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## Division 10 of the California Commercial Code: California Personal Property Lease Law Codified

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# Division 10 of the California Commercial Code: California Personal Property Lease Law Codified

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I. INTRODUCTION

The passage of Senate Bill 1580<sup>1</sup> and Senate Bill 2492,<sup>2</sup> enacting Division 10 of the California Commercial Code (Division 10),<sup>3</sup> and the amending of the Commercial Code's definition of "security interest"<sup>4</sup> represent a major development in California commercial law. Prior to Division 10, there was no single codified body of law governing personal property leases.<sup>5</sup> Personal property leases in California had been described as being governed by "a crazy-quilt amalgamation of principles derived variously from the common law of contracts, analogy to the U.C.C., analogy to real property leasing rules, and miscellaneous statutory provisions."<sup>6</sup>

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1. 1988 Cal. Stat. ch. 1359, at \_\_\_\_.

2. 1988 Cal. Stat. ch. 1368, at \_\_\_\_.

3. CAL. COMM. CODE §§ 10101-10532 (West Supp. 1989).

4. *Id.* § 1201(37).

5. Hereinafter the words "lease," "lessor," and "lessee" refer to personal property leasing unless otherwise indicated.

6. *Report of the Uniform Commercial Code Committee of the Business Law Section of the State Bar of California on Proposed California Commercial Code Division 10 (Article 2A) (Senate Bill 1580, As Amended September 11, 1987)* at 2 [hereinafter *Report*]. California personal property leases have been governed primarily by three bodies of law. *Id.* Where disputed lease issues were not governed by express statutory provisions, courts applied the general common law of contracts or real property principles. *See, e.g., Industrial Leasing Corp. v. Lawson*, 149 Cal. App. 3d 1098, 1103, 197 Cal. Rptr. 291, 293 (1983) (a lease of personal property which is neither a security lease nor a contingent sale is outside the scope of the Commercial Code; instead, contract law principles of mitigation of damages apply); *Puritan Leasing Co. v. August*, 16 Cal. 3d 451, 457-58, 128 Cal. Rptr. 175, 179 (1976) ("Though the cases have primarily involved leases of real property, we discern no policy reason preventing the principles expressed therein from applying equally to leases of personalty.").

The courts also have analogized to or applied Division 2 (Sales) and Division 9 (Secured Transactions) of the Commercial Code to settle lease disputes, particularly in the area of

During the past twenty years, the personal property leasing industry in the United States has grown to tremendous proportions.<sup>7</sup> Although leasing has become a pervasive form of acquisition in the commercial world, there has not been a concomitant development of commercial law to govern the lease transactions.<sup>8</sup> This failure to develop a single body of law governing leases has led to nonuniformity among the states and unpredictability in results.<sup>9</sup> Because of the pervasiveness of personal property leasing and the imperfections which existed in applying an "amalgamation of principles" to leases, the National Conference of Commissioners on Uniform State Laws (the Conference) and the American Law Institute (the Institute) developed Article 2A of the Uniform Commercial Code (1987) (Article 2A).<sup>10</sup> With the exception of a few significant changes, the California Legislature substantially adopted the text and Official Comments of Article 2A.<sup>11</sup> In addition to the development of Article 2A, the Conference and the Institute amended the U.C.C.'s definition of "security interest."<sup>12</sup> This amended

warranties. See, e.g., *Holmes Packaging Machinery Corp. v. Bingham*, 252 Cal. App. 2d 862, 873, 60 Cal. Rptr. 769, 775 (1967) (implied warranties applicable to leased equipment are analogous to those applicable to sales transactions). See generally Boss, *Panacea or Nightmare? Leases in Article 2*, 64 B.U.L. REV. 39 (1983); Ayer, *On the Vacuity of the Sale/Lease Distinction*, 68 IOWA L. REV. 667 (1983); 1985 ANN. SURVEY AM. L. 95 (1985).

Leases also are expressly governed by the California Civil Code and other statutory provisions. Civil Code sections 1925-1935 (hiring in general) and 1955-1959 (hiring of personal property) define certain lessor and lessee duties, and section 3308 provides for agreement as to damages upon breach of a lease. Civil Code section 1795.4 applies the Song-Beverly Consumer Warranty Act (CAL. CIV. CODE §§ 1790-1795.7) to leases and defines warranty rights for leases of new and used consumer goods, while sections 2985.7-2990 (California Vehicle Leasing Act), the Federal Consumer Leasing Act of 1976 (15 U.S.C. 1667 (1976)), and Federal Reserve Regulation M (12 C.F.R. 213 (1988)) govern certain consumer leases.

7. See Boss, *The History of Article 2A: A Lesson for Practitioner and Scholar Alike*, 39 ALA. L. REV. 575, 577 (1988). In 1986, over \$90 billion worth of equipment was leased and equipment leasing accounted for approximately twenty percent of capital investment in the United States. *Id.* One third of all new equipment accepted for delivery in the United States is through lease agreement. *Id.*

8. See Mooney, *Personal Property Leasing: A Challenge*, 36 BUS. LAW. 1605, 1609 (1981) ("survey of various state statutes indicates that comprehensive statutory treatment of personal property leasing is not the norm").

9. See Boss, *supra* note 7, at 578-79.

10. U.C.C. art. 2A foreword (1987). The U.C.C. identifies three significant issues which prior case law had left unresolved: (1) What is a lease?; (2) what warranties will the lessor be deemed to have made?; and (3) what remedies are available to the lessor upon the lessee's default? U.C.C. § 2A-101 comment (1987). See also Boss, *supra* note 7 (concise history of Article 2A). As of this printing, only Oklahoma and California have adopted Article 2A. Telephone conversation with John M. Mc Cabe, Legislative Director for the National Conference of Commissioners on Uniform State Laws, January 6, 1989 (notes on file at *Pacific Law Journal*).

11. See *infra* notes 85-171 and accompanying text (discussion of significant differences between Division 10 and Article 2A).

12. U.C.C. § 2A-201(37) comment (1987).

definition was adopted in its entirety by the California Legislature.<sup>13</sup>

Part II of this Note will examine the California Commercial Code's adoption of the U.C.C.'s amended definition of "security interest." Part III of this Note will provide a brief overview of Division 10.<sup>14</sup> Part IV will focus on the principal changes made to Article 2A by the California Legislature in enacting Division 10 and will attempt to unveil the reasoning behind the changes.<sup>15</sup> Part V will discuss potential legal ramifications of the new Division.<sup>16</sup>

## II. THE AMENDED DEFINITION OF "SECURITY INTEREST" (CALIFORNIA COMMERCIAL CODE SECTION 1201(37))

One of the major issues encountered by the drafters of Article 2A and Division 10 was whether the requirement of public filing should be extended to include personal property leases.<sup>17</sup> In enacting Article 2A, the American Law Institute and the National Conference of Commissioners on Uniform State Laws decided against the filing requirement and chose instead to amend the definition of "security interest."<sup>18</sup> According to the drafting committee of the National Conference of Commissioners on Uniform State Laws, this amended definition more clearly distinguishes true leases from leases intended as

13. See *infra* notes 17-28 and accompanying text (discussion of definition of security interest).

14. See *infra* notes 29-84 and accompanying text.

15. See *infra* notes 85-99 and accompanying text (general provisions); notes 100-12 and accompanying text (formation and construction of lease contract); notes 113-35 and accompanying text (effect of lease contract); notes 136-41 and accompanying text (performance of lease contract: repudiated, substituted, and excused); notes 142-71 and accompanying text (default).

16. See *infra* notes 172-96 and accompanying text.

17. CAL. COMM. CODE § 10101 comment; U.C.C. § 2A-101 comment (1987). The issue of a public filing requirement for leases has produced volumes of support and opposition. See generally, Baird & Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175, 178 (1983) ("A party who wishes to acquire or retain a nonpossessory interest in property that is effective against others must, as a general matter, make it possible for others to discover that interest."); Mooney, *The Mystery and Myth of Ostensible Ownership and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases*, 39 ALA. L. REV. 683, 737, 743 (1988) (expanding filing requirement to include leases is not supported by legal history or by the ostensible ownership argument); Burns, *Uniform Commercial Code, Public Filing and Personal Property Leases: Questions of Definition and Doctrine*, 22 WAKE FOREST L. REV. 425, 468 (1987) (real issue to be addressed is not public filing for leases, but rather the insufficiency of the Uniform Commercial Code definition of security interest).

18. U.C.C. § 2A-101 comment (1987) (focus of changes was to draw sharper line between leases and security interests disguised as leases and create greater certainty in commercial transactions). See also *id.* § 1-201(37) (1987) (definition of security interest); *id.* comment.

security and provides a clearer indication of when to file.<sup>19</sup> The California Legislature adopted both the U.C.C.'s amended definition of security interest and the drafters' rationale for the amendment.<sup>20</sup>

Under prior California law, the definition of security interest depended in part upon the intent of the parties.<sup>21</sup> This definition tended to create confusion and unpredictable results as courts attempted to distinguish between a true lease and a lease intended as security.<sup>22</sup> The new definition of security interest deletes all references to intent and focuses on the economics of the lease transaction.<sup>23</sup> Although the facts of each case are determinative of whether a transaction creates a lease or security interest, the definition identifies four transactions that will create a security interest.<sup>24</sup> A security interest is created if the consideration to be paid to the lessor by the lessee for the right to possession and use of the goods is an obligation for the term of the lease that is not subject to termination by the lessee and: (1) the original term of the lease equals or is greater than the remaining economic life of the goods; (2) the lessee must either renew the lease for the remaining economic life of the goods or become the owner of the goods; (3) upon compliance with the lease agreement, the lessee has an option to renew for the remaining economic life of the goods for no additional or nominal additional consideration; or (4) upon compliance with the lease agreement, the lessee has an option to become the owner of the goods for no additional or nominal additional consideration.<sup>25</sup>

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19. *Id.* § 2A-301 comment (1987).

20. Compare CAL. COMM. CODE § 1201(37) (definition of security interest) and *id.* § 10301, comment with U.C.C. § 1-201(37) (1987) (definition of security interest) and *id.* § 2A-301 comment.

21. 1984 Cal. Stat. ch. 927, sec. 3, at 3097 (amending CAL. COMM. CODE § 1201) (unless lease was intended as security, reservation of title was not a security interest).

22. See Burns, *supra* note 17, at 426 n.3 (collection of cases and commentaries that exemplify the confusion over the security interest/lease distinction).

23. See CAL. COMM. CODE § 1201(37); *Report, supra* note 6, at 12; CAL. COMM. CODE § 1201(37) comment (discussion of focus on economics of the transaction).

24. CAL. COMM. CODE § 1201(37)(b)(i)-(iv).

25. *Id.* Conversely, a transaction will not create a security interest merely by providing that: (1) The present value of the consideration the lessee is obligated to pay the lessor for the right to possess and use the goods substantially equals or is greater than the fair market value of the goods at the time of entering into the lease; (2) the lessee assumes the risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods; (3) the lessee has an option to renew the lease or become owner of the goods; (4) the lessee has an option to renew for a fixed rent equal to or greater than the reasonably predictable fair market rent for use of the goods for the term of the renewal at the time the option is to be performed; or (5) the lessee has an option to become owner of the goods for a fixed price equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed. *Id.* § 1201(37)(c)(i)-(iv).

By placing emphasis on the economic life of the goods and the lessor's residual economic interest, the new definition should help clarify the lease/security interest distinction.<sup>26</sup> Although it does not create a bright line test of distinction, the new definition will likely decrease the number of lessors who would previously have filed a financing statement as a precaution and will more clearly signal the need to file.<sup>27</sup> However, lessors concerned with whether a transaction creates a security interest or a lease will continue to file a protective financing statement.<sup>28</sup>

### III. OVERVIEW OF DIVISION 10 OF THE CALIFORNIA COMMERCIAL CODE

Division 10 of the California Commercial Code is divided into five chapters: (1) General Provisions;<sup>29</sup> (2) Formation and Construction of Lease Contract;<sup>30</sup> (3) Effect of Lease Contract;<sup>31</sup> (4) Performance of Lease Contract: Repudiated, Substituted, and Excused;<sup>32</sup> and (5) Default.<sup>33</sup>

Chapter 1 (General Provisions) defines the scope<sup>34</sup> of Division 10 and provides pertinent definitions including "lease,"<sup>35</sup> "consumer lease,"<sup>36</sup> and "finance lease."<sup>37</sup> The Chapter also states that certain consumer protection laws are applicable to leases,<sup>38</sup> and limits the power of the parties to a consumer lease to choose the applicable law and judicial forum.<sup>39</sup>

Chapter 2 (Formation and Construction of Lease Contract) is modeled in part on Division 2 of the California Commercial Code (Sales),<sup>40</sup> with revisions to reflect leasing practices and terminology and the

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26. See Report, *supra* note 6, at 12. The Committee agreed that the U.C.C. amendment's economic basis of analysis is appropriate. *Id.*

27. *Id.* See CAL. COMM. CODE § 10301, comment; Report, *supra* note 6, at 13.

28. CAL. COMM. CODE § 10301 comment.

29. *Id.* § 10101-10107.

30. *Id.* § 10201-10221.

31. *Id.* § 10301-10310.

32. *Id.* § 10401-10407.

33. *Id.* § 10501-10532.

34. *Id.* §§ 10102 ("applies to any transaction, regardless of form, that creates a lease"), 10103(1)(j) (definition of lease).

35. *Id.* § 10103(1)(j) (definition of lease).

36. *Id.* § 10103(1)(e) (definition of consumer lease).

37. *Id.* § 10103(1)(g) (definition of finance lease).

38. *Id.* § 10104(1)(d) (leases subject to applicable decisional and statutory state consumer law).

39. *Id.* § 10106(1), (2) (enforceability vel non of parties' choice of law and forums).

40. See *id.* §§ 2101-2801 (Article 2).

differences between a sale and a lease.<sup>41</sup> The Chapter includes a statute of frauds provision;<sup>42</sup> a parol evidence rule;<sup>43</sup> provisions governing formation in general,<sup>44</sup> firm offers,<sup>45</sup> offer and acceptance,<sup>46</sup> course of performance,<sup>47</sup> modification, rescission, and waiver;<sup>48</sup> and a provision that extends to the lessee the benefit of the supplier's promises to the lessor and all warranties under the supply contract.<sup>49</sup> Also included are implied warranties of merchantability<sup>50</sup> and fitness,<sup>51</sup> and provisions governing risk of loss.<sup>52</sup>

Chapter 3 (Effect of Lease Contract) governs enforceability<sup>53</sup> of the lease contract, transfer of interests in the goods subject to the lease,<sup>54</sup> subsequent leasing of goods under an existing lease,<sup>55</sup> and sale or sublease of the goods by the lessee.<sup>56</sup> The Chapter establishes priority for liens arising by application of law,<sup>57</sup> sets out the rights of the lessor's and lessee's creditors,<sup>58</sup> and defines the lessor's and lessee's rights when goods under a lease are either fixtures or accessions.<sup>59</sup>

Chapter 4 (Performance of Lease Contract: Repudiated, Substituted, and Excused) governs performance of the lease contract.<sup>60</sup> The Chapter

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41. See *id.* §§ 10201-10221 comments. The drafting committee of the National Conference of Commissioners on Uniform State Law determined that Division 2 was the appropriate statutory analogue. *Id.* § 10101 comment.

42. *Id.* § 10201 (requires all consumer leases and all other leases over \$1,000 to be in writing).

43. *Id.* § 10202.

44. *Id.* § 10204(1) (lease contract may be made in any manner sufficient to show agreement).

45. *Id.* § 10205.

46. *Id.* § 10206(1).

47. *Id.* § 10207(1).

48. *Id.* § 10208(1)-(4).

49. *Id.* § 10209(1) (benefit extends to the lessee to the extent of the lessee's interest, subject to the terms of the supply contract and all of the supplier's defenses and claims).

50. *Id.* § 10212. Except in a finance lease, if the lessor is a merchant with respect to goods of the kind leased, there is an implied warranty that the goods are merchantable. *Id.* 10212(1).

51. *Id.* § 10213 (implied warranty of fitness for particular purpose, except in finance lease).

52. *Id.* § 10219 (lessor retains risk of loss except in a finance lease, in which case risk of loss passes to lessee); § 10220(1)(a), (b) (exceptions to passage of risk of loss to lessee).

53. *Id.* § 10301.

54. *Id.* § 10303 (subject to certain exceptions, lessor's residual interest in the goods and any interest of a party under a lease contract may be transferred).

55. *Id.* § 10304.

56. *Id.* § 10305.

57. *Id.* § 10306 (lien upon leased goods in possession of a person who has furnished services or materials with respect to those goods generally takes priority over the lessor's or lessee's interests under the lease contract).

58. *Id.* §§ 10307, 10308 (except as otherwise provided, creditor of a lessor or lessee takes subject to the lease contract).

59. *Id.* §§ 10309 (pertaining to fixtures), 10310 (pertaining to accessions).

60. *Id.* § 10401-10407.

provides for the right of a party to demand adequate written assurance of due performance if reasonable grounds for insecurity arise,<sup>61</sup> and defines the rights of a party upon repudiation<sup>62</sup> and retraction of repudiation.<sup>63</sup> The Chapter requires the tender and acceptance of commercially reasonable substitute performance in certain instances,<sup>64</sup> and furnishes the rules for excused performance because of impracticability.<sup>65</sup>

Chapter 5 (Default) covers default under a lease contract by either the lessor or lessee.<sup>66</sup> Whether a party is in default is to be determined by the lease agreement and Division 10.<sup>67</sup> The parties to a lease agreement are allowed to include or substitute additional rights and remedies and may limit or alter the damages recoverable under Division 10.<sup>68</sup> Liquidation of damages is permissible, subject to certain limitations.<sup>69</sup> A party must commence an action for default within four years after the cause of action accrues,<sup>70</sup> but this statute of limitations may be reduced to a period of not less than one year in leases that are not consumer leases.<sup>71</sup>

Chapter 5 defines the rights of the lessee upon the lessor's default.<sup>72</sup> The Chapter also defines when acceptance of goods takes place,<sup>73</sup> describes the effect of the lessee's acceptance,<sup>74</sup> provides the lessee with the right to cover upon the lessor's default,<sup>75</sup> and specifies the measure of damages for a lessor's nondelivery or repudiation and a lessee's rejection or revocation of acceptance.<sup>76</sup> The parameters of incidental

61. *Id.* § 10401(2). A lease contract imposes an obligation not to impair the other party's expectation of receiving due performance. *Id.* § 10401(1).

62. *Id.* § 10402.

63. *Id.* § 10403.

64. *Id.* § 10404(1).

65. *Id.* § 10404-10406.

66. *See id.* §§ 10501-10507 (default in general), 10508-10522 (default by lessor), 10523-10532 (default by lessee).

67. *Id.* § 10501(1).

68. *Id.* § 10503(1). Consequential damages may be liquidated, limited, altered, or excluded unless to do so would be unconscionable. *Id.* § 10503(3).

69. *Id.* § 10504(1) (damages may be liquidated subject to section 1671 of the Civil Code which governs validity of liquidated damages provisions for breach of contract).

70. *Id.* § 10506(1) (includes actions for breach of warranty or indemnity).

71. *Id.* (reduced according to terms of original lease agreement).

72. *Id.* § 10508(1) (if the lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, or if the lessee rightfully rejects or revokes acceptance, the lessor is in default). *See also id.* §§ 10508-10522 (lessee's rights upon lessor's default). The lessor or supplier may cure if goods under the lease are rejected as nonconforming and the time for performance has not yet expired. *Id.* § 10513(1).

73. *Id.* § 10515(1).

74. *Id.* § 10516.

75. *Id.* § 10518.

76. *Id.* § 10519.

and consequential damages are set forth,<sup>77</sup> as well as the right to specific performance,<sup>78</sup> various remedies in the event cover is unavailable or unavailing,<sup>79</sup> and the right to recover goods in the event of lessor insolvency.<sup>80</sup>

Under Chapter 5, the lessor is granted specified remedies upon default<sup>81</sup> by the lessee.<sup>82</sup> The Chapter sets out the damages which the lessor may recover for default,<sup>83</sup> and states that the lessor is entitled to full compensation for loss or damage to the lessor's residual interest in goods caused by the lessee's default.<sup>84</sup>

#### IV. AREAS OF SIGNIFICANT DIFFERENCE BETWEEN DIVISION 10 OF THE CALIFORNIA COMMERCIAL CODE AND U.C.C. ARTICLE 2A

##### A. General Provisions

###### 1. *Definition of Consumer Lease (California Commercial Code section 10103(1)(e))*

Division 10 makes two changes to the Article 2A definition of "consumer lease."<sup>85</sup> Under Article 2A, a consumer lease is a lease

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77. *Id.* § 10520(1), (2).

78. *Id.* § 10521(1), (2).

79. *Id.* § 10521(3).

80. *Id.* § 10522.

81. *Id.* § 10523(1) (if lessee wrongfully rejects or revokes acceptance, fails to make a payment when due, or repudiates with respect to part or whole, then with respect to any of the goods involved (and with respect to all the goods if under an installment lease contract the value of the whole contract is substantially impaired) lessee is in default).

82. *See, e.g., id.* § 10505(1) (upon cancellation of lease contract, cancelling party retains any remedy for default); § 10524 (1)(a), (b) (lessor may identify to the lease contract conforming goods and dispose of them in specified circumstances); § 10525(2) (lessor may take possession of the goods); § 10526(1) (lessor may stop delivery of goods in the possession of a carrier or other bailee); § 10527 (lessor may dispose of goods by lease, sale, or otherwise and recover damages as specified); § 10528 (lessor may retain goods and recover damages); § 10529(1)(a), (b) (lessor may recover rent in specified circumstances).

83. *See, e.g., id.* § 10503(1) (limitation or enhancement of damages by lease agreement), § 10503(3) (limitation and liquidation vel non of consequential damages), § 10504 (liquidation of damages in lease agreement), § 10527(2) (damages recoverable where lessor disposes of goods), § 10528 (damages recoverable where lessor elects to retain goods or dispose of goods by lease agreement, sale, or otherwise), § 10529(1)(a) (damages for goods accepted by lessee and not repossessed or effectively tendered back and for conforming goods lost or damaged after risk of loss passes to lessee), § 10529(1)(b) (damages for certain goods identified to lease contract where lessor has made reasonable efforts to dispose of goods or circumstances indicate such effort would be unavailing), § 10530 (definition of incidental damages).

84. *Id.* § 10532.

85. *Compare* U.C.C. § 2A-103(1)(e) (1987) (definition of consumer lease) *with* CAL. COMM. CODE § 10103(1)(e) (consumer lease is lease made to a lessee who is a natural person and who takes primarily for personal, family, or household purposes).

made to a lessee, except an organization, who takes primarily for a personal, family, or household purpose.<sup>86</sup> Under Division 10 the words “except an organization” are replaced with “who is a natural person,”<sup>87</sup> bringing the Division 10 definition into conformance with Federal Reserve Regulation M.<sup>88</sup> Article 2A limits consumer leases to leases with total payments not exceeding \$25,000.<sup>89</sup> Concerns over potentially disparate treatment of lessees of goods over \$25,000 and the suggestion that this limit could deny those lessees the protection of California’s consumer protection statutes prompted the California legislature not to adopt this cap in Division 10.<sup>90</sup>

## 2. *Definition of Finance Lease (California Commercial Code section 10103(1)(g))*

Under both Article 2A and Division 10, a finance lease is a tripartite transaction in which the lessor does not select, manufacture, or supply the goods, but acquires the goods or the right to possession and use of the goods from the supplier in connection with the lease and: (1) the lessee, on or before signing the lease contract, receives a copy of the lessor’s purchase contract; or (2) the lessee’s approval of the lessor’s purchase contract is necessary for the lease contract to be effective.<sup>91</sup> Under Division 10, a finance lease may additionally be created if the lessor does not select, manufacture, or supply the goods, but acquires the goods or the right to possession and use of the goods from the supplier in connection with the lease and: (1) the lessor informs the lessee in writing of the identity of the supplier (unless the lessee has selected the supplier and directed the lessor to purchase goods from the supplier), informs the lessee in writing that the lessee may have rights under the lessor’s purchase contract, and advises the lessee in writing to contact the supplier for a description of the rights; or (2)

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86. U.C.C. § 2A-103(1)(e) (1987). *See id.* § 1-201(28) (1987) (definition of organization).

87. CAL. COMM. CODE § 10103(1)(e).

88. *See* Federal Reserve Regulation M, 12 C.F.R. 213 (1988).

89. U.C.C. § 2A-103(1)(e) (1987). *See generally* Miller, *Consumer Leases Under Uniform Commercial Code Article 2A*, 39 ALA. L. REV. 957 (1988).

90. The California Attorney General argued that U.C.C. § 2A-103(1)(e) (1987) was inconsistent with existing California law which does not define consumer transactions with reference to a dollar amount and that inclusion of the \$25,000 cap would create confusion between Division 10 and existing law. Letter from California Attorney General’s Office to Senator Robert Beverly, May 20, 1988 [hereinafter *Attorney General Letter*] (on file at *Pacific Law Journal*).

91. *See* U.C.C. § 2A-103(1)(g) (1987); CAL. COMM. CODE § 10103(1)(g)(A), (B).

the lease contract discloses all warranties and rights provided to the lessee by the lessor and supplier and informs the lessee that there are no warranties or rights provided to the lessee other than those disclosed in the lease contract.<sup>92</sup>

3. *Leases Subject to Other Statutes (California Commercial Code section 10104)*

Article 2A and Division 10 provide that leases are subject to applicable United States statutes, state certificate of title statutes, and state consumer protection statutes.<sup>93</sup> Division 10 adds to the consumer protection laws that are applicable to leases by specifying that certain provisions of the California Vehicle, Health and Safety, Civil, and Business and Professions Codes are applicable to leases.<sup>94</sup> Most significantly, Division 10 provides that case law as well as statutory consumer law is applicable to leases.<sup>95</sup> This addition preserves existing judicially created consumer protections and ensures that future judicially created protections will apply to leases.<sup>96</sup>

4. *Limitation on Power of Parties to Consumer Leases to Choose Applicable Law and Judicial Forum (California Commercial Code section 10106)*

Under Article 2A, the choice of judicial forum by the parties to a consumer lease is not enforceable if the chosen forum is one that

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92. CAL. COMM. CODE § 10103(1)(g)(C), (D). The Uniform Commercial Code Committee of the Business Law Section of the State Bar of California [Hereinafter Committee] described the Article 2A definition as narrower than what many persons in the leasing industry would term a finance lease. *Report, supra* note 6, at 20. See generally Huddleson, *Old Wine in New Bottles: U.C.C. Article 2A—Leases*, 39 ALA. L. REV. 615, 664 (1988) (additions made by California legislature appear to be consistent with policy of the U.C.C. finance lease provisions).

93. U.C.C. § 2A-104(1) (1987), CAL. COMM. CODE § 10104(1)(a)-(d).

94. CAL. COMM. CODE § 10104(1)(b), (d). See, e.g., CAL. VEH. CODE §§ 4000-4021 (vehicles subject to registration), CAL. HEALTH & SAFETY CODE §§ 18075-18093.5 (registration of mobilehomes and commercial coaches), CAL. CIV. CODE §§ 1725-2382 (obligations arising from particular transactions); CAL. BUS. & PROF. CODE §§ 17200-17208 (unfair competition), 17500-17577.5 (regulation of advertising). The listing of applicable consumer protection law in section 10104 is not meant to be exclusive, but merely identifies several of the important statutory consumer protections. CAL. COMM. CODE § 10104 comment.

95. CAL. COMM. CODE § 10104(1)(d).

96. *Id.* § 10104(1). The California Attorney General argued that the failure to define which consumer protection statutes were applicable would create substantial problems in determining which laws apply. *Attorney General Letter, supra* note 90.

would not otherwise have jurisdiction over the lessee.<sup>97</sup> Under Division 10, the judicial forum must either be the county where the lease is signed by the lessee, the county where the lessee resides at the commencement of the action, the county where the lessee resided at the time the lease contract became enforceable, or the county where the goods are permanently stored.<sup>98</sup> This provision was apparently added to bring section 10106 into line with existing California consumer law which attempts to discourage suits against consumers in remote forums.<sup>99</sup>

## B. Formation and Construction of Lease Contract

### 1. Unconscionability (U.C.C. § 2A-108 (1987))

Division 10 does not adopt the Article 2A section on unconscionability; the Article 2A section is based on the U.C.C. Article 2 (Sales) unconscionability section and the Uniform Consumer Credit Code,<sup>100</sup> which have not been adopted in California. California, however, in the Civil Code, has codified a similar unconscionability provision that is applicable to all contracts.<sup>101</sup>

### 2. Option to Accelerate at Will (U.C.C. § 2A-109 (1987))

Division 10 does not adopt Article 2A's option to accelerate at will.<sup>102</sup> Existing California commercial law, however, contains a provision similar to the Article 2A section that is applicable to leases.<sup>103</sup>

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97. U.C.C. § 2A-106(2) (1987).

98. CAL. COMM. CODE § 10106(2).

99. The California Attorney General claimed that Article 2A's choice of forum provision is inconsistent with provisions in most state consumer protection statutes and permits suits against consumer lessees in remote venues. *Attorney General Letter, supra* note 90. *See, e.g.,* CAL. CIV. CODE § 2986.3 (available judicial forums in vehicle leases).

100. *See* U.C.C. § 2A-108 comment (1987).

101. CAL. CIV. CODE § 1670.5. *Compare id.* (defining unconscionable contract or clause of contract) *with* U.C.C. § 2A-108(4)(a) (1987) (containing additional language that provides for reasonable attorney fees to be awarded to the lessee if the court finds unconscionability in a consumer lease). The Committee argued that there is no reason to adopt an unconscionability section that treats leases different from other contracts. *Report, supra* note 6, at 24.

102. *See* U.C.C. § 2A-109 (1987).

103. *Compare* CAL. COMM. CODE § 1208 (option to accelerate at will) *with* U.C.C. § 2A-109 (1987) (option to accelerate at will under lease contract). Article 2A contains additional language that places the burden of establishing good faith in a consumer lease on the party who exercised the option. U.C.C. § 2A-109(2) (1987). The California Attorney General felt

3. *Statute of Frauds (California Commercial Code section 10201)*

Division 10 adopts the Article 2A statute of frauds, which requires that all leases with total payments greater than \$1,000 be in writing to be enforceable;<sup>104</sup> Division 10, however, additionally requires that all consumer leases be in writing to be enforceable.<sup>105</sup>

4. *Seals Inoperative (U.C.C. § 2A-203 (1987))*

Division 10 does not adopt this Article 2A section; existing California law abolishes the distinction between sealed and unsealed instruments.<sup>106</sup>

5. *Rescission and Modification of Supply Contract (California Commercial Code section 10209(3), (4))*

Division 10 includes the Article 2A section which specifies that a rescission or modification by the supplier and lessor is effective against the lessee unless the supplier had prior notice that the lessee has entered into a finance lease related to the supply contract.<sup>107</sup> Division 10 does not include the language from Article 2A that gives the lessee a cause of action against the supplier if the supply contract is modified or rescinded and the supplier had notice of the lessee's finance lease.<sup>108</sup> The excluded language implied that the rescission or modification of a supply contract would be effective against the lessee even though the

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that the Article 2A section is inconsistent with provisions in California consumer statutes that prohibit acceleration in the absence of default or other statutorily authorized circumstances. *Attorney General Letter, supra* note 90.

104. CAL. COMM. CODE § 10201(1)(a), U.C.C. § 2A-201(1) (1987) (payments for options to renew or buy excluded). The writing must be sufficient to indicate a lease contract has been made between the parties, describe the leased goods and the lease term, and be signed by the party against whom enforcement is sought or that party's authorized agent. CAL. COMM. CODE § 10201(1)(b), U.C.C. § 2A-201(1)(b) (1987).

105. CAL. COMM. CODE § 10201(1)(a), (b). *See generally id.* § 10103(1)(e) (definition of consumer lease). The California Attorney General felt that Division 10 should give special treatment to the form of consumer leases and require that all consumer leases be in writing. *Attorney General Letter, supra* note 90.

106. *See* CAL. CIV. CODE § 1629.

107. CAL. COMM. CODE § 10209(3), U.C.C. § 2A-209(3) (1987).

108. *Compare* U.C.C. § 2A-209(3) (1987) (lessee has cause of action against lessor and supplier, if supplier has notice of finance lease when supply contract is modified or rescinded) *with* CAL. COMM. CODE § 10209(3) (lessee has cause of action against lessor).

supplier had notice.<sup>109</sup> By excluding this language, Division 10 provides that a rescission or modification is not effective against the lessee where the supplier received prior notice of the supply contract.<sup>110</sup> Also, this exclusion of language apparently produces the result that a modification or rescission of the supply contract will give the lessee a cause of action only against the lessor, but not against the supplier.<sup>111</sup> Division 10 additionally includes a provision which ensures that the lessee retains all rights and remedies against the supplier arising out of any agreement between the lessee and the supplier.<sup>112</sup>

### C. Effect of Lease Contract

#### 1. Alienability of Party's Interest Under Lease Contract and of Lessor's Residual Interest in Goods (California Commercial Code section 10303)

Under both Article 2A and Division 10, a party's interest under a lease contract and the lessor's residual interest in the goods may be voluntarily transferred unless the the lease contract prohibits the transfer.<sup>113</sup> Division 10 additionally precludes any such contractual prohibition upon the transfer of a party's interest from invalidating a security interest in the lessor's residual interest in the goods or in any interest of the lessor under the lease contract.<sup>114</sup> This addition is intended to further the policy found in existing California law that encourages free alienability for security purposes of intangible assets such as accounts and general intangibles.<sup>115</sup>

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109. See U.C.C. § 2A-209(3) (1987). The deletion of this language from Division 10 is consistent with the recommendation of the Committee that California Commercial Code section 10209(3) be reworded to state clearly that the rescission or modification is not effective against the lessee. *Report, supra* note 6, at 31.

110. CAL. COMM. CODE § 10209(3).

111. *Id.* See *supra* note 108 (comparing Division 10 with Article 2A).

112. CAL. COMM. CODE § 10209(4) (also retained are lessee's rights and remedies against supplier that arise from any other law).

113. See U.C.C. § 2A-303(1)(a) (1987), CAL. COMM. CODE § 10303(1)(a).

114. CAL. COMM. CODE § 10303(3)(a) (applies to creation or enforcement of a security interest). See generally *id.* § 1201(37) (definition of security interest). See *infra* notes 175-185 and accompanying text (discussion of amended definition of security interest).

115. See CAL. COMM. CODE § 10303 comment. Under existing California law, a term in a contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or the creation of a security interest in a general intangible for money due or to become due or requires the account debtor's consent to an assignment or security interest. *Id.* § 9318(4).

Division 10 includes the Article 2A provision that under certain circumstances prohibits transfer of an interest if the transfer materially changes the duty or increases the burden or risk of the other party.<sup>116</sup> Division 10 provides that this prohibition against transfer does not apply to the creation of a security interest in the lessor's residual interest in the goods or interest under the lease contract, or to the exercise of rights as a secured party pursuant to the security interest,<sup>117</sup> unless the transfer is pursuant to a Division 9 (Secured Transactions) foreclosure.<sup>118</sup> Division 10 additionally provides that the lessor may enforce an obligation in a lease contract requiring the lessee to keep the lessee's interest in the lease contract or the goods free from encumbrances or liens.<sup>119</sup>

2. *Priority of Liens Arising by Attachment or Levy on, Security Interest in, and Other Claims to Goods (California Commercial Code section 10307)*

Under both Division 10 and Article 2A, a lessor's creditor takes subject to the lease contract unless the creditor holds a lien that attached to the goods before the lease contract became enforceable.<sup>120</sup> Additionally, under Division 10 a lessor's creditor takes subject to the lease contract "unless the creditor holds a security interest in the goods and the lessee did not give value and receive delivery of the goods without knowledge of the security interest."<sup>121</sup> This section treats the lessee in

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116. See U.C.C. § 2A-303(1)(b) (1987); CAL. COMM. CODE § 10303(1)(b) (except as otherwise provided). Division 10 further requires that, in order to prohibit the transfer of an interest under these circumstances, within a reasonable time after notice of the transfer the other party must demand (and the transferee fail to comply) that the transferee: (1) cure or provide adequate assurances that any default other than one arising from the transfer will promptly be cured; (2) compensate or provide adequate assurance that the other party to the lease contract or any other person holding an interest in the lease contract, except the party whose interest is being transferred, will promptly be compensated for any loss resulting from the transfer; (3) provide adequate assurance of future due performance under the lease contract; and (4) assume the lease contract. CAL. COMM. CODE § 10303(2).

117. CAL. COMM. CODE § 10303(3)(c). The Committee expressed concern that U.C.C. section 2A-303(1)(b) could be interpreted to prevent a lessor from assigning the right to receive payments under the lease contract and could "cause enormous practical problems in the availability of chattel paper financing." *Report, supra* note 6, at 39.

118. CAL. COMM. CODE § 10303(c). See also *id.* § 9504 (secured party's right to dispose of collateral after default); § 9505 (compulsory disposition of collateral and acceptance of collateral as discharge of obligation); § 10303 comment.

119. CAL. COMM. CODE § 10303(3)(d); *id.* § 10303 comment.

120. *Id.* §§ 10307(2)(a) (except as otherwise provided in Commercial Code sections 10307(3), (4); §§ 10306; and 10308). See also U.C.C. § 2A-307(2)(a) (1987) (except as otherwise provided in U.C.C. sections 2A-307(3), (4); 2A-306; 2A-308).

121. CAL. COMM. CODE § 10307(2)(b).

the same manner as a buyer not in the ordinary course of business under Division 9 (Secured Transactions).<sup>122</sup>

Unlike Article 2A, Division 10 declares that unless a lessor's creditor holds a security interest in the goods that attached and was perfected before the lessee gave value and received delivery of the goods, the creditor takes subject to the lease contract.<sup>123</sup> Division 10 contains an additional provision, not found in Article 2A, that governs a purchase money security interest.<sup>124</sup> Under this provision, a creditor of a lessor takes subject to the lease contract unless the creditor's security interest in the goods attached and was perfected before twenty days after the lessor received possession of the goods or the lessee received possession of the goods, whichever is earlier.<sup>125</sup> This addition is derived from existing California law that governs priorities among conflicting security interests in the same collateral.<sup>126</sup> In order to conform with the protections given to buyers other than buyers in the ordinary course of business in Division 9 (Secured Transactions), Division 10 does not adopt certain language found in Article 2A.<sup>127</sup>

### 3. *Special Rights of Creditors (California Commercial Code section 10308)*

Under both Article 2A and Division 10, a creditor of a lessor in possession of goods subject to a lease contract may treat the lease as

122. *Id.* § 10307 comment. Under existing California law, an unperfected security interest is subordinate to the rights of, "in the case of goods, instruments, documents, and chattel paper, a person who is not a transferee in bulk or other buyer not in ordinary course of business to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected." *Id.* § 9301(1)(c).

123. *Id.* § 10307(2)(c)(ii) (except as otherwise provided); *compare id.* § 10307(2)(c)(ii) with U.C.C. § 2A-307(2)(b) (1987).

124. CAL. COMM. CODE § 10307(2)(c)(iii) (except as otherwise provided); *see id.* § 9107 (definition of purchase money security interest).

125. *Id.* § 10307(2)(c)(iii) (except as otherwise provided); § 10307 comment.

126. *See id.* § 10307 comment; *Compare id.* § 10307(2)(c)(iii) (pertaining to lessor's creditors who hold purchase money security interest in goods) with *id.* § 9312(4) (pertaining to purchase money security interests). Under existing California commercial law, a purchase money security interest in collateral has priority over a conflicting security interest in the same collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter. *Id.* § 9312(4).

127. *Compare id.* § 10307(4) (pertaining to when lessee other than lessee in the ordinary course of business takes leasehold interest free of security interest) with U.C.C. § 2A-307(4) (1987) (pertaining to when lessee other than lessee in the ordinary course of business takes leasehold interest free of security interest). *See generally* CAL. COMM. CODE § 9307(3) (protection of buyer other than a buyer in ordinary course of business). The Committee felt that there was no policy reason to afford a lessee not in the ordinary course of business more favorable treatment than a buyer not in the ordinary course of business. *Report, supra* note 6, at 50. *See generally* CAL. COMM. CODE § 10103(1)(a) (definition of buyer in ordinary course of business as applied to Division 10).

void if retention of possession by the lessor is fraudulent as against the creditor under any statute or rule of law.<sup>128</sup> Division 10 additionally allows the creditor to treat the lease as void if, as against the creditor, retention of possession by the lessor is void under any statute or rule of law.<sup>129</sup>

Article 2A declares that the rights of creditors of a lessor are not impaired by Article 2A if two conditions are met.<sup>130</sup> First, a lease contract must be made under circumstances which make it a fraudulent transfer or voidable preference under any other statute or rule of law.<sup>131</sup> Second, the lease contract must become enforceable not in the ordinary course of trade but in satisfaction of or as security for a preexisting claim.<sup>132</sup> In contrast, Division 10 states that the rights of creditors of a lessor are not impaired by Division 10 if a lease contract is made under circumstances that would make it a fraudulent transfer or voidable preference under any statute or rule of law other than Division 10.<sup>133</sup>

#### 4. *Lessor's and Lessee's Rights When Goods Become Fixtures* (California Commercial Code section 10309)

Division 10 adopts the Article 2A provision governing fixtures, but deletes certain language to bring it into conformity with parallel provisions in Division 9 (Secured Transactions)<sup>134</sup> covering fixtures and fixture filings.<sup>135</sup>

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128. CAL. COMM. CODE § 10308(1); U.C.C. § 2A-308(1) (1987).

129. CAL. COMM. CODE § 10308(1) (however, retention of possession in good faith and current course of trade by lessor for commercially reasonable time after lease contract becomes enforceable is not void or fraudulent). The Committee recommended that the word "void" be added to be consistent with the California Uniform Fraudulent Transfer Act (Civil Code sections 3439-3439.12), which covers conveyances of personal property without delivery. *Report, supra* note 6, at 52.

130. U.C.C. § 2A-308(2) (1987).

131. *Id.*

132. *Id.* (preexisting claim may be for money, security, or the like).

133. *Compare id.* § 2A-308(2) (pertaining to rights of creditors of a lessor) with CAL. COMM. CODE § 10308(2) (excludes language referring to lease contract becoming enforceable in satisfaction of or as security for a preexisting claim). This change is consistent with the Committee's argument that the language used in Article 2A is inappropriate because a lease transaction which is fraudulent under the California Uniform Fraudulent Transfer Act (Civil Code sections 3439-3439.12) should be avoidable whether "in the current course of trade" or not. *Report, supra* note 6, at 52.

134. *See* CAL. COMM. CODE § 9313 (fixtures and fixture filing).

135. *Compare id.* § 10309 (pertaining to fixtures and fixture filings) with U.C.C. § 2A-309 (1987) (pertaining to fixtures and fixture filings). Because California never adopted the uniform version of U.C.C. section 9-313, which is the statutory analogue for U.C.C. section 2A-309, the

D. *Performance of Lease Contract: Repudiated, Substituted, and Excused*

1. *Anticipatory Repudiation of a Lease Contract (California Commercial Code section 10402)*

Both Division 10 and Article 2A grant the aggrieved party in an anticipatory repudiation certain rights and remedies.<sup>136</sup> Unlike Article 2A,<sup>137</sup> Division 10 specifies that these rights and remedies are not applicable to an anticipatory repudiation of a consumer lease and that the rights and remedies of a party to a repudiated consumer lease are to be determined under other laws.<sup>138</sup>

2. *Promises Irrevocable Upon Acceptance (California Commercial Code section 10407)*

Division 10 adopts the Article 2A provision that makes the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods under a finance lease that is not a consumer lease.<sup>139</sup> Division 10 includes additional language stating that the provision does not affect the validity under any other law of covenants in lease contracts making the lessee's promises irrevocable and independent upon acceptance.<sup>140</sup> This addition is intended to make it clear that California Commercial Code section 10407 carries no positive or negative implication as to the validity of irrevocable and independent clauses in situations where section 10407 does not apply.<sup>141</sup>

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Committee recommended changes to California Commercial Code section 10309 that would bring it into conformance with California Commercial Code section 9313. *Report, supra* note 6, at 55. See generally Comment, *Article 9 and Fixtures: A Real Fix With No Perfect Solution*, 17 *Lox. L. REV.* 977 (1984).

136. See CAL. COMM. CODE § 10402(1)(a)-(c); U.C.C. § 2A-402(a)-(c) (1987).

137. See U.C.C. § 2A-402 (1987).

138. CAL. COMM. CODE § 10402(1), (2). See generally *id.* § 10103(1)(e) (definition of consumer lease). The California Attorney General argued that the Article 2A anticipatory repudiation provision is inconsistent with California consumer protection statutes permitting default remedies only when there has been a default and that consumer lessors should not be allowed to invoke default remedies unless an actual default has occurred. *Attorney General Letter, supra* note 90.

139. See U.C.C. § 2A-407(1) (1987), CAL. COMM. CODE § 10407(1).

140. CAL. COMM. CODE § 10407(3).

141. *Id.* § 10407 comment.

E. Default

1. *Modification or Impairment of Rights and Remedies for Default (California Commercial Code section 10503)*

Under Article 2A, the limitation of consequential damages for personal injury in a lease of consumer goods is prima facie unconscionable, but the limitation of damages for commercial loss is not.<sup>142</sup> In contrast, Division 10 provides that the limitation of consequential damages for injury to a person in the case of consumer goods is invalid unless proved not unconscionable; however, the limitation of consequential damages where the loss is commercial is valid unless proved unconscionable.<sup>143</sup> This change in standards brings Division 10 into conformity with a parallel provision in Division 2 (Sales).<sup>144</sup>

2. *Liquidation of Damages (California Commercial Code section 10504)*

Both Division 10 and Article 2A allow for the liquidation of damages for default or any act or omission.<sup>145</sup> Division 10, however, has deleted the U.C.C.'s standard controlling the enforceability of a liquidated damages clause and replaced it with the existing standard found in the California Civil Code.<sup>146</sup>

3. *Statute of Limitations (California Commercial Code section 10506)*

Both Division 10 and Article 2A establish a four year statute of limitations for default under a lease contract, including breach of

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142. U.C.C. § 2A-503(3) (1987) (consequential damages may be liquidated, limited, altered, or excluded unless to do so is unconscionable).

143. CAL. COMM. CODE § 10503(3).

144. Compare *id.* with *id.* § 2719 (contractual modification or limitation of remedy).

145. *Id.* § 10504(1); U.C.C. § 2A-504(1) (1987). Under both Division 10 and Article 2A, indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest may also be liquidated. CAL. COMM. CODE § 10504(1), U.C.C. § 2A-504(1) (1987).

146. CAL. COMM. CODE § 10504(1). Under existing California law, a liquidated damages clause is valid unless it is established that the provision was unreasonable under the circumstances existing at the time the contract was made; under Article 2A, damages may be liquidated only at an amount that is reasonable in light of the then anticipated harm. Compare CAL. CIV. CODE § 1671 (standard for determining validity of liquidated damages provision) with U.C.C. § 2A-504(1) (controls liquidation of damages in lease agreements) (1987). The Committee believed that the existing Civil Code provision represents the better rule. *Report, supra* note 6, at 59.

warranty or indemnity.<sup>147</sup> Similarly, both provide that the parties can include an agreement in the original lease contract which reduces this statute of limitations to a period of not less than one year.<sup>148</sup> Division 10, however, restricts this reduction to lease contracts other than consumer leases.<sup>149</sup> Additionally, Division 10 includes language that brings it into compliance with the holding in *E.L. White, Inc. v. City of Huntington Beach*.<sup>150</sup> Under Division 10, a cause of action for indemnity against liability accrues when the act or omission upon which the indemnity claim is based is or should have been discovered by the indemnified party, whichever is later;<sup>151</sup> in the case of an indemnity against loss or damage, the cause of action accrues when the person indemnified makes payment.<sup>152</sup>

#### 4. *Effect of Acceptance of Goods (California Commercial Code section 10516)*

Division 10 and Article 2A both declare that a lessee's acceptance of the goods under the lease precludes a rejection of the goods accepted;<sup>153</sup> similarly, under a finance lease, acceptance cannot be revoked because of a nonconformity if acceptance was made with knowledge of the nonconformity.<sup>154</sup> Division 10 creates an exception to this rule by providing that this prohibition on revocation of acceptance does not apply to a finance lease that is a consumer lease in which the supplier assisted in preparing the lease contract or participated in negotiating the terms of the lease contract with the lessor.<sup>155</sup> Division

147. CAL. COMM. CODE § 10506(1), U.C.C. § 2A-506(1) (1987).

148. CAL. COMM. CODE § 10506(1), U.C.C. § 2A-506(1) (1987).

149. CAL. COMM. CODE § 10506(1). The California Attorney General argued that the Article 2A statute of limitations would enable a lessor to "unreasonably truncate the period within which a consumer would have to file a breach of warranty action." *Attorney General Letter, supra* note 90.

150. 21 Cal. 3d 497, 507, 579 P. 2d 505, 510, 146 Cal. Rptr. 614, 619 (1978) (cause of action for implied indemnity does not accrue until indemnitee has suffered actual loss through payment). See CAL. COMM. CODE § 10506 comment.

151. CAL. COMM. CODE § 10506(2)(a).

152. *Id.* § 10506(2)(b).

153. *Id.* § 10516(2); U.C.C. § 2A-516(2) (1987).

154. CAL. COMM. CODE § 10516(2); U.C.C. § 2A-516(2) (1987).

155. CAL. COMM. CODE § 10516(2). See also *id.* § 10516 comment (this exception derived from California law regarding seller assisted financing). See *Hernandez v. Atlantic Fin. Co.*, 105 Cal. App. 3d 65, 80, 164 Cal. Rptr. 279, 289 (1980) (transaction in which seller assisted buyer in obtaining personal loan from finance company to acquire automobile from seller, where finance company took security in buyer's personal possessions in addition to automobile, violated Rees-Levering Automobile Sales Finance Act (Civil Code sections 2981-2984.4) especially since conduct appeared to be scheme designed to evade Act's requirements)). In any other case acceptance cannot be revoked if it was made with knowledge of a nonconformity unless the

10 also includes language that requires a lessee in a finance lease who has accepted tender to notify the supplier of any default within a reasonable time after the lessee discovers or should have discovered the default.<sup>156</sup>

5. *Cover; Substitute Goods (California Commercial Code section 10518)*

Under Article 2A and Division 10, the lessee may cover upon default by the lessor.<sup>157</sup> Division 10 further specifies that if the lessee covers by a lease agreement substantially similar to the original lease agreement made in good faith and in a commercially reasonable manner, the present value of the recoverable damages is to be calculated as of the commencement of the term of the new lease agreement, not the date of default as provided in Article 2A.<sup>158</sup>

6. *Lessor's Right to Dispose of Goods (California Commercial Code section 10527)*

Article 2A and Division 10 give a lessor the right to dispose of the goods (or the undelivered balance of the goods) under a lease agreement if the lessee defaults<sup>159</sup> or the lessor refuses to deliver or takes possession of the goods.<sup>160</sup> Under Article 2A, if the lessor chooses to

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acceptance was made on the reasonable assumption that the nonconformity would be cured seasonably. CAL. COMM. CODE § 10516(2).

156. CAL. COMM. CODE § 10516(3)(a)(ii) (lessee barred from any remedy against supplier if supplier is not notified). This provision does not apply to consumer leases. *Id.* § 10516(6). See *id.* § 10516 comment.

157. *Id.* § 10518(1), U.C.C. § 2A-518(1) (1987). The lessee may purchase, lease, or contract to purchase or lease goods in substitution for those due from the lessor. CAL. COMM. CODE § 10518(1), U.C.C. § 2A-518(1) (1987).

158. Compare CAL. COMM. CODE § 10518(2)(a) (except as otherwise provided, lessee may recover present value of difference between total rent for lease term of new lease agreement and total rent for then remaining lease term of original lease agreement and incidental or consequential damages, less expenses saved as a result of lessor's default) with U.C.C. § 2A-518(2)(a) (1987) (damages recoverable where lessee covers by lease agreement substantially similar to original lease agreement). See generally CAL. COMM. CODE § 10103(1)(u) (definition of present value).

159. See CAL. COMM. CODE § 10523(1) (circumstances in which lessee is in default).

160. CAL. COMM. CODE § 10527(1), U.C.C. § 2A-527(1) (1987). The lessor may dispose of the goods concerned by lease, sale, or otherwise. CAL. COMM. CODE § 10527(1), U.C.C. § 2A-527(1) (1987). See CAL. COMM. CODE § 10525(1), (2) (lessor may refuse to deliver goods if lessee insolvent and has right to take possession of goods if lessee defaults); § 10526(1) (lessor may stop delivery of goods in possession of carrier or other bailee if lessor discovers lessee is insolvent; lessor may also stop delivery of shipment(s) of express or freight if lessee repudiates or fails to make payment due before delivery for rent, security, or otherwise, or if for any other reason lessor has right to withhold or take possession of the goods).

dispose of the leased goods through a lease agreement substantially similar to the original lease agreement made in good faith and in a commercially reasonable manner, the lessor may recover accrued and unpaid rent as of the date of default.<sup>161</sup> Division 10 changes the date from which accrued and unpaid rent is calculated to the date of the commencement of the term of the new lease agreement.<sup>162</sup>

7. *Lessor's Damages for Default (California Commercial Code section 10528)*

Under Article 2A, if the lessor elects to retain or dispose of the leased goods through a lease agreement, sale, or otherwise, the lessor may recover damages for nonacceptance or repudiation by the lessee in the form of accrued and unpaid rent as of the date of default.<sup>163</sup> In contrast, under Division 10, if the lessor similarly elects, the lessor may recover damages for default by the lessee in the form of accrued and unpaid rent as of the date the lessor obtained possession of the goods or, if earlier, when the lessee made an effective tender of possession of the goods back to the lessor.<sup>164</sup>

8. *Lessor's Action for Rent (California Commercial Code section 10529)*

The Article 2A section governing the lessor's action for rent has been criticized for allowing the lessor to avoid any duty to mitigate

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161. U.C.C. § 2A-527(2) (1987) (also recoverable is present value, as of date of default, of difference between total rent for remaining lease term of original lease agreement and total rent for lease term of new lease agreement plus any incidental damages, less expenses saved).

162. CAL. COMM. CODE § 10527(2)(a) (except as otherwise provided). Also calculated from the commencement of the term of the new lease agreement is the present value of the difference between the total rent remaining under the original lease agreement and the total rent under the new lease agreement. *Id.* § 10527(2)(b) (except as otherwise provided). The Committee felt that it is not correct to discount the lessor's damages to the date of the initial default, given that a delay will usually occur between the default and re-leasing. *Report, supra* note 6, at 65-66.

163. U.C.C. § 2A-528(1)(a) (1987) (except as otherwise provided with respect to damages liquidated or determined by agreement and where lease agreement does not qualify for treatment under U.C.C. § 2A-527(2)). Also recoverable is the present value as of the date of default of the difference between remaining rent due under the original lease and the market rent at the time and place for tender computed for the same lease term plus incidental damages, less expenses saved. *Id.* § 2A-528(1)(b), (c).

164. CAL. COMM. CODE § 10528(1)(a). Division 10 also uses this date to calculate the damages recoverable for the present value of the difference between the total rent remaining under the original lease agreement and the market rent. *Id.* § 10528(1)(b) (market rent determined at place where goods were located on that date). The Committee indicated that it would be unfair to discount the lessor's damages back to the time of the original default without giving the lessor adequate time to dispose of the goods. *Report, supra* note 6, at 67.

damages.<sup>165</sup> Division 10 makes several changes that promote mitigation of the lessor's damages upon default by the lessee.<sup>166</sup> Unlike Article 2A, Division 10 specifies that the lessor may recover certain damages for goods that are accepted by the lessee and not repossessed by or effectively tendered back to the lessor.<sup>167</sup> Division 10 also changes the date from which accrued and unpaid rent and the present value of the lease term's remaining rent are determined; instead of calculating from the date of default, the damages are calculated from the date of entry of judgment in favor of the lessor.<sup>168</sup> A similar change is made to the date used in calculating damages in the form of rent for goods identified to the lease contract where the lessor has not delivered the goods or has taken possession of them or the lessee has effectively tendered the goods back to the lessor.<sup>169</sup>

### 9. *Lessor's Rights to Residual Interest (California Commercial Code section 10532)*

Division 10 includes a section, not found in Article 2A, that codifies the common law right of a lessor to protect its reversionary interest in the goods.<sup>170</sup> The section provides that the lessor will be entitled to recover an amount from the lessee that will fully compensate for any loss or damage to the lessor's residual interest in the goods caused by the lessee's default.<sup>171</sup>

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165. See Kripke, *Some Dissonant Notes About Article 2A*, 39 ALA. L. REV. 791 (1988). Coupled with U.C.C. section 2A-503, U.C.C. section 2A-529 allows the lessor to circumvent mitigation. *Id.* at 795-96. The lessor could contract for the right to reclaim the leased goods and then bring an action for the entire unpaid rent. *Id.*

166. Compare CAL. COMM. CODE § 10529(1)(a), (b) (pertaining to damages recoverable by lessor after default by lessee under the lease contract) with U.C.C. § 2A-529(1)(a), (b) (pertaining to damages for rent recoverable upon default by lessee under the lease contract). See Report, *supra* note 6, at 69 (the Committee based their recommendation for modification on "the general notion of mitigation of damages"). See also Kripke, *supra* note 165, at 796-97 (indicating that many of the modifications recommended by the U.C.C. Committee of the Business Law Section of the State Bar of California are clearly superior to the Article 2A version).

167. CAL. COMM. CODE § 10529(1)(a).

168. Compare *id.* § 10529(1)(a)(i), (ii) (damages recoverable upon lessee's default for goods accepted by lessee) with U.C.C. § 2A-529(1)(a)(i) (1987) (damages recoverable upon lessee's default for goods accepted by lessee and not repossessed by or effectively tendered back to the lessor).

169. Compare CAL. COMM. CODE § 10529(1)(b)(i), (ii) (damages recoverable after lessor makes reasonable effort to dispose of goods or circumstances indicate such effort would be unavailing) with U.C.C. § 2A-529(1)(b)(i), (ii) (damages recoverable after lessor makes reasonable effort to dispose of goods or circumstances indicate such effort would be unavailing).

170. CAL. COMM. CODE § 10532. See *id.* § 10532 comment (intended to supplement and not displace principles of law and equity with respect to protection of reversionary interest).

171. *Id.* § 10532. Because there is no specific reference to the lessor's reversionary interest

## V. LEGAL RAMIFICATIONS OF DIVISION 10

Article 2A of the Uniform Commercial Code is the first comprehensive statutory treatment of personal property leasing in American commercial law history.<sup>172</sup> The California Legislature utilized the U.C.C. statute as a framework for codifying California's first personal property lease division. In enacting Division 10, the Legislature attempted to obviate several problems with the U.C.C. framework.<sup>173</sup> Despite this attempt there remain certain immediate challenges and criticisms that the new law must overcome, some of which will be taken up in the remainder of this note. Several Uniform Commercial Code scholars have criticized the Article 2A drafters' excessive reliance on U.C.C. Article 2 (Sales) as a statutory analogue.<sup>174</sup> One critic maintains that this "excessive reliance" has led to omissions in Article 2A because certain issues unique to a lease transaction have no sales provision analogue.<sup>175</sup> For example, Article 2A fails to include provisions governing the protection of the lessor's reversion, the obligation on the lessee to return the goods, the degree of care to be exercised by the lessee, and the distribution of the duty to repair and maintain the leased goods.<sup>176</sup> Another critic argues that by using Article 2 as an analogue, Article 2A inherits the existing deficiencies in the sales provisions and therefore will need to be revised whenever Article 2 is revised.<sup>177</sup> The foregoing criticisms are applicable to Division 10 to the extent that the California Legislature did not make changes to Article 2A in enacting Division 10.

Although not all issues raised by the critics have been addressed, the Legislature compensated for many of Article 2A's alleged omissions by including language that grants additional rights and protec-

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in Article 2A, the Committee recommended this section to provide clearly for the lessor's right to the reversionary interest. *Report, supra* note 6, at 73-74.

172. See U.C.C. art. 2A foreword (1987).

173. See generally *supra* notes 85-171 and accompanying text (discussion of changes made to the U.C.C. framework by the California Legislature).

174. See Boss, *supra* note 7, at 602 (many Article 2 sections have been carried over to Article 2A even though they relate to issues rarely arising in a leasing context); Kripke, *supra* note 165, at 792 (use of Article 2 as analogue guarantees that several sets of problems will arise); *Report, supra* note 6, at 16 (the Committee felt Article 2A would have benefitted from more independent approach). *But see* U.C.C. § 2A-101 (1987), Comment (drafting committee concluded Article 2 was the appropriate statutory analogue).

175. See Boss, *supra* note 7, at 602.

176. *Id.* at 603.

177. Kripke, *supra* note 165, at 792.

tions and more adequately provides for those situations unique to a lease transaction.<sup>178</sup> For example, Division 10 provides more thorough protection for consumer lessees<sup>179</sup> and lessees in general,<sup>180</sup> and includes more complete protection for the creation of certain security interests.<sup>181</sup> Division 10 also establishes calculations for damages that provide a more accurate recovery and promote mitigation,<sup>182</sup> and provides for full compensation for loss of or damage to a lessor's residual interest in the goods resulting from a lessee's default.<sup>183</sup>

Despite the claims that excessive reliance on existing sales provisions as an analogue will result in the inheritance of existing sales provisions deficiencies,<sup>184</sup> the California Legislature adopted the rationale behind the National Conference of Commissioners on Uniform State Laws drafting committee's use of the Article 2 as a statutory analogue.<sup>185</sup> The Legislature agreed that because the obligations of the parties to a lease are bilateral and the common law of leasing is dominated by

178. See *id.* at 796-97; Boss, *supra* note 7, at 603; Huddleson, *supra* note 92, at 664.

179. Compare CAL. COMM. CODE § 10103(1)(e) (deletes \$25,000 cap from Article 2A definition of consumer lease) with U.C.C. § 2A-103(1)(e) (1987) (definition of consumer lease). See also CAL. COMM. CODE § 10104(1)(d) (provides that additional consumer protection laws are applicable to consumer leases); § 10201(1)(a), (b) (requires that all consumer leases be in writing); § 10402(2) (provides that specified rights and remedies with respect to anticipatory repudiation are not applicable to consumer leases but that such rights and remedies are determined under other laws); § 10506(1) (exempts consumer leases from reduction of period of statute of limitations); § 10516(2) (provides additional protection to consumer lessee where supplier assists in preparation of consumer finance lease). See generally *supra* notes 85-90 and accompanying text (discussion of definition of consumer lease), notes 93-96 and accompanying text (discussion of additional consumer laws applicable to leases), notes 104-105 and accompanying text (discussion of statute of frauds), notes 136-138 and accompanying text (discussion of anticipatory repudiation), notes 147-152 and accompanying text (discussion of statute of limitations), notes 153-156 and accompanying text (discussion of revocation of acceptance in consumer leases where supplier assists in preparation).

180. See, e.g., CAL. COMM. CODE § 10106(2) (places further limitations on choice of judicial forum), 10209(4) (expressly provides that lessee retains all rights and remedies that lessee may have against supplier arising from any agreement between lessee and supplier or from any law). See generally *supra* notes 97-99 and accompanying text (discussion of choice of judicial forum by parties to a consumer lease), notes 107-112 and accompanying text (discussion of effect of rescission or modification of supply contract).

181. See, e.g., CAL. COMM. CODE § 10303(3)(a), (c) (protects creation and enforcement of certain security interests); § 10307(2)(a)-(c) (protects certain additional security interests held by creditors of lessors). See generally *supra* notes 113-119 and accompanying text (discussion of transferability of a party's interest or lessor's residual interest).

182. Report, *supra* note 6, at 65-66, 69. See CAL. COMM. CODE § 10527(2) (calculates certain lessor's damages from commencement of the term of the new lease agreement); § 10529(1)(a), (b) (requires lessor to mitigate damages in action for rent after default by lessee). See generally *supra* notes 159-162 and accompanying text (discussion of lessor's right to dispose of goods), notes 165-169 and accompanying text (discussion of lessor's damages for default).

183. See CAL. COMM. CODE § 10532.

184. See *supra* notes 173-76 and accompanying text.

185. See CAL. COMM. CODE § 10101 comment. The drafting committee chose Division 2 (Sales) as a statutory analogue rather than Division 9 (secured transactions). *Id.*

the need to preserve freedom of contract, a lease is closest in spirit and form to a sale.<sup>186</sup> Additionally, Division 10 should benefit from years of Division 2 case law interpretation that exists as persuasive authority for the potentially difficult issues which will arise.<sup>187</sup> Many of the imperfections that would have required endless litigation had Division 10 been written on a clean slate have already been worked out in litigation over Division 2.

Another criticism of Division 10 focuses on the alleged lack of adequate protection conferred upon a lessee if a supplier breaches a finance lease.<sup>188</sup> In a finance lease, the lessor generally plays the least active role in the transaction and the lessee looks almost exclusively to the supplier for representations, covenants, and warranties.<sup>189</sup> Both Division 10 and Article 2A state that the benefit of the supplier's promises and all warranties to the lessor under the supply contract extend to the lessee "subject to the terms of the supply contract and all of the supplier's defenses or claims arising therefrom."<sup>190</sup> Because the supply contract is solely between the lessor and the supplier, and no other section in Division 10 confers upon the lessee warranty rights or remedies against the supplier, there is the potential that the lessor and the supplier could draft the supply contract devoid of any warranties applicable to the lessee.<sup>191</sup> Critics claim that this result would be contrary to both existing California law and the reasonable expectations of suppliers and lessees.<sup>192</sup>

Division 10 provides, however, that the lessee retains all rights and remedies that the lessee may have against the supplier which arise out of any agreement between the lessee and supplier.<sup>193</sup> This express retention of rights and remedies should create a cause of action against the supplier for breach of a warranty that arose from

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186. *Id.*

187. *See id.* (case law interpreting Division 2 should be viewed as persuasive but not binding when deciding a similar issue with respect to leases).

188. *See* DIVISION OF CONSUMER SERVICES CRITIQUE OF DIVISION 10 (June 17, 1988) [hereinafter CRITIQUE] (on file at *Pacific Law Journal*). *See generally* CAL. COMM. CODE § 10103(1)(g) (definition of finance lease). *See also supra* notes 91-92 and accompanying text (discussion of definition and creation of finance lease).

189. *See* CAL. COMM. CODE § 10103(g) comment. Division 10 includes a cluster of rules applicable only to finance leases. *Id.*

190. *Id.* § 10209(1); U.C.C. § 2A-209(1).

191. *See* CRITIQUE, *supra* note 188, at 7.

192. *Id.*

193. CAL. COMM. CODE § 10209(4) (lessee also retains all rights and remedies arising from any other law).

representations made during negotiations between the lessee and supplier.<sup>194</sup> Additionally, the lessee in a finance lease will have an opportunity to be informed of the available rights and warranties and is able to receive the benefit of the supplier's promises and warranties by ensuring that the terms of the supply contract extend to the lessee.<sup>195</sup> Despite these protections, critics maintain that the failure of Division 10 to provide comprehensive protection for the finance lessee ensures that the courts will ultimately be called upon to decide many finance lease issues.<sup>196</sup>

## VI. CONCLUSION

Division 10 of the California Commercial Code represents an attempt to codify the "amalgamation of principles" which has governed personal property leases in California. The new statute substantially adopts the Uniform Commercial Code Article 2A provisions while making deletions and additions to reflect California commercial law particularities. The changes also reflect an attempt to enact a more complete personal property lease statute than that provided in the U.C.C.. Although there are certain areas of Division 10 that are not immune to criticism and inevitably will require judicial interpretation, the new division has received overwhelming support from the California leasing industry<sup>197</sup> and will likely serve as a model for other state legislatures that adopt U.C.C. Article 2A.

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194. See *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 493, 186 Cal. Rptr. 114, 126 (1982) (upon review of the totality of the circumstances, disclaimers of warranties and exclusion of consequential damages in contract held unconscionable and unenforceable); *Randy Knitwear, Inc. v. American Cyanamid Co.*, 181 N.E. 2d 399, 404 (1962) (manufacturer held liable for breach of express warranties notwithstanding lack of privity of contract between manufacturer and plaintiff). See generally Comment, *Unconscionability and the Enforcement of Standardized Contracts in Commercial Transactions*, 16 PAC. L.J. 247 (1984) (analysis of the *A & M Produce* decision).

195. See CAL. COMM. CODE § 10103(1)(g)(A), (B), (C), (D). See generally *supra* notes 91-92 and accompanying text (discussing creation of a finance lease).

196. See CRITIQUE, *supra* note 188, at 10.

197. See Letters to California Governor George Deukmejian from the California Association of Equipment Lessors, the California Bankers Association, United States Leasing International, Inc., the National Commercial Finance Association, Security Pacific National Bank, the American Association of Equipment Lessors, the Western Association of Equipment Lessors, and the National Vehicle Leasing Association (all indicating support for Division 10 and requesting Governor Deukmejian sign Senate Bill 1580 and Senate Bill 2492) (on file at *Pacific Law Journal*).

APPENDIX

*Code Sections Affected*

SB 1580 (Beverly); 1988 STAT. Ch. 1359

Commercial Code §§ 11101, 11102, 11103, 11105, 11106, 11107, 12101, 12102, 12103, 12104 (repealed); §§ 10101, 10102, 10103, 10104, 10105, 10106, 10107, 10201, 10202, 10204, 10205, 10206, 10207, 10208, 10209, 10210, 10211, 10212, 10213, 10214, 10215, 10217, 10218, 10219, 10220, 10221, 10301, 10302, 10303, 10304, 10305, 10306, 10307, 10308, 10309, 10310, 10401, 10402, 10403, 10404, 10405, 10406, 10407, 10501, 10502, 10503, 10504, 10505, 10506, 10507, 10508, 10509, 10510, 10511, 10512, 10513, 10514, 10515, 10516, 10517, 10518, 10519, 10520, 10521, 10522, 10523, 10524, 10525, 10526, 10527, 10528, 10529, 10530, 10531, 10532 (repealed and new); §§ 13101, 13102, 13103, 13104, 13105, 14101, 14102, 14103, 14104, 14105, 14106, 14107, 14108, 14109, 15101, 15102, 15103, 15104 (new); §§ 1105, 1201, 9113 (amended).

SB 2492 (Beverly); 1988 Stat. Ch. 1368

Commercial Code §§ 2201, 2402, 2718, 6103, 9318, 9402, 10103, 10106, 10209, 10307, 10402, 10516, 10518, 10516 (amended); Civil Code §§ 1624, 3308, 3340.1, 3440.9 (amended); Code of Civil Procedure §§ 697.610, 697.730, 697.740 (amended).

*Support and Opposition*

SB 1580 (Beverly); 1988 STAT. Ch. 1359

Support: American Association of Equipment Lessors; California Association of Equipment Lessors; State Bar of California; Security Pacific Corporation; National Vehicle Lease Association.

SB 2492 (Beverly); 1988 Stat. Ch. 1368

Support: American Association of Equipment Lessors; California Association of Equipment Lessors; State Bar of California; Security Pacific Corporation; National Vehicle Lease Association.

