47 monthly payments of $75 each. At the end of the lease term, the dealer takes back the car and tries to sell it, or has it appraised. If it sells or appraises for anything less than $1,975, then Lee is liable to the dealer for the difference. Moreover, the contract provides that if Lee doesn't keep up his payments, the dealer can repossess, resell and charge Lee the deficiency.

In other words, Lee faces a schedule of modest monthly payments, with a whopper liability at the end. Of course, if the value of the car holds up, there is no great problem. Someone else may buy the car and liquidate the obligation. Or the consumer may choose to refinance and buy it himself. But if the value of the car goes down, then the consumer must pay. That is, he bears the "downside risk." This is not normally regarded as a risk of leasing; it is a risk of ownership. *It is because the lessee bears this downside risk that he ought fairly to be regarded as an owner.*[3]

If all this seems complicated, read it again, and don't feel lonely. It was probably meant to seem complicated. At any rate it is difficult to see why any consumer would give up the protections accorded a "sale" transaction for this kind of a "lease." One simply cannot study these contracts at any length without developing a conviction that the consumer has been deceived.[4]

I should emphasize here that I am talking about only one specific kind of "lease"—the consumer transaction in which the user bears the down-

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debtor and has to repay $110 either at the end of one month or at the end of one year. If he pays at the end of one month, he is paying $10 for the use of the money for only one month, or a rate of 120 percent a year, while if he pays at the end of the year, he is paying $10 for the use of the money for an entire year, or a rate of 10 percent per year. The balloon payment transaction is analytically similar.

3. Although the term "downside risk lease" may include many forms of consumer auto leases, throughout the course of this article it is used interchangeably with the term "open-end lease." While the latter term is more commonly used in the leasing industry, I believe that the former term more accurately reflects those situations in which the lessee bears the risk of depreciation or loss.

4. This and similar *ipse dixits* throughout this paper are based on my experience examining auto leases shown to me by students and other friends; and by discussing the issue with people who work in government consumer-protection agencies. *See* also S. LEE, INTRODUCTION TO LEASING 108 (1965):

> It should be obvious that where it is intended that the lessee will pay the full cost of depreciation, monthly rental rates can be reduced only by lengthening out the period of usage or by lowering the amortization rate. Any leasing company that reduces monthly payments too drastically is deliberately misleading its lessee if it does not warn him that an unrealistic depreciation rate can only result in a large balloon deficiency payment when the car is returned. At that point, when the lessee finds that he must come up with a lot of money or drive the car longer, trouble is certain to ensue between the leasing company and customer.

side risk.[5] There are many other kinds of transactions called "leases," and for all I know, they present no problems. At any rate, I do not intend to examine these leases here. There are, for example, many leases in which the user does *not* bear the downside risk—an airport rental car would be an example. And there are downside risk leases in which the user is a businessman, presumably equipped with resources sufficient to allow him to take care of himself. Conceivably these transactions involve abuses. I don't know. About the particular transaction at hand, I do know, or at least I have some fairly strong opinions, and these are what this article will set forth.

In the balance of this article, I undertake several tasks. First, I try to set forth a distinction, appropriate for the purposes of this article, between "sales" and "leases," and to show how existing statutes deal with this distinction. I try to show that the existing statutes deal with it inadequately, or not at all. Secondly, I compare the substantive provisions of two California consumer statutes, one dealing with automobiles acquired by purchase, and the other with those acquired by lease. Here I try to show that the purchaser is protected while the lessee is left vulnerable, despite the absence of any satisfactory justification for the disparity. Thirdly, I examine the sale-lease distinction in four other regulatory schemes. These are: chattel security law under the Uniform Commercial Code; rate regulation under the Truth-in-Lending Act; limitations on the price of money; and the law governing warranties and strict liability. I contend that in all of these areas, courts presently have the power to treat the downside risk lease as a "sale," although the existing statutes probably are not as clear as they should be on the point.

I also consider briefly the prospect that "leasing" will be extended to goods other than autos. Finally, I examine two reform proposals. One, developed in the Uniform Consumer Credit Code and also proposed as an amendment to the Truth-in-Lending Act seems to me to misconceive the issue. The other is my own. Not surprisingly, I think my proposal is to be preferred.

The Sale-Lease Distinction

The purpose of this section is to try to develop some coherent notion of the proper demarcation between "lease" and "sale." I will also try to explore this notion in the context of a number of relevant statutes, and to show where and to what extent these statutes go wrong.

5. By a "consumer" I mean one who, in the words of the Rees-Levering Act, buys his auto "primarily for personal or family purposes [and not] primarily for business or commercial purposes." Cal. Civ. Code §2981(j). For substantially similar definitions in other contexts see Cal. Civ. Code §§1761(a), 1785.2(a), 1791(a), 1802.1; Cal. Comm. Code §9109.

The beginning of wisdom is to recognize that no comprehensive demarcation is possible. The problem begins with the fact that "sale" and "lease," are not, after all, categories that are inalterably fixed by objective reality. They are characterizations that the human mind imposes on conduct, and conduct always has a way of being more slippery than categories. To put the point in sharper focus, it may be useful to recall that each term—"sale" and "lease"—implies some fundamental notion about "ownership" or "property." And if the last fifty years have taught us anything, they should have convinced us that "property" is the ultimate weasel word in the law, the ultimate abstraction, serving to block inquiry rather than advance it. Property is (to repeat) not one "thing" but a great number of "things."

An illustration will serve to illuminate the point. Suppose Harold is standing next to a mule; a harness runs from the mule's head to Harold's hand. Does Harold "own" the mule? The question is meaningless. What, exactly, do we want to know? If the mule runs away, will the state help Harold recapture it? If the state imposes a property tax on mules, will Harold have to pay it? If the mule bites somebody, will Harold have to respond in damages? If the price of mules goes up, will Harold be able to sell the mule at a profit? This is only the beginning; we could ask a hundred similar questions.

The next fundamental point—it ought to be axiomatic by now—is that we do not have to answer all these questions alike. It may be that Harold is the "owner" for purposes of getting the mule back, but not for paying taxes; the "owner" for paying the tax, but not for paying the damages; the "owner" for paying the damages, but not for enjoying gains. The answers to these questions do not exist independently in the universe. They are answers that people give in shaping (or misshaping) the universe to their (supposed) ends. Something similar can be said for leases: whether a transaction is a lease or not, is not one question; it is many.

All this may be necessary by way of background. But we need to get back to the subject at hand. One person (call him a dealer) is delivering an auto over to another person (call him a consumer), who gets the right to use it, and who undertakes to pay something for its use.[6] When should this consumer be treated as a "buyer" for purposes of the consumer pro-

6. Throughout this article, I have tried to refer to parties as "dealer" and "consumer" so as to avoid the conceptual issue of whether a particular party is a "seller" or "lessor," a "buyer" or "lessee." The term "consumer" is reasonably satisfactory; see note 5 *supra*. The term "dealer" may be misleading, since a good deal of leasing activity seems to be carried on by banks, leasing companies, and others. I trust the misdirection causes no material harm to the thesis.

tection law? My thesis is this: the ordinary person on the street thinks (if he thinks about it at all) of the notion of ownership in this situation as involving the *risk of decline in value.* Unless he is the "owner" (as he perceives the situation), he doesn't think of himself as assuming the risk.[7] For the purpose of deciding whether to apply consumer protection statutes, that distinction ought to be the demarcation between "sale" and "lease."

The classic treatises explicitly recognize such a distinction. Thus Story, in his *Commentaries on Bailments,*[8] discourses at length on the liability of the bailee for harm to the property. If the bailee is negligent in any of a variety of situations he is liable, Story declares. But by contrast, "bailees in general are not responsible for losses resulting from inevitable accident, or from irresistible force. . . ."[9] That is, the owner, not the bailee, is to bear the downside risk. Williston, who was not given to free flights of fancy, regarded the downside risk demarcation as more or less fundamental when he published his *Treatise on Sales* in 1909.[10] Some of the ablest contemporary commercial law scholars have made it clear that they also share this opinion.[11] From England, Professor Goode and his colleagues have treated the downside risk distinction as fundamental.[12] And there is case law on point.[13] But let's focus on the

7. So far I have said nothing about the "upside risk," the possibility of enjoying an increase in value. I will say something about it later; see text accompanying notes 22-24, *infra.* But as I explain there, the melancholy fact is that "upside risk" simply isn't that important. This is intriguing, because standard treatments of property seem to focus on the upside risk. *See, e.g.,* 2 J. KENT, COMMENTARIES ON AMERICAN LAW 390 (9th ed. 1858) which states:

> The sense of property is graciously bestowed on mankind for the purpose of rousing them from sloth, and stimulating them to action; and so long as the right of acquisition is exercised in conformity to the social relations, and the moral obligations which spring from them, it ought to be sacredly protected. The natural and active sense of property pervades the foundations of social improvement. It leads to the cultivation of the earth, the institution of government, the establishment of justice, the acquisition of the comforts of life, the growth of the useful arts, the spirit of commerce, the productions of taste, the erections of charity, and the display of the benevolent affections.

There are situations where the consumer has the "upside risk" without the "downside risk;" for example, under anti-deficiency legislation protecting either consumer goods or personal real estate.

8. J. STORY, COMMENTARIES ON THE LAW OF BAILMENTS, *passim* (6th ed., 1856). Story laces out his argument with citations to the French law, and the Scotch, and administers the *tour de force* with a few lines of Latin. He quotes Heineccius: *"In contractibus, . . . in quibus penes unum commodum, penes alterum incommodum est, ille ordinarie culpam etiam levissimam, hic, non nisi latam, proestat. Ubi par utriusque contrahentis commodum atque incommodum est, culpa etiam levis ab utroque proestanda est." Id.* §25, at 26-27.

9. *Id.* §25, at p. 27.

10. S. WILLISTON, THE LAW GOVERNING SALES OF GOODS AT COMMON LAW AND UNDER THE UNIFORM SALES ACT §334, at 525-26 (1st ed. 1909).

11. *See, e.g.,* G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §11.2; R. JOHNSON, R. JORDAN & W. WARREN, ATTORNEY'S GUIDE TO TRUTH-IN-LENDING §1.4; CONTINUING EDUCATION OF THE BAR, CALIFORNIA COMMERCIAL LAW: III §1.5, at 8.

12. R. GOODE & J. ZIEGEL, HIRE-PURCHASE AND CONDITIONAL SALE 136-46; R.

sale-lease distinction as it has been developed in consumer protection law. We shall begin with the Uniform Conditional Sales Act, then turn to the Uniform Commercial Code, and then to the California acts regarding the sale and leasing of automobiles.

A. The Sale Lease Distinction in the UCSA

The Uniform Conditional Sales Act (hereinafter referred to as UCSA or Act), adopted by the National Conference of Commissioners of Uniform State Laws in 1922,[14] is the veritable grandfather of modern consumer protection law. The sponsors of the Act recognized that merchants might seek to evade its protections by engaging in "conditional sales" that looked like leases. So they provided that the term "conditional sale," for purposes of their act, should include certain "leases," namely:

> any contract for the bailments or leasing of goods by which the bailee or lessee contracts to pay as compensation a sum substantially equivalent to the value of the goods, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming, the owner of such goods upon full compliance with the terms of the contract.[15]

There are two elements in this definition. The first is the idea that the "lessee contracts to pay as compensation a sum substantially equivalent to the value of the goods. . . ." By "value" the Act seems clearly to refer to the value the goods are presumed to have at the time of the making of the transaction. This being so, the necessary corollary is that any diminution in value falls on the buyer. This is, clearly, the downside risk factor discussed above. The second element is the matter of whether "the lessee is bound to become, or has the option of becoming, the owner of such goods upon full compliance with the terms of the contract." This element is somewhat more perplexing. The commissioners themselves felt the need to defend it—or rather more specifically, to defend the language about "options." They said in their comments: "That the buyer, in some cases, has the option of becoming the owner and thus a sale is not sure to take place, is of but small im-

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GOODE & L.C.B. GOWER, IS ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE EXPORTABLE?: ASPECTS OF COMPARATIVE COMMERCIAL LAW, 325-26.

13. A defendant was not liable for the death of a mule caught in a fire while in defendant's possession because defendant was not negligent, and was only a lessee. Sawyer v. Wilkinson, 166 N.C. 497, 82 S.E. 840 (1914).

14. 2 UNIFORM LAWS ANNOTATED, UNIFORM CONDITIONAL SALES ACT, (Greene ed., 122) [hereinafter cited as UCSA]. All further citations to the UCSA will be to this edition. On the relationship between the UCSA and modern retail installment sales law, see generally Hogan, *A Survey of State Retail Installment Sales Legislation*, 44 CORNELL L.Q. 38, 42 (1958).

15. USCA §1(2), at 2.

portance, for, as a practical matter, the buyer will always be willing to accept ownership when he has paid the value."[16]

So far, so good. What is perplexing here is that the commissioners, having covered themselves on one flank, appear to have left themselves exposed on the other. That is, suppose the contract provides that the buyer will pay a sum substantially equivalent to the value of the goods—but says nothing about whether he has an option to purchase? Conceivably, in a strict sense, one might argue that the absence of any explicit option to purchase leaves the lessee outside the scope of the Act. If this is so, it opens up the possibility of a remarkable loophole whereby the seller-lessor may try to exempt himself from the provisions of the Act. In fact, no such remarkable reading is desirable, or necessary, or even indicated, by the UCSA. Two points explain this proposition. In the first place, there is nothing in the Act that says an "option" has to be a writing, a piece of paper. Concededly, a lawyer tends to think of an option as a term of art, denoting a particular type of binding agreement, frequently used in real estate transactions and thus of necessity in writing. But "option" has a common-sense meaning as well. There is no reason at all to suppose that the draftsmen were thinking of the "legal" meaning of "option" when they developed their definition of "conditional sale." On the other hand, it seems entirely plausible to suppose that the draftsmen were envisioning the practical concept of "option." This brings me to my second point.

The proposition is this: In practice, it seems that *if* the lessee bears the risk of decline in value, he *has* the option to become the owner whether the contract says so or not; it is thrust upon him. Consider a lease deal like the one described at the end of the last section. Suppose the balance due from the lessee is $1,000. There is no explicit "option to purchase" in the agreement. The lessor has just reclaimed the leased property. A "willing buyer" has offered to pay $600 for it. This means that the lessee faces a potential liability of $400. What is the lessee to do? If he feels the car is worth no more than $600, he might as well let it go to the "willing buyer." On the other hand, if he feels that it is worth a greater sum—say $650—in his own hands, then he is going to offer to buy it from the lessor for a sum in excess of $600—say $625. At this point, what is the dealer to do except sell it to the lessee for $625—whereupon the consumer had exercised an "option to become the owner" even though the contract failed to provide it to him.

This was exactly the view of the court deciding *In re Brothers Coach*

16. UCSA, *Commissioners' Note* at 3. *Cf.* RESTATEMENT OF CONTRACTS §24 (1932) which provides in part: "An offer is also a contract, commonly called an option, if the requisites of a formal or an informal contract exist. . ."
17. 9 UCC REP. SERV. 502 (E.D.N.Y. 1971).

Corp.,[17] a bankruptcy case involving computer equipment. While the numbers were somewhat larger than those in the auto cases, the substance of the agreement was strikingly similar. The "lease" not only failed to mention an option to purchase, but expressly denied that any such option existed. Nevertheless, the bankruptcy referee and the district judge saw that the user was liable to pay the full value of the equipment in any case, and they treated that factor as dispositive. The district judge said:

> In this case the only one interested and the only one affected by the disposition of the equity in the computer under the terms of the agreement is the "Lessee." As a practical matter, the "Lessee" could, if it so desired, obtain title as against the rest of the world. The bidding of the "Lessee" would be nothing more than a bookkeeping item.[18]

Thus the court was satisfied that the "lease" ought to be treated as a security interest. A number of other recent cases are in accord.[19] To find an invisible option to purchase when a lessee pays full value is the correct view of the situation; any other would permit the creditor to get around the statute by the simple strategem of leaving the "option to purchase" off the face of the agreement while permitting it in fact.[20]

The UCSA thus provides an adequate, but hardly inspiring, approach to the sale-lease distinction. To its credit, its net effect is to view a "lessee as a "buyer" when he is required to bear the downside risk. Regrettably, things have gone downhill from there. It seems as though each successive legislative innovation has served only to complicate the issue. The next important line of development begins with the Uniform Commercial Code, which provides a comprehensive scheme of chattel security law that replaces (among other things) the UCSA.

B. *The Sale-Lease Distinction in the UCC*

The sponsors of the UCSA were concerned that a "conditional sale"

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18. *Id.* at 505.

19. *See, e.g., In re* Walter W. Willis, Inc., 313 F. Supp. 1274 (N.D. Ohio 1970), *aff'd* 440 F. 2d 995 (6th Cir. 1971); *In re* Polaris Industries, Inc., 14 UCC REP. SERV. 182 (E.D. Tenn. 1973); *cf. In re* Industro Transistor Corp., 14 UCC REP. SERV. 522 (E.D.N.Y. 1973). A federal judge in Seattle, Wash., reportedly has held that a national bank may engage in open-end leasing without violating the National Banking Act. This is so, he said, because the open-end lease is merely a variation in the traditional manner of extending credit and is the functional equivalent of a loan. *See* M & M Leasing Corp. v. Seattle-First National Bank, 43 U.S.L.W. 2419 (1975). See the discussion of *Thomas v. Wright* at text accompanying note 38 *infra*, and *Sawyer v. Pioneer Leasing Corp.* at text accompanying note 121 *infra*. The court deciding *In re* Financial Computer Systems, Inc., 474 F.2d 1258 (9th Cir. 1973), held that to permit evidence of an option to purchase would violate the Statute of Frauds. But the Statute of Frauds only bars evidence when one is seeking to enforce an agreement; in this case, we are not trying to enforce it, we are merely trying to determine its real purpose. *See* UNIFORM COMMERCIAL CODE §2-202 [hereinafter cited as UCC].

20. *See* UNIFORM COMMERCIAL CODE §9-203, Comment 4.

might escape the provisions of their Act by looking like a lease. The Uniform Commercial Code (hereinafter referred to as UCC) addresses a similar problem in the regulation of transactions involving "security interests." So we ask: when will a "lease" be regarded as a "security interest" for purposes of bringing the transaction within the scope of the UCC? The Code's answer is as follows:

> Unless a lease . . . 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 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.[21]

There are probably a number of significant changes from the old UCSA here, but for the moment, one is noteworthy. That is, as Professor Coogan has recently pointed out, the old downside risk test that was built into the UCSA seems somehow to have disappeared.[22] Professor Coogan argues that the omission was an oversight, and that the old test can be read into the new statute anyway. In any event, he leaves no doubt that he feels it *should* be there.[23]

It is true that the UCC definition will include most downside risk leases. Leases in which options to purchase may be exercised without substantial additional consideration are generally those in which the lessee has already paid the substantial value of the chattel in the form of lease payments. When the lessee is obligated to make such payments he is indeed bearing the downside risk. But, the fact that the UCC definition includes such lease does not mean that it was directed at their inclusion. In fact, the definition appears to be pointed at the symmetrical opposite of the downside risk lease.

Consider, for example, a lease which provides that the lessee may pay an amount equal to the value of the chattel and which further provides that he may exercise an option to purchase with no additional consideration. So far this looks very much like our downside risk lease. But now let's add a variation: an additional term that at anytime during the period of the lease, the lessee may terminate the agreement without liability.

21. UNIFORM COMMERCIAL CODE §1-201(37), *adopted without change as* CAL. COMM. CODE §1201(37).
22. Coogan, *Leases of Equipment and Some Other Unconventional Security Devices: An Analysis of UCC Section 1-201(37) and Article 9*, 1973 DUKE L.J. 908, 936-41.
23. *Id.* at 941-42.

Now the lessee does *not* bear the downside risk. Moreover, he would not be within the protections of the UCSA, since he is not obligated to pay the full value of the chattel. But the lease is still within the UCC definition of "security interest." Thus, the focus of the UCC definition is not on the downside risk, but on the "upside risk." The lessee under our lease can exercise his option to capture the gain from appreciation, and terminate the lease to avoid loss.

Why, we might ask, did the drafters of the UCC choose to adopt such a definition? Perhaps there was good reason for it. After all, a major premise of this article is that different problems require different solutions, and it may be that the security interest provisions of the Commercial Code are sufficiently unique to justify this anomalous definition. Values may go up—indeed there is reason to believe that values have recently gone up in some cases (of all places) in auto leasing.[24] But the stark, staring fact is that over the whole universe of conditional sales cases, the downside risk is the general rule. Indeed, the Commercial Code seems to have focused our attention on the wrong issue. Thus, we are compelled to concur with the suggestion of Professor Coogan, that the sale-lease distinction is insufficiently understood. The absence of an express downside risk test in the UCC has enhanced misunderstanding.

The Code definition remains on the books and thus retains continuing relevance to the issues under scrutiny here, as will be discussed. But it is not the only currently relevant definition. Still another statutory definition developed in the 1960's, and is now embodied in substantially similar language in the Truth-in-Lending Act,[25] the proposed Uniform Consumer Credit code,[26] and in California's motor vehicle installment sales act, the Rees-Levering Act.[27]

C. *The Sale-Lease Distinction in California's Law Governing Automobile Transactions*

California now has two distinct acts governing automobile transactions: the Rees-Levering Act[28] (hereinafter referred to as RLA) and the Moscone Automobile Leasing Act[29] (hereinafter referred to as Moscone Act). The RLA is the older of the two. Originally it provided protections for individuals who purchased automobiles and, after judicial inter-

24. This is true (if it is true) because a great deal of leasing takes place in high-priced foreign cars, where second hand values have been very strong.
25. 15 U.S.C. §1601 *et seq.*
26. UNIFORM CONSUMER CREDIT CODE (Final Draft, 1974) [hereinafter cited as UCCC].
27. CAL. CIV. CODE §2981 *et seq.*
28. CAL. CIV. CODE §2981 *et seq.*
29. CAL. CIV. CODE §2985.7 *et seq.*

pretation, for individuals who had leased automobiles under open-end leasing arrangements. Subsequently, the RLA was amended to exclude this latter group of individuals from its protective scope, and the Moscone Act was enacted to provide them with somewhat less protection. Let us look at the sale-lease distinction in the context of these two acts.

We may begin with the RLA incarnation of the downside risk test, originally designed to bring certain automobile leases within the scope of the Act. The RLA provided (and, though rendered ineffective by amendment, still provides) that

> Conditional sale contract means . . . any contract for the bailment or leasing of a motor vehicle between a buyer and a seller, with or without accessories, by which the bailee or lessee agrees to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the vehicle and its accessories, if any, at the time the contract is executed, and by which it is agreed that the bailee or lessee will become, or for no other or for a nominal consideration has the option of becoming, the owner of the vehicle upon full compliance with the terms of the contract . . . .[30]

What we have then is "substantial value" *and* "option to purchase" (both from the UCSA) *and* "nominal consideration" (from the UCC). Note that the "nominal consideration" standard is no longer disjunctive as it was in the UCC; it is part of a three-legged stool. This suggests all sorts of questions. Did the draftsmen think the old conditional sales standard was inadequate? Why? Did they think the Uniform Commercial Code was inadequate? Why? Did they fail to preceive that they were making any change? Could it be that there is, in fact, no real change of substance at all?[31]

Our own question can be narrower. We can ask: Will this statute apply to the open-end lease? Careful analysis suggests that the answer is yes. Our lease certainly meets the "substantial value" test. It meets the "option" test as well. The only issue is: what about the "nominal consideration" standard? It appears that the answer is yes here, too. The points need explaining.

I have already remarked that the problem in open-end leases is that there is a risk of enormous end-of-term payments. But the statute talks

30. CAL. CIV. CODE §22981(a)(2); *cf.* 15 U.S.C. §1602(9); UCCC §1.301(35).

31. There is at least one situation in which the change may be important, although it is not directly relevant for our purposes. That is: what if the buyer has the *obligation* to pay a sum substantially equal to the aggregate value, and the *option* to purchase for more than a nominal consideration? Reading the present definition strictly, apparently this deal cannot be regarded as a sale. I have never seen a contract in this form, and one may well wonder why any customer would sign such a contract. But experience suggests that consumers will sign a lot of strange documents if they are clothed in enough elaborate jiggery-pokery.

about "nominal consideration." How can a big payment be "nominal"? The answer is that it can't—but we are looking at the statute wrong. The point is that the enormous payment is part of the downside risk. Thus, we have already disposed of that payment before we ever get to the nominal consideration clause—and the problem evaporates in our fingers. That ought to be dispositive of the issue, but there is a catch.

The catch is that the analysis has not prevailed. The Federal Reserve Board has implicitly rejected the analysis as it would apply to the Truth-in-Lending Act.[32] Likewise, the sponsers of the Uniform Consumer Credit Code have indicated their view that separate legislation should be enacted for consumer leases.[33] We shall deal with these positions more fully below. For now it is more important to note that the California Legislature has chosen to treat automobile sales differently than their functional equivalent, the downside risk lease. Let's see how this happened.

In the late 1950's and early 1960's, the business of open-end leasing began to boom. Presumably this leasing boom was fueled at the outset by the allure of leases as a financing device for business purchases, where there are tax and accounting factors that appear to make it attractive to dealer and business customer alike.[34] But as time passed, the use of open-end lease began to spill over into the consumer marketplace as well. Not surprisingly, the expansion into the consumer market quickly provoked the assertion that the consumer needed protection against the dealer through the law.[35]

Protection was forthcoming, but in a curious form. The legislature responded, not by making it clear that a lease ought to be treated like a sale, but by passing a wholly separate consumer statute, the Moscone Automobile Leasing Act of 1969, which purports the deal separately with the leasing question.[36] It defines a "leasing contract" as: "any con-

32. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, TRUTH-IN-LENDING, ANNUAL REPORT TO CONGRESS FOR THE YEAR 1974, *in* CCH INSTALLMENT CREDIT GUIDE 14-16 (No. 326, pt. II, Jan. 15, 1975); BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, TRUTH-IN-LENDING, ANNUAL REPORT TO CONGRESS FOR THE YEAR 1973, *in* CCH INSTALLMENT CREDIT GUIDE 14-15 (No. 271, pt. II, Jan. 16, 1974). Although there may be a real need for disclosures on these leases, most of them are not "credit sales" under section 103(g) of the Act, FRB Letter, Sept. 12, 1973 [1969-1974 Transfer Binder] CCH CONSUMER CREDIT GUIDE ¶ 31,029 (1973). A lease without an option to purchase is not covered by section 103(g). FRB Letter, Apr. 18, 1974, CCH CONSUMER CREDIT GUIDE ¶ 31,105 (1974). But cf. R. JOHNSON, R. JORDAN & W. WARREN, ATTORNEY'S GUIDE TO TRUTH IN LENDING §1.4.

33. See UCCC §§1.301(14), 3.202, 3.401. *See* notes 129-150 *infra*.

34. For some notes on the tax factors, see text accompanying note 75 *infra*.

35. *See generally* Comment, *Automobile Leasing: A subject for Legislative Consideration*, 13 U.C.L.A. L. REV. 138 (1965). The comment is a useful summary of the situation up to its time, but the author takes the position, for reasons I do not find convincing, that a lease requires separate stautory treatment.

36. CAL. CIV. CODE §§2985.7-2985.93. For another adverse review of the Mos-

tract for the bailment or leasing for a term exceeding four months of a motor vehicle by which it is agreed that the bailee or lessee bear the risk of the motor vehicle's depreciation."[37] Clearly the Act is aimed at our downside risk lease. But why was the Act necessary if the RLA already provided protection for lessees in such transactions? Or did the RLA in fact provide such protection?

Consider the story of Mrs. Jean W. Thomas, a grocery clerk, who acquired an auto from her local Ford dealer under an "Automobile Leasing Contract."[38] Mrs. Thomas signed her agreement before the Moscone Act went into effect, but the case was not decided until afterwards—the importance of this fact will be made clear shortly. It provided that she would pay a "total lease price" of $3,856.32, comprised of $300 down payment and 48 monthly installments. The contract provided that "for purposes of this lease," the "cash value" would be $2,-325.80. The difference of $1,530.52 is referred to as the "rental markup." Within a year she fell behind in her payments. The finance company repossessed and sought to recover $1,850.77.

The finance company computed this balance due in the following way: first, it charged her the *entire* rental markup of $1,530.52, even though she had kept the car for only a fraction of the 48-month period. Then it added a sum of $955.32, which is said to include both the cost of refurbishing the car, and the "depreciation," figured by subtracting its value at repossession from the so called "cash value" of $2,324.80 at the time of the lease. The sum of $955.32 plus the $1,530.52 added up to a total of $2,485.84 which meant that Mrs. Thomas would be paying something in excess of $200 per month for her use of a 1965 Ford. The company did deduct the $635.07 that she had already paid before it sued for this deficiency.

Not having the whole contract available, it is difficult to determine exactly what sort of provisions were in Mrs. Thomas' lease contract that would not have been permitted in a sale contract under the RLA. But several disparities are evident. For one, if the "rental markup" had been treated (as it should have been) as a charge for the use of money, then it clearly would have exceeded the statutory limit on such charges.[39] More-

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cone Act, including some useful lore about the leasing industry itself, see Comment, *Automobile Leasing—Is the Moscone Act Really Protecting the Consumer*, 14 SANTA CLARA LAWYER 612 (1974).

37. CAL. CIV. CODE §2985.7(b).

38. All the facts are taken from the opinion in Thomas v. Wright, 21 Cal. App. 3rd 921, 98 Cal. Rptr. 874 (1971).

39. The finance charge for an RLA transaction is limited to no more than one percent of the unpaid balance times the number of months in the transaction—in this case, $2,025.80 x 1% x 48 or $972.38. *See* CAL. CIV. CODE §2982(c). That is an effective annual percentage rate of 20.75 percent. *See* COMMERCE CLEARING HOUSE,

over under the RLA, the dealer would not have been permitted to collect the entire charge; he would have been required to forgive at least a portion of it.[40] And there is one more point. As additional security for the original deal, the seller took a deed of trust in Mrs. Thomas' home—expressly prohibited in automobile sales contracts.[41]

Mrs. Thomas went to court to keep her home. She argued that the transaction was in fact a sale and that the trust deed was thus unlawful. She lost in the trial court, but won on appeal.[42]

Mrs. Thomas struck her deal before the Moscone Act was on the books, but the Court of Appeals did not settle the case until after that event. Thus the decision provoked a quick response—one of those legislative-judicial pirouettes that have become increasingly common in a way that throws a bone to the consumers and a chicken to the leasing industry. First, the legislature expressly prohibited the taking of a deed of trust in connection with a lease transaction.[43] So far, so good: This was clearly the abuse that offended the court the most. But then it addressed itself to the "depreciation" clause, expressly validated the use of the open-end lease, and expressly excluded it from the coverage of the Rees-Levering Act. The crucial new section of the RLA provides:

> A contract for the bailment or leasing of a motor vehicle, with or without accessories, which establishes the maximum for which a bailee or lessee could be held liable at the end of the lease or bailment period, or upon an earlier termination, by reference to the value of the vehicle at such time, is not a contract by which the bailee or lessee will become or for no other or for a nominal con-

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TRUTH-IN-LENDING, REGULATION Z, ANNUAL PERCENTAGE RATE TABLES (1969). The rental markup here thus exceeds the permissible finance charge by $558.14. Stated in annual percentage rate terms, the "rental markup" would be 31 percent.

40. CAL. CIV. CODE §2982(d).

41. CAL. CIV. CODE §2984.2.

42. There is one other California lease/sale case which, while it does not alter the direction of the argument here, cries out to be retold. The case is People v. One 1955 Buick 2-Door Coupe, 187 Cal. App. 2d 684, 10 Cal. Rptr. 79 (1969). The state had taken the car here, on grounds that it was used to transport marijuana, under a forfeiture statute. At the time of the forfeiture, the car had been in the possession of a lessee. The lessor sought to reclaim it from the state. A statute permitted lienholders to repossess, but not lessors. Hence the lessor found himself in court arguing that the document he himself called a "lease" was in fact a conditional sale. He lost. The court's opinion relied almost exclusively on the document.

What adds spice to the story is that the lessor in the 1955 Buick case evidently was the same person (in different entrepreneurial dress) as the lessor in *Thomas v. Wright*. *See* Plaintiff's Brief on Appeal at 6, People v. One 1955 Buick 2-Door Coupe, 187 Cal. App. 2d 684, 10 Cal. Rptr. 79 (1969). Not surprisingly, the statute was later amended to provide that lessors, like lienholders, might reclaim from forfeiture; see CAL. STATS. 1965, c. 411, §1, at 1726, *repealed by* CAL. STATS. 1967, c. 280, §1, at 1437 as part of a general repealer of the forfeiture provisions. For another unsuccessful effort to avoid the consumer protection statutes, see Brewer v. Home Owners Auto Finance Co., 10 Cal. App. 3d 337, 89 Cal. Rptr. 231 (1970).

43. CAL. CIV. CODE §2985.81, *as enacted*, CAL. STATS. 1973, c. 696, §3, at 1264.

> sideration has the option of becoming the owner of the vehicle for purpose of [the Rees-Levering Act].[44]

This is curious language, indeed. Recall that there were two parts to the old UCSA definition; both carried over to the RLA when it was adopted, to wit: (1) risk of decline in value; and (2) option to acquire title. The legislature has not materially tampered with either of these old tests, but it has added a new one. Reading the old and the new together, it is only stretching things a little to paraphrase the RLA definitions as follows: "A lease will be treated as a sale where the consumer has the risk of decline in value; *except that* a lease will not be treated as a sale where the consumer has the risk of decline in value." The legislature went on to add one of those self-serving slices of "legislative history" designed to "interpret" the statute. It said that the new sections

> are declaratory of existing law and are intended to clarify and restate existing law in light of uncertainty in the law as evidenced by Thomas v. Wright . . . which may be construed to affect the validity of automobile leasing contracts executed in good faith compliance with statutes enacted subsequent to the transaction giving rise to that litigation.[45]

Well, well. Whether the sections are in fact declaratory of existing law prior to *Thomas* seems open to question, but presumably they are existing law now.[46] The California Legislature has expressly rejected the history and the logic of equating the open-end (downside risk) lease with a sale. This leaves us in the anomalous position of having one set of statutory regulations for sales and one for the (functionally identical) downside risk lease.

Up to now, I have examined situations in which the law seeks to draw distinctions between "sale" and "lease." I have sought to show that these distinctions are frequently inadequate, or wrong. But there are other areas where the distinction may be relevant, yet where authoritative sources of doctrine are silent on how to draw the distinction. One such area is the issue of liability for dangerous or defective products. Will the "lessee" have the same rights with respect to these deficiencies as a "buyer"? Another such area is the issue of the applicability of usury limitations. Will the "lessor" be under the same sort of constraints as the "seller"? In each case, I think the answer is yes; or at least that a court should so hold. But the area is ambiguous, to say the least. The existence of the

44. CAL. CIV. CODE §2981.5, *as enacted*, CAL. STATS. 1973 c. 696, §2, at 1264.
45. CAL. STATS. 1973, c. 696, §4, at 1265.
46. But perhaps not. I have talked to one attorney who says he is prepared to challenge a lease contract with the contention that the 1973 amendments are invalid since they are not "declaratory of existing law." Stranger arguments have prevailed.

Moscone Act serves at once to suggest that there is much popular confusion on the issue, and at the same time to perpetuate that confusion. Facts like these suggest it is worthwhile to discuss how "lease" transactions ought to be handled in these other areas, as well. This will be done presently.

For now, let us consider the direct result of the California Legislature's decision to treat the automobile buyer and the lessee under a downside risk lease as deserving of different degrees of protection; let us compare the substantive protections of the RLA to those of the Moscone Act.

The Rees-Levering Act and the Moscone Act

California, like many other states, has long provided special legislation that is calculated to deal with the abuses supposed to arise in the course of consumer installment sales transactions. For automobiles, the basic statute is the Rees-Levering Act already referred to.[47] The RLA includes substantive provisions that deal with finance charges, third party defenses, creditor's remedies, and other issues. The Moscone Automobile Leasing Act[48] deals with a situation which, I have contended, is the functional twin of the Rees-Levering Act sale. But it accords almost none of the protections. It is not my immediate purpose to argue that the protections for buyers are desirable or that they are not. My point now is only that there is no intelligible—or at any rate no creditable—basis for the distinction. One aspect of the problem—the issue of limitations on finance charges—is dealt with later in this article. Another, the matter of repossession and resale, is also dealt with later. For the present, I propose to undertake two tasks. First, I will itemize a number of areas where the RLA buyer gets protections that the Moscone Act lessee simply does not have. Then I will seek to show that the Moscone Act lessee gets no compensating advantages for what he gives up.

A. Third-Party Defenses

Suppose the following facts: Sam's Volcano Agency sells a New Blue Volcano to Ben on credit, Ben agreeing to pay the price in 48 monthly installments. Sam assigns his right of payment over to the Third-Party Bank. The car fails to live up to some fundamental warranty of

47. CAL. CIV. CODE §§2981-2984.4. Transactions involving consumer goods other than autos are governed by a separate California statute, the Unruh Act, CAL. CIV. CODE §1801 *et seq.*

48. CAL. CIV. CODE §§2985.7-2985.93. For another comparison of the Moscone Act and the RLA see Comment, *Automobile Leasing: Is the Moscone Act Really Protecting the Consumer?*, 14 SANTA CLARA LAWYER 612 (1974).

merchantability, express or implied, and this default is sufficient to give Ben a right of action against Sam. The aggrieved Ben quits making payments and Third-Party Bank brings an action against him. Ben responds: "Because of Sam's breach of warranty, I am not obliged to pay Sam. You stand in the shoes of Sam. Therefore, I am not obliged to pay you."

Here is one of the most dramatic differences between a buyer and a lessee. If Ben is a buyer under the Rees-Levering Act, his answer is probably sufficient to defeat Third-Party Bank's claim. If Ben is a lessee under the Moscone Act, it probably is not. Specifically, the RLA provides:

> An assignee of the seller's rights is subject to all equities and defenses of the buyer against the seller existing in favor of the buyer at the time of the assignment.[49]

It also provides:

> No conditional sale contract shall contain any provision by which:
> (a) The buyer agrees not to assert against the seller a claim or defense arising out of the sale or agrees not to assert against an assignee such claim or defense.[50]

There is no such language in the Moscone Act. This matter of third-party freedom from defenses is one of the most persistent issues in the folklore of consumer rights and remedies. Indeed, in California it has been the subject of a tug-of-war that goes back over 50 years.[51] To restore third-party freedom now by the "lease" route would surely require some justification—which, to my knowledge, has not been presented.

There is a further issue of third-party liability. Suppose the dealer,

49. CAL. CIV. CODE §2983.5.
50. CAL. CIV. CODE §2983.7.
51. American National Bank of San Francisco v. A.G. Sommerville, Inc., 191 Cal. 364, 216 P. 372 (1923); *see also* Vasquez v. Superior Court of San Joaquin County, 4 Cal. 3d 800, 484 P.2d 964, 94 Cal. Rptr. 796 (1971); Commercial Credit Corp. v. Orange County Machine Works, 34 Cal. 2d 766, 214 P.2d 819 (1950). There is one section of the Commercial Code which gives the lessee a thread of hope. This is section 9206, dealing with cutoff clauses in contracts. The clause permits cutoff clauses, subject to certain limitations. By its terms, it applies to buyers and lessees alike. Official Comment Number 1 remarks that the section applies to a lease "whether or not the lease is intended as security." This permission is made "[s]ubject to any statute which establishes a different rule for buyers or lessees of consumer goods . . . ." Of course, currently, no statute provides a different rule for lessees of consumer goods. But the section has been amended, effective January 1, 1976, to provide that it is "[s]ubject to any statute *or decision* which establishes a different rule for buyers or lessees of consumer goods . . . ." CAL. STATS. 1974, c. 997, §19. This amendment brings the California text of this section into conformity with the Official Text of the Uniform Commercial Code. As to why the clause was left out in the first place see SENATE FACT FINDING COMMITTEE ON JUDICIARY, SIXTH PROGRESS REPORT TO THE LEGISLATURE, THE UNIFORM COMMERCIAL CODE 398, 561, 643, 648 (pt. I, 1959-61). The section might be regarded as an invitation to a judge to treat cutoff clauses in sale contracts and lease clauses alike. The code seems clearly to espouse such a policy. But surely such an attenuated argument is hardly the protection the lessee deserves.

rather than breaching a warranty, fails to conform to some provision of the RLA, or of the Moscone Act. Suppose the dealer then assigns his right to a third party who acquires it without knowledge of the violation. Is the assignee subject to the sanctions that the consumer might be able to impose on the dealer? Under the leasing act, the short answer is "no."[52] The assignee is exempted from this liability. Under the sales act, the short answer is "yes."[53] The assignee does have an opportunity to correct the violations; but if he fails to do so, the buyer is excused from payment of the unpaid finance charge. That is not as much of a penalty as is imposed on the seller, but it is more than is imposed on an assignee under a lease.

B. Confessions of Judgment

Normally, if someone owes me money under a contract and denies liability, I have to take him to court and get an independent third-party arbiter to decide which of us is right and whether he has to pay. But let us suppose I can get my promisor to sign a piece of paper which contains the following language:

> The promisor agrees that if at any time the promisee determines that the promisor has not kept his promise, then the promisor agrees that the promisee may enter judgment against the promisor in any court of law.

This is surely one of the handiest weapons that a promisee might hope to possess. It allows the promisee at his discretion to get a conclusive judgment without so much as a courtesy call to the promisor. Any remedy that so completely ousts the judiciary from its function is bound to meet with a negative reception from the legal system, and this one has.[54] California by statute expressly permits a modified form of confession,[55] but it is subject to a judicial gloss that removes some of its fangs.[56] The

52. CAL. CIV. CODE §2985.9.
53. CAL. CIV. CODE §2983.1.
54. *See generally* B. CLARK & J. FONSECA, HANDLING CONSUMER CREDIT CASES, § 27, at 110-13.
55. CAL. CODE CIV. PROC. §§1132-1135.
56. Restrictive readings on the confession of judgment statute may be found in Barnes v. Hilton, 118 Cal. App. 2d 108, 257 P.2d 98 (1953), General Motors Acceptance Corp. v. Codiga, 62 Cal. App. 117, 216 P. 383 (1923). Evidence that confessions are still in use (or abuse) in California is evidenced by the following statement:

> The Bureau has undertaken investigation of confession of judgment practices by collection agencies in several municipal court districts . . . . Among the abuses that have been documented by the Bureau are: improper collection charges; improper escalation of contracts; improper interest charges; contract provisions prohibited by Rees-Levering and Unruh Act refinancing provisions; improper attorney fees; absence of supporting documents with filing; improper conformance to the requirements of CCP 1132-1135; inducing debtor to sign confession without full knowledge of its contents; and practice of law by collection agency personnel.

Federal Courts, in a somewhat ambiguous series of decisions, have at least limited, although they have not outlawed, the use of confessions clauses.[57] The RLA auto buyer has one additional protection. The RLA expressly prohibits the use of confessions in auto sales contracts.[58] There is no such provision favoring the lessee.

C. Consumer Remedies

There are differences between the RLA and Moscone Act in the realm of consumer remedies, as well. The consumer has no remedy under either act for "accidental or bona fide errors in computation."[59] Moreover both acts provide the merchant opportunities to correct his violations.[60] For uncorrected, non-trivial errors, the basic remedy under each act is the same: rescission.[61] The consumer gets to turn back the automobile, and receive back the money he had paid for it.

As indicated above, the buyer may also be excused from paying finance charges to an assignee in somē cases, while the lessee is never so excused.[62] Finally, willful violation of the RLA is a misdemeanor.[63] This may not be a very meaningful remedy, given the difficulties of proving "willfulness" and the historic unwillingness of prosecutors to bring cases of this sort, but it might conceivably have some deterrent effect. There is no such provision in the leasing act.

D. Disclosure of Contract Terms

A realm in which the two statutes deserve special scrutiny has to do with disclosure of contract terms. Many disclosures are, of course, mandated by the Federal Truth-in-Lending Act; the applicability of this act is discussed later in this article. Certain disclosures are also required by the RLA, and the two acts bear at least a superficial resemblance to one another. But nevertheless, the idea that the Monscone disclosure provisions give any significant protection appears, on examination, to be an illusion.

The basic disclosure provisions of each act purport to give the consumer a minimal understanding of the financial obligations of the contract. Thus, the RLA requires a statement of the cash price (plus any

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California Department of Consumer Affairs, Bureau of Collection and Investigation Services, Information Bulletin No. 20 (Dec. 1972).

57. Swarb v. Lennox, 405 U.S. 191 (1972); D. H. Overmyer Co., Inc. v. Frick Co., 405 U.S. 174 (1972).

58. Cal. Civ. Code §2983.7.

59. *See* Cal. Civ. Code §§2983, 985.9.

60. *See* Cal. Civ. Code §§2984, 2985.91.

61. Cal. Civ. Code §§2983, 2985.9.

62. *See* text accompanying notes 49-53 *supra*.

63. Cal. Civ. Code §2983.6.

fees and insurance charges), the down payment, the unpaid balance, the finance charge, and the total of payments.[64] The Moscone Act, by comparison, requires disclosure of the value of the motor vehicle, the amount of periodic payments to be credited to the lessee in the establishment of any end-of-term liability, the total amount not to be so credited, and the maximum for which the lessee could be liable at the end of the lease term.[65]

Setting these two provisions alongside one another raises a number of problems. For example, there is the threshold question of whether any disclosure *at all* really enlightens the consumer; or whether, by contrast, the sheer barrage of information only adds to his confusion. But assuming he can understand these terms, what are we to make of them? "Value" is defined in the Moscone Act as "the value placed on the vehicle which value is to be used as an element in the establishment of any liability of the lessee or bailee at the end of the lease."[66] Who sets this "value" that is the linchpin of final judgment? What is to prevent the dealer from picking a figure out of the upper air? Who decides how to prorate payments? More directly, why not simply call these "cash price," "amount financed," and "finance charge"—since that, in practice, is what they are?

Perhaps even more important than what the Moscone Act contains is what it lacks. Nowhere in the Moscone Act is there a section that would require every contract to declare: "NOTICE TO LESSEE: While this contract is in form a lease, you in fact bear the risks of a buyer, without the protection."

Lacking such protections, the consumer simply is not likely to know what he most needs to know. What is particularly ironic about this is that in the RLA itself—where, by hypothesis, the buyer ought to have some inkling of his potential liability—the legislature has deemed it necessary to include just such a provision, not once, but twice. Thus, the RLA requires every contract to contain a statement which provides: "If you default in the performance of your obligations under this agreement, the vehicle may be repossessed and you may be subject to suit and liability for the unpaid indebtedness evidenced by this agreement."[67]

Moreover, once the RLA buyer defaults, he gets a second notice, which provides: "Notice: You are subject to suit and liability if the

64. CAL. CIV. CODE §2982(a).
65. CAL. CIV. CODE §2985.8.
66. CAL. CIV. CODE §2985.7(c).
67. CAL. CIV. CODE §2982(a)(10).

amount obtained upon sale of the vehicle is insufficient to pay the contract balance and any other amounts due."[68]

So this is our situation: the buyer, who ought to know he is bearing the downside risk, gets notified twice of that fact. The lessee, who has no such expectation, gets no notice. One can only conclude that the Moscone Automobile Leasing Act is about as near to pure cosmetics as a piece of consumer legislation can be. Or rather, it is worse than cosmetics. By pretending to do something while doing nothing, it creates the illusion that the problem has been dealt with and thus discourages further reform.[69]

E. Other Provisions

There are other cases in which a provision may be present in the RLA and absent from the Moscone Act, but in which the disparity is not so obvious. For example, the RLA has limitations on attorney fees[70] and on venue.[71] No provision is made for these in the Moscone Act, but general statutes on these topics may do the job.[72] Further, several provisions of the RLA deal with down-payments and trade-ins;[73] and it appears that the "lessor" does not normally require a down payment.

Finally, the RLA includes a provision that prohibits so-called "referral sales" agreements.[74] This is a contract whereby the buyer's obligation will be reduced if he refers the customers to the seller. If the consumer

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68. CAL. CIV. CODE §2983.2.

69. There are other disclosure provisions in both acts, but they do not seem to alter the thesis set forth here. One of special interest is the 1974 amendment to the Moscone Act which requires that a "solicitation to enter into a leasing contract" under the act, if it mentions a monthly payment, shall also give substantially the other information that goes into the contract. It would appear that the statute was directed at advertising. At this writing, some dealers are taking the position that a "solicitation" is an "offer" and that an advertisement is not an "offer," so the act does not apply. Aside from the statute, an informal disclosure obligation is imposed under standards set forth jointly by the National Automobile Dealers Association and the Council of Better Business Bureaus, Inc., in their standards for Automobiles and Trucks . . . advertising and selling . . . rental and leasing. (July, 1974). It provides:

> If a rate is advertised and the lessee is, or may be, required to meet any additional financial obligation or expense either during or at the end of the lease period, including without limitation, liability for costs in excess of the price at which a vehicle may be sold, the specific obligations of the lessee shall be set forth in the advertising.

70. CAL. CIV. CODE §2983.4.

71. CAL. CIV. CODE §2984.4.

72. CAL. CIV. CODE §1717 (attorney fees); CAL. CODE CIV. PROC. §395(b) (venue).

73. *See, e.g.*, CAL. CIV. CODE §2982.7. As indicated earlier, each act also contains a prohibition on the taking of security in other property. *See* CAL. CIV. CODE §§2084.2, 2985.81. The Rees-Levering Act also contains a provision calling for a warning notice about insurance coverage, section 2984.1 and a provision limiting the acceleration of payments in the absence of default by purchaser, section 2983.3. Neither of these are included in the Moscone Act.

74. CAL. CIV. CODE §2982.1.

buyer needs this protection, it would seem that the lessee should have it as well. He does not.

F. The Case for Leasing

This analysis surely suggests that the consumer gives up (knowingly or not) a great deal of statutory protection when he chooses to lease, rather than to buy. Is this the end of the story? Or can it be that there are some contervailing advantages that justify this invidious discrimination against the consumer lessee?

Practically speaking, my answer is "no." But a few persistent counter-arguments need to be disposed of to bring this point home.

It is commonly asserted that there are tax factors that might induce parties to characterize their transaction as a "lease" rather than a "sale."[75] For example, particularly in times past, the person acquiring the equipment might have found that he could get more favorable tax treatment by deducting large "rentals" than he could by deducting smaller sums for depreciation on a "purchase."[76] Additionally, there is the investment tax credit.[77] Under the credit provision, the entrepreneur who purchases new equipment which he will offer for lease may deduct a substantial portion of that cost from his tax liability. For any of a number of reasons, the lessee may not have the opportunity; and if the lessor can "sell" part of his credit to the lessee, he may have engineered a transaction in which no one gets hurt but the public treasury.

Leasing also owes part of its growth to a curiosity of accounting lore.[78] With varying degrees of liberality, accountants have long provided that certain kinds of leases are not "debt" and thus do not need to appear as liabilities on the balance sheet. The difficulty with all of these is that they don't fit our case. Practically speaking, any advantages they may have are going to accrue to *business* lessees, but not to *consumers*. The accounting reasons are obviously irrelevant since the consumer household does not run on a balance sheet. The depreciation deduction is a business deduction. The investment tax credit concededly presents a somewhat different problem. It may be that an individual dealer, enjoying an investment tax credit for an auto held for lease to a consumer, will "sell"

75. *See generally* Baskes, *Tax Planning for Lease Transactions*, 1972 U. ILL. L.F. 482; Meyer, *Tax Aspects of Lease Transactions*, 23 TAX. EXEC. 616 (1971).

76. This was generally true under the Internal Revenue Code of 1939, but has not been generally true since the coming of accelerated depreciation under the Internal Revenue Code of 1954.

77. *See* Baskes, *Tax Planning for Lease Transactions*, 1972 U. ILL. L.F. 482, 491-95.

78. *See generally* T. FIFLIS & H. KRIPKE, ACCOUNTING FOR BUSINESS LAWYERS 505-22 (1971); Wyatt, *Accounting for Leases*, 1972 U. ILL. L.F. 497.

some of that advantage to the consumer in the form of lower rentals. But this is sheer speculation. And even if true, the consumer, in order to get this advantage, will have to forego his right to a deduction for interest paid.[79] Thus, it isn't at all clear in the abstract that he would profit from such a tradeoff.

There is one puzzling fact about lease transactions that might be characterized as an advantage. That is, the dealer customarily lets the consumer into a lease transaction for a smaller front-end fee than he imposes in a sale. There may be a small "security deposit," but there is no substantial down payment. It is not clear why this is so. Perhaps it is because it is so much easier to make money at the end of the deal that he can afford to forego the higher front-end charge.

But there is another reason to question whether the benefit of the open-end lease sufficiently offsets the costs of foregoing the legal protection of the RLA. It is this: While it may be that the slight advantages would compensate for what the consumer loses in some cases, there is good reason to doubt that the consumer ever suspects just what he is giving up to get what he gets. Until he knows, he can't possibly say for sure that this is a good deal for him.

There is one final possible benefit to the open-end lease transaction. It seems that some consumers—probably not the ordinarily hapless householders who are the usual victims of consumer fraud, but perhaps the upper-middle-class doctors and executives—get positive satisfaction out of entering into a complicated razzle-dazzle that they don't quite understand. True, the consumer doesn't know all the details; but he knows that leasing is in vogue and that there are some tax and accounting factors in the picture. He can go to the country club and boast airily that his financial advisers told him it was a good idea. There is an increase in psychic wealth. Some people may count this an advantage.[80]

OTHER DISPARITIES

Up to now, the discussion has focused on the disparities between the treatment of the buyer under the RLA and the treatment of the lessee under the Moscone Act. There are several other areas in which the sale-lease distinction may appear unsatisfying. In no one of these is there the

79. INT. REV. CODE OF 1954, §163(a). I suppose it is conceivable there are instances where the lessee, contending that the lease is a *de facto* sale, is taking the interest deduction allowable under INTERNAL REVENUE CODE section 163(b), and is thus getting the best of both worlds.

80. *Cf.* S. LEE, INTRODUCTION TO LEASING 100 (2d rev. ed. 1965): "Dealers should lease if only to hold on to what has always been the dealer's best business, the type of people who now consider it a status-symbol to lease their cars rather than to purchase them."

kind of explicit, invidious exception for lessees that obtains under the Moscone Act. On the other hand, the question of what sort of law to apply to lessees in these other areas remains at best obscure. In all cases, I think a court has the power to, and should, treat the downside risk lessee just like a buyer.

A. Repossession and Division 9 of the Commercial Code

If the buyer of an automobile fails without excuse to keep up his payments, then the seller can repossess the car, resell it, subtract the sale proceeds from the balance due on the contract and sue the consumer for any deficiency. If the lessee fails to keep up his payments, then the lessor repossesses, credits the lessee for the present "value" of the car, and sues the lessee for any deficiency.

So far, the two are in the same position—and this is the chief reason, as contended above, why the long-term lessee ought to be treated as if he were a buyer. But unfortunately, it doesn't end there. As with so many other aspects of the transaction, the relevant statutes would seem to impel a court to give a buyer more favorable treatment than a lessee. In fact, no such conclusion is justified, but the point needs explanation.

The issue was left for separate discussion here, rather than being discussed earlier, because it involves a reading not of two statutes, but of three. Repossession and resale procedure are not governed by the consumer protection statutes alone. The ultimate source of law on these topics is the Commercial Code.[81] With regard to sale transactions, it is supplemented by the RLA.[82] This fact is explicitly recognized by the Commercial Code itself. The provisions of the two dovetail, and sometimes overlap.

With regard to lease transactions, the Moscone Act is silent. Examination of many standard leases currently in use indicates that the draftsmen think they are bound by no law at all. But this is a misconception. The Moscone Act of course explicitly exempts the downside risk lease from the RLA, but it says nothing about the applicability of the Com-

81. The secured transactions provisions are primarily in Division 9 of the California Commercial Code, supplemented by some definitions in Division 1. The California Commercial Code is patterned after the Uniform Commercial Code, subject to some important differences. So far as here relevant, the most important differences would be in section 9504(3), with reference to the right to take a deficiency judgment.

82. California Commercial Code Section 9203(2) provides that a transaction, although subject to that division, is also subject to a number of other specified consumer sales and loan statutes. The list includes the Rees-Levering Act; it does not include the Moscone Act. This might suggest a legislative intent to exclude the transaction from the Commercial Code. A much more likely interpretation is that no one ever saw the problem in the perspective here suggested.

mercial Code. On the other hand, as argued earlier,[83] there is every good reason to assume that the Commercial Code applies to the downside risk lease, just as it would to a sale.

The Commercial Code, as supplemented by the RLA, provides that upon the debtor's default, the creditor has a right to repossess, if he can do so "without breach of the peace . . . ."[84] After repossession, the creditor normally must dispose of the collateral, and such a disposition must be carried out "in a commercially reasonable manner."[85] Normally, no disposition can take place without notice to the debtor.[86] At any time before disposition, the debtor has a right to redeem the collateral.[87] If the creditor is not proceeding in accordance with these standards, he may be enjoined or restrained from further misconduct.[88] If disposition has already taken place, an aggrieved party may recover for "any loss caused by" the creditor's failure to comply.[89]

Moreover, beyond the language of the Commercial Code itself, the courts characteristically impose a very heavy burden upon the creditor to prove[90] and also to plead[91] that he conformed to these standards. Further, a substantial body of authority reads the Code to mean that a creditor who does not conform loses his right to a deficiency judgment.[92] Finally, and perhaps most important, with reference to most of these provisions, the Code declares that the parties may not waive the procedures set forth in the statute.[93]

83. See text accompanying notes 21-23 *supra*.
84. The term has an elaborate pre-code history. *See* Jordan v. Talbott, 55 Cal. 2d 597, 361 P.2d 20, 12 Cal. Rptr. 488 (1961); Devincenzi v. Faulkner, 174 Cal. App. 2d 250, 344 P.2d 322 (1959); People v. Northum, 41 Cal. App. 2d 284, 106 P.2d 433 (1940); People v. Anderson, 117 Cal. App. Supp. 763, 1 P.2d 64 (1931).
85. *See* CAL. COMM. CODE §9504(3). On what constitutes a "commercially reasonable manner," see CONTINUING EDUCATION OF THE BAR, CALIFORNIA COMMERCIAL LAW III §6.29 (1966) (Supp. 1973).
86. CAL. COMM. CODE §9504(3); CAL. CIV. CODE §2983.2. The secured party need not give the debtor a notice if the collateral is perishable, threatens to decline in value, or is of a type customarily sold on a recognized market. The only exemption that would seem to apply to leased cars is the idea of collateral "of a type customarily sold on a recognized market . . . ." CAL. COMM. CODE §9504(3). But what if a particular auto, though "customarily" sold on a recognized market, is in a particular case not so sold? Will the creditor be able to escape the notice requirement in such a case? Amendments effective January 1, 1976, provide that the Commercial Code notice may be waived by the debtor in a statement signed after default. *See* CAL. STATS. 1974, c. 997, § 44 (*effective* Jan. 1, 1976).
87. *See* CAL. COMM. CODE §9506; CAL. CIV. CODE §2983.2.
88. *See* CAL. COMM. CODE §9507(1).
89. *See* CAL. COMM. CODE §9507(1).
90. *See, e.g.*, Barber v. LeRoy, 40 Cal. App. 3d 336, 115 Cal. Rptr. 272 (1974), Credit Bureau Metro, Inc. v. Mims, 45 Cal. App. 3d Supp. 12, 119 Cal. Rptr. 622 (1975).
91. *See, e.g.*, Barber v. LeRoy, 40 Cal. App. 3d 336, 115 Cal. Rptr. 272 (1974); J.T. Jenkins Co. v. Kennedy, 45 Cal. App. 3d 474, 119 Cal. Rptr. 578 (1975).
92. *See* cases cited at notes 90-91 *supra*; *see also* Atlas Thrift Co. v. Horan, 27 Cal. App. 3d 999, 104 Cal. Rptr. 315 (1972).
93. *See* CAL. COMM. CODE §9501. Amendments effective January 1, 1976, permit waiver of the provision of notice of prospective resale in California Commercial Code

In practice, these all turn out to be slender protections at best; there is a good deal of sentiment that the consumer-buyer doesn't get enough protection from the scheme.[94] But at least, he gets some protection. What does the lessee get? In fact, leasing contracts vary; some give the consumer-lessee protection similar to the (minimal) protection enjoyed by the consumer buyer. Some give much less. Perhaps the worst is the form which says that on termination of the lease, the value of the car will be determined by an appraiser *chosen by the lessor.* This permits sheer self-dealing. At least in theory, there is nothing to prevent the appraiser from setting the value of the car at zero and charging the consumer for all the balance due—after which the appraiser and the lessor together sell the car for a sum in excess of zero, and carve up the swag between them. True once again, a court might take a dim view of this transaction if it came to a court's attention—but it isn't inevitable that a court would take such a view, and it isn't likely that the matter would ever come to its attention.

Lessors don't need to be quite as blatant as that. For example, a contract in use in California now provides that on return of the vehicle to the dealer, the dealer shall, as soon as practicable cause same to be sold and shall promptly thereafter render an accounting of such sale to lessee. There is no provision at all for notice to the lessee of the prospective sale and no suggestion of any mechanism whereby the lessee can observe the sale to see if it is bona fide. Indeed, it is doubtful whether the lessee in such a case could ever assure himself that the sale actually took place, other than in the lessor's imagination.

Another contract now in use seems to do a bit more for the lessee, but in fact does not. It provides that on termination the lessor shall endeavor to obtain two offers to buy the vehicle for cash at wholesale, and shall also receive any offer to buy the vehicle for cash made by any person specified by the Lessee within three days after the vehicle is returned. A promise to "endeavor" may not be completely illusory, but it is pretty close. Moreover, the contract specifies that the lessor may accept the

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section 9504(3); but the waiver may be taken only in a writing signed after default. *See* CAL. STATS. 1974, c. 997, §44 (*effective* Jan. 1, 1976). A correlative new California Commercial Code section 9508 provides that no renunciation or modification by the debtor of this waiver right shall be valid or enforceable unless the secured party in exchange relinquishes his right to a deficiency judgment. "Consumer goods" are defined in California Commercial Code Section 9109(1) to include goods "used or bought for use primarily for personal, family, or household purposes." That definition presumably is broad enough to cover a leased auto. But whatever this statute may do to the Commercial Code notice requirement, it does not seem to authorize waiver of the similar requirement in the RLA.

94. *See generally* Clark, *Default, Repossession, Foreclosure, and Deficiency: A Journey to the Underworld and a Proposed Salvation,* 51 ORE. L. REV. 302 (1972).

highest cash bid received or reject all bids. What happens when he chooses to reject all bids isn't even suggested in the contract.

What all these contracts have in common is that they seem to have been drafted on the supposition that the lessor is under no authoritative constraints at all. There are several ways in which a consumer lessee might attack them. Thus, a court, faced with such a one-sided agreement, might impose some constraints on creditor behavior as a matter of common-law adjudication. But surely the most straightforward way of approaching the problem is the one suggested here: simply recognize that the downside risk lease is a secured transaction for purposes of the Commercial Code, and bring it under the Code's protection directly.[95]

B. Rate Disclosure and Regulation

If it is true (as I have argued) that the open-end consumer auto lease ought to be regarded as a sale, then the lease payments ought to be regarded as indistinguishable from the purchase payments. Since the consumer in all our examples is paying for the car in installments, then by analogy, some portion of lease payment must be regarded as a finance charge. If the charge is properly regarded as a finance charge, then the consumer has two more protections which as a "true" lessee, he is not thought to enjoy. First, he has a right to know the finance charge being imposed on him (the "disclosure" obligation). Second, there is a limit to the size of the finance charge that can be imposed (the "regulation"

95. Case law on the points at issue here is scanty at best, but generally contrary to the position set forth in the text. In Executive Car Leasing Co. of New Orleans, Inc. v. Alodex Corp., 279 So. 2d 169 (La. 1973), the Supreme Court of Louisiana resolved a conflict among the lower courts by holding that the lessor did have a right to a deficiency judgment. The decision effectively overrules Clay-Dutton, Inc. v. Coleman, 219 So. 2d 307 (La. App. 1969), which appears to be the only decision denying the deficiency judgment. Louisiana is, of course, the only state in the nation that has not adopted the Uniform Commercial Code. Both *Executive Car Leasing* and *Clay-Dutton* were based on conflicting constructions of a local deficiency judgment statute. *See also* Clay-Dutton, Inc. v. Plantation Nursing Home, Inc., 239 So. 2d 442 (La. App. 1970); Mossy Enterprises, Inc. v. Piggy-Bak Cartage Corp., 177 So. 2d 406 (La. App. 1965). And see Stone Heating & Ventilating Co. v. Anacostia Leasing Corp., 256 A.2d 923 (D.C. App. 1969). In Hertz Drive-Ur-Self Stations v. Schenley Distillers Corp., 119 Cal. App. 2d 754, 260 P.2d 93 (1953), a California court imposed on the lessee a contractual obligation to purchase a leased vehicle at the end of the lease term. But the issue was one of construction of the agreement. The opinion does not suggest that the fundamental propriety of such an obligation was in question. *Accord*, American Fruit Purveyors, Inc. v. Avis Rent-A-Car Systems, Inc., 118 Ga. App. 840, 165 S.E.2d 879 (1968); Universal Leaseway System, Inc. v. Herrud & Co., 366 Mich. 473, 115 N.W.2d 294 (1962). All the cases cited in this note are discussed in an annotation at 43 A.L.R. 3d 1238. In Rosenthal v. Executive Car Leasing Co., 435 S.W.2d 168 (Tex. Civ. App. 1968), the contract provided that the lessor would offer to sell the vehicle to the lessee, but if the lessee failed to accept the offer within 10 days, the lessee would be liable for a deficiency judgment. Failure to give such notice was held to bar a deficiency judgment. *Contra*, Brown v. Leasing Associates, Inc., 453 S.W.2d 863 (Tex. Civ. App. 1970). *See also* Stone Heating & Ventilating Co. v. Anacostia Leasing Corp., 256 A.2d 923 (D.C. App. 1969).

principle). The obligation to *disclose* the size of the finance charge is extended to the consumer by the Federal Consumer Credit Protection Act, commonly called the Truth-in-Lending Act.[96] The *size* of the finance charge in automobile sales is regulated by the RLA, which sets a limit of 21.5 percent per year.[97]

With that as background, the proposition, again, is that a downside risk lessee ought to be treated exactly like a buyer. As a matter of elementary economics, this would seem to be inevitable. But there are two difficulties with it. First, as indicate above, the downside risk lease is expressly exempted from the RLA.[98] Second, the staff of the Federal Reserve Board (which is charged with the responsibility of administering the Truth-in-Lending Act) has consistently taken the position that leases of this sort are not within the scope of the Act.

The *disclosure* problem is ultimately a problem of federal law; the rules governing disclosure of finance charges are in the Federal Truth-in-Lending Act.[99] The Moscone Act may complicate the problem in California by giving extra impetus to leasing as a means of doing business, but the federal act would be there even if the Moscone Act were not. To its credit, the Federal Reserve Board in dealing with truth-in-lending, has recognized that the downside risk lease does present a problem that needs to be dealt with. In its two most recent annual reports to Congress and in its opinion letters, the Board has called attention to the problem of open-end leasing and called for reform.[100] Nevertheless, it would seem that the Federal Reserve Board already has the power to deal with open-end leasing because the definition of "sale" under the Truth-in-Lending Act would seem to be broad enough to include consumer leases within its scope.[101] Unfortunately, the Board does not take this position. The Board has indicated that the Act does not apply if the purchase option is not explicit in the contract,[102] and that it is impossible to

96. 15 U.S.C. §1601 *et seq.*
97. CAL. CIV. CODE §2982(c).
98. See text accompanying note 44 *supra.*
99. 15 U.S.C. §1601 *et seq.*
100. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, TRUTH-IN-LENDING, ANNUAL REPORT TO CONGRESS FOR THE YEAR 1974, *in* CCH INSTALLMENT CREDIT GUIDE 14-16 (No. 326, pt. II, Jan. 15, 1975); BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, TRUTH-IN-LENDING, ANNUAL REPORT TO CONGRESS FOR THE YEAR 1973, *in* CCH INSTALLMENT CREDIT GUIDE 14-15 (no. 271, pt. II, Jan. 16, 1974).
101. See text accompanying notes 25-32 *supra* (where the RLA definition, similar to that of Truth-in-Lending, is discussed).
102. *See* authorities cited at note 100 *supra. See also* FRB Letter, Apr. 18, 1974, 4 CCH CONSUMER CREDIT GUIDE ¶ 31,105 (1974). It has been stated that "A Staff letter may be the visceral reaction of a harassed Staff member who has before him an inquiry containing only the sketchiest description of the transaction, or it may be the result of a lengthy study by several Staff members." Warren & Larmore, *Truth-in-Lending: Problems of Coverage*, 24 STAN. L. REV. 793, 794 n.7. But compare the following:

No provision of this section [civil liability] or section 112 [15 U.S.C. §1611, identify a finance charge component in lease cases.[103] In fact, there is no problem determining the "finance charge" for the typical open-end lease. To the contrary, all the information necessary to compute it already appears on the face of the contract. The dealer is required to put it there, under terms of the Moscone Act itself.[104] Recall that a contract of the sort under discussion here must contain a figure defining the consumer's ultimate liability.[105] And it must contain a breakdown of each monthly payment, showing the amount that will be credited against the lessee's liability, and the amount not to be so credited.[106] If it is thus possible to allocate the payments for purposes of the deal,[107] there would seem to be no difficulty in making the same allocations for purposes of regulation and disclosure as well.

This would seem to be dispositive of the matter. But if more is necessary, it may be helpful to note that the California Supreme Court and other courts have found that it is possible to identify a "finance charge" component from a review of the whole transaction, even when it is hidden from the consumer.[108] Normally, the dealer is selling the consumer's obligation to some third party for collection. Normally, he has to sell for less than the face value of the contract: that is, the third party pays a smaller present sum now for the right to collect the larger sum over time. The disparity between nominal sale price and "discount" price is economically indistinguishable from a finance charge. There is another point. It is not always easy to identify a finance charge in a *sale* transaction. The seller, arguably, may be able to bury some part of his finance

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> criminal liability] imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board, notwithstanding that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

Act of Oct. 28, 1974, Pub. L. No. 93-495, §406, 88 Stat. 1518, *adding* 15 U.S.C. § 1640(f).

103. S.R. REP. No. 392, 90th Cong., 1st Sess. 12 (1967) which states:

> The definition of credit sale is also limited only to those leases which are in essence, disguised sale arrangements. The definition has been so limited because there is no way to disclose a finance charge or rate in connection with a conventional lease . . . .

As the subsequent argument is intended to show, the author must not have been visualizing the kind of lease we are addressing here.

104. *See* CAL. CIV. CODE §2985.8.

105. *See* CAL. CIV. CODE §§2985.7(c), 2985.8(d)-(e).

106. CAL. CIV. CODE §2985.8(b), (c).

107. *Cf.* CAL. CIV. CODE §2981(e)-(h), California Civil Code Section 2982(c) limits the finance charge under the RLA. There are some residual inconsistencies between the approach of the two acts to insurance and costs, and also to allocation of individual payments between amount financed and finance charge, but nothing that any reasonably competent draftsman couldn't fix in moments.

108. Glaire v. La Lanne-Paris Health Spa, Inc., 12 Cal. 3d 915, 117 Cal. Rptr. 541, 528 P.2d 357 (1974). *Accord,* Kriger v. European Health Spa, Inc. of Milwaukee, Wis., 363 F. Supp. 334 (E.D. Wis. 1973); Garza v. Chicago Health Clubs, Inc., 347 F. Supp. 955 (N.D. Ill. 1972); Joseph v. Norman's Health Club, 336 F. Supp. 307 (E.D. Mo. 1971).

charge in the cash price. But this has never been regarded as a sufficient reason not to regulate finance charges in sales transactions.[109] All that has been said about disclosure is relevant to the issue of rate *regulation* as well. If, as shown above, a finance charge can be identified in a lease transaction, there is no reason that a lessee should be given any less protection than a purchaser. The lease ought to be regarded as coming under the relevant regulation law.[110]

There is one other "finance charge" issue that may lend itself to judicial handling, but certainly needs statutory correction otherwise. This has to do with the rebate on early termination. Remember *Thomas v. Wright*,[111] where Mrs. Thomas obligated herself to pay $1,530.52 as "rental markup" in 48 monthly installments. (This "rental markup" is the functional twin of a finance charge.) Mrs. Thomas quit paying before the first year of the contract had expired, and the merchant tried to collect from her the entire 48-month rental markup. As the court correctly observed, if the transaction had been treated as a sale, the dealer would not have been able to collect a finance charge that it had not "earned," and thus it would have had to rebate part of the sum to Mrs. Thomas.

There was no such obligation under the leasing act. Clearly, that was one of the reasons why the court in *Thomas* was so eager to see through the transaction and call it a sale. Unfortunately, that aspect of the statute has never been changed. Meanwhile, the Moscone Act has been changed to assure that it protects precisely the sort of lease at issue in *Thomas v. Wright*. Thus, it may be easier to impose the "unearned finance charge" on the lessee today than it was before *Thomas v. Wright*.

A final, smaller, but still palpable issue with regard to finance charges involves delinquency payments. The RLA provides that the contract may provide for a delinquency charge of no more than five percent of the installment, in the case of payments overdue at least 10 days. It provides that such a charge may be collected only once per installment.[112] There is no regulation of delinquency charges in the Moscone Act.

C. *Consumer Warranties*

A consumer who enters into a transaction to acquire a product is concerned with issues other than the risks of loss on default. Basically, he

109. Never formally, anyway. But it may have something to do with the development of the "time-price doctrine."
110. A recent Alaska case holding a "lease" to be a purchase for the purpose of the usury laws is McGaloiard v. Liberty Leasing Co. of Alaska, Inc., 43 U.S.L.W. 2348 (1975).
111. See text accompanying notes 38-43 *supra*.
112. CAL. CIV. CODE §2982(c).

wants a product. He wants a washing machine that will wash, a TV set that will show a clear picture, an auto that will get him where he wants to go. He doesn't want it to leak, squeak or explode. He doesn't want it to damage him or his family, or put him to any cost or inconvenience. If it does, he wants to have redress against the person who put him in possession. As he seeks redress, the question again arises: does it matter whether the transaction was a "sale" or a "lease"?[113]

At least part of the question seems to have a clear answer. That is: as far as personal injuries are concerned, it appears that in California, a lease will be treated exactly like a sale. In *Price v. Shell Oil Co.*,[114] the court held that an injured workman might recover damages for his personal injuries from a lessor just as he would from a seller. Quoting from an earlier opinion, the court remarked that the lessor, like the seller, "places [an article] on the market, knowing that it is to be used without inspection for defects. . . ."[115] It appears that the lease in *Price* was a "true" lease and not the sort of downside risk lease under scrutiny here. But there is nothing in the opinion to suggest that the court would limit its holding to "true" leases only.[116]

In any event, the story doesn't end with *Price*. *Price* was decided as a matter of strict liability in tort. Not all cases are personal injury cases. The California Supreme Court has held that for cases involving mere "economic loss," tort law will not control.[117] Rather, the basic body of doctrine will be the law of warranty. In California, there are two relevant sources of warranty law. If the transaction is a "sale," the controlling doctrine comes from Division 2 of the Commercial Code, supplemented by the Song-Beverly Consumer Warranty Act.[118] If, by contrast, it is a "lease," then the transaction is governed by a separate section of the Civil Code.[119]

Both of these sources impose basic liabilities on the merchant that appear to be at least roughly analogous with one another. But there is an important difference. The "sale" sources impose restrictions on the merchant's power to *disclaim*—get out of—the liabilities that would other-

113. *See generally* Murray, *Under the Spreading Analogy of Article 2 of the Uniform Commercial Code*, 39 FORDHAM L. REV. 447, 449-51 (1971).
114. 2 Cal. 3d 245, 85 Cal. Rptr. 178, 466 P.2d 722 (1970).
115. *Id.* at 251, 85 Cal. Rptr. at 182, 466 P.2d at 726, *quoting* Greenman v. Yuba Power Products, Inc., 59 Cal. 2d 57, 62, 27 Cal. Rptr. 697, 700, 377 P.2d 897, 900 (1962). *See also* Cintrone v. Hertz Truck Leasing, 45 N.J. 434, 212 A.2d 789 (1969).
116. For an interesting argument in favor of such a limitation, see Comment, *Finance Lessor's Liability For Personal Injuries*, 1974 U. ILL. L.F. 154.
117. Seely v. White Motor Co., 63 Cal. 2d 9, 45 Cal. Rptr. 17, 403 P.2d 145 (1965).
118. CAL. COMM. CODE Div. 2, §2101 *et seq.*; Song-Beverly Consumer Warranty Act, CAL. CIV. CODE §§1790-1790.4.
119. CAL. CIV. CODE §1955.

wise be imposed.[120] These apply to "sales" but not (at least not explicitly) to "leases." So the question becomes: will the warranty provisions of the Commercial Code and the Song-Beverly Act apply to leases as well as to sales?

There is no authority on the point in California, but there are favorable authorities from other states. The leading case is *Sawyer v. Pioneer Leasing Corp.*,[121] where the court held that a downside risk lease was "analogous" to a sale, and that the Code warranty would apply. Other cases are in accord.[122] Supportive as they are, at least one nagging question remains. That is, what did the *Sawyer* court mean when it said that this type of lease is "analogous" to a sale? In what sense was it *not* a sale? For all practical purposes, it seems that the only material distinction between the "lease" in *Sawyer* and a "sale," was that the parties chose to call it a "lease" rather than a "sale." Surely vital principles should not be made to turn on such slender distinctions. The court undoubtedly reach the right conclusion, but it was too tentative in its reasoning.

WHAT IS TO BE DONE?

Up to now, we have said nothing about consumer goods other than autos. It seems to be the case that open-end leasing grew up first in the auto industry. But there is evidence that it is extending to other products as well.[123] The possibilities are inspiring: leased speedboats and golf clubs, then leased color television sets, finally leased encyclopedias, vacuum cleaners and kiddie chairs. Presumably, the definition of "retail installment contractor" in the consumer goods act is substantially the same as the definition of "sale" that was in the RLA at the time of *Thomas v. Wright*.[124] Presumably some lawyers have been advising their clients that *Thomas v. Wright* is good law and would apply (as it certainly should) to golf clubs as it did to autos.

Moreover, California's "cooling-off" statute, which permits the consumer to rescind a contract for goods or services sold door to door, ex-

120. CAL. COMM. CODE §2316; CAL. CIV. CODE §1792.4.
121. 244 Ark. 943, 428 S.W.2d 46 (1968).
122. Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House, 59 Misc. 2d 226, 298 N.Y.S. 2d 392 (1969), *rev'd on other grounds*, 64 Misc. 2d 910, 316 N.Y.S.2d 585 (1970); KLPR TV, Inc. v. Visual Electronics Corp., 327 F. Supp. 315 (D.C. Ark. 1971). *See generally* Shapiro, *The ABC's of Leasing*, 1972 U. ILL. L.F. 433, 441, and Comment, *The Extension of Warranty Protection to Lease Transactions*, 10 B.C. IND. & COM. L. REV. 127 (1968).
123. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, TRUTH-IN-LENDING, ANNUAL REPORT TO CONGRESS FOR THE YEAR 1974, *in* CCH INSTALLMENT CREDIT GUIDE 14-16 (No. 326, pt. II, Jan. 15, 1975); BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, TRUTH-IN-LENDING, ANNUAL REPORT TO CONGRESS FOR THE YEAR 1973, *in* CCH INSTALLMENT CREDIT GUIDE 14-15 (No. 271, pt. II, Jan. 16, 1974).
124. CAL. CIV. CODE §1802.6. This, of course, is essentially the old UCSA language again.

plicitly covers leases as well as sales.[125] Thus while we may be treated to the spectacle of encyclopedia leasing, at least the law does not allow it to be done door to door. The Consumer Legal Remedies Act is similarly broad.[126]

The problem of how to treat a transaction that looks like a lease but acts like a sale has not spread significantly beyond auto leasing. Not yet, anyway. But the potential is there, and it does not appear premature to include all open-end leases in our interrogatory and to ask: what is to be done?

My view should be obvious by now. If someone gives me something that he calls a trombone, but which I recognize as an Airedale, I want to get it a dog license. Similarly, for purposes of consumer protection statutes, I want to treat downside risk leases like sales. I would get rid of the Moscone Act as a snare and a delusion. As a policy proposal, this is bound to provoke howls of anguish, but as a technical matter it isn't difficult at all.

A brief statute to be used as a definition is included at the end of this section, but first it may be useful to discuss an alternative reform proposal, to show its virtues and its defects. This proposal is offered in the proposed Uniform Consumer Credit Code.[127] A closely similar variant has been offered by the Federal Reserve Board as a proposal for amendment to the Truth-in-Lending Act.[128] The proposal has much to recommend it. But ultimately it is flawed. In any event, it merits examination.

The Uniform Consumer Credit Code provides that it will apply where there is a "consumer credit transaction,"[129] defined to include, among other things, "a consumer credit sale"[130] and "a consumer lease."[131] One form of sale is a "sale of goods," which, in language that ought to be familiar by now:

> includes an agreement in the form of a bailment or lease of goods 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

125. CAL. CIV. CODE §§1689-1693.
126. CAL. CIV. CODE §§1750-1784.
127. *See* UCCC §§1.301(14), 3.202, 3.301, 3.401. For another reform proposal see Comment, *Automobile Leasing: Is The Moscone Act Really Protecting The Consumer?*, 14 SANTA CLARA LAWYER 612, 650-58 (1974). The proposal has many constructive aspects. My main quarrel with the Santa Clara proposal is that it seems to take the "sale-lease" transaction at face value, failing to recognize that they have such functional similarity that they can best be treated as identical.
128. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, TRUTH-IN-LENDING, ANNUAL REPORT TO CONGRESS FOR THE YEAR 1974, *in* CCH INSTALLMENT CREDIT GUIDE 19-24 (No. 326, pt. II, Jan. 15, 1975).
129. UCCC §1.301(13).
130. UCCC §1.301(12).
131. UCCC §1.301(14).

> of the goods 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 upon full compliance with the terms of the agreement.[132]

"A Consumer lease" is defined to include:

> a lease of goods: (i) which a lessor engaged in the business of leasing makes to a person, except an organization, who takes under the lease primarily for a personal, family, household or agricultural purpose; (ii) in which the amount payable under the lease does not exceed $25,000; (iii) which is for a term exceeding four months; and (iv) which is not made pursuant to a lender credit card . . .[133]

So far, this is very encouraging stuff. One may note, for example, that the definitions expressly exclude short-term leases, like the airport rental car. That is all to the good. But further, there seems to be a clear intent to do something significant about the lease problem.

And the promise is fulfilled. A number of rules apply alike to sales and leases. These include general limitations on confession of judgment,[134] assignment of earnings,[135] attorney fees,[136] advertising,[137] delinquency charges[138] and deferral charges.[139] Other sections seek to preserve defenses, both against assignees[140] and against third party lenders.[141] Another section restricts the use of referral sales agreements.[142] The leases transaction is also protected by the provisions regulating insurance,[134] and is covered by the sections on administration[144] and remedies.[145]

Most intriguing are two sections that apply to leases alone. The first has to do with disclosure.[146] The disclosure statement requires that the consumer lessee be given notice of a variety of basic terms in his agreement. Among other terms, the consumer must get a "statement of the conditions under which the lessee may terminate the lease before the end of the term; and [a] statement of the liabilities the lease imposes upon the lessee at the end of the term."[147]

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132. UCCC §1.301(35).
133. UCCC §1.301(14).
134. UCCC §3.306.
135. UCCC §3.305.
136. UCCC §2.507.
137. UCCC §3.209.
138. UCCC §2.502.
139. UCCC §2.503.
140. UCCC §§3.303, 3.404; *see also* §3.204.
141. UCCC §3.405.
142. UCCC §3.309.
143. UCCC art. 4.
144. UCCC art. 6.
145. UCCC art. 5.
146. UCCC §3.202.
147. UCCC §3.202(g)-(h).

Plainly, these provisions are aimed at mitigating the "supposed evils" of the open-end lease. But a further look at the Act suggests that there is no need for this protection. This is so because a separate section of the Act provides that the obligation of a lessee upon expiration of a consumer lease may not exceed twice the average payment allocable to a monthly payment under the lease.[148] The comment removes all doubt that the section is directed at the open-end leasing problem, which it summarizes with admirable clarity. Just why the draftsmen felt it was so important to give notice of the end-of-lease liability when they weren't going to allow anything special anyway is hard to perceive.

There are other curiosities about this liability limitation section. One is that the protection given the lessee under this section is much better than the protection given the buyer against the comparable problem of balloon payments.[149] When the sale contract includes a balloon payment, the payment is not void; rather the consumer gets only a right to refinance on terms no less favorable than those of the original transaction. Since, practically speaking, this is probably all the seller ever hoped for anyway, the balloon payment section is equal to nothing at all. But here we have a familiar theme, played backwards. If the limitation on final payments is good for the lessee, why isn't it good for the seller?

Another difficulty with the limitation on the final payments clause may be accidental. But at least it certainly needs correction. And at most, it may be a clue as to how little the draftsmen understood the leasing problem. This provision says that the limitation on final payments in a consumer lease "does not apply to charges for damages to the leased property or for other default."[150] Presumably, if "damage" means the case where the lessee ordinarily would be liable for physical damage to the property, he will still be liable. There seems to be no obvious problem in holding him liable here. But the "default" problem is a different issue. As it stands, the provision would seem to say that if the lessee has paid 36 out of 36 payments, he can be held liable for a sum equal to no more than two or three extra monthly payments; but if he defaults in the 35th month, he can be held for the entire decline in the value of the car. There is no apparent basis for the distinction. It would seem to have the effect of encouraging the dealer to induce or assert default whenever he feels there is the slightest chance to get any significant extra sum out of the consumer. It must be an oversight or a misunderstanding on the part of the draftsmen.

The result, then, is a muddle. The situation is so confused that I can't

148. UCCC §3.401.
149. UCCC §3.308.
150. UCCC §3.401.

even say for sure which statute a dealer would prefer to operate under: there are some advantages in the "sale" section, and some in the "lease" section. But assuming there is some advantage in one section over another, then there is an additional anomaly. It is this: if the dealer feels he is constrained by the disclosure sections of the Uniform Consumer Credit Code, he can simply rename his transaction a "lease" and be rid of them. On the other hand, if he feels limited by the balloon payment provisions of the "lease" he can call it a "sale" and be free of them. The choice is his. There is no "real" sale or "real" lease at the heart of the section. It is all a matter of names. This brings me around again to the basic point I have been contending for throughout this section. That is: there is no need for a special article. The typical open-end lease ought properly to be regarded as within the specific definition of "sale" carried down through the generations from the UCSA.

Obviously, this is not the prevailing view. But it seems that by any measure, the situation is unsatisfactory. Better to try again—and here is a suggested approach. Scuttle the consumer lease provision for time being, until there is some evidence of need for a special statute addressing leases where there is no "downside risk." Settle the balloon payment issue, one way or another. Then broaden the basic coverage of the act. Something like the following ought to do the job:

> "Transaction" for purposes of this act shall include any arrangement, however characterized, whereby a consumer acquires the right to take possession and make use of goods in exchange for a promise to pay a sum substantially equal to or in excess of the aggregate value of the goods involved. The term includes, but is not limited to, an agreement that the consumer for no other or for a nominal consideration has the option to become the owner of the good upon full compliance with its terms.

Undoubtedly this definition has problems, and perhaps it could be put more clearly. Obviously, the use of this definition would require some adjustment to related definitions in particular statutes, as well. But it seems to be a starting point. And it has an additional virtue: it sets the demarcation between "sale" and "lease" without mentioning either term.