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The Structure of Lessees' and Lessors' Remedies Regarding Finance Leases of Equipment and Personal Property Under United States and German Law

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I. INTRODUCTION

"Neither a borrower nor a lender be."1

Today, many business people fail to consider Polonius's advice to his son Laertes when evaluating investment policies. For decades, borrowers — companies, merchants, and, increasingly, consumers in need of capital but in poor financial condition — have been leasing equipment. Often these are finance leases, an alternative to conventional debt financing.2 Further, lenders — commercial banks, finance companies, and equipment manufacturers — learned that finance leases of equipment are frequently as safe and profitable as secured loans.

This Article focuses on lessee and lessor remedies regarding finance leases of equipment or personal property. First, it will high-
light the structure of such leases and the driving force behind them, since knowledge of the parties' motives makes it easier to understand resulting legal problems. Then this Article will describe, in detail, both the United States and German rules on finance leases. Within the analysis for each country, this Article will discuss the legal provisions governing finance leases and their applicability to freedom of contract principles. Further, it will analyze remedies available to lessees and lessors within each country, with a focus on rights linked to such remedies. While not purporting to be an exhaustive survey of potential conflicts under finance leases, this Article instead emphasizes the structure of the parties' rights and remedies, and compares them under United States and German law.

In the last section of this Article, particular attention is paid to finance leases for personal property. In addition to comparing the United States and German approaches towards these leases, this section will analyze the leases under the Draft Unidroit Conventions on International Factoring and International Finance Leasing. This last section will also analyze the differences in rights among consumer and non-consumer lessees. In the end, the question arises regarding what extra protection should be afforded to consumers, and this Article suggests some possible answers. Yet the question remains whether Polonius' advice should be updated to read: "Neither a lessor nor a lessee in a finance lease be."

II. THE STRUCTURE AND PURPOSE OF FINANCE LEASES

The economic structure of finance leases typically involves three parties: the person supplying the goods (supplier), who does not want to lease them or does not want to lease them to the person being supplied (lessee); the lessee, who does not want to buy the goods because of tax considerations, lack of creditworthiness, or inability to raise enough capital; and a third-party lessor, who becomes a conduit between the two primary parties with conflicting interests. Generally, the lessee initiates the transaction by selecting the goods from the supplier and arranging for the lessor to either buy or lease the goods from the supplier. The essential characteristic of a finance lease is that the lessor merely supplies the money and is not a merchant in the goods. The lessor then leases or subleases them to the lessee. While the transaction between supplier and lessor may be either a lease or a sale, the transaction between lessor and lessee can never be a sale.3

3. The requirements placed on lessor-lessee transactions under United States and Ger-
The advantages of finance leases are many, but this Article only explains them briefly. First, suppliers make contracts with financially stable lessors, since they are more likely to be solvent and reliable. Second, certain advantages in federal tax treatment has caused equipment leases to “boom” over other means of acquiring equipment. Specifically, the relationship between an owner-lessee’s accelerated depreciation, a lessee’s deduction of rental payments and, significantly, the financial treatment of these payments has provided both lessor and lessee with the opportunity to obtain tax benefits from owning or possessing the leased goods. However, the extent of tax benefits to a lessee depends on whether the lessee is a merchant or a consumer. Non-tax related advantages of finance leases should not be underestimated. Most importantly, the lessor in a finance lease generally has few obligations to the lessee. This is due to the fact that the lessor functions merely as a vehicle to facilitate the transaction between supplier and lessee.

Leasing equipment and personal property is still a comparatively larger business in the United States than in Germany. While finance leases of computers, office equipment, vehicles, other transportation equipment, and manufacturing equipment were setting themselves apart from other financing methods, both United States and German laws failed to keep pace. Given the rapid rise of finance leases, it is surprising that a more comprehensive and definitive body of law does not govern these leases. This is especially surprising when compared to other commercial transactions like sales and secured transactions

man law will be discussed in detail later in this Article. See infra notes 32-41, 216-24 and accompanying text.


6. Id. at 56-1, 56-3. See Arno Städtler, Leasinggesellschaften investieren über 40 Mrd. DM, FINANZIERUNG, LEASING, FACTORING [FLF] 3-8 (1991) (F.R.G.). The value of leasing, measured by the original cost of equipment, rose from $78.7 billion in 1985 to an estimated $122.4 billion in 1989. In Germany, it rose from DM18.6 billion to DM31.5 billion. The estimated value for the United States in 1990 was $131.6 billion, and in Germany it was DM35.2 billion. In the United States, the leasing volumes in 1989 and 1990 accounted for 33% of the business investment in equipment during those years, whereas in Germany the leasing volumes accounted for 14.5% in 1989 and 14.3% in 1990. Following reunification, the number of equipment leases in Germany should significantly increase.
in personal property.\footnote{7}{James E. Foster & David G. Shields, Personal Property Leasing in Florida: Moving 2A Uniform Treatment, 18 Fla. St. U. L. Rev. 295-96 (1990).} Eventually, the widespread success of equipment leasing forced legislatures to respond with laws dealing with new developments in debt financing.

This movement towards statutory regulation was a natural reaction to the explosive growth of equipment leasing. The efforts to promulgate pertinent statutes in the United States, however, differ notably from those in Germany. In the United States, the era of explicit statutory regulations regarding finance leases started in 1987. It began with the promulgation of Article 2A of the Uniform Commercial Code\footnote{8}{U.C.C. art. 2A (1990).} ("U.C.C." or "Code") which was amended in 1990. As of June 30, 1992,\footnote{9}{See Gerald T. McLaughlin & Neil B. Cohen, Headline: UCC § 1-206 — Statute of Frauds, 206 N.Y. L.J. 1, 3 (1991).} sixteen states adopted either the 1990 Official Text of Article 2A or the 1987 Official Text.\footnote{10}{Aside from minor changes in style or content, the following states have adopted either the 1990 or the 1987 Official Text: California, Colorado, Florida, Hawaii, Indiana, Kentucky, Minnesota, Montana, Nevada, New Mexico, Oklahoma, Oregon, South Dakota, Utah, Virginia, and Wyoming.} Further, U.C.C. Article 2A legislation has been introduced and considered in seven states.\footnote{11}{The seven states are Delaware, Illinois, Kansas, Maine, Nebraska, Rhode Island, and Wisconsin.} Other states expect to initiate corresponding legislation in the near future.\footnote{12}{These include Alaska, the District of Columbia, Georgia, Iowa, Massachusetts, Michigan, Mississippi, New Hampshire, New York, North Dakota, Ohio, Tennessee, Texas, Vermont, Washington, and West Virginia.} In the long run, U.C.C. Article 2A is likely to be adopted with slight modifications in forty-nine states and two territories.\footnote{13}{See U.C.C. § 2A-101 official cmt. (1990) ("Rapid and uniform enactment of Article 2A is expected as a result of the completed amendments."). As to the consequences of legislation by voluntary U.C.C. model rules, and the efficiency, effects, and pros and cons of the U.C.C.'s approach, see generally F. Stephen Knippenberg & William J. Woodward, Jr., Uniformity and Efficiency in the Uniform Commercial Code: A Partial Research Agenda, 45 Bus. Law. 2519-31 (1990).}

The notable exception is Louisiana. The Louisiana Civil Code is a code of Roman-Germanic and especially French tradition. The enactment of U.C.C. Articles 2 and 2A amount to a derogation of numerous Louisiana code provisions. However, Louisiana has adopted U.C.C. Articles 1, 3, 4, 5, 7, and 8. U.C.C. Article 2A provisions regarding leases will create the same consistency in Codes that was created by Article 2 in regards to sales transactions.\footnote{14}{Richard P. Hirtreiter, Analogy's Failure Supports the Adoption of Article 2A of the Uniform Commercial Code: A Partial Research Agenda, 45 Bus. Law. 2519-31 (1990).}
German leases, particularly finance leases, are governed by different provisions. Although leases already were subject to federal laws when finance leases emerged in the 1960s, finance leases still lacked explicit statutory provisions and were mostly regulated by case law. Thus, when dealing with legal problems related to finance leases, German courts apply by analogy the leasing provisions that are tailored to two-party transactions. Finance leases, however, were mentioned, but not defined, in a recent act governing consumer credits.

III. UNITED STATES

A. Preliminary Comments

1. History of U.C.C. Article 2A and its Subsequent Amendments

Although only a few years have passed since the promulgation of U.C.C. Article 2A, determining its origins is a difficult task. In retrospect, several aspects considerably affected the development of leasing statutes.

Since the late 1970s, the leasing industry has expanded enormously. The lack of rational rules governing the rights, remedies, and duties of a lessor in the event of a lessee's default created the need for statutory provisions. Most lease contracts contain some standard and important stipulations. However, the language and content of these stipulations vary widely, as no two standard lease forms are completely alike. In addition, great uncertainty and confusion was created by the unguided courts' varying interpretations of the clauses. Thus, the lack of concrete legal principles to resolve leasing disputes inevitably caused courts to render decisions that were typically inconsistent and irreconcilable.

Naturally, as the problem grew, it attracted the attention of practitioners and legal scholars who searched for remedial and counter measures. Charles W. Mooney's article entitled "Personal Property Leasing: A Challenge" was one of many critical evaluations that


identified several uncertainties in the then-current leasing law.\textsuperscript{19} Therefore, this movement may be another influence that gave rise to statutory leasing provisions.

In 1985, the National Conference of Commissioners of Uniform State Laws ("NCCUSL") approved a proposed uniform state law on equipment leasing.\textsuperscript{20} The Uniform Personal Property Leasing Act ("UPPLA") was accepted after three years of revisions by a drafting committee of law professors and practitioners.\textsuperscript{21} The NCCUSL, however, considered it better to incorporate the UPPLA into the existing framework of the U.C.C., rather than creating a free-standing act.\textsuperscript{22} This was due to the already-existing correlation between the common law and U.C.C. Articles 2 and 9. Slight changes were later made, resulting in proposed U.C.C. Article 2A. The final draft was adopted in 1987 by the American Law Institute ("ALI") and the NCCUSL.\textsuperscript{23} These two bodies sponsored and approved Article 2A and its conforming amendments to U.C.C. Articles 1 and 9. This marked the first essential addition to the U.C.C. since its original promulgation in 1951.

The new Article 2A is confined to the leasing of personal property.\textsuperscript{24} While in theory the drafters of Article 2A created an entirely new body of law, many of the U.C.C.'s provisions under Article 2 governing sales were carried over to Article 2A, as "the lease is closer in spirit and form to the sale of goods than to the creation of a security interest."\textsuperscript{25} Thus, the provisions adopted from Article 2 were modified in order to reflect the differences in leasing terminology and practices. Additionally, the drafters codified the common law of finance leases in at least two significant respects. First, they provided that the Official Comments to those provisions carried over from Arti-


\textsuperscript{21} Id.

\textsuperscript{22} Id.

\textsuperscript{23} Id.


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Cle 2 would be incorporated in Article 2A by reference. Second, and equally important, they deemed persuasive any case law applicable to sections borrowed from Article 2, but did not hold them as binding on courts deciding similar questions on leases.

There are risks involved, however, when moving into entirely new statutory territory. In fact, the actions described above led to criticism from practitioners and legal scholars regarding, among other things, the procedure by which Article 2A was promulgated. Further, they criticized the omission of a "battle of the forms" provision in U.C.C. Article 2A, along with unresolved issues in the interplay between finance leases, transactions that create a security interest, and the lessor's remedy structure under Article 2A.

Because the debate over issues such as those above hindered the enactment of Article 2A, the NCCUSL eventually addressed several issues with amendments in 1990. They did this by forging a compromise between the Official Text of 1987, the California and Massachusetts amendments, and problems put forth in other states. Notwithstanding the doubts attending U.C.C. Article 2A, it represents a major advance in substantive commercial law.

2. Finance Leases Under U.C.C. Article 2A

For a transaction to qualify as a finance lease it must first comply with U.C.C. section 2A-103(1)(j), which defines the term "lease."
Second, it must meet the definition of a “finance lease,” per the numerous and comprehensive requirements of U.C.C. section 2A-103(1)(g). Any problems encountered while interpreting these sections can be resolved by looking at the relevant section of the Official Comment. Nevertheless, some significant questions regarding finance leases still remain. Because of its limited scope, however, this Article will only focus on the crucial issues regarding finance leases.

The issue of the complicated distinction between “true” finance leases under U.C.C. section 2A-103(1)(g) and transactions that create a security interest in terms of U.C.C. section 1-201(37) addresses a


33. U.C.C. § 2A-103 provides:

“Finance lease” means a lease with respect to which:
(i) the lessor does not select, manufacture, or supply the goods;
(ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and
(iii) one of the following occurs:
   (A) the lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract;
   (B) the lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;
   (C) the lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications of remedies, or liquidated damages, including those of a third party, such as the manufacturer of the goods, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods; or
   (D) if the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor, unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this Article to the promises and warranties, including those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies.


question of fundamental importance. The U.C.C. treats a lease transaction creating a security interest as providing for a sale and taking a security interest. A true lease, on the other hand, is treated simply as a lease. Therefore, if a lease involves a security transaction, the sales aspect of the transaction will be governed by U.C.C. Article 2 (Sales), while the security aspects will be governed by U.C.C. Article 9 (Secured Transactions). Conversely, if a lease is a “true” lease, it will be covered under U.C.C. Article 2A. Since some of the provisions in Articles 2, 2A, and 9 differ significantly, identifying “true” finance leases from transactions creating a security interest will affect the rights of all parties to the transaction. To illustrate, a lessor must usually file a financing statement for a lease intended as security only if he wishes to perfect his security interest and protect his rights in the leased property against other claimants. It is likely, however, that many lessors will continue to file financing statements as a safeguard, because the line between a “true” lease and a “security interest” lease is not completely clear.

The differences between security interest leases and true leases are especially striking in the case of finance leases. Although U.C.C. Article 2A generally follows U.C.C. Article 2, it contains special additional rules for true leases that also qualify as finance leases. In this manner, U.C.C. Article 2A recognizes the fact that the structure and issues underlying three-party finance leases differ from those governing two-party leases. While U.C.C. Article 2A deals explicitly with true finance leases, neither U.C.C. Article 2 nor Article 9 provides specifically for security interest leases that also qualify as finance leases.

Since an elaboration of the basic issues indicated in the preceding paragraph is beyond the scope of this Article, the discussion is limited to providing recent references to these points of controversy. These references give comprehensive information about the distinction between true leases and security interest leases, the 1990 amendment


to U.C.C. section 1-201(37), the uncertainties surrounding filing requirements, and critical evaluations.


39. U.C.C. Article 2A's approach is generally endorsed by White & Summers, supra note 20, at 18 ("[t]he new section 1-201(37) will bring some of the wayward judicial sheep back into the fold, and we think it leaves fewer lawyer questions unanswered"). See also Cooper, supra note 36, at 247-48 ("[g]rand improvement over the current guidelines provided by the U.C.C. . . . the parties and the courts will for the first time have a sound basis upon which to judge the nature of their contractual agreements"); Foster & Shields, supra note 7, at 312 ("[w]ill not reduce litigation, at least the definition in Article 2A expressly eliminated a number of factors which should have no bearing on the determination of whether a transaction is a true lease or creates a security interest"); Michael J. Herbert, Getting Better All the Time: The Official (Revised) Remedy Provisions of the Uniform Commercial Code's Article 2A, 96 COMM. L.J. 1, 30 (1991) ("Article 2A is thus by no means an ideal codification of personal property lease law. . . . However, as revised, Article 2A provides a reasonable framework within which leases can be drafted, interpreted, and enforced. No better framework is on the horizon."); Huddleston, supra note 36, at 681 ("The statute clarifies the difference between a true lease and a 'security interest.' Moreover, it provides clarity and uniformity in state law . . . "). But see Gaines, supra note 36, at 83-84 ("[s]ubsection 1-201(37) . . . is a poorly drafted code provision . . . [a] definitional nightmare both for those attempting to structure a lease transaction and those subsequently called upon to interpret it . . . . While [the] proposed definition may be perfectly clear to an economist or the drafters, it is both convoluted and inartfully drafted."); Ivy Ozer, Note, Article 2A of the Uniform Commercial Code: An Unnecessary Perpetuation of the Lease-Sale Distinction, 54 BROOK. L. REV. 1357, 1358 n.10, 1365-66 (1989) ("[h]owever, the new definition [of U.C.C. § 1-201(37)] still does not provide a broadly appli-
Surprisingly, U.C.C. section 2A-103(1)(g) fails to address the question of whether one of the most common types of three-party leases qualifies as a finance lease. Some leasing companies are affiliates of parent companies which, either themselves or through subsidiaries, manufacture goods which may qualify as an equipment lease. However, this current practice of three-party leases, such as automobile finance leases, is at least mentioned in the Official Comment to U.C.C. section 2A-103: "[t]his Article creates no special rule where the lessor is an affiliate of the supplier; whether the transaction qualifies as a finance lease will be determined by the facts of each case." In these crucial situations, leasing subsidiaries of manufacturers are not concerned with the uncertainty of the Code. The reason for this is quite simple. They may contract for the same benefits provided by the statute. The Official Comment to the U.C.C. refers to this "freedom of contract" approach as follows: "If a transaction does not qualify as a finance lease, the parties may achieve the same result by agreement; no negative implications are to be drawn if the transaction does not qualify." Thus, U.C.C. section 2A-103(1)(g) should be viewed only as a safe harbor by those lessors who structure their lease contracts under the definition of a "finance lease." Further, it should not be viewed as restricting the rights of parties to lease contracts to create their own contractual variations of statutory finance lease provisions.

3. Freedom of Contract and Its Consequences on Lessee and Lessor Remedies in a Finance Lease

Though no specific provision of U.C.C. Article 2A addresses a party's freedom to contract, this principle is nonetheless the overriding theme of Article 2A. In other words, most of Article 2A's provisions are not mandatory. Therefore, except in few instances, the principles of Article 2A only apply when the parties have not agreed
to be bound by them. Further, within reasonable limits, the parties to a lease are given the freedom to create their own set of rights and remedies in the lease agreement. Therefore, Article 2A serves as a "gap-filler" where the agreement of the parties is incomplete or inconclusive. As Edwin Huddleson has stated, "the impact of the new statute on standard lease forms will vary, depending on the sophistication of the particular form."

So, does U.C.C. Article 2A turn out to be merely an auxiliary statute covering true leases, with little, if any, impact on finance leases? Why, then, explore the details of statutory remedies available to lessees and lessors that may never directly be used? Without a doubt, at least some finance leases repeatedly are based on agreements that lack a comprehensive remedies section. In those cases statutory remedies are directly applicable. In cases of doubt, courts measure the fairness of a contractual remedy by testing its validity and enforceability against the standards provided in Article 2A.

Moreover, these standards play a significant role in the lease market. On the one hand, Article 2A serves as a yardstick, indicating to lessors the extent to which their contractual rights and remedies are without objection. On the other hand, lessees can use the statutory provisions as a guideline when evaluating their obligations, and in exceptional cases, rights under a lease agreement. For that purpose statutory remedies mirror those which lessors and lessees would approve if each had the knowledge and leverage to bargain effectively. Therefore, when checking the legality of finance lease stipulations for remedies, knowledge of Article 2A is indispensable. Finally, when considering the effect of U.C.C. Article 2A on the principle of free-

44. U.C.C. § 2A-503 states:

Except as otherwise provided in this Article, the lease agreement may include rights and remedies for default in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article. Resort to a remedy provided under this Article or in the lease agreement is optional unless the remedy is expressly agreed to be exclusive. If circumstances cause an exclusive or limited remedy to fail of its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this Article.


45. Bayer, supra note 24, at 1494.

46. Huddleson, supra note 36, at 622.

47. Boss, supra note 37, at pts. XII(B), (C); Herbert, supra note 26, at 459; Herbert, supra note 39, at 28; Rapson, supra note 17, at 885. See also Jeffrey J. Wong, Article 2A (Leases) of the Uniform Commercial Code: Selected Issues, 94 CoM. L.J. 57, 58, 63 (1989).

48. Herbert, supra note 26, at 459; Herbert, supra note 39, at 28.
dom of contract, Professor Gregory Naples is certainly correct in saying: "However, as with all else in life, such freedom of contract as may be espoused in theory is not always so unfettered in practice." 49

B. General Lessee's Remedies in a Nonconsumer Finance Lease

Pursuant to U.C.C. section 2A-501(2), the remedy structure of Article 2A is triggered only by default. A lessor's default is defined in U.C.C. section 2A-508(1), as that which provides a remedy merely "if a lessor fails to deliver goods in conformity to the lease contract under section 2A-509, repudiates the lease contract under section 2A-402, or a lessee rightfully rejects the goods under section 2A-509, or justifiably revokes acceptance of the goods under section 2A-517." 50 The comprehensive remedies of Article 2A should not be automatically applied in cases of minor default without the express agreement of the parties.

In addition, it is important to recognize that the remedies available to finance lessees depend on whether the leased goods have been accepted by the lessee. Therefore, this section will first explain the lessee's rights and remedies prior to acceptance of goods. Subsequently, this section will address the changes resulting from the lessee's acceptance of the goods. After briefly explaining a lessee's rights, independent of U.C.C. Article 2A, against manufacturers and other remote sellers and suppliers, this section will then discuss the topic of a nonconsumer lessee's rights and remedies.

1. Lessee's Rights and Remedies Prior To Acceptance of Goods

Under U.C.C. section 2A-509, lessees may reject goods delivered in a single lot, 51 "if the goods or the tender or delivery fail in any respect to conform to the lease contract." 52 The same right is available to the lessee under U.C.C. section 2A-510 in an installment lease, 53 if a nonconforming delivery "substantially impairs the value of that delivery and cannot be cured or the nonconformity is a defect in the required documents." 54 A merchant lessee's duties concerning rightfully rejected goods are covered by U.C.C. section 2A-511 and

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49. Naples, supra note 24, at 347.
50. For a more extensive appreciation of the scope, see Herbert, supra note 26, at 423-41.
52. U.C.C. § 2A-509 (paralleling the "perfect tender" rule of U.C.C. § 2-601).
54. U.C.C. § 2A-510 (paralleling the "substantial impairment of value and cannot be cured" test of U.C.C. § 2-612).
2A-512, whereas U.C.C. section 2A-513 sets standards for the lessee's or supplier's right to cure. Finally, U.C.C. section 2A-514 directs how to state defects, and U.C.C. section 2A-515 defines "acceptance."

Also, in cases of breach by a lessor where the lessee has not accepted the goods, the lessee may exercise the aggregate rights enumerated in U.C.C. section 2A-508(1). Under section 2A-508(1), a lessee may:

(a) cancel the lease contract;
(b) recover so much of the rent and security as has been paid and is just under the circumstances;
(c) cover and recover damages as to all goods affected, whether or not they have been identified to the lease contract, or recover damages for nondelivery;
(d) exercise any other rights or pursue any other remedies provided in the lease contract.

Additionally, U.C.C. section 2A-508(2) lists two alternative and cumulative remedies for the recovery of goods by the lessee with respect to the rights named in the previous paragraph.

Subsections (3) and (1)(d), both amended in 1990, are typical examples of the freedom of contract axiom reflected throughout Article 2A. According to the Official Comment to the U.C.C., both subsections:

recognize that the lease agreement may provide rights and remedies in addition to or different from those which Article 2A provides. In particular, subsection (3) provides that the lease agreement may give the remedy of cancellation of the lease for defaults by the lessor that would not otherwise be material defaults which would justify cancellation under subsection (1).

In the case of breach of warranty by the lessor, the lessee may recover damages under U.C.C. sections 2A-508(4) or 2A-519(4). In

56. See U.C.C. § 2A-513 (paralleling the cure provision in U.C.C. § 2-508).
59. U.C.C. § 2A-508(1) (paralleling the rights provided to buyers in U.C.C. § 2-711(1)).
60. See 2A-508(2) (a version of the provisions of U.C.C. § 2-711(2)).
62. U.C.C. § 2A-508(4) is new and merely adds to the completion of the section's index, whereas U.C.C. § 2A-519(4) is a revised version of the provisions of U.C.C. § 2-714(2). For further discussion of these provisions, see White & Summers, supra note 20, at 32-33; Herbert, supra note 39, at 3-4.
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a finance lease, however, the lessee automatically becomes a beneficiary of all the supplier's warranties under the contract, and thus has only limited warranty rights against the lessor. Such a lessee generally cannot revoke an acceptance of goods, and therefore must reject the goods immediately upon receipt in order to have any remedies against the lessor.

The controversy over warranties was one of the most litigated areas in leasing prior to the promulgation of U.C.C. Article 2A. In general, and with only a few exceptions, the warranty rules of U.C.C. sections 2A-210 through 2A-216 parallel the corresponding provisions of Article 2 on sales. As stated by the drafters of the Code, "the lease of goods is sufficiently similar to the sale of goods to justify this decision." As a result, under U.C.C. Article 2A a lessee has at least six different sources for warranty rights relating to leased goods.

Under U.C.C. section 2A-210, express warranties are created in all leases by actions of the lessor that become part of the "basis of the bargain." These actions can include any affirmation of fact or promise made with regard to the goods, any description of the goods, or the use of a sample or model of the goods. While a warranty is not created by merely advertising leased goods, formal words are not necessary to create an express warranty under Article 2A.

U.C.C. Article 2 abolished the warranty of quiet possession with respect to sales. In contrast, under U.C.C. section 2A-211(1), each type of lease includes a warranty by the lessor, protecting the lessee from third-party claims "that arise from an act or omission of the lessor, other than a claim by way of infringement or the like, which will interfere with the lessee's enjoyment of its leasehold interest."

For non-finance leases, providing the lessor is a merchant who regularly deals in goods of that kind, U.C.C. section 2A-211(2) creates an implied warranty that "the goods are delivered free of rightful claims of any person by way of infringement or the like." Also, in this situation, U.C.C. section 2A-212 creates an implied warranty of

64. For a detailed discussion of warranty rights in finance leases, see infra notes 78-88 and accompanying text.
66. Huddleston, supra note 33, at 72; Huddleston, supra note 36, at 667.
68. This section follows the express warranty provisions of U.C.C. § 2-313.
71. U.C.C. § 2A-211(2) (1990) (paralleling U.C.C. § 2-312(3)).
merchantability given by the lessor.\textsuperscript{72}

Further, in non-finance leases, U.C.C. section 2A-213 contains a warranty of fitness for particular purposes. This warranty arises if, at the time the lease is made, the lessor has reason to know: (1) the particular purpose for which the goods are required; and (2) that the lessee is relying upon the lessor's skill or judgement to select or furnish suitable goods.\textsuperscript{73}

As in U.C.C. Article 2,\textsuperscript{74} the lease agreement may disclaim or limit warranties. Thus, Article 2's requirement of conspicuous disclaimers for warranties is repeated in U.C.C. section 2A-214.\textsuperscript{75} The Official Comment states: "[T]o exclude or modify the implied warranty[ies] of merchantability, fitness or against interference or infringement the language must be in writing and conspicuous."\textsuperscript{76} Besides these warranties, third-party beneficiaries of express and implied warranties are covered under U.C.C. section 2A-216.\textsuperscript{77}

Finally, U.C.C. section 2A-209 is a landmark provision regarding finance leases.\textsuperscript{78} This section provides that, in a finance lease, the lessee may enforce all promises made by the supplier to the lessor.\textsuperscript{79} Also, the lessee may enforce all warranties accompanying the supply contract between supplier and lessor against the supplier, despite a lack of privity.\textsuperscript{80} For the protection of the lessee, the Code treats the lessee as if he had contracted with the supplier directly. If the lessor acquired leased goods through a sale, the lessee's warranties would include warranties of title, warranties against infringement, express warranties, implied warranties of merchantability, and warranties of fitness for a particular purpose.\textsuperscript{81} In essence, U.C.C. Article 2A limits

\textsuperscript{72} The source of this provision is found in the merchantability provisions of U.C.C. § 2-314. For a critical examination of this approach, see Jonathon H. Rudd, Rejection of Implied Warranty Theories of Article 2A of UCC, 57 DEF. COUNS. J. 14, 14-28 (1990). Additionally, the author disagrees with the exemption of finance lessors from U.C.C. § 2A-212 and identifies conflicts between Article 2A's warranty sections and product liability laws. \textit{Id.} at 26-27.

\textsuperscript{73} U.C.C. § 2A-213 (1990). These requirements essentially mirror those of U.C.C. § 2-315. For an in-depth discussion of this approach, see Rudd, \textit{supra} note 72, at 14-28.

\textsuperscript{74} See U.C.C. §§ 2-316, 2-312(2) (1990).


\textsuperscript{76} \textit{Id.} official cmt. (1990). See also WHITE & SUMMERS, \textit{supra} note 20, at 51-52.

\textsuperscript{77} See U.C.C. § 2A-216 (1990). These ideas modify the provisions of U.C.C. § 2-318.

\textsuperscript{78} See U.C.C. § 2A-209 (1990).

\textsuperscript{79} \textit{Id.}

\textsuperscript{80} \textit{Id.}

\textsuperscript{81} See U.C.C. §§ 2-312 to 2-315 (1990). At first sight it appears difficult to find an implied warranty of fitness for a particular purpose either under U.C.C. §§ 2-315 and 2A-213 in a supply contract. This is because the lessee relies on the supplier's skill and judgement based upon his knowledge of the lessee's particular purpose that gives rise to the warranty. See
the finance lessee’s recourse for defective goods to a claim against the supplier under the supply contract between the supplier and the lessor. By providing protection to the lessee as a third-party beneficiary, U.C.C. section 2A-209(1) not only continues leasing practices in effect before its enactment, but also sets out a rule that harmonizes the interests of the parties to a finance lease. The lessee in such a transaction generally looks to the supplier for assurances concerning the quality of the goods, while the supplier, as a seller of goods, is subject to the warranty provisions of U.C.C. Article 2.

Since the supply contract is made between the supplier and the lessor, however, an aggrieved lessee is not in privity with the supplier if he takes legal action directly against him for breach of warranty. To accommodate the interests involved in third-party finance leases, the self-executing provision of U.C.C. section 2A-209(1) extends the benefit of the supplier’s promises and all warranties under the supply contract to the lessee.82 This provision relieves the lessor of the burden of inserting a clause specifying the above provisions into the lease. In addition to this “pass through,” U.C.C. section 2A-209 also restricts the abilities of the supplier and lessor to modify any warranties without the consent of the lessee.83 It makes clear the fact that any warranties made by third parties, such as manufacturers, to the supplier also affect the lessee.84 Because the lessor serves only as “a conduit for a transaction between the supplier and the lessee,”85 the lessee faces only a few responsibilities, while the primary responsibilities are

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82. "As a matter of policy, the operation of this provision may not be excluded, modified, or limited." U.C.C. § 2A-209 official cmt. (1990).
83. Id.
84. See U.C.C. § 2A-209(3), amended in 1990, providing the circumstances under which a modification or rescission of the supply contract is effective between the supplier and the lessee. U.C.C. § 2A-209(4), added in 1990, spells out that the lessee retains whatever rights it may have against the supplier based on “an agreement between the lessee and the supplier” or “other law.” See also U.C.C. § 2A-209 official cmt. (1990); Breslauer, supra note 34, at 331-32.
85. Herbert, supra note 26, at 419, 433. See also Boss, supra note 37, at pt. VI (“[lessor] who in most instances simply furnishes the money to purchase the goods, and then leases them to the ultimate user, the lessee . . . [w]hile the lessor is merely the provider of financing); Breslauer, supra note 34, at 325 (“[r]estricted role played by the lessor in a finance lease [is] essentially the provision of funds for the purchase or lease of goods from the supplier”); WHITE & SUMMERS, supra note 20, at 25 (“The lessor’s responsibility is merely to provide the money, not to instruct the lessee like a wayward child concerning a suitable purchase.”).
imposed on the supplier.86 Accordingly, this "pass through" provision is a natural consequence of the provisions insulating a finance lessor from warranty liability.87 The landmark provision U.C.C. section 2A-209 works in concert with the "finance lease" definition in U.C.C. section 2A-103(g), which guarantees the finance lessee the knowledge, or the ability to obtain knowledge, of those promises and warranties.88

These benefits to lessees, however, do not come without corresponding burdens. U.C.C. section 2A-407, for example, the self-executing counterpart to U.C.C. section 2A-209, provides in the case of nonconsumer finance leases that a lessee's promises to a lessor, under a lease contract, become irrevocable and independent upon the lessee's acceptance of the goods.89 This statutory "hell or high water" clause allows the parties in a finance lease transaction to require a lessee who has accepted goods to pay the agreed rent regardless of the circumstances.90 Nevertheless, prudent lessors will probably continue to use contractual "hell or high water" clauses as precautions, in case a court denies finance lease status to a transaction. The lessee's promises are also enforceable by or against third parties, including assignees, even if the lessor's performance after the lessee's acceptance is not in accordance with the lease contract.91 As a result, assurance of payment is the major incentive to the lessor to furnish the funds necessary for a finance lease transaction.

Finally, in finance leases, the lessee automatically bears the risk of loss. U.C.C. section 2A-219(1) states: "In the case of a finance lease, risk of loss passes to the lessee."92

2. Lessee's Rights and Remedies After Acceptance of Goods

Acceptance occurs after the lessee has a reasonable opportunity to inspect the goods and either fails to reject them effectively or engages in conduct that otherwise signifies acceptance.93 After ac-

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86. See supra notes 80-84 and accompanying text.
93. U.C.C. § 2A-515(1) (1990). An effective rejection of goods requires that the rejection
cepting goods, the lessee under a finance lease cannot then reject them. In the case of a finance lease, U.C.C. section 2A-516(2) provides that a lessee who has accepted goods with knowledge of their nonconformity cannot then revoke acceptance. The underlying idea is that, after the lessee's acceptance, and despite any knowledge of nonconformity, the lessor ordinarily becomes bound to pay the purchase price to the supplier. Therefore, the lessee's obligation to pay the lessor becomes irrevocable. Further, pursuant to U.C.C. section 2A-517(1)(b), finance lessees may not revoke an acceptance merely because the nonconformity was difficult to discover prior to acceptance. In each situation mentioned above, however, the lessee may still bring an action against the supplier for breach of warranty pursuant to U.C.C. section 2A-209(1).

In any case, U.C.C. section 2A-517(1)(b) offers the lessee only statutory opportunity to revoke acceptance in a finance lease. A lessee may revoke acceptance if nonconformity substantially impairs the value of the goods to the lessee, the lessee accepted without knowledge of the nonconformity, and the lessee's acceptance was reasonably induced by the lessor's assurances. Without these three factors, the lessee must continue to perform even if the lessor fails to perform in accordance with the terms of the lease contract. Again, however, the lessee may proceed against the supplier pursuant to the warranties enumerated in U.C.C. section 2A-209(1).

occur within a reasonable time after delivery, and that seasonable notice is given to the lessor. U.C.C. § 2A-509(2) (1990). Additionally, in some cases, the lessee must state the defects upon which rejection is based. See U.C.C. § 2A-514(1) (1990).

95. U.C.C. § 2A-516(2) (1990). For some appreciation of the lessee's revocation of acceptance, see Breslauer, supra note 34, at 326-29. See also Tsai, supra note 36, passim. The author surveys finance lessees' revocation of acceptance under the U.C.C. and argues that, at least with respect to revocation of acceptance, the policy concerns implicated in a security interest finance lease are the same as those implicated in a true finance lease. He then makes the interesting suggestion that U.C.C. Article 2A's treatment of true finance leases as to lessees' revocation of acceptance should be adopted by the courts in the context of security interest finance leases. Id. at 969-70. As to parallel problems emerging under the provisions governing sales (U.C.C. Article 2), see John A. Sebert, Jr., Rejection, Revocation, and Cure Under Article 2 of the Uniform Commercial Code: Some Modest Proposals, 84 NW. U. L. REV. 375, 375-436 (1990).
96. Boss, supra note 87, at pt. II(B)(10).
100. Id.
3. Rights Against Manufacturers, Other Remote Sellers, and Suppliers Independent of U.C.C. Article 2A

Despite the comprehensive system of rights and remedies available to lessees in a finance lease against lessors and suppliers, there are cases in which the best remedy for a lessee may involve an action against a manufacturer, a seller other than the supplier, or another remote person based upon theories independent of U.C.C. Article 2A. The origins of these actions are usually found in established case law, which permits lessees to bring actions on tort or warranty theories rather than on statutory provisions. This section, therefore, will describe the basic ideas of case law relevant to these types of actions.

A characteristic issue, linked to actions against manufacturers and remote sellers, and which considerably affects the lessee's efforts, is the absence of privity between a plaintiff lessee and a defendant manufacturer or remote seller. Assuming this privity problem does not restrict the lessee's claims, the following tort and warranty rights may complete U.C.C. Article 2A's remedy structure available to lessees in finance leases.102

An action against a remote seller can be found in tort law under the theory of products liability. After U.C.C. Article 2A's promulgation, some authors expressed their concern over the problematic relationship between the statutory law of warranty and products liability law.103 These authors were concerned that Article 2A's codification would interfere with the development of products liability law.

Their apprehensions, however, were without merit. In 1990, subsection (4) was added to U.C.C. section 2A-209, extending the benefit of the supplier's promises and warranties.104 U.C.C. section 2A-209(4) also provided that "the lessee retains all rights that the lessee may have against the supplier which arise from an agreement between the lessee and the supplier or under other law."105 Additionally, the Official Comment makes clear that U.C.C. section 2A-209 "does not affect the development of other law with respect to products liability."106

102. For references to pertinent precedents, see Rohwer, supra note 81, at 24-27.
103. Herbert, supra note 26, at 431-32. See also Kripke, supra note 28, at 792, 794-95.
105. Id.
106. U.C.C. § 2A-209 official cmt. (1990). As to a finance lessor's liability for personal injuries and damages resulting from a defect in the product under common law, see Schoenfeld, supra note 4, at 565 nn.2, 11. Generally, lessors who merely finance the sale, but do not engage in the business of leasing the leased product, are not considered liable because they are
In cases of a manufacturer's malicious misrepresentation in advertising, for example, a tort action for fraud or misrepresentation, which is not based upon privity of contract, can apply despite any provisions of the U.C.C. If express warranties are included in advertisements, such as statements contained on labels or otherwise attached to goods, written warranties, or statements given or made directly to the lessee, an action for breach of express warranty can prevail despite the absence of privity between manufacturer or remote seller and lessee.

Cases might also exist that entitle the lessee to assert rights arising from its own relationship with the supplier. Thus, in addition to the benefits provided in U.C.C. section 2A-209, a lessee may assert warranty or other common law rights against the supplier for breach of representations and promises made directly to the lessee. Pursuant to U.C.C. section 2A-103(1)(g)(iii), however, the lessor must show either the supply contract or an accurate and complete statement designating all promises and warranties, including any disclaimers and limitations of warranties or remedies, to the lessee. As the supply contract is likely to contain disclaimers, particularly those regarding express warranties of the supplier, it is questionable whether the lessee can reasonably rely on any express warranties made by the supplier. Some authors find that in business transactions, people regularly rely upon statements made by those with whom they deal and consider that reliance to be reasonable. A preferable approach, however, is one that considers the lessee's different needs of protection. Lessees experienced in business should not be expected to rely on a supplier's express warranty, especially one inconsistent with disclaimers contained in the supply contract. Inexperienced consumers, however, should be given a higher degree of protection.

4. Evaluation of Nonconsumer Lessee's Rights and Remedies in Finance Leases

U.C.C. Article 2A provides a comprehensive statutory structure governing the rights and remedies of lessees in both true lease transactions and finance leases upon default. It is likely that the long-awaited establishment of warranty liability of lessors, and the exceptions to
warranty liability in the case of finance lessors, will settle a much-litigated area of law.\textsuperscript{110} The new remedy provisions will undoubtedly not only be used by courts in states having already adopted U.C.C. Article 2A, but also by courts in states that have not yet adopted U.C.C. Article 2A. The latter group of courts presumably will refer to the Code for guidance in determining the appropriate remedies on default.\textsuperscript{111}

Unfortunately, U.C.C. Article 2A fails to provide for lessee’s remedies and rights arising from breaches of lease or supply contracts that do not qualify as a default under the statute or contract. The U.C.C. Article 2A also does not address the interrelation between breach of representations or promises made by the supplier directly to the lessee, and the corresponding disclaimers in the supply contract. Likewise, disputes will presumably center around the term “benefit” contained in U.C.C. section 2A-209(1).\textsuperscript{112} Finance lessors regularly have no incentive to incorporate into the lease contract all of the detailed specifications found in the corresponding supply contract, as their primary role is to supply financing, not to take personal responsibility for the goods. Thus, although goods might not conform to the supply contract, they may conform with the more lenient standards of the lease contract, restricting the lessee’s right to revoke the lease contract.

Similar uncertainties might arise in cases of late delivery by the supplier. In a recently published article, Professor Breslauer seeks to clarify both the questions and corresponding problems which originate from the ill-coordinated provisions of both supply contracts and lease contracts.\textsuperscript{113} Although a tort law framework for resolving finance lessees’ actions against manufacturers or remote sellers would have exceeded the purpose of Article 2A, the Code should have clarified these issues.

In summary, the main objective of the finance lease rules is to absolve the lessor from responsibility for matters not related to his function as a financier. The lessee generally looks to the supplier of the goods for warranties, so the only purpose of interposing a finance lessor is to implement the financial obligations between supplier and lessee. In order to achieve that goal, U.C.C. Article 2A provides two

\begin{itemize}
  \item \textsuperscript{110} Boss, \textit{supra} note 87, at pt. I(A).
  \item \textsuperscript{111} See \textit{supra} note 50 and accompanying text.
  \item \textsuperscript{112} U.C.C. § 2A-209(1) (1990).
  \item \textsuperscript{113} See Breslauer, \textit{supra} note 34, at 339-49.
\end{itemize}
firmly established pillars on which the statutory framework concerning finance leases is founded: (1) the self-executing rules that make the finance lessee the beneficiary of the supply contract;¹¹⁴ and (2) providing the irrevocability and independence of the lessee’s promises under the lease contract upon the lessee’s acceptance of the goods.¹¹⁵

Of course, no rule is without an exception. Thus, the lessee may assert a few rights and remedies against the lessor. First, if the lessor bears some degree of responsibility for the lessee’s previous acceptance of non-conforming goods pursuant to U.C.C. section 2A-517(1)(b), the lessee can revoke acceptance.¹¹⁶ Second, since the parties are free to determine which defaults are material enough so as to justify cancellation by the lessee, the agreement itself might offer the lessee opportunities to avoid a “hell or high water” clause after acceptance of the goods.¹¹⁷ Further, finance lessees are given a cause of action should the lessor breach warranty obligations to the lessee under U.C.C. sections 2A-210 and 2A-211(1).¹¹⁸ Finally, a breach of finance lessors’ obligation of good faith under U.C.C. sections 2A-103(3), 2-103(1), and 1-203,¹¹⁹ an obligation which is applicable to all conduct governed by the Uniform Commercial Code, would presumably enable lessees to avoid their obligation to pay under U.C.C. section 2A-407.¹²⁰

In principle, however, U.C.C. Article 2A provides less protection to the finance lessee than to the finance lessor. The Code thus reflects the lessor’s limited function of serving merely as a financing party for the lessee. Under freedom of contract principles, finance lessors additionally establish remedy provisions to strengthen their positions.

C. Lessee’s General Remedies and Rights in a Consumer Finance Lease

A commercial transaction usually involves two knowledgeable parties of comparable economic position and bargaining power. Therefore, one party generally does not need to rely on the knowledge and fairness of the other party. Presumably, both parties understand

¹¹⁸. See U.C.C. §§ 2A-210, 2A-211(1) (establishing these warranty obligations). However, it should be noted that these warranty obligations are rarely made.
the contractual provisions and appreciate their implications. As a result, the final agreement will not usually burden one party to the transaction in favor of the other.

Conversely, in consumer transactions, relatively inexperienced and unsophisticated individuals, who enter such transactions for their own benefit, generally are no match for sophisticated and often unscrupulous merchants. Such individuals often find themselves in an inferior negotiating position. The agreements between parties to a commercial transaction are ordinarily written forms drafted by the merchants, in technical or legal jargon rather than in plain language, and normally contain only a few, if any, provisions that result from negotiation. Thus, the freedom of contract priority, as set forth in U.C.C. Article 2, could expose the consumer lessee to potentially abusive situations.

Under these circumstances, adequate consumer protection cannot be reached "under an 'agreement' that is merely an agreement in form."¹²¹ These gaps in consumer protection might best be addressed through consumer-oriented laws tailored exclusively to commercial transactions. Like U.C.C. Article 2, Article 2A purports to cover both commercial and consumer transactions. The widespread use and abuse of consumer leasing, however, has created the perception that special provisions linked to consumer leases might be desirable to stop such abuse.

1. History of Consumer Law Regarding Finance Leases

The 1957 official text of the Uniform Commercial Code was prepared before consumer protection became an established body of law, particularly regarding finance leases. The Code, therefore, gives little recognition to consumer law. Only vague references to consumer law, for example, exist in U.C.C. Article 2,¹²² the statutory analog to U.C.C. Article 2A.¹²³ Beginning in the late 1960s, the consumer law movement led to extensive legislative enactments governing consumer


¹²² See, e.g., U.C.C. § 2-302 (unconscionability); § 2-318 (elimination of horizontal priority requirements for family and household members); § 2-719(3) (prima facie unconscionability of any limitation of consequential damages for personal injuries). See also WHITE & SUMMERS, supra note 20, at 58 n.1.

transactions. Thus, before the enactment of U.C.C. Article 2A in 1987, courts were resorting to law outside the Code to implement protection for consumers.124

The Consumer Leasing Act of 1976 applies to consumer leases of personal property, primarily for personal, family, or household use, for a period exceeding four months, where the consumer's total contractual obligation does not exceed $25,000.125 This statute requires the lessor to provide the lessee with a clear written statement, before consummation of a consumer lease, identifying the costs, warranties, and termination rights of the parties.126 Further, it limits the lessee's liability on expiration or termination of the consumer lease127 and imposes civil liability on a lessor for failure to comply with these statutory requirements.128

The other major federal legislative provision affecting consumer leases is the Magnuson-Moss Warranty — Federal Trade Commission Improvement Act of 1975 ("Magnuson-Moss").129 Magnuson-Moss bars any supplier, including lessors, from completely disclaiming implied warranties to a consumer, when the supplier gives a written warranty to the consumer or enters into a service contract for the product with the consumer.130 In addition, section 2310 requires that consumer disputes be fairly and expeditiously settled through informal dispute settlement mechanisms.131

Other federal and state statutes may also affect consumer leases. These statutes include the Motor Vehicle Information and Cost Savings Act,132 as amended by the Truth in Mileage Act of 1986, and the Uniform Consumer Credit Code of 1968, known as the "U3C," which includes several consumer leasing provisions.133

When the drafters of U.C.C. Article 2A were deciding how to

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124. Lawrence & Minan, supra note 36, at 113-14; Miller, supra note 121, at 962-63.
127. Id. § 1667(b).
128. Id. § 1667(d).
129. Id. §§ 2301-2312.
130. Id. § 2308.
131. Id. § 2310.
132. Id. §§ 1901-2304.
coordinate new consumer-oriented provisions with existing federal laws, such as the Consumer Leasing Act and Magnuson-Moss, they attempted to avoid problems of conflict, preemption, and difficulties caused by varied state consumer protection laws. Initially, instead of imposing a new body of consumer protection law on each state, the drafters made the consumer-oriented provisions of U.C.C. Article 2A subject to other consumer protection legislation. Accordingly, U.C.C. section 2A-104(1)(c) makes clear that a lease, although governed by the scheme of Article 2A, may also be governed by each state's "consumer protection statute . . . or final consumer protection decision of a court . . . existing on the effective date of this Article."134 In addition, subsection (2) provides that "in case of conflict between this Article . . . and a statute or decision referred to in subsection (1), the statute or decision controls."135 It is clear, therefore, that U.C.C. Article 2A was not intended to preempt consumer lease developments in existing case law. Finally, as state law, Article 2A remains subject to federal consumer protection law.136

2. Consumer Finance Leases Under U.C.C. Article 2A

U.C.C. Article 2A, as amended in 1990, defines a "consumer lease" as:

[A] lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee [except an organization] who is an individual and who takes under the lease primarily for a personal, family, or household purpose [if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed [$25,000]].137

The U.C.C. drafters modeled the "consumer lease" definition after that of the Consumer Leasing Act138 and the Uniform Consumer

135. HUDDLESON, supra note 33, at 78. The author argues convincingly that the consumer lease definition, as well as the accompanying comment, as amended in 1990, implicates "that the statute incorporates only 'preexisting' case law (not evolving case law) protecting consumer lessees." Id. Following Huddleson, one might doubt whether it is possible to "freeze" a certain status quo of consumer protection in this manner. It remains to be seen whether courts will accept such an interpretation preventing them from breaking new ground in issues related to consumer leases.
138. 15 U.S.C. § 1667(1). Although similar in language, the Consumer Leasing Act provides limited assistance in interpreting Article 2A's "consumer lease" definition. Miller, supra note 121, at 965 n.44.
Credit Code. Unlike the definition in the Consumer Leasing Act, Article 2A covers consumer leases that are shorter than four months. Additionally, "lessor" under Article 2A encompasses both those in the business of leasing and those who sell goods. The 1990 amendment allows states to decide whether to put a $25,000 cap on lease contracts to qualify under the Act. The amended definition and the accompanying Official Comment clarified "that a lease to two or more individuals having a common interest through marriage or the like is not excluded as a lease to an organization under section 1-201(28)." Finally, a consumer lease must comply with the requirements of U.C.C. section 2A-103(1)(g) and (j) to qualify as a finance lease.

3. Consumer-Oriented Provisions Under U.C.C. Article 2A

a. U.C.C. Section 2A-106: Choice of Law and Judicial Forum

Section 2A-106 seeks to protect lessees from unfair choices of law and forum clauses in consumer leases. The Code's Official Comment states:

[T]here is a real danger that a lessor may induce a consumer lessee to agree that the applicable law will be a jurisdiction that has little effective consumer protection, or to agree that the applicable forum will be a forum that is inconvenient for the lessee in the event of litigation. This section invalidates such clauses, unless the state law of the consumer's residence or the location of goods governs, or the chosen forum is one that would otherwise have jurisdiction over the lessee.

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141. Id.
142. Id. The amendment and clarification concerning the limitation by dollar amount and the distinction between couples and organizations reflects a response to corresponding criticism and different statutory definitions. For some appreciation of the scope, see White & Summers, supra note 20, at 60-61; Daryl B. Robertson, Report of the Commercial Code Committee of the Section of Business Law of the State Bar of Texas on UCC Article 2A, 43 Baylor L. Rev. 235, 242 (1991).
143. See supra notes 32-41 and accompanying text.
145. Id.
b. U.C.C. Section 2A-108(2): Unconscionability

Section 2A-108(2)'s grant of relief for unconscionable conduct provides perhaps the broadest limitation on parties' contractual freedom in a consumer lease. The provision allows a court to provide a remedy sua sponte in cases of unconscionable inducement to enter into a lease contract or unconscionable conduct in the collection of a claim arising from a lease contract. Therefore, a consumer lessee need not raise the issue of unconscionability.

Although U.C.C. Article 2A does not precisely explain unconscionable conduct, the U.C.C.'s comprehensive concept of "unconscionability" does not leave parties without direction. The Official Comments of Article 2 are "incorporated by reference" into Article 2A. Additionally, Article 2 case law is "persuasive but not binding" in interpreting the comparable provisions of Article 2A. Therefore, the Official Comments and case law of U.C.C. section 2A-302 lend specific meaning to its comparable provision in U.C.C. section 2A-108.

This statutory construction adds important limitations and guiding principles to the interpretable term "unconscionable." Additionally, the Consumer Credit Protection Act and the Uniform Consumer Credit Code may provide helpful interpretive guidance. An in-depth discussion of the definitional nuances in each of the named authorities, however, is beyond the scope of this Article.

c. U.C.C. Section 2A-108(4): Unconscionability and Attorneys' Fees

Bringing a legal action as a consumer may be a double-edged
sword. If the consumer prevails, he may be released from liability. However, an inadequate recovery could discourage consumers from suing lessors. U.C.C. section 2A-108(4) diminishes a consumer lessee's financial risk by awarding reasonable attorney's fees if the court finds a consumer lease unconscionable.\textsuperscript{154} Conversely, a court may award the lessor attorney's fees if the lessee knowingly brings a meritless claim of unconscionability.\textsuperscript{155} This provision is likely to be ineffectual, however, because federal courts and many state courts have adopted similar rules of civil procedure that allow imposition of sanctions against parties asserting bad faith claims or defenses.\textsuperscript{156} Nonetheless, this issue is quite controversial. Apart from a limited number of exceptions, the familiar "American Rule" generally requires parties to bear the costs of their own attorneys' fees.\textsuperscript{157}

d. U.C.C. § 2A-407: Irrevocability of Promises in Consumer Finance Leases

As discussed, U.C.C. section 2A-407 virtually assures the finance lessor a continual stream of payments from the lessee as consideration. In fact, U.C.C. section 2A-407 does not give consumer finance lessees substantial protection. Unlike commercial finance leases, consumer finance leases do not qualify for the statutory imposition of automatic "hell or high water" obligations on the lessee.\textsuperscript{158} In other words, even after acceptance of the goods, a lessor's non-performance is a condition of the lessee's performance. Consequently, the finance lessee retains the power to withhold payment for the goods. Due to complex statutory construction, many leasing parties do not notice the significant dangers that lie within this facially consumer-friendly provision. Therefore, few consumer finance lessees assert their avail-


\textsuperscript{155} This provision, however, "is independent of, and thus will not override, a term in the lease agreement that provides for the payment of attorney's fees." U.C.C. § 2A-108 official cmt. (1990).

\textsuperscript{156} See Fed. R. Civ. P. 11; Alyeska Pipeline Service Co. v. Wilderness Society, 421 U.S. 240 (1975). See also Huddleston, supra note 33, at 76 (pointing out that the requirements of U.C.C. § 2A-108 "may be somewhat easier to satisfy than the 'bad faith' test in the old 'American rule' on attorney's fees."); Herbert, supra note 146, at 737-39.


\textsuperscript{158} For some appreciation of U.C.C. § 2A-407, see supra notes 89-91 and accompanying text.
able rights or remedies against finance lessors.\(^{159}\)

Other U.C.C. provisions considerably restrict the benefits awarded to consumer lessees under section 2A-407. Under the Code, finance lessors are not bound by implied warranties of fitness\(^{160}\) or merchantability;\(^{161}\) nor do lessors have to provide against infringement.\(^{162}\) Thus, in a suit for rent, a finance lessee will have a defense only for a lessor's breach of an express warranty\(^{163}\) or the implied warranty against interference.\(^{164}\) Given that finance lessors do not generally grant warranties of quality, the result under U.C.C. section 2A-407 normally prevails even in consumer finance leases.\(^{165}\)

U.C.C. section 2A-517(2) will probably not aid consumer finance lessees in this situation. This section, added in the course of the 1990 amendments, provides: “Except in the case of a finance lease that is not a consumer lease, a lessee may revoke acceptance of a lot or commercial unit if the lessor defaults under the lease contract and the default substantially impairs the value of that lot or commercial unit to the lessee.”\(^{166}\) At first glance, this provision appears consumer-friendly. However, finance lessors, using their superior bargaining power, undermine this right by inserting contractual provisions that widely restrict or even exclude U.C.C. section 2A-517(2).\(^{167}\)

A finance lessor may rigorously curtail, or completely eliminate, a consumer lessee's rights and remedies against him by using the freedom of contract principle. Using a “hell or high water” clause in the lease agreement, finance lessors could completely insulate themselves against consumer lessees' defenses.\(^{168}\) The Official Comment, unfor-

\(^{159}\) WHITE & SUMMERS, supra note 20, at 65 (stating that “[t]his exception from the hell or high water rule may promise more than it delivers.”). See also Schoenfeld, supra note 4, at 565 n.7 (assuming that U.C.C. § 2A-407 will have little practical impact on consumer finance leases).


\(^{164}\) U.C.C. § 2A-211(1) (1990). See also Miller, supra note 121, at 969-70 n.62 (indicating that it is possible for a court to not allow the lessee to raise the defense, in a suit for rent by the finance lessor, because the lessee might have recourse against the supplier.).

\(^{165}\) See supra notes 89-91 and accompanying text. See also WHITE & SUMMERS, supra note 20, at 27 n.22; Huddleson, supra note 36, at 666; Miller et al., supra note 36, at 434 n.135; Schoenfeld, supra note 4, at 565 nn.7-8 (attributing this trend to the narrow definition of consumer leases).


\(^{167}\) See U.C.C. § 2A-517 official cmt. (1990); Herbert, supra note 39, at 6-7.

\(^{168}\) Such a clause would not be precluded under the current Federal Trade Commission
tunately, is ambiguous. On the one hand, it indicates that under certain circumstances such clauses might be permissible:

This section does not address whether a "hell or high water" clause . . . is enforceable if included in a finance lease that is a consumer lease or a lease that is not a finance lease. That issue will continue to be determined by the facts of each case and other law which this section does not affect.169

On the other hand, the same Official Comment states: "[T]his section excludes a finance lease that is a consumer lease. That a consumer be obligated to pay notwithstanding defective goods or the like is a principle that is not tenable under case law, state statute, or federal statute."170 Therefore, how courts or state legislatures, adopting or amending U.C.C. Article 2A's provisions, will fix this legal loophole remains to be seen.171

Ultimately, when scrutinizing the validity of "hell or high water" clauses incorporated in consumer finance lease agreements, at least three statutory criteria should be examined. First, whether the warranty disclaimers contained in the lease agreement satisfy the requirements of conspicuousness under U.C.C. section 2A-214.172 Second, whether circumstances cause an exclusive or limited remedy to fail of its essential purpose, or, more importantly, whether a provision for an exclusive remedy is unconscionable under U.C.C. section 2A-503(2).173 Third, whether the lease contract or any clause of a lease contract can be considered unconscionable at the time it was made under U.C.C. section 2A-108(1).174

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169. Rule on Preservation of Consumer's Claims and Defenses, 16 C.F.R. § 433 (1975). See 16 C.F.R. §§ 433.1(d), (e), (i), and 433.2.
171. Boss, supra note 37, at pt. VI (clarifying that new U.C.C. § 2A-407(3) makes "[i]t clear that the section does not affect the validity of such [contractual] "hell or high water" clauses if included in a finance lease which is a consumer lease . . . . Such clauses will continue to be governed by law outside Article 2A."); Miller, supra note 121, at 970-71 n.66 (expressing vague assumptions regarding the further development of this issue). See also Schoenfeld, supra note 4, at nn.42, 102 and accompanying text. By referring to In re O.P.M. Leasing Servs., 21 B.R. 993, 1006 (Bankr. S.D.N.Y. 1982) and CIT Fin. Servs. v. Gott, 615 P.2d 774 (Kan. 1980), Schoenfeld points out that "hell or high water" clauses in common law finance leases have been upheld in commercial, but not in consumer, cases. With reference to Unico v. Owen, 232 A.2d 405 (N.J. 1967) the author anticipates that courts will reach the same result if leased goods under a consumer lease are defective.
174. U.C.C. § 2A-108(1) (1990). Herbert, supra note 146, at 743 n.117 (pointing out convincingly that the test under the second question is broader than and preferable to the test
e. Other Consumer-Oriented Provisions of Importance

Unlike commercial leases, lessors to a consumer lease who exercise their option to accelerate payment "at will" or because of insecurity have the burden of establishing their good faith. U.C.C. section 2A-504 limits the amount a consumer lessor may retain from the lessee's payments, when the lessor withholds or stops delivery of goods because of the lessee's default or insolvency. Where the lessee justifiably withholds or stops delivery of the goods because of the lessee's default or insolvency, U.C.C. section 2A-516 limits the lessor's right to retain part of the price already paid by a defaulting consumer lessee as liquidated damages. Moreover, this section does not require a consumer lessee to notify the lessor of litigation for infringement.

4. Evaluation of Consumer-Oriented Provisions Under U.C.C. Article 2A

To this point, Article 2A has been followed in the leasing practice of only nineteen states and only for a limited time. A scarcity of precedents and criticisms regarding the new consumer-oriented rules makes evaluating Article 2A difficult. Some facts, however, allow partial conclusions when scrutinizing consumer leases. At the very least, the new U.C.C. "consumer lease" definition provided in section 2A-103(1)(e) will extend the scope of consumer lease protection in some states.

Nevertheless, U.C.C. Article 2A deals only peripherally with consumer leases. Equally important, most of Article 2A's consumer-oriented provisions may fall victim to the freedom of contract axiom. Indiscriminate application of this principle in both commercial and consumer leases may not be appropriate. The extent to

under the third, "because the latter refers only to provisions that are unconscionable 'at the time it was made'" and not to provisions that "become unconscionable because of subsequent events.")

178. Id. See Miller, supra note 121, at 974; WHITE & SUMMERS, supra note 20, at 67.
179. See supra note 137 and accompanying text.
180. Burke & Cannel, supra note 121, at 118 nn.16, 135; Herbert, supra note 26, at 414, 421-22; Huddleson, supra note 36, at 668-71; Naples, supra note 24, at 359-60.
181. Burke & Cannel, supra note 121, at 118. See also Herbert, supra note 39, at 29-30;
which courts will accept contractual exclusions of consumer rights remains to be seen.

Of course, the Article 2A drafters could have included additional consumer protection provisions impervious to the freedom to contract. However, the drafters faced serious problems when attempting to reconcile the new provisions with preexisting consumer protection laws. Eventually, in order to avoid problems of conflict and pre-emption, they avoided a more difficult decision by carefully coordinating the new provisions with federal law and the varied state consumer protection laws. As a result, Article 2A's consumer rights breakthrough became rather modest. Moreover, Article 2A gives relatively little attention to explicit protections. Therefore, the courts will probably have to determine which of the Article's consumer-oriented provisions express fundamental ideas of consumer protection law.

Courts could refer to provisions based on the idea of unconscionability, particularly in U.C.C. sections 2A-108(1), (2), and 2A-503(2), even in cases where finance lessors excluded or modified consumer lessee's rights and remedies. In the leasing business, consumer lessees almost always face the barrier of the parol evidence rule. As a result of the inferior bargaining power of consumer lessees, lessors generally require acceptance of the contract as presented. Under these circumstances, a court may find a contract unconscionable if the lessor attempts to use the parol evidence rule to eliminate previous promises and warranties. According to the Official Comment to U.C.C. section 2A-108: "To make a statement to induce the consumer to lease the goods, in the expectation of invoking an integration clause in the lease to exclude the statement's admissibility in a subsequent dispute, may be unconscionable." However, while unconscionability is an important enforcement doctrine governing consumer finance leases, it is not a panacea. The good faith rule, while tainted with similar concerns, provides another approach to the prob-

Miller, supra note 121, at 961 ("This rule [freedom of contract] is a virtual license to limit or eliminate that protection and to impose whatever conditions the traffic will bear.").

182. See supra notes 103-09 and accompanying text. See also Lawrence & Minan, supra note 36, at 113-15; Miller supra note 121, at 962-63.

183. White & Summers, supra note 20, at 67-68; Herbert, supra note 146, at 715, 751-55. See also Herbert, supra note 39, at 7 ("Unless the courts are willing to make vigorous use of their power to excise unbalanced provisions as unconscionable, it is likely that the lessee of this world will have to learn to live with defective and unrepaid leased goods.").

184. Herbert, supra note 146, at 754.

Good faith governs "[e]very contract or duty" within the Code.\footnote{186}{Good faith, in the case of a merchant, means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade. U.C.C. § 2-103(1)(b) (1990).}

Several authors have suggested that if the courts are reluctant to exhaust Article 2A’s consumer-oriented provisions to the full extent, it is likely that additional consumer protection will have to come from laws beyond the scope of the Code, whether by precedents or by additional federal laws and state statutes.\footnote{187}{See U.C.C. §§ 2A-103(3), 2-103(1)(b), 1-203 (1990).}

\textbf{D. General Lessor's Remedies in a Finance Lease}

In its treatment of lessor’s remedies, the drafters of U.C.C. Article 2A adhered to three principles previously discussed.\footnote{188}{See supra note 36, at 668; Lawrence & Minan, \textit{supra} note 36, at 113-14; Miller, \textit{supra} note 121, at 974.} First, U.C.C. section 2A-501(2) triggers the remedies available to lessors as catalogued in U.C.C. section 2A-523, as well as the remedy structure for the benefit of lessees,\footnote{189}{See supra notes 158-69 and accompanying text.} only by default. Pursuant to U.C.C. section 2A-523(1), the finance lessee defaults if he "wrongfully rejects or revokes acceptance of goods or fails to make a payment when due or repudiates with respect to a part or the whole . . . ."\footnote{190}{U.C.C. section 2A-502 does not require the lessor to give the lessee notice of default or notice of enforcement. Further, under U.C.C. sections 2A-501 and 2A-523(3), the parties to the lease contract may specify other material breaches by the lessee which bring the listed remedies into effect. Since the requirements under U.C.C. section 2A-523(3) are more strict than those under subsection (1), the distinction between contractual and statutory defaults may be important in determining the lessor’s remedies.}

Second, the drafters persistently stressed the importance of the freedom of contract principle.\footnote{191}{See supra notes 42-49 and accompanying text.} Thus, only in the absence of parties’ contractually stipulated remedies will Article 2A fill the void.\footnote{192}{Remedies are listed in U.C.C. § 2A-523 and then detailed in U.C.C. §§ 2A-505, and 2A-524 to 2A-531.} This may result in lessor remedies resembling those available to sellers.\footnote{193}{Remedies are catalogued in U.C.C. § 2-703 and then reflected in U.C.C. §§ 2-704 to 2-710.}
Note, however, that unlike a finance lessee's remedies, those for lessors under Article 2A are not affected by the lessee's acceptance of the goods.\textsuperscript{195}

Finally, as stated in the Official Comment, Article 2A rejects any general doctrine of election of remedy:

Whether, in a particular case, one remedy bars another, is a function of whether the lessor has been put in as good a position as if the lessee had fully performed the lease contract. Multiple remedies are barred only if the effect is to put the lessor in a better position than it would have been in had the lessee fully performed under the lease.\textsuperscript{196}

1. Lessor's Rights and Remedies Under U.C.C. Article 2A in Case of Statutory Defaults

When a statutory default occurs, U.C.C. sections 2A-523(1) and (2) provide the lessor a series of remedies.\textsuperscript{197} Because this section does not offer special treatment for finance leases,\textsuperscript{198} distinguishing between a lessor's and a finance lessor's rights and remedies is unnecessary.

Upon a lessee's default, a lessor may cancel the lease under U.C.C. sections 2A-523(1)(a) and 2A-505(1) and discontinue performance. This discharges all executory obligations on each side, while preserving rights based on prior default or performance. Moreover, under U.C.C. sections 2A-523(1)(b) and 2A-524, a lessor may proceed with respect to goods not identified in the lease contract. Accordingly, the lessor may:

(a) identify in the lease contract conforming goods not already identified if at the time the lessor learned of the default, they were in the lessor's or the supplier's possession or control;\textsuperscript{199} and (b) dispose of goods that demonstrably have been intended for the particular lease contract even though those goods are unfinished.\textsuperscript{200}

\textsuperscript{195} As to the effect of the lessee's acceptance of goods on his remedies, see supra notes 93-101 and accompanying text.
\textsuperscript{196} U.C.C. § 2A-523 cmt. 4, referring to U.C.C. §§ 2A-103(4), 2A-501(4), and 1-106(1).
\textsuperscript{197} U.C.C. § 2A-523(1) (1990). While subsection (1) is a substantially rewritten version of U.C.C. § 2-703, subsection (2) was added in 1990. For a hypothetical which conspicuously explains the lessor's remedies listed in U.C.C. § 2A-523(1), see U.C.C. § 2A-523 cmts. 4-18. See also Rapson, supra note 36, at pt. A(4) (regarding lessor's remedies on default).
\textsuperscript{198} U.C.C. § 2A-523 cmt. 21 (1990).
\textsuperscript{200} U.C.C. § 2A-524(1)(b) (1990).
Additionally, U.C.C. section 2A-524(2) provides rules for the treatment of unfinished goods.

U.C.C. sections 2A-523(1)(c) and 2A-525 establish the lessor's right to take possession of or reclaim goods previously delivered. Pursuant to U.C.C. section 2A-525(2), the lessor may leave the goods in place, and render unusable any goods employed in trade or business. Under U.C.C. section 2A-527, the lessor may dispose of the goods on the lessee's premises. Further, U.C.C. sections 2A-523(1)(d) and 2A-526 entitle the lessor to stop delivery of goods by a bailee.

The lessor, after statutory default, may also dispose of the goods by lease, sale, or otherwise and recover damages under U.C.C. sections 2A-523(1)(e) and 2A-527. U.C.C. section 2A-527(2) specifies the measure of a lessor's damages recoverable from the lessee, in case of a lessor's disposition by a "substantially similar" lease agreement "made in good faith and in a commercially reasonable manner." Although the Code's 1990 Official Comment extensively addresses these terms, interpretation is likely to give rise to a sharp judicial and scholarly debate. If the lessor disposes of the goods by a lease agreement not substantially similar to the original lease, or by a sale, he may be entitled to the remedies under U.C.C. section 2A-528.

Those lessors who choose to retain the goods and recover damages under U.C.C. sections 2A-523(e) and 2A-528 have similar remedies. Calculating damages under U.C.C. section 2A-528 is considerably different than under U.C.C. section 2A-527. Through use of "market rent at the place where the goods are located," instead of the actual rent for the new lease to calculate damages, the lessor may be in a better position. Lessors may also recover "the present value of profit, including reasonable overhead" if the other remedies provided by the section are inadequate to give the lessor the benefit of the bargain.

An action for rent under U.C.C. sections 2A-523(1)(e) and 2A-529 is the lessor's final statutory remedy. The latter section allows the

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206. See generally U.C.C. §§ 2A-527, 2A-528 official cmt. (1990). See also Foster & Shields, supra note 7, at 319; Herbert, supra note 26, at 451-55; Rapson, supra note 17, at 891-900.
lessor to recover rent as specified in subsections (1)(a) and (1)(b). If the goods were "accepted by the lessee and not repossessed by or tendered to the lessor," or were "conforming goods lost or damaged within a commercially reasonable time after risk of loss passes to the lessee," then subsection (1)(a) allows rent recovery. Respectively, in subsection (1)(b), "if the lessor is unable, after reasonable efforts, to dispose of them at a reasonable price or the circumstances reasonably indicate that efforts will be unavailing," then recovery of rent is also available.

Finally, U.C.C. section 2A-523(2) provides a remedy if the lessor does not pursue a right to completion or actually obtains a remedy available under subsection (1). Subsection (2) acknowledges that a lessor entitled to assert rights and remedies under subsection (1) may choose not to do so. For example, in the case of non-payment of rent, the lessor may sue for unpaid rent plus lost interest or other damages "determined in any reasonable manner" rather than canceling the lease or taking possession of the goods.

2. Lessor's Rights and Remedies Under U.C.C. Article 2A in Case of Contractual Defaults

After substantial amendment in 1990, U.C.C. section 2A-523 currently sets out standards concerning the interrelation between statutory and contractual remedies triggered by actions or omissions defined in the lease as an event of default. Accordingly, U.C.C. section 2A-523(1)(f) allows lessors in the case of statutory defaults to "exercise any other rights or pursue any other remedies provided in the lease contract." In addition, the substantially revised subsection (3) provides:

If a lessee is otherwise in default under a lease contract, the lessor

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209. U.C.C. § 2A-523 states:
   If a lessor does not fully exercise a right or obtain a remedy to which the lessor is entitled under subsection (1), the lessor may recover the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner, together with incidental damages, less expenses saved in consequence of the lessee's default.
213. See WHITE & SUMMERS, supra note 20, at 44-45; Herbert, supra note 39, at 5-6.
may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease. In addition, unless otherwise provided in the lease contract:

(a) if the default substantially impairs the value of the lease contract to the lessor, the lessor may exercise the rights and pursue the remedies provided in subsections (1) or (2); or

(b) if the default does not substantially impair the value of the lease contract to the lessor, the lessor may recover as provided in subsection (2).\footnote{U.C.C. § 2A-523(3) (1990).}

In other words, even in the case of defaults other than those specified in subsection (1), such as non-statutory or contractual defaults, the lessor may conditionally pursue statutory remedies. In such cases, litigation will generally focus on two questions. First, whether breach of a lease contract equals being otherwise in default under a lease contract, and second, whether a material default substantially impairs the value of the lease contract to the lessor.

Finally, the freedom of contract principle allows the lessor and lessee to modify their Article 2A rights and remedies. For example, the parties could agree to treat contractual defaults as statutory defaults, or could create a totally new scheme of rights and remedies triggered by statutory or contractual defaults.\footnote{U.C.C. § 2A-523 cmt. 2 (1990).}

3. Evaluation of Lessor's Rights and Remedies in Finance Leases

Articles and comments discussing lessors' Article 2A remedies in finance leases have drawn different conclusions. On the one hand, several authorities praise Article 2A's remedies as a significant improvement from the uncertain and confused state of prior law.\footnote{Boss, supra note 36, pt. III(D)(a); Miller et al., supra note 36, at 440.} On the other hand, Article 2A's remedy provisions are dismissed as being "disastrously ill-coordinated."\footnote{Herbert, supra note 26, at 463.}

As for the first observation, Article 2A does provide a comprehensive statutory structure governing the finance lessor's rights and remedies. Presumably, even courts in states that have not yet adopted U.C.C. Article 2A will consider the Code's provisions when evaluating lessor's rights and remedies.\footnote{See supra notes 45-46 and accompanying text.}

The second consideration may seem grossly exaggerated. However, the U.C.C. has remaining gaps despite its seemingly comprehen-
sive complexity. Article 2A, for example, does not apply to a breach that is not a statutory or contractual default, since all of the lessor's remedies require default. It remains to be seen whether courts will fill this void by applying common law remedies or Article 2A remedies by analogy. As a consequence, this gap should be filled by creating contractual defaults with regard to those minor breaches of the lease that do not qualify as statutory defaults under U.C.C. section 2A-523(1).

In summary, the lessor's remedy structure reflects the drafters' efforts to minimize the discrepancy between the treatment of statutory and contract default remedies. This assimilation process, evidenced by the U.C.C. section 2A-523(1)(f) and (3) amendments, not only removes uncertainties and settles disputes concerning the correlation of contractual and statutory remedies upon contractual and statutory defaults, but also illustrates the development of lessor's remedies without statutory clarifications. Therefore, leasing parties have the freedom to create a scheme of lessor's remedies different from the statutory model with only two exceptions: (1) the lessor may not be in a better position than he would have had the lessee fully performed; and (2) the pertinent clauses may not be unconscionable under U.C.C. sections 2A-108(1) and 2A-503(2). Whether the same provisions carry over to consumer leases remains to be seen. Even without specific limitations on consumer lessor's remedies, however, the other exceptions could reasonably protect consumers.

Finally, the remedies of finance lessors against suppliers require consideration. Before leasing goods to finance lessees, lessors generally buy or lease them from suppliers. Therefore, lessors may assert rights and remedies under sales contracts or leasing contracts against suppliers.

The finance lease regulations attempt to insulate lessors from responsibility for matters unrelated to their functions as financing sources. Accordingly, U.C.C. section 2A-209(1) treats finance lessees

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219. See Marion W. Benfield, Jr., Lessor's Damages Under Article 2A After Default by the Lessee As To Accepted Goods, 39 ALA. L. REV. 915, 918-19; Herbert, supra note 26, at 439-40.


221. See supra notes 144-53 and accompanying text.


223. See supra notes 211-15 and accompanying text.
as third-party beneficiaries of supply contracts. Upon acceptance of the goods, the lessees' promises under the contract become irrevocable under U.C.C. section 2A-407. Consequently, finance lessors and suppliers ordinarily need not settle any matters between them.

IV. GERMANY

A. Preliminary Comments

1. Problems in Representing the Structure of Provisions Governing Finance Leases

A complete survey of the German finance lease provisions is difficult for several reasons. First, the pertinent legal provisions are spread over several codes, acts, and decrees. Second, these provisions do not deal explicitly with finance leases. The legal system lacks provisions that are tailored to three-party transactions. Third, judges must close the gaps left by a lack of statutes. Uniquely, case law regulates finance leases rather than statutory provisions. This is typical for the German legal system. Further, legal scholars regularly criticize Federal Supreme Court precedents, such as those of the Bundesgerichtshof ("BGH"), while practitioners try to comply with the standards and requirements laid down by the BGH. Finally, the ancient Greek axiom "panta rhei" (everything is in flux) applies to finance lease provisions. As a result, this branch of law is subject to continuous changes.

Due to these factors, the following section will not be a complete discussion of the remedy structure concerning finance leases. Instead, this section will explain the legal nature of finance leases, the interplay of their pertinent provisions, and the basic remedies available to consumer lessees and lessors. It will do so to a degree that will enable readers to duplicate and judge the provisions underlying finance leases. In order to reach that goal, this section will focus primarily on the prevailing standards in the leasing practice. BGH precedents will be emphasized, and critiques from legal scholars will be delineated, without being discussed in depth.

2. Defining Finance Leases and Their Application Rules.

To enable a better understanding of finance lease provisions, this

224. See supra notes 158-65 and accompanying text.
225. For a list of the most important BGH decisions on finance leases, see Martinek, supra note 2, at 36-37.
section will use a four-part analysis. The first step analyzes the circumstances in which courts consider a three-party transaction to be a finance lease. Second, this section will explain the vehement discussion of the legal nature and status of finance leases and their far-reaching consequences. Next, the law governing contractual provisions that the lessor dictates to the lessee will be discussed. Finally, this section explores the law that applies when a consumer lessee is involved in a finance lease.

a. Three-Party Transactions Treated as Finance Leases

Compared to other means of investment and debt financing, tax laws offer the main advantages for finance leases. Commercial finance lessees profit by deducting monthly lease payments as operating expenses without the restriction of equipment depreciation rules. This beneficial fiscal treatment for finance lessees, however, depends on whether the transactions are considered to be fiscally disguised purchases. In other words, finance lessees may not purchase leased goods for the purpose of avoiding tax liability.

In the early 1970s, when the fiscal classification of finance leases became controversial, the Supreme Tax Court ("Bundesfinanzhof," or "BFH") and the Finance Ministry (Bundesministerium der Finanzen) laid the legal foundation for the treatment of finance leases. Thereafter, the leasing industry generally accepted and adopted these standards.

In its first leading case dealing with the fiscal classification of finance leases, the BFH held that an economic, rather than a strictly legal, approach should be applied to tax laws. As a result, the law taxes lessees for their leased goods regardless of contractual characterization. Therefore, taxpayers may be economic, but not legal, owners of the goods. Civil law deems lessees economic owners if they have actual control over leased goods so as to economically exclude the true owners from controlling the goods for the average duration of

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227. The financial advantages, however, are not as extensive as one might think. See Volker Emmerich, Grundprobleme des Leasings, 30 JURISTISCHE SCHULUNG [JuS] 1, 2 n.10 (1990) (F.R.G.) (explaining that the taxes which are saved by the finance lessee accrue to the finance lessor who, of course, will charge the finance lessee with these costs. Thus, the fiscal classification only results in a delay of tax-payments by the finance lessee).

their use. In short, lessees have economic ownership if the legal owner's claim for restitution\(^{229}\) is \textit{de facto} impossible or at least insignificant and meaningless. Therefore, lease contracts regularly stipulate that finance lessors are both the legal \textit{and} economic owners.\(^{230}\)

In an effort to create uniform guidelines for interpretation of the BFH judgment, and also to overcome difficulties in following the decision, the Finance Ministry issued decrees on fully amortized lease contracts (Vollamortisationsverträge)\(^{231}\) and partially amortized lease contracts (Teilamortisationsverträge).\(^{232}\) Ordinarily, finance leases conform to these decrees because the leasing practice has accommodated itself to the described guidelines.\(^{233}\) Therefore, these "decree-conforming" finance leases will be the basis for further remarks.

\textbf{b. The Legal Nature of Finance Leases}

Determining the legal nature of finance leases gives rise to a number of additional conclusions with great implications. Roughly speaking, such a determination sets a precedent of establishing rules regarding the contractual agreement, the contents, the performance, and the liquidation of finance leases.

The Bürgerliches Gesetzbuch ("Civil Code," or "BGB"), enacted in 1896 and almost entirely effective in former East Germany since October 3, 1990,\(^{234}\) is a comprehensive code regarding several contractual relationships, including contracts for sale (Kaufvertrag),\(^{235}\) leases (Mietvertrag),\(^{236}\) commissions (Auftrag),\(^{237}\) and loans (Darlehen).\(^{238}\) United States lawyers examining the German legal

\(^{229}\) BGB art. 985.


\(^{233}\) MARTINEK, \textit{supra} note 2, at 51-52.


\(^{235}\) BGB arts. 433-514.

\(^{236}\) BGB arts. 535-580.

\(^{237}\) Commissions are gratuitous contracts, by which one party undertakes to do something on behalf of the other while receiving no compensation. BGB arts. 662-676.

\(^{238}\) BGB arts. 607-610.
system should realize that the term "leasing," though neither defined nor mentioned in the Civil Code, is synonymous in German with "finance leases" (finanzierungsleasing). Therefore, the Civil Code lacks explicit provisions regarding the hybrid nature of finance leases, because "the law could not possibly regulate anything that was still an unknown." Further, contract law under the BGB is limited to two-party transactions, since three-party transactions such as finance leases, purchases where consumers obtain a loan covering the purchase price directly from a third party lender, and purchases by credit card did not emerge until five or six decades after the enactment of the Civil Code. As a result, issues linked to finance leases do not come directly within the purview of the BGB. This causes practitioners to force these leases into legal structures inadequately designed to accommodate them. In response, judges and legal scholars have struggled to remedy the flaws in the Civil Code and to allow leasing parties to draw analogies to existing law.

This struggle is one of the most discussed and controversial issues concerning civil law. A complete discussion of the disparity of views and conflicting arguments, however, is beyond the scope of this Article. Nevertheless, the predominant opinions and corresponding objections will be outlined. Thereafter, this section explores the specifics of the BGH’s approach to provide an impression of the prevailing legal environment.

To better understand the conflict, one should reflect upon the finance lessor’s and lessee’s basic duties of performance. The lessor must warrant the lessee’s right to use the leased object for a stipulated period of time and must finance its purchase. In turn, the lessee must make corresponding monthly or annual payments.

The prevailing opinion in legal literature supports similar treatment between finance leases and ordinary leases and tenancies. Consequently, a recourse to BGB Articles 535 and following, whether or not by analogy, is still the most common and favored solution for problems linked to finance leases. Beyond this general unanimity, however, the legal community has yet to agree on specifics.

240. See Martinek, supra note 2, at 64-90.
nomic differences between ordinary leases and finance leases serve as the main foundation for criticism. While lessees strictly want use of the leased objects, finance lessees additionally seek lease financing to optimize their tax benefits.242

Another approach refers to the provisions on contracts of sale. In part, this law treats finance leases as purchases of goods,243 and partly deems them as purchases of rights to use the leased objects.244 The most significant objection to this approach is that, while buyers become owners of goods, finance lessees only want to be possessors of goods, for the fiscal reasons discussed above.245 Meanwhile, yet another approach classifies finance leases as loans or credit.246 This idea, however, is also subject to considerable debate, as borrowers obtain ownership of the objects of agreement.247 Other attempts to draw analogies, such as having lessors classify the transaction as commiss
tion business,248 have similarly failed. In sum, the legal community criticizes these approaches because they deemphasize the parties' main objectives of vesting a finance lessor with both legal and eco-

nomie ownership.

Finally, in the 1980s a fresh approach gathered momentum,

242. See MARTINEK, supra note 2, at 72-75.


245. See MARTINEK, supra note 2, at 76-79.


247. See MARTINEK, supra note 2, at 80-83.

which qualifies finance leases as contracts sui generis, and emphasizes that these three-party transactions do not fit within the statutory structure. Instead of formulating general principles, supporters of this approach believe that solutions should focus on the circumstances of each case. Although the proponents of this theory agree that finance leases characteristically combine two equally important functions of lessors, ensuring both the use and financing of leased goods, their results differ significantly.249

The BGH did not express its view regarding the legal nature of finance leases until 1975.250 The Court considered finance leases without option to buy to be unique, and held that BGB Articles 535 and following should govern the parties’ legal relationship. Subsequently, the BGH extended its holding to finance leases with option to buy and to cases in which the finance lessee agreed to buy the leased goods at the lessor’s request after expiration of the lease.251 Today, the BGH presumes that finance leases conforming to decrees by the Finance Ministry252 can be analogized to the statutory provisions on leases.253 Eventually, the Court recognized that finance leases are a means of debt financing, but repeatedly explained that the financial aspect associated with finance leases was only an annex to the lessor’s main obligation of ensuring the right to use the leased object. Therefore, these BGB articles apply to finance leases.254


253. See supra notes 231-33 and accompanying text.


c. Standards for Regulating the Content of Finance Leases

In business, finance lessors generally use standardized lease contracts as the basis for their agreements. These contract forms regularly contain preformulated stipulations and include the finance lessor's general terms and conditions of trade. With few exceptions, non-merchant parties to a finance lease do not bargain for individual stipulations or for two separate agreements.

These adhesion contracts tend to strengthen the lessor's position under the pertinent laws while simultaneously restricting the lessee's rights. Accordingly, in 1976 the legislature set standards under the Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen ("AGBG"). In short, the AGBG limits finance lessors' freedom of contract in order to curb their potential to abuse their superior negotiating power.

AGBG sections 1-3 define the general terms and conditions of trade and determine when they are included in agreements. AGBG sections 9-11, the core of the Act, render numerous stipulations void. In this context, AGBG section 9 is particularly important because it provides a general clause invalidating stipulations that place an unreasonable disadvantage on the customer, or in this case, lessee. Courts will presume such a disadvantage if a stipulation is inconsistent with fundamental ideas of the legal provisions from which it deviates, or if it restricts fundamental rights or obligations that follow from the nature of the contract to such an extent that the fulfillment of the agreement's purpose is jeopardized.

When interpreting the "fundamental ideas of the legal provisions," "the nature of the contract," or "the agreement's purpose" with regard to finance leases, the BGH and legal scholars strictly follow the statutory language governing leases.

Regarding the scope of the Act, one should note that only non-merchants receive benefits under the AGBG. Agreements between merchants embodied in standard form contracts must comply with the aforementioned requirements of AGBG section 9. This clarifies

257. See Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen [AGBG] § 9(2) No. 1, 2 (1976) (F.R.G.). This means of transforming flexible legal provisions into mandatory legal provisions appears to be unknown in the United States. Id.
258. See supra notes 250-55 and accompanying text.
259. See supra note 241 and accompanying text.
260. BGBl arts. 535-580.
how litigation over finance lease stipulations has given the leasing practice its contour, profile, and structure.

Finally, AGBG section 4 provides that individual agreements override general terms and conditions of trade referred to in standard form contracts. This has clarified the relationship between the Act and the freedom of contract principle. Individual agreements, however, must still meet the general bona fide principle of BGB Article 242261 and must not be founded upon considerations contra bonos mores, as set forth in BGB Article 138.

d. Consumer-Related Provisions Concerning Finance Leases

Strictly speaking, the AGBG's various requirements for standard form contracts involving non-merchants and merchants (AGBG section 24) are a product of the consumer protection movement. Non-merchants primarily include consumers and a limited number of small business tradespeople, farmers, and forest enterprisers who are not merchants262 under the Commercial Code.263

Further, the Verbraucherchreditgesetz ("VerbrKrG"), effective as of January 1, 1991, is a new Consumer Credit Act that provides some consumer-oriented provisions regarding finance leases.264 The Act's predecessor, the Abzahlungsgesetz ("AbzG") of 1894, governed agreements based on installment plans and was repealed on December 31, 1990. Today, the AbzG only applies to transactions concluded before 1991, and its scope will dwindle in the course of time. Because of this development, and because it is hotly debated whether Courts can apply the AbzG to finance leases, this Article will not discuss the AbzG.265

To summarize, the German legal system lacks a comprehensive

261. This provision provides: "The debtor is bound to effect performance according to the requirements of good faith, common habits being duly taken into consideration." BGB art. 242.


263. HGB arts. 2, 3.


265. For a discussion of the AbzG's treatment of finance leases, see MARTINEK, supra note 2, at 91-109. See also Teichmann, supra note 249, at 721-29.
statute that controls the myriad issues ensuing from the use of finance leases. Instead, German courts have established a patchwork of case law. Most decisions focus on whether stipulations in finance lease adhesion contracts comply with the AGBG, particularly section 9. In making these decisions, the BGH generally draws analogies to BGB Articles 535 and following (the statutory provisions governing leases). Additionally, some provisions of the VerbKrG enhance the consumer finance lessee’s legal status and bargaining position. Since tax considerations are significant in choosing a finance lease as means of debt financing, the Finance Ministry’s decrees on finance leases must be closely watched in order to optimize the tax benefits.

Several legal scholars have made efforts to distinguish between finance lessors’ independence from suppliers versus their affiliation with suppliers. Despite these attempts, however, authorities unanimously reject an equal treatment of both situations. The BGH simply declined to draw conclusions from the aforementioned distinction.

3. Freedom of Contract Principle

Although the freedom of contract principle is not explicit in any German statute, it is deeply ingrained in German civil law. Accordingly, this basic principle applies to provisions governing finance leases contained in the AGBG, VerbrKrG, and BGB. Each of these statutes, however, limits the application of the freedom of contract principle.

The BGB establishes the conflicting bona fides principle and voids legal transactions that are contra bonos mores. The AGBG

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266. See supra notes 256-57 and accompanying text.
267. See supra notes 250-55 and accompanying text.
268. See supra notes 226-33 and accompanying text.
270. See BGB art. 242 ("The debtor is bound to effect performance according to the requirements of good faith, common habits being duly taken into consideration.").
271. See BGB art. 138 ("A declaration of intention is void if it is immoral."). The Reichsgericht has defined the term “immoral” as “contravening the sense of decency of every person
follows another approach, setting different standards for stipulations contained in adhesion contracts than in non-adhesion contracts. Finally, the VerbrKrG makes severe demands on informational obligations placed upon the consumer credit business, and offers special consumer-oriented rights. Further, the VerbrKrG emphasizes the priority and precedence of its consumer-protection approach in section 18, which states that the Act's provisions are unalterable, nonwaivable, and unyielding.

B. Lessee's Remedies in a Nonconsumer Finance Lease

1. Inherent Remedies Against the Finance Lessor Based on the Finance Lessee's Legal Status

During negotiations, the supplier might breach his obligations arising under provisional agreements by non-delivery, default, or delay. He might also breach his duty of care or another duty arising before entering into a definite contractual agreement, whether with the lessee or, what is more common, with the finance lessor. Of course, the finance lessor himself must also meet such obligations. In these cases, the finance lessee may claim damages based on the implicit principle of culpa in contrahendo if the breaches are committed by the supplier acting as an agent of the finance lessor or by the


273. See supra notes 256-57 and accompanying text.
274. For more details, see infra notes 365-67 and accompanying text.
275. Under U.C.C. §§ 2A-209 and 2A-407, in the case of a nonconsumer finance lease, the lessee's contractual promises become irrevocable and independent upon the lessee's acceptance of the goods. The lessee is a beneficiary of the supply contract instead. German laws, or rather the BGH-precedents, however, do not link such a far-reaching cut-off of lessee's remedies to the acceptance of goods. For the remedies available to lessees in nonconsumer finance leases, see, e.g., Herbert Klauss & Ludwig Ose, Verbraucher-Kreditgeschäfte Kommentar 331-59 (2d ed. 1988); Martinek, supra note 2, at 118-91; Dietrich Reincke & Klaus Tiedtke, Kaufrecht 424-45 (4th ed. 1989).

276. The principles of contractual liability have been extended by numerous court decisions so as to cover cases in which a contract has in fact not yet been concluded, but where the parties have entered into legal relations with a view to concluding a contract. This is the case of the so-called culpa in contrahendo. The consequence of a violation of the semi-contractual relation of mutual confidence arising from the preparation of a contract is the duty on the part of the responsible party to compensate the other party for any damage caused to this party, either wilfully or negligently.

277. See BGB art. 278 (The debtor is vicariously liable for intentional and negligent acts committed by its statutory representative or by a person whom it employs in the performance of its obligations.).
finance lessor.\textsuperscript{278} The BGH considers a supplier to be a finance lessor's agent if the supplier behaves like an ancillary person authorized to solicit for the finance lessor's business.\textsuperscript{279} A stipulation excluding the finance lessor's liability for his agent's misconduct is void under AGBG section 9.\textsuperscript{280}

In case of commercial transactions, German law generally requires the buyer to examine and, if necessary, reprove the goods delivered for any defects. If he fails to do so seasonably, the Commercial Code deems the goods accepted.\textsuperscript{281} If the parties exclude warranty claims under HGB Article 377 because of the finance lessor's negligence, the finance lessee may have a cause of action for damages. The BGH\textsuperscript{282} held that this uncodified principle of law provides culpability based on a breach of contract other than default or non-performance.\textsuperscript{283} The leasing practice, however, regularly makes stipulations which exempt the finance lessor from the obligations under HGB Article 377, and imposes them on the finance lessee instead. Legal objection cannot be raised to such stipulations.\textsuperscript{284}

With respect to the delivery of leased goods, the legal effects of default and delay has generated controversy.\textsuperscript{285} As previously mentioned, the BGH has repeatedly emphasized the finance lessor's main obligation of ensuring the right to use the leased goods. At the same time, it considers the financial aspect of finance leases to be annexed to this obligation. Thus, in the case of default or delay, the Court has held that the equivalence of the finance lessee's and finance lessor's contractual obligations and duties would be severely upset if the finance lessor were exempt from its promises and, simultaneously, the finance lessee had to make payments.\textsuperscript{286} As a result, the finance lessee may cancel the lease in cases of default, or may defer his payments in cases of delay.

In view of the precedents granting privileges to finance lessees, it

\begin{thebibliography}{9}
\bibitem{} 280.  \textit{GRAF VON WESTPHALEN, supra} note 241, at 153, 155; \textit{MARTINEK, supra} note 2, at 121.
\bibitem{} 281.  HGB art. 377.
\bibitem{} 283.  So-called "Positive Vertragsverletzung" or "Positive Forderungsverletzung."
\bibitem{} 285.  For some appreciation of the scope, see, e.g., \textit{MARTINEK, supra} note 2, at 126-43.
\end{thebibliography}
is not surprising that the financing practice has been seeking to evade these consequences through default or delay clauses. The Justices of the Federal Supreme Court tend to invalidate exemption clauses discharging finance lessors from liability for default or delay.\footnote{287} This issue, however, is hotly debated by legal commentators and academicians.\footnote{288} Finance lessors may not be able to validate the aforementioned exemption clauses by assigning their potential damage claims, which are rooted in the supply contract, to finance lessees. Apparently, the BGH is inclined to prohibit this effort by the leasing practice,\footnote{289} but has not explicitly settled this issue. Opinions among commentators, however, differ according to individual attitudes toward the legal nature of finance leases.\footnote{290}

A special case of default exists if the delivery of leased goods fails because of the supplier's insolvency. Standardized contracts often contain stipulations imposing the risk of the supplier's insolvency upon the finance lessee. Again, the equivalence of the finance lessor's and finance lessee's contractual obligations and duties would be considerably affected\footnote{291} if the finance lessee had to answer for the supplier's insolvency.\footnote{292} Therefore, such "risk-of-insolvency clauses" are inconsistent with AGBG provisions.\footnote{293}

Pursuant to stipulations generally included in standard form contracts, finance lessees bear the risk of incidental\footnote{294} destruction, damage, and theft of leased goods. Further, they remain liable for continuous lease payments. Additionally, finance lessees agree to

\footnote{289. See Judgment of Oct. 9, 1985, 96 BGHZ 103 (1985).}
\footnote{290. See GRAF VON WESTPHALEN, supra note 241, at 224. But see HAGENMÜLLER & STOPPOK, supra note 226, at 24-25.}
\footnote{291. See supra note 286 and accompanying text.}
\footnote{292. Judgment of Court of Appeals Hamm, 35 BB 441, 442; MARTINEK, supra note 2, at 141; PAPAPOSTOLOU, supra note 249, at 111; Klaus Ebenroth, Inhaltliche Schranken in Leasing-Formularverträgen auf Grund des AGB-Gesetzes, 31 DB 2109, 2114 (1978). But see Coester-Waltjen, supra note 288, at 187; Flume, supra note 288, at 56.}
\footnote{293. See AGBG arts. 7-9, 11.}
\footnote{294. "Incidental" is used when neither a finance lessor nor a finance lessee is responsible for an event.}
maintain, repair, and insure the leased objects. Finally, lessees must replace stolen or damaged leased goods. Courts generally uphold these clauses without objections. However, if in these cases the finance lessee can no longer use the leased goods, lessee may immediately cancel the underlying agreement without notice. Yet there is still no legally binding decision whether the above is true even before the goods are delivered to the finance lessee.

2. Remedies Based on Rights Against the Supplier Which Have Been Assigned by the Finance Lessor

Finance lessors almost always seek to destroy finance lessees' warranty rights which would otherwise arise from the lease agreement. In return, finance lessors regularly extend lessees the benefit of the supplier's promises and warranties under the supply contract. This is usually done by means of a contractual stipulation. Lessors accomplish this "pass through" either by assigning the corresponding rights to the finance lessee or by empowering the lessee to assert the named rights in his own name and on his own account and risk.

Until the groundbreaking BGH Judgments of September 16, 1981 and April 24, 1985, a highly disputed issue concerned whether these finance lease agreements were in compliance with AGBG provisions. Since then, the general consensus is that the standards set by the AGBG do not conflict with the described contractual terms.


296. Judgment of Oct. 15, 1986, 40 NJW 377, 379 (1986). In that case, however, the agreement was canceled due to an alternative notice of termination which became effective after a certain time period.

297. For some appreciation of the scope, see MARTINEK, supra note 2, at 146-47.

298. Following the BGH's point of view concerning the legal nature of finance leases, the excluded warranty rights are: BGB art. 536 (right to have defects cured by the lessor); BGB art. 537(1) (right to reduce the rent in case of defect independent of the lessor's fault or responsibility); BGB art. 538(1) (claim for damages caused by the defect); BGB art. 542 (cancellation without notice in case of failure to ensure the use).

299. BGB arts. 398-413.

300. See BGB arts. 459-493 (sales contracts); BGB arts. 633-651 (manufacturing contracts).

301. BGB art. 185(1).

302. See 81 BGHZ 298, 301 (regarding AGBG's commercial scope); 94 BGHZ 180, 187 (regarding AGBG's non-commercial scope).

303. For more details concerning this dispute, see MARTINEK, supra note 2, at 153-60.
These finance leases, however, do not ordinarily leave finance lessors entirely immune from warranty liability to lessees. Contrary to general expectations, finance lessors regularly reserve the right to assert pecuniary claims that derive either from warranty claims or the supply contract. Nevertheless, it is possible that finance lessors may extricate themselves entirely from any warranty liability by additionally assigning their warranty claims for damages to finance lessees. Yet, under most finance leases, lessors reserve the right to assert warranty claims against suppliers, for damages based on the supply contract, and to assert claims for damages caused by impossibility of performance by suppliers. In addition, lessors often reserve the right to assert claims for damages for non-performance due to the supplier's default. On the other hand, finance lessees are entitled to assert non-monetary warranty claims against the supplier, and claims for their own damages against the finance lessor. The reasons for this subtle partition between lessor's and lessee's claims are not entirely obvious, but explainable; first, if a finance lessee could only assert damage claims that were embodied in the supply contract it could demand the finance lessor's damages, but not its own, which may be higher than those of the finance lessor.

The second reason is more striking. Most frequently, finance lessees choose rescission of supply contracts as a remedy for defective merchandise. Rescission of the supply contract is best in the following situations: when leased goods prove to be defective and it is impractical to cure the particular defects; when suppliers fail to eliminate shortcomings or to repair defects or, worse, refuse to take any steps to remedy the defects; and when suppliers flatly deny any defects. Yet, there are many unresolved questions concerning the legal consequences of the finance lessee's rescission of the supply contract. For example, it is unclear who receives the reimbursed

304. MARTINEK, supra note 2, at 153, 160, 186; REINICKE & TIEDTKE, supra note 275, at 426.
305. BGB arts. 463, 480(2) (covering damages due to non-performance under sale contracts); BGB art. 635 (covering damages due to non-performance under manufacture contracts).
306. GRAF VON WESTPHALEN, supra note 241, nn.341-49 (validating the described entire insulation from warranty liability). But see MARTINEK, supra note 2, at 158-60. Of course, finance lessors may take this step if their original liability is not thereby replaced.
307. BGB arts. 463, 480(2), 635.
308. BGB art. 325.
309. BGB art. 326.
310. Such a claim could be based on non-performance of the obligations under the finance lease under BGB arts. 325-326 or breach of contract other than non-performance or default.
purchase price or wages from the supplier, and whether the finance lessee is thereafter obliged to make payments. Thus, it is highly controversial whether and when the finance lessor’s claim to payments ceases.  

Because of the multitude of views on these questions, this Article focuses on those of the BGH. The BGH holds that finance lessees who seek to rescind the supply contract are obliged to demand repayment of the purchase price or wages on the finance lessor’s behalf.  

Further, a material rescission of the supply contract inevitably leads to an *ex tunc* frustration of the finance lease agreement. Thus, the rescission completely erases all of the lessor’s and lessee’s obligations under the agreement, including the lessee’s payment obligation, and lessee’s promise to pay in compliance with the finance lease agreement becomes retroactively void. Lessees thus terminate their payment obligation as soon as they act to rescind the supply contract, whether such rescission is justified or not. As soon as the action to rescind is asserted provisionally, the BGH releases the lessee from further payments. In addition, if the rescission proves to be material, the finance lessee may reclaim past payments already received by the lessor, except for payments made during the time that the leased goods were properly useable.

Finance lessees may also sue for breach of contract, including consequential damages due to the defective nature of the goods. However, a claim for such damages may not be based on default or non-performance and may only occur after assignment of the corresponding monetary claim. As previously stated, finance lessees are

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311. For a comprehensive discussion of the arguments on that issue, see Martinek, supra note 2, at 166-91.


315. This claim follows from BGB art. 812 (governing unjust enrichment).

only entitled to assert the finance lessor's consequential damages against the supplier, but not their own, possibly higher claim for damages. Instead, for their own damages, finance lessees must seek recourse against the finance lessor.

Finally, this Article will analyze another current dispute regarding these leases. Undoubtedly, the benefit of the supplier's warranties to the lessor extends to the finance lessee by virtue of assignment. However, the question arises whether the finance lessee is also entitled to raise objections based on the supplier's warranties. In other words, it is debatable whether the finance lessee may refuse to make payments with reference to warranty rights established in the supply contract. According to obiter dictum contained in a 1977 BGH decision, courts were to provide finance lessees with this remedy, thereby preferring lessees' interests over the finance lessors' interest of being insulated from any warranty claims. Currently, the BGH has never affirmed this obiter dictum, and it has been widely criticized by other authorities. Thus, at least as far as nonconsumer finance leases are concerned, finance lessees are not entitled to raise the described objections against finance lessors.

As a result, rights and remedies ordinarily available to finance lessees under standardized finance lease agreements can be outlined as follows:

A. Most Important Rights Against the Supplier due to Assignment or Authorization:
   (i) If the supply contract is a sale contract:
      (a) rescission of the contract (BGB Articles 462, 465-67) in case of material defects inherent in the goods (BGB Article 459 (1)), or in case of lack of characteristics or qualities promised by the seller or supplier (BGB Article 459 (2));

318. Gitter, supra note 249, at 367; Koch, supra note 241, at 77-78; Martinek, supra note 2, at 187-91; Reinicke & Tiedtke, supra note 275, at 437; Graf von Westphalen, supra note 241, at n.543; Helmut Schreiner, Stornierungskosten des Herstellers oder des Lieferanten beim Finanzierungs-Leasing, 35 BB 294, 295 (1980); Sonnenberger, supra note 241, at 2217, 2220. The obiter dictum is at least partly favored by Dieter Mayer, Finanzierungsleasing und Abzahlungsge setz 230-37 (1987); Papapostolou, supra note 249, at 57, 70, 95-96; Canaris, supra note 248, at 309; Coester-Waltjen, supra note 288, at 193; Hiddemann, supra note 241, at 840.
319. For the legal situation of consumer finance leases, see infra notes 375-86 and accompanying text.
320. Since a detailed description of each right is beyond the scope of this Article, a simple enumeration with references to the corresponding sections is provided.
(b) reduction of the purchase price (BGB Articles 462, 465, 472) under the same circumstances as described under (A);

(c) if stipulated by lessor and supplier, right to have the defect remedied by the seller/supplier (BGB Article 478(a));

(ii) If the supply contract is a contract for manufacture:

(a) remedy of any defects by the manufacturer/supplier (BGB Article 633);

(b) rescission of the contract in case of material defects have not been remedied despite request (BGB Article 634);

(c) reduction of wages (BGB Article 634) under the same circumstances as described under (i)(B);

(iii) Independent of the nature of the supply contract:

(a) if stipulated by lessor and lessee, claim for consequential damages resulting from defects of the leased goods on the grounds of breach of contract other than default or non-performance;

(b) if stipulated by lessor and supplier, contractual rights concerning advice, instruction, installation, and so forth.321

The claims based on rights under A(i) are barred by the statute of limitations six months after delivery.322 Claims under A(ii) are barred by the statute of limitations six months after acceptance of the leased goods,323 unless the lessor, manufacturer, or supplier fraudulently withholds the defect. The statutory period of limitation concerning claims under A(iii) depends upon whether the damages are closely linked to the leased goods, in which case the statutory period is six months, or not, in which case the statutory period is thirty years. The debate over this issue, however, is still in flux.

The rights of finance lessees against finance lessors can also be outlined as follows:

B. Rights Against the Finance Lessor:

(i) claims for damages because of impossibility of performance due to finance lessor's responsibility (BGB Article 325); eventual vicarious liability of lessor for supplier's acts as agent (BGB Article 278);

(ii) claims for damages because of finance lessor's default (BGB Article 326); eventual vicarious liability of lessor for supplier's acts as agent (BGB Article 278);

(iii) claim for damages because of breach of contract other than

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321. This survey does not consider the question regarding the extent to which suppliers may exempt or restrict the rights specified under (i) and (ii).

322. BGB art. 477(1).

323. BGB art. 638(1).
non-performance or default, possibly concerning personal consequential damages; 
(iv) if stipulated, contractual rights concerning advice, instruction, installation and so forth.324

Claims under thirty years are barred after they come into existence.325

3. Other Rights and Remedies Available to the Finance Lessee Against the Finance Lessor

Generally, contracts come into existence by two concurring declarations of intention (Willenserklärungen), offer and corresponding acceptance. Each declaration of intention can be subject to challenge for several reasons. The most common facts constituting a challenge are:

(i) error in the contents of the declaration of intention (BGB Article 119 (1));
(ii) error in describing essential characteristics of a person (e.g. finance lessor) or a thing (e.g. leased goods) (BGB Article 119 (2));
(iii) fraudulent deception or illegal threat by the lessor and possibly by the supplier acting as lessor’s agent that induced the declaration of intention (BGB Article 123).

Thus, a finance lessee may under certain circumstances contest the validity of lessee’s declaration that led to the conclusion of a finance lease agreement, whether lessee is offeror or offeree. As a result, when there are legitimate and material challenges, lessee is entitled to re-claim payments already made based on unjust enrichment.326

In addition, a claim for unjust enrichment might be successfully raised if the declaration of intention is void because it was contra bonos mores,327 violated a legal ban,328 contained formal defects,329 or was given by an incompetent person.330

4. Additional Rights Against Manufacturers, OtherRemote Sellers, and Suppliers

Admittedly, a multitude of conceivable situations could trigger

324. This enumeration of rights is based on standard form finance leases. See supra notes 308-10 and accompanying text.
325. BGB arts. 195, 198.
326. BGB art. 812.
327. BGB art. 138. See also supra note 272 and accompanying text.
328. BGB art. 134.
329. BGB art. 125.
330. BGB art. 104.
successful actions against the aforementioned groups. This Article, however, can only highlight those arrangements which repeatedly occur or have recently given rise to legislation.\textsuperscript{331}

Actions against manufacturers and remote sellers were chiefly founded in tort law, under the theory of products liability. On January 1, 1990, a new Products Liability Act became effective,\textsuperscript{332} integrating the basic theories of products liability as they had emerged from tort law. It is important to recognize that the manufacturer’s liability under the Act can neither be excluded nor limited in advance, and agreements conflicting with this provision are deemed void.\textsuperscript{333} Otherwise, liability pursuant to other provisions is not affected.\textsuperscript{334}

If untrue and misleading commercials, advertising campaigns, or other materials induce customers to enter into an agreement, in certain cases such materials may cancel the contract. If the publicity campaign is fabricated by a third person, customers are only entitled to cancel their agreements if the other party to the contract knew the misleading character of the materials and agreed to them.\textsuperscript{335}

Finally, in certain cases finance lessees might be entitled to invoke rights arising from their own relationship with the supplier. If the supplier breaches any obligations derived from provisional agreements without acting as an agent of the finance lessor,\textsuperscript{336} lessees may claim damages against the supplier under the \textit{culpa in contrahendo} principle.\textsuperscript{337} Privity is established even though both finance lessee and supplier did not intend an agreement.\textsuperscript{338}

5. Evaluation of Nonconsumer Lessee’s Rights and Remedies in Finance Leases

This Article will not attempt to criticize the BGH’s approach to

\textsuperscript{332} BGBl. I 2198 (1989).
\textsuperscript{333} ProdHaftG art. 14.
\textsuperscript{334} ProdHaftG art. 15(2).
\textsuperscript{335} \textit{See GESETZ GEGEN DEN UNLAUTEREN WETTBEWERB [UWG] art. 13(a)(1) (Law Against Restraints of Competition) (1990) (F.R.G.).}
\textsuperscript{336} With regard to the legal consequences in cases in which suppliers deal as finance lessor’s agents, see \textit{supra} note 277 and accompanying text.
\textsuperscript{337} As to the specifics of that principle, see Judgment of June 6, 1984, 37 NJW 2938 (1984).
\textsuperscript{338} \textit{Id. See also} Judgment of Oct. 9, 1985, 96 BGHZ 103 (1985).
finance leases. Indeed, the appraisal of finance lessee's rights and remedies requires an analysis of case law developed by the BGH, due to the lack of pertinent statutory provisions regarding finance leases. Therefore, one should scrutinize the BGH's approach while keeping in mind that the BGH emphasizes the lessor's obligation to ensure the right to use the leased goods, and relegates lessor's financing function to a lower priority.

Generally, the benefits received by the lessor from the supplier's warranties also extend to the finance lessee. However, finance lessors ordinarily do not assign to leases the monetary claims resulting from warranties in the supply contract. Thus, finance lessees are not treated as if they had contracted with the supplier directly. In short, the finance lessee dominates the negotiations, since the lessee regularly selects the leased goods, and is obliged to request the cure of any defects from the supplier, or to declare the rescission of the supply contract. Further, if necessary, the lessee must commence legal proceedings against the supplier for defects or a reduction in the purchase price. On the other hand, the lessor must initiate further proceedings regarding supplier's repayments which arise from the warranty rights asserted by the lessee. The question remains, therefore, over what justifies this half-hearted attempt to extricate the lessor from any warranty liability. It seems that finance lessors might as well assign all pecuniary claims derived from the warranties under the supply contract to the finance lessee, while remaining the beneficiary of these claims.

The current practice, however, is used primarily because of the landmark BGH decision of February 23, 1977, which is full of meaning. As a consequence of this decision, after a material rescission of the supply contract, the finance lessee may reclaim all payments made to the lessor under the finance lease. Therefore, security reasons dictate that lessors do not assign their monetary claims derived from the supplier's warranty liability. Further, even without the need for this precautionary measure, lessors would still follow the same practice of reserving monetary claims under the supply contract. Indeed, it is usually of minor interest to the lessor by which means finance lessees assert their own damages resulting from warranties. In sum, it seems that finance lessors are only willing to assign claims

339. For such criticism, see MARTINEK, supra note 2, at 72-75, 175.
340. 68 BGHZ 118, 125. See also supra note 312 and accompanying text.
341. For more details regarding this issue, see supra notes 308-10 and accompanying text.
from supply contract warranties when they do not interfere with a finance lessee's eventual recourse.

Among other characteristics of these finance leases, a finance lessor remains subject to a finance lessee's claims based on the lessor's or agent-supplier's non-performance, default, or delay. Further, finance lessees may recover damages from breach of contract other than non-performance or default. If any obligations are breached during the negotiations, even if no agreement has been reached, the lessee can hold either the supplier or the finance lessor responsible for damages pursuant to the *culpa in contrahendo* principle. As a result, the finance lessor's insulation from warranty claims is very porous. Alternatively, far-reaching minimum standards concerning the finance lessee's rights and remedies are not subject to contractual exemptions or stipulated restrictions.

**C. Lessee's General Remedies and Rights in a Consumer Finance Lease**

Finance leases do not accurately fit the statutory model. Thus, courts have assumed the function of setting lease standards. Today, finance leases are largely dominated by case law. One might even argue that BGH precedents are, for the most part, in a rut. However, the BGH has not yet considered that commercial and consumer finance lessees might require a different level of legal protection. Admittedly, the Act on General Terms and Conditions of Trade applies certain standards to consumers and a limited number of small business owners, farmers, and forest enterprisers. The BGH, however, applies a different standard. Besides this, consumer finance lessees were given little additional protection. Not before January 1, 1991, were legal provisions introduced that were applicable to finance leases, and consumer lessees in particular. Accordingly, the following discussion will concentrate on the Verbraucherkreditgesetz ("Consumer Credit Act," or "VerbrKrG"). Within this discussion other consumer-related provisions will also be briefly mentioned, but without direct reference to finance leases.

342. See supra note 256 and accompanying text.
343. See supra notes 262-63 and accompanying text.
344. The AbzG governs agreements based on installment plans, and furnishes finance lessees with supplemental protection. The Act's provisions, however, are applicable to finance leases only by analogy and under certain circumstances. See MARTINEK, supra note 2, at 91-109.
1. History of the VerbrKrG

The VerbrKrG developed from the European Communities’ (“EC”) Council Directive for the approximation of the laws, regulations, and administrative provisions concerning consumer credit. By January 1, 1990, the Act on General Terms and Conditions of Trade (“AGBG”) had met most of the Directive’s requirements. After several Ministerial Bills were proposed, a Government Bill was passed in August 1989. Thereafter, the Upper House of Parliament (Bundesrat) suggested several amendments to the Bill, but the Federal Government opposed the amendments. On June 1, 1990, the Legal Committee held a hearing at which authorities from banks, members of the legal community, and members of consumer information centers expressed their views on the Bill. At first, it appeared unlikely that the Legal Committee would pass the VerbrKrG during the session ending December 1990. Yet, on October 30, 1990, the Lower House of the German Federal Parliament (Bundestag) passed the VerbrKrG. In contrast to the Government Bill, the VerbrKrG considers consumer interests to a higher extent, largely because of the Upper House’s amendments. In response to the “urgent” need for protection of former East Germans during the transition to capitalism, the VerbrKrG came into operation on January 1, 1991.

The surprisingly rapid introduction of the VerbrKrG is primarily due to two facts. First, the transformation of the EC Council Directive was one year overdue by the time the VerbrKrG finally became effective. Second, the drafters of the VerbrKrG relied heavily on its predecessor, AbzG, governing agreements based on installment plans. Both laws held the same goal, namely to protect socially and economically inferior consumers from overly-hasty and costly agreements.

347. See 9 ZIP 1215.
350. BT-Drucks. 11/5462, sched. 3, at 47.
353. BT-Drucks. 11/8274, at 22.
354. Id. at 33.
355. Id. at 22.
Thus, it is a small wonder that the VerbrKrG contains several provisions similar or identical to those in the AbzG.

Now, two years after enactment of the VerbrKrG, published cases applying the new provisions are slow in coming. Meanwhile, lawyers receive assistance from annotations and commentaries that elaborate upon this relatively new branch of law.\textsuperscript{356}

2. Consumer Finance Leases Under the VerbrKrG

As far as finance leases are concerned, the VerbrKrG's scope is fixed by the definitions of "consumer," "creditor," and "credit agreement."\textsuperscript{357} The term "consumer" means a natural person who, in transactions covered by the VerbrKrG, is acting for purposes which can be regarded as outside his trade or profession. The term "creditors" means natural or legal persons who grant credits in the course of their trade, business, or profession. Finally, "credit agreement" is defined as an agreement whereby a creditor grants or promises to grant to a consumer a credit in the form of a loan, deferred payment, or other similar accommodation.

Without a doubt, the definition of "consumer" comprises the joint and several raising of credits, e.g., by married people. Naturally, the question whether consumers act for private purposes or aim at business outside their trade and profession will present considerable difficulties, particularly in cases of mixed purposes. Courts will hopefully provide guidelines to settle this issue. Further, finance leases are indisputably deemed as credit agreements representing an accommodation similar to loans and deferred payments.\textsuperscript{358} This understanding is corroborated by VerbrKrG section 3(2) No. 1 that specifies those provisions of the VerbrKrG that are not applicable to "finance leases." This technique of including legal relationships in a law demonstrates that finance leases were not covered by the Government Bill, but were later incorporated into the Act. As will be illustrated

\textsuperscript{356} PETER BüLOW, VERBRAUCHERKREDITGESETZ KOMMENTAR 176, passim (1991); WALTER MÜNSTERMANN & RUDI HANNES, VERBRAUCHERKREDITGESETZ KOMMENTAR 50, passim (1991); ULRICH SEIBERT, HANDBUCH ZUM VERBRAUCHERKREDITGESETZ 18, passim (1991); JÜRGEN VORTMANN, VERBRAUCHERKREDITGESETZ KOMMENTAR 172, passim (1991); FRIEDRICH GRAF VON WESTPHALEN ET AL., VERBRAUCHERKREDITGESETZ KOMMENTAR 140, passim (1991); Ralf Kilimann, Das neue Verbraucherkreditgesetz, 6 DEUTSCHE RECHTSPRECHUNG 4 [DR] (Supp. 1991) (F.R.G.).

\textsuperscript{357} VerbrKrG § 1(1), (2).

\textsuperscript{358} Friedrich Graf von Westphalen, Leasing als "sonstige Finanzierungshilfe" gemäß § 1 Abs. 2 VerbrKrG, 12 ZIP 639, 642 (1991).
later,\textsuperscript{359} this subsequent and poorly devised\textsuperscript{360} inclusion of finance leases in the VerbrKrG has led to considerable difficulties in aligning the VerbrKrG with the standards already set by the BGH.

Finally, one should consider consumer finance lessee's remedies and rights under the VerbrKrG with one eye on the Act's exemptions that limit its scope. The VerbrKrG is not applicable to credit agreements if any of the following conditions are met: (1) if the money to be borrowed or the cash payment price does not exceed DM400;\textsuperscript{361} (2) if the credit is intended for the establishment of a trade or profession, and the money to be borrowed or the cash payment price exceeds DM100,000;\textsuperscript{362} (3) if the consumer is given a moratorium of less than three months;\textsuperscript{363} or (4) if employer and employee enter into a credit agreement with an interest rate below the rates at any given time in the market.\textsuperscript{364}

3. Supplementary Consumer-Oriented Provisions Under the VerbrKrG

\textit{a. Choice of Law and Judicial Forum}

Since the VerbrKrG is a federal law with legal validity in all sixteen states of the Federal Republic of Germany, intricate questions concerning the choice of law do not arise. In addition, the consumer-friendly approach of the Act is fully guaranteed to the target group under VerbrKrG section 18. This section deems void any agreements declaring the Act's provisions inapplicable to the detriment of the consumer. Furthermore, it provides that the VerbrKrG must not be circumvented by the formulation of agreements. Thus, VerbrKrG section 18 results in an unyielding, nonwaivable minimum standard of statutory consumer protection under credit agreements.

The applicable forum for disputes regarding the finance lease agreement is usually the judicial district of the consumer's residence. The VerbrKrG does not cover this, or any jurisdictional provisions for that matter. Instead, jurisdiction is determined by the Civil Proce-
dure Statute ("Zivilprozeordnung," or "ZPO"). Therefore, the agreement cannot call for a court that has no original jurisdiction to rule over the parties’ disputes,365 and instead the ZPO's general provisions determine jurisdiction. Thus, if the finance lessor commences legal proceedings against the consumer lessee, either ZPO article 13 (forum of the defendant’s residence) or ZPO article 29 (forum of place of performance) will establish the appropriate forum.366 Regardless, consumers can only be sued in the judicial district of their residence. On the other hand, consumers suing finance lessors may choose as the forum the place of performance.367

b. Unconscionability

The idea of "unconscionability" as a legal basis is not explicitly expressed within the VerbrKrG’s scope. This idea, however, finds its counterpart in the statutory provisions setting limits to the freedom of contract principle.368 Essentially, the VerbrKrG’s sympathy towards consumers both emanated from the “unconscionability” concept, and established the concept within the VerbrKrG.

c. Attorneys’ Fees

Generally, the ZPO provides that attorneys’ fees and costs in civil law cases are awarded to the successful party.369 If a party only partially "wins," costs are proportionately divided between the parties.370 These rules are applied to civil cases without exception. Given the VerbrKrG’s described principle, the legislature considered additional protection for the benefit of consumers inappropriate.

d. Right of Revocation: The Right to Raise Objections Directly Against Finance Lessors Based on Supply-Contract Warranties

Under VerbrKrG sections 7 and 9(2), consumers may unilaterally revoke their offer or acceptance. This led to the conclusion of the

366. Place of performance for payment of credits is the debtor’s residence. BGB art. 269(1).
367. This is regularly the consumer's judicial district. See ZPO art. 29.
368. See supra notes 271-74 and accompanying text.
369. ZPO art. 91.
370. ZPO art. 92.
finance lease agreement. By this provision, the VerbrKrG gives consumers the opportunity to reflect on the reach and financial consequences of the finance lease, and to watch for other offers to provide a basis for comparison. Nevertheless, VerbrKrG section 7 places a time limit on this right; it requires that consumers forward their revocation within one week. Further, if the finance lessor fails to duly instruct the consumer as to his right of revocation, the remedy expires within one year. Therefore, finance lessors should go to great lengths to bring their lessee instructions in line with the VerbrKrG’s requirements. Yet, this is more easily said than done, as several practitioners have discovered. Nevertheless, it is reasonable to expect that these uncertainties are only temporary and will soon be settled by litigation.

Another provision of VerbrKrG\textsuperscript{372} contains sufficient strength to call into question the prevailing understanding of the remedy structure of finance leases. Through this section, “Einwendungsdurchgriff,” a common-law remedy,\textsuperscript{373} became law with regard to consumer installment-plan purchases that are financed by banks.\textsuperscript{374} Through these arrangements the consumer is both buyer of the goods and borrower of the money, while seller and lender are different people. Two legally independent agreements are joined together to become one economically undivided transaction. Thus, the seller gets a lender for the consumer or borrower. Regularly, the lender is the bank with whom the seller does permanent business. After the bank pays the purchase price to the seller based on a credit agreement with the consumer or borrower, that party is obliged to repay the lender. By this time, intricate legal problems can emerge.

In the eyes of the law, the transactions between seller and lender,


\textsuperscript{372} See VerbrKrG § 9(3).

\textsuperscript{373} For more details, including the development of this common law remedy, see VORTMANN, supra note 356, at 172-80; GRAF VON WESTPHALEN ET AL., supra note 356, at 149-51, nn.76-80, and 348-57, nn.86-106; Thomas E. Abeltshauser, \textit{Der Einwendungsdurchgriff zwischen Rechtsgeschäftslehre und Vertrauenshaftung}, 10 ZIP 693, 694-98 (1990). \textit{See also} Thomas Raiser, \textit{Einwendungen aus dem Kaufvertrag gegenüber dem Finanzierungsinstitut beim finanzierten Abzahlungskauf}, 33 RabelsZ 457-75 (1969) (providing a comparative study of Germany, England, and the United States, with regard to emerging difficulties in determining the buyer’s legal status in installment plan purchase contracts, financed by third party lenders).

\textsuperscript{374} VerbrKrG § 9(3).
and lender and consumer are separate. Where the lender sues the consumer, the consumer cannot assert a defense based on the unsatisfactory character of the transaction. To illustrate, if the purchase contract is void after the seller fails to meet his contractual obligations, the credit agreement between consumer and lender is legally independent and thus unaffected by seller's non-performance. The same is true if the seller cancels the contract. Thus, the consumer is in danger of losing remedies otherwise available had the seller granted the credit directly. With this conflict in mind, the legislature adopted a statutory remedy similar to the common law remedy, in an attempt to settle the debate between legal scholars, practitioners, and judges.\(^3\)

VerbrKrG section 9(3) provides that a consumer may refuse to repay credit to the extent that remedies provided by a "combined" purchase contract would allow. VerbrKrG section 9(1) defines "combined" contracts as those that are regarded as an "economic unit." The provision further refers to criteria for determination, as developed by BGH precedents.\(^3\) It is unclear, however, how VerbrKrG section 9(3) will affect the remedies available to consumer finance lessees. Depending on which point of view one takes in the dispute regarding VerbrKrg section 3(2), the answer will differ significantly.

VerbrKrG section 3(2) enumerates those provisions of the VerbrKrG that are inapplicable to finance leases. Some argue that this section does not exempt the application of VerbrKrG section 9(3). They argue further that finance leases are comparable to purchases based on installment plans and financed by a third party. Therefore, they argue that consumer finance lessees may assert rights pursuant to VerbrKrG section 9(3).\(^3\)

Others, however, object that triangle transactions like financed purchases based on installment plans are not analogous to finance leases, because consumers in triangle transactions enter into two agreements (purchase and credit), while finance lessees only conclude one agreement (lease). Accordingly, they argue that finance leases

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\(^{375}\) VerbrKrG § 9(3).


cannot be "combined" transactions under VerbrKrG section 9(1). Consequently, subsection (3) also cannot be applied.378 Further, these critics believe that VerbrKrG section 9(3) does not provide consumers with any rights or remedies which could improve their current legal status.379

It appears that the arguments of the second approach are more compelling. The other, more formalistic argument that references VerbrKrG section 3(2) fails to apply VerbrKrG section 9(3) to finance leases. Even if finance leases could be considered triangle, or "combined" transactions in terms of VerbrKrG section 9(1), however, the question of whether this interpretation creates any additional remedies beyond those already developed by the BGH remains unanswered.380

As discussed previously, finance lessees are generally entitled to stop payments under the finance lease when they rescind the supply contract and, if necessary, to take corresponding legal action. Further, where the rescission is material, finance lessees may reclaim most of the payments already made to the finance lessor.381 Given these circumstances the pressure is obviously on the finance lessee's rather than on the finance lessor's interests. It is, however, conceivable that VerbrKrG section 9(3) can ameliorate the consumer finance lessee's inferior position. Indeed, the scope of remedies under VerbrKrG section 9(3) is broader, and also includes remedies which are not derived from warranties,382 such as remedies founded on the supplier's non-delivery. Further, assuming VerbrKrG section 9(3) is applicable to finance leases, consumer finance lessees could refuse to make further payments to the finance lessor if the supply contract were void or subject to challenge. Ultimately, a finance lessee could set off the finance lessor's claim to payments against any claims of its own for damages against the supplier.

378. Bülow, supra note 356, at 192 n.61; Martinek, supra note 2, at 189, 191; Münstermann & Hannes, supra note 356, at 51-52, 312-13; Lieb, supra note 371, at 1534.

379. Lieb, supra note 371, at 1536-40; Kurt Reinking & Thomas Nieen, Problemschwerpunkte im Verbraucherkreditgesetz, 12 ZIP 634, 638 (1991). See also Peter Seifert, Aspekte des Verbraucherkreditgesetzes aus Sicht eines Leasingunternehmens, Der langfristige Kredit 16, 18 (1991) (arguing that the BGH precedent that validates the assignment of warranties and corresponding warranties as well as lessor's remedies is no longer valid if the rights granted by VerbrKrG § 9(3) are available to consumer finance lessees).

380. The BGH's position on this issue is difficult to predict.

381. See supra notes 315-16 and accompanying text.

382. This aspect has not yet been discussed. Two works that particularly disregard this issue are Lieb, supra note 371, at 1536-40 and Reinking & Nieen, supra note 379, at 638.
It remains to be seen which view the BGH will take in this animated discussion. In any case, the legislature appears to have overlooked the considerable impact that VerbrKrG section 9(3) could exercise on finance leases. Thus, it let slip the obvious opportunity to harmonize the standards concerning finance leases set by the BGH and the VerbrKrG.

e. Other Consumer-Oriented Provisions Under the VerbrKrG That Impact Finance Leases

Pursuant to the first sentence of VerbrKrG section 4(1), finance lease agreements must be in writing. Further, the finance lessor has to surrender a duplicate of the agreement to the consumer.\(^3\)\(^8\)\(^3\) Finance lessors, however, need not provide the consumer with the specifics enumerated in VerbrKrG section 4(1), such as the price for cash payment, or the annual rate of interest, because the corresponding provisions cannot be applied to finance leases.\(^3\)\(^8\)\(^4\) Moreover, VerbrKrG section 12 sets out the circumstances under which finance lessors may terminate the agreement. Interestingly, this section provides that the consumer shall have the opportunity to talk to the lessor about the feasibility of settlement.

4. Evaluation of Lessee’s Remedies and Rights in a Consumer Finance Lease

The consumer’s legal status as a finance lessee is still being developed. The troubles encountered during this process have just begun, and consumers may not outgrow them for quite some time.

Compared to commercial finance lessees, consumers receive very little additional protection under the VerbrKrG. Certainly, the right to revoke the finance lease agreement under VerbrKrG sections 7 and 9(2) is a welcome development. Apart from that, the VerbrKrG provides only marginal improvements as far as consumer finance lessees are concerned. Further, the BGH has not yet explicitly addressed the situation of consumer finance lessees. The AGBG only distinguishes between merchants and non-merchants. Nevertheless, consumers do not remain totally unprotected. Even before the enactment of the VerbrKrG, consumer and commercial finance lessees enjoyed a virtually sound system of remedial rights, particularly due to several BGH precedents.

\(^3\)\(^8\)\(^3\) VerbrKrG § 4(3).
\(^3\)\(^8\)\(^4\) VerbrKrG §§ 3(2), 4(1).
Indeed, the AGBG, the AbzG,\textsuperscript{385} and the corresponding BGH precedents restricted the freedom-of-contract principle to such a degree that, in 1986, German provisions largely met the requirements of the EC Council Directive concerning consumer credit. This exemplifies the high standard that debtor protection already had before the VerbrKrG, even without special allowances for consumer protection. Nonetheless, consumer finance lessees are still in need of a well-developed remedy system.\textsuperscript{386}

Although they provide substantial protection to debtors, the coexistence of AGBG, VerbrKrG, and corresponding precedents could be more effective if they were streamlined. First, the AGBG and VerbrKrG should be adjusted so that the AGBG's non-merchant provisions harmonize with VerbrKrG's "consumer" definition.\textsuperscript{387} Further, to the extent practical, consumer lessees should be provided with meaningful data needed to determine the reasonableness of the finance lease offer.\textsuperscript{388} Equally important, VerbrKrG section 9(3) should be brought into line with common law remedies. In fact, a restatement, or even legislation reinforcing well established common law remedies, should be drafted. In any case, due to the hasty adoption of the VerbrKrG, consumer's and merchant lessee's roles in finance leases should be carefully reconsidered. Even if the current or broader spectrum of consumer finance lessee's remedial rights is desirable, a certain threshold must be established. The more similarities that exist between consumer finance lessee's and finance lessor's rights and remedies under the supply contract, the less finance leases will be distinct from purchase installment contracts. Although this probably makes no difference to consumers, this could create fiscal difficulties and perhaps destroy tax incentives.

\textbf{D. Lessor's General Rights and Remedies Under a Finance Lease}

No German statutory provisions exist governing finance leases and leasing parties' remedial rights. Instead, lawyers deal with a patchwork of statutory provisions. Certain aspects of these leases, on

\textsuperscript{385} See MARTINEK, supra note 2, at 91-109.

\textsuperscript{386} Concededly, the crucial question is not whether more consumer protection is reasonable. Rather, the question is whether the current standard should be applied equally to merchants and consumers. Unfortunately, analysis of this question, however interesting, is too complex to deal with here. See Lieb, supra note 371, at 1540.

\textsuperscript{387} See AGBG art. 24 (concerning the merchant/non-merchant distinction); VerbrKrG § 1(1) (regarding the definition of "consumer").

\textsuperscript{388} See supra note 382 and accompanying text.
the other hand, are governed specifically by statutory provisions (AGBG, VerbrKrG). Some statutory provisions are applicable to finance leases, either generally or by analogy. In addition, lawyers also rely on the common law, culpa in contrahendo, to interpret finance leases. Under these circumstances, it is impossible to develop a detailed outline of lessor's rights and remedies. Thus, this section of the Article will analyze a finance lessor's right to terminate a standardized finance lease. Further, it will discuss the legal consequences resulting from such a termination. To do so, this section utilizes both common law precedents and generally accepted legal opinions. Thereafter, this section will examine the validity of the most frequently used leasing provisions.

1. Lessors' Rights and Remedies Connected with the Termination of the Finance Lease Agreement

Undoubtedly, the finance lessor's most important claim is against the finance lessee for the lease payments. Since finance lessors ordinarily assign their warranties arising from the supply contract to lessees, lessors generally are not concerned with warranty rights and remedies. Lessors become involved in such disputes, however, when the finance lessee or supplier does not perform as expected.

If leased goods are accidentally irreparably damaged or destroyed, the finance lessor may terminate the finance lease agreement without notice. Certainly, the lessor may cancel the lease agreement in the aforementioned situations, if the lessee caused the damage to the leased goods. In any case, the finance lessor is entitled to compensatory damages, meaning damages for the purchase costs and invested capital, including his lost profits. If the finance lessee fails to return the leased goods within the time stipulated, finance lessors are entitled to further payments under the agreement.

389. See BGB arts. 138, 242, 325, 326.
390. It should be noted that a division of finance lessor's rights and remedies into those triggered by statutory defaults and those following from contractual defaults is not feasible under the German legal system.
391. Judgment of Oct. 15, 1986, 40 NJW 377, 379 (1986). As previously discussed, the lessee may also terminate the agreement. See supra note 296 and accompanying text.
392. BGB art. 325.
393. For an in depth analysis of how to compute such damages, see GITTER, supra note 249, at 323; KOCH, supra note 241, at 170; MARTINEK, supra note 2, at 151; SANNWALD, supra note 241, at 159.
394. See BGB art. 557; Judgment of Apr. 5, 1978, 71 BGHZ 196, 205. See also Jürgen K. Friedrich & Ralf Gölzenleuchter, Anmerkung zu OLG Düsseldorf, Urteil vom 17.04.1988, 44
Probably the most frequent event triggering finance lessee’s remedies is the finance lessee’s default. When default causes the lessor to terminate the agreement, he must obey certain preconditions first. As the BGB states, a lessor may only terminate:

(1) if the lessee defaults on payments during two consecutive rent periods or if he defaults on payments consisting of a “not-insubstantial” part of the lease; or

(2) if the lessee during a period of time longer than two consecutive rent periods defaults on payments amounting to the lease due for two months.\(^{395}\)

If agreements contain stipulations inconsistent with these minimum standards, the inconsistent provisions are replaced by the statutory precondition “during two consecutive rent periods.”\(^{396}\)

In consumer finance leases, lessors have to observe additional requirements under VerbrKrG section 12(1) Nos. 1 and 2. First, past due payments must amount to at least ten percent of the net sum of the credit, and at least five percent of the net sum when the terms of the contract exceed three years. Further, the lessor must set a two-week deadline for the payments and express to the lessee that in case of non-performance the total balance will be due.

Of course, if a finance lease is materially terminated, the lessor may seek restitution for the leased goods or, if necessary, bring a replevin action.\(^{397}\) In addition, the lessor may assert a claim for damages, because it is “typical of and therefore inherent in finance leases”\(^{398}\) that the lessor may obtain amortization of the paid-up capital, even in case of termination without notice.\(^{399}\)

\(^{395}\) BGB art. 554(1).

\(^{396}\) See AGBG art. 6(2); Judgment of Apr. 4, 1984, 37 NJW 2687 (1984). See also Joachim Quittnat, Unwirksamkeit von Verfallklauseln in Leasing-Formularverträgen, 34 BB 1530, 1531 (1979).

\(^{397}\) BGB art. 985.


Certainly, besides default of payment, there are other circumstances that permit the lessor to terminate the finance lease agreement without notice; for example, if the lessee uses leased goods contrary to the agreement.\textsuperscript{400} In any case, the lessor must first provide the lessee with a warning letter, urging the lessee to act in conformity with the contract.\textsuperscript{401}

Since finance leases are naturally limited in time, the agreement usually contains provisions for the "natural" termination of the contract. These clauses are mainly influenced by fiscal considerations,\textsuperscript{402} and usually raise no legal problems because they strictly adhere to the decrees issued by the Finance Ministry.\textsuperscript{403}

2. Validity of Commonly Used Clauses and Stipulations Created by the Leasing Industry

As already indicated, the leasing industry ordinarily exempts finance lessors from examining leased goods for defects after delivery by the supplier.\textsuperscript{404} Instead, finance lessors may impose that obligation on finance lessees. For example, lessees are regularly obliged to create a test certificate after the supplier's delivery of the leased goods. The certificate must attest that the lessee received and accepted the goods without defect, and certify the usefulness of the goods.\textsuperscript{405} If the finance lessee delays such certification without justification, the finance lessor is entitled to compensatory damages.\textsuperscript{406}

The BGH bars clauses that discharge finance lessors from any liability for the supplier's default or delay in delivering the goods.\textsuperscript{407} Finance lessors lose their claim for payments in these cases, and the BGH bars provisions that allow lessors to demand compensation for their expenditures.\textsuperscript{408}

\begin{flushleft}
\textsuperscript{400}See BGB art. 553.
\textsuperscript{401}See GIT\textsc{e}R, supra note 249, at 343-47; MARTINEK, supra note 2, at 205; Coester-Waltjen, supra note 288, at 190.
\textsuperscript{402}See supra notes 226-33 and accompanying text.
\textsuperscript{403}See supra notes 231-33 and accompanying text.
\textsuperscript{404}See HGB art. 377. See also supra notes 281-84 and accompanying text.
\textsuperscript{405}For more details of these generally accepted certificates, see MARTINEK, supra note 2, at 122-25.
\textsuperscript{406}BGB art. 286. See also HAGENMÜLLER & STOPPOK, supra note 226, at 18.
\textsuperscript{407}See supra note 288. See also supra note 290 and accompanying text.
\textsuperscript{408}Judgment of Sept. 17, 1981, 81 BGHZ 298, 309 (1981). See also MARTINEK, supra
\end{flushleft}
Finance Leases

Further, courts tend to rule out clauses under such circumstances that impose the risk of the supplier's insolvency upon the finance lessee. Likewise, the BGH refuses to validate provisions that give finance lessors the right to withdraw from an already signed agreement if the supply contract fails, or if the leased goods cannot be delivered on time or at all.

Finance lessors, who are never at a loss for self-advantageous clauses, frequently attempt to exempt their liability if finance lessees fail to enforce assigned warranties under the supply contract. In these cases, lessors attempt to reserve the right to burden finance lessees with the supplier's insolvency after conclusion of the supply contract. Moreover, lessors often establish rights to opt out of the finance lease in such situations, and to demand compensation for their expenditures. Although some authorities consider these clauses justifiable, the BGH makes it quite plain that it will not validate such immunity for lessors.

Regularly, the resourceful leasing industry seeks to protect itself against any deterioration of leased goods. Pursuant to common law principles, finance lessees often possess the following obligations: to compensate damages of the leased object resulting from fair wear and tear; to remedy at their own cost any damages of the leased object caused by third parties; to enter into a contract providing for routine maintenance in order to ensure the performance of the aforementioned obligations by trained and competent servants (this clause is especially used in case of leased computers, photocopiers, and telephone systems); to replace leased goods which have been stolen or irreparably destroyed. Likewise, finance lessees are often obliged to insure the leased goods against risk of destruction or deterioration,

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Note 2, at 140-41; PAPAPOSTOLOU, supra note 249, at 110-11; Friedrich Graf von Westphalen, _Das Insolvenzrisiko des Lieferanten beim Finanzierungsleasing_, 34 WM 942, 946 (1980).

409. See supra note 292 and accompanying text.


411. HAGENMÜLLER & STOPPOK, supra note 226, at 20; Rainer Bernstein, _Auswirkungen der neuen höchstrichterlichen Rechtsprechung auf die Vertragsgestaltung des Mobilien-Finanzierungsleasingvertrages_, 38 DB 1877, 1882 (1985); Coester-Waltjen, supra note 288, at 186; Flume, supra note 288, at 56; Lieb, supra note 284, at 2499; Graf von Westphalen, supra note 408, at 942, 949-50.


413. These clauses are generally accepted and comply in particular with the standards set forth in the AGBG. MARTINEK, supra note 2, at 148-49; GRAF VON WESTPHALEN, supra note 241 n.249. See supra note 257 and accompanying text. Concerning the lessee's possible counteraction, see supra note 296 and accompanying text.
including theft, fire, water, and comparable events.414

3. Evaluation of Lessor's Rights and Remedies

The multitude of legal precedents and statutes delineating finance lessors' legal status may seem confusing and unsystematic. A synopsis, however, substantiates that this apparent disarray does promote certain valid ideas. The knowledge of these basic ideas helps to predict the courts' attitudes towards yet unknown restrictions on finance lessors' liabilities.

Recall that, with the court's authorization, finance lessees dominate negotiations; for example, they regularly select the leased goods, request the cure of defects from the supplier, or rescind the supply contract. Yet, as far as monetary claims are concerned, especially those derived from warranties under the supply contract, finance lessees prefer to enforce these rights personally.415

This typical structure mirrors finance lessors' efforts to ensure the amortization of the capital invested in the leased goods.416 Therefore, it is small wonder that the BGH scrutinizes the amortization-aspect as a clause insulating finance lessors from liability. The following principles summarize the BGH's approach. If an event originating from finance lessors' sphere of responsibility causes their (or finance lessees') default or non-performance, courts tend to outlaw clauses extricating finance lessors from liability. Finance lessors are not only responsible for their own obligations under the finance lease contract, but are also responsible for the suppliers' performance under the supply contract. Consequently, finance lessors are vicariously liable for suppliers' default. In these cases, finance lessors may not contract to amortize their invested capital.417

If finance lessees' default or non-performance is due to an event falling within their own or third parties' (other than suppliers) sphere of responsibility, or is caused accidentally after delivery of the goods, finance lessors may contract to amortize their invested capital.418 In addition, courts validate clauses shifting the responsibility to lessees

414. GITTER, supra note 249, at 320; MARTINEK, supra note 2, at 148-49; SANNWALD, supra note 241, at 154-55; GRAF VON WESTPHALEN, supra note 241 n.264; Flume, supra note 288, at 54, 58.

415. See supra notes 298-310 and accompanying text.

416. This is an understandable and legitimate objective because finance lessors, above all, profit by financing the lease.

417. See supra notes 407-10 and accompanying text.

418. See supra notes 391-99 and accompanying text.
for the deterioration of leased and previously delivered goods.\textsuperscript{419}

Finally, finance lessors may assert remedies and claims against suppliers to the extent that they shield themselves only incompletely from warranty liability, and reserve all their monetary claims under the supply contract.\textsuperscript{420} These actions by lessors are, of course, in response to the BGH’s lessee-friendly provisions. In the case of a material rescission of the supply contract, the finance lessor has to reimburse payments already made by the finance lessee. Nonetheless, the lessor may demand that the supplier repay the purchase price based on unjust enrichment.

V. COMPARISON OF THE LEGAL SYSTEMS REGARDING THE RIGHTS AND REMEDIES AVAILABLE TO THE PARTIES IN A FINANCE LEASE

A. Preliminary Remarks

This Article does not purport to be an in-depth comparative study of the aforementioned remedial rights. Such an attempt is doomed to failure since the United States and German approaches are rooted in entirely different legal cultures. The United States legal system is largely influenced by the common law approach, despite a multitude of statutory provisions. In particular, the adoption of the Uniform Commercial Code in the United States suggests the contrary. Yet, besides the Official Comments to the corresponding Article 2 provisions, which are incorporated by reference in Article 2A, “any case law interpreting those provisions should be viewed as persuasive but not binding on a court when deciding a similar issue with respect to leases.”\textsuperscript{421} Thus, as far as the law of contracts is concerned, the Anglo-American legal sphere has been generally left untouched by Roman legal thinking, its contract typology, and the dogmatics dealing with the normative classification of contracts. Instead, contracts in the Anglo-American legal system are devised by and generally accepted in the various industries. Thus, United States parties can develop contractual relationships pragmatically, and new legal problems can be handled without reference to ancient tomes. The United States approach has no need to predetermine the legal nature of new con-

\begin{itemize}
\item[419.] See supra notes 413-14 and accompanying text.
\item[420.] See supra notes 308-10 and accompanying text.
\end{itemize}
tractual relationships, or to fit such relationships into the existing statutory classification, in order to identify the applicable law.

In the growing realm of finance leases, however, common law principles have been newly restated in U.C.C. Article 2A. It will be interesting to see how United States lawyers deal with these new provisions, and whether efforts will be touched with the classical legal style prevalent in Germany. Similarly, Germany is now confronted with many new legal problems that might create a need for a more flexible system of interpreting contracts.

The following remarks will only resort to the basic ideas of both approaches. Through this, it is hoped that the reader acquires a sympathetic understanding of finance leases. Further, the comparison is designed to generate discussion of the practical and theoretical problems linked to finance leases.

1. Trilateral Transactions

When trilateral transactions, today known as finance leases, emerged sometime in the second half of the twentieth century, they did not fit the statutory bilateral models of either the United States or Germany. Ultimately in 1987, the United States legal system introduced special statutory provisions tailored to these three-party transactions. On the other hand, the German legislature has not yet broken new statutory ground. Yet, the Federal Supreme Court (Bundesgerichtshof) still seeks to insert finance leases into the existing legal framework. This effort, however, is not widely accepted by the German leasing industry, and raises several questions. It is unclear whether the introduction of U.C.C. Article 2A is a step towards improving the administration of the law. It may be that the U.C.C. set its sights too high in this respect. The answer to this last issue will determine whether the German approach is simply behind the times, or completely outdated.

2. Defining Finance Leases

Defining finance leases is a rather complicated matter. Again, under the U.C.C. "true" finance leases are distinguished from sales, and particularly security interests, through stunningly detailed and comprehensive definitions.422 However, the crucial question remains whether a trilateral transaction qualifies as a "true" finance lease

422. See supra notes 32-41 and accompanying text.
under U.C.C. section 2A-103(1)(g) or whether it creates a security interest in terms of U.C.C. section 1-201(37). Contrary to the German approach, fiscal valuation is not a relevant factor within the definition. In light of the German fiscal classification of finance leases by the Supreme Tax Court (Bundesfinanzhof), and the subsequently issued explanatory decrees by the Finance Ministry, the decisive question is whether German finance lessors retain legal and economic ownership.

Two realizations emerge from the characteristics of finance leases. First, unlike the German approach, U.C.C. section 2A-103(1)(g) specifies a certain proceeding to be followed by the parties to a finance lease. What is particularly striking are the U.C.C. provisions that “the lessor does not select, manufacture, or supply the goods,” and that lessees have to receive certain information concerning the supply contract. Prohibiting lessors from selection, manufacture, or supply is consistent with relieving them of any statutory obligation to extend implied warranties of merchantability or fitness for a particular purpose.

Second, as far as the lessor’s contractual obligations are concerned, the U.C.C emphasizes different aspects. The lessor's role under the U.C.C. is basically restricted to financing the purchase or lease of the goods from the supplier. In contrast, the German Federal Supreme Court has repeatedly stressed the lessor’s obligation to ensure the use of the leased goods, while minimizing the lessor’s role as financier. This evaluation of the lessor’s functions mirrors the countries’ different understanding of these triangle transactions. U.C.C. Article 2A’s definition of finance leases focuses on the transaction, not on the status of the parties. Thus, the question is not whether the lessor has dealt in goods of the kind, but whether the lessor is performing a financing or credit function. Thus, the United States approach is best characterized as finance or distribution oriented, while the German approach ensures the finance lessee’s right to use the leased goods.

423. See supra notes 227-33 and accompanying text.
426. See supra notes 85-86 and accompanying text.
427. See supra notes 250-55 and accompanying text.
3. Freedom of Contract

The freedom of contract principle is firmly embodied in both legal frameworks governing finance leases. While the U.C.C. explicitly gives the parties freedom to craft their own set of remedial rights under lease agreements, the German rules embody freedom of contract principles without explicitly referring to them. Under both legal systems, however, the legislature felt compelled to set statutory bounds on the freedom of contract axiom, in an effort to equalize the parties in all contracts.

Again, the specific approaches to freedom of contract differ significantly between the United States and Germany. As an example, the U.C.C. contains several statutory limitations on the freedom to contract. In addition, the landmark sections 2A-209 and 2A-407 of the U.C.C. become statutory terms of the lease without a separate drafting. Finally, the general obligation of good faith also applies to finance leases. Likewise, the German approach relies on general statutory principles such as *bona fides* and *contra bonos mores*. More importantly, the Act on General Terms and Conditions of Trade, and the inflexible provisions of the Consumer Credit Act solidify the aforementioned general principles. Because of their open-ended language, these Acts could raise considerable interpretation problems. Thus, relatively sweeping limitations are set to restrict the freedom of contract axiom.

B. Liability of Lessors vs. Lessees

Finance leases follow a pattern widely divergent from the typical bilateral lease. In particular, the absence of a comparable model of statutory provisions paved the way for leasing finance rules which meet the interests of all parties involved in finance lease transactions. Particularly, the leasing practice established attempts to equalize the parties' positions, in the contexts of warranties and lessees' obligations, rights, and remedies. Once again, different methods of achieving the same goals have ultimately prevailed under the United States and German legal systems. The objective in each system has been both to shift finance lessors' contractual obligations and rights from

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430. See supra notes 83-91 and accompanying text.
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the supply contract (except those linked to the financing aspect) to the non-contractual lessee-supplier relationship.

Because this relationship is not contractual, it is characterized by a lack of privity. The drafters of the U.C.C., when restating generally accepted common law principles, followed the lead of United States’ finance lessors and used third-party beneficiary theory to overcome this lack of privity. As a result, U.C.C. section 2A-209 provides that lessees’ warranties under a finance lease originate from the supplier of the goods rather than from the lessor. The supplier makes the lessee a beneficiary of any promises and warranties made to the lessor in the supply contract. In contrast to third-party beneficiary theory, the assignment theory governs the German approach. By means of stipulations contained in standardized lease agreements, finance lessors regularly assign their non-monetary warranty claims arising out of the supply contract to lessees. The reason for assigning rights related to warranties under the supply contract, rather than all rights following from the lessor’s legal status as party to the supply contract, is generally fiscal. Even after the assignment, finance lessors must retain both legal and economic ownership, lest they lose the tax benefits attached to finance leases.

Until now, the differences between the approaches seemed insignificant. Indeed, only when considering which promises and obligations remain enforceable under finance lease agreements do fundamental differences emerge.

Pursuant to U.C.C. section 2A-407(1), the lessee must pay rent, "come hell or high water," upon acceptance of the goods. No remedy will be available to relieve the lessee of that obligation. The lessee's ability to avoid the effect of the statutory "hell or high water" clause is limited to the following: where lessors breach the obligation of good faith; where they bear some degree of responsibility for the lessee's previous acceptance of inadequate goods; where they breach express warranties; and, where they breach the implied warranty against interference. Only in these situations can finance lessees escape their irrevocable and independent promise to pay.

Since the exceptions described above generally lack practical rel-

433. U.C.C. §§ 2A-103(3); 2-103(1)(b); 1-203 (1990).
437. See supra notes 160-65 and accompanying text.
The immunity of finance lessors is nearly free from responsibility for matters not related to their function as a finance source. Even the benefits the lessee receives pursuant to U.C.C. section 2A-209 may be tainted unexpectedly if, for example, stipulations concerning express warranties or consequential damages contained in the supply contract and lease agreement are not reconciled. Equally important, finance lessees bear the risk of the supplier’s insolvency after acceptance of the goods. As a result, U.C.C. Article 2A favors the legal status of finance lessors rather than finance lessees. To illustrate, the rules concerning the lessee’s rights hinge a great deal on timing. The lessor may cancel at any point in the lease contract if there is a sufficiently severe breach and the lessee usually must cancel at an early stage of the transaction or not at all.

In contrast to the United States approach, the legal position of German finance lessees appears to be relatively strong due to the lessee-friendly interpretation of cases by the German Federal Supreme Court. However, although finance lessors are insulated from warranty liability, they do bear the risk of suppliers’ subsequent insolvency. They also are subject to claims for reimbursement of prior payments made by the lessee under the finance lease where the supply contract has been materially rescinded. The Court juxtaposes obligations and duties which follow from both the lessor’s and the supplier’s legal status and largely treats the merchant and financier as a single legal entity. In this way, the BGH combines lessor’s and supplier’s duties and responsibilities under the finance lease transaction and sets them against the lessee’s obligations. Efforts to shield the finance practice from liability are thus extensively invalidated. To compensate, finance lessees enjoy a far-reaching and, equally important, unyielding minimum standard of remedial rights.

C. Consumer Protection

The consumer protection movement is unlikely to come to a halt. Huddleson has accurately observed that “[t]he strength and popularity of the ‘consumer protection’ movement seem established facts of contemporary life.” Even though “[w]ary [United States] consumers paid off more debt than they took on in 1991, causing installment

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438. Id.
439. See supra notes 104-06 and accompanying text.
440. See supra notes 298-310 and accompanying text.
441. HUDDLESON, supra note 33, at 68 n.8.
credit to shrink for the first year since 1958,\textsuperscript{442} this trend is unlikely to change. Besides, the traditional reasons for providing consumer protection still apply: consumers regularly lack bargaining power, often have little understanding of the risks involved, and sometimes base their decisions to enter into finance leases or other credit agreements on false estimations of the related risks. Undoubtedly, many reasons justify explicit consumer protection, but each finds its origin in the same basic evil. Because the classical contract theory ignores adhesion contracts, it disregards the premise that contract negotiations do not occur at arm's length. Thus, both the United States and the German legal systems seek to counteract the drawbacks inherent in the classical contract theory.

The preliminary issue challenging legislators is to identify the true target group. If consumers, what qualifies a person as a consumer? The world is not neatly divided into naive consumers and shrewd merchants. Some so-called consumers are equipped with more extensive financial funds and broader economic experience than many small businesses which resemble shoestring operations. On the other hand, merchants are generally more sophisticated in commercial matters than unenlightened individuals who are vulnerable to exploitation in the marketplace.

Both the Consumer Leasing Act of 1976 and U.C.C. Article 2A of 1987 took as a basis similar definitions of the "consumer lease."\textsuperscript{443} Surprisingly, until the enactment of the VerbrKrG in 1991, German laws lacked any reference to "consumers," let alone to "consumer" credits. However, the German legal system did respond to increased consumer consciousness before 1991, defining "non-merchants"\textsuperscript{444} to consider consumer interests before they were explicitly addressed in the Consumer Credit Act. Both the scope of "consumer leases" under the U.C.C. and "consumer credits" under the VerbrKrG show significant similarities. Only the German legal system, however, takes into account the special interests arising from small businesses or the start of a new business.\textsuperscript{445}

Both approaches provide consumers finance lessees with additional statutory protection, but both also give only modest consumer

\textsuperscript{442} Reuters, Consumer Credit Off for First Year Since '58, N.Y. TIMES, Feb. 8, 1992, at 47.


\textsuperscript{444} AGBG art. 24.

\textsuperscript{445} See generally AGBG art. 24; notes 262-63 and accompanying text. But see VerbrKrG § 3(1) No. 2; note 367 and accompanying text.
rights. Their reasons for modest protections, however, originate from different sources. U.C.C. section 2A-407 benefits consumers by barring "hell or high water" clauses. The legislature, however, failed to restrict the U.C.C.'s rule of freedom of contract which constitutes a "virtual license to limit or eliminate [the U.C.C.'s consumer] protection and to impose whatever conditions the traffic will bear" or the judges will validate."447

The tricky provision U.C.C. section 2A-407 will continue to cause the rise of unfounded expectations. Only time will tell to what degree the statutory exclusion of "hell or high water" clauses for the benefit of consumers will fall victim to the freedom of contract axiom and how courts will delineate merchants' and consumers' interests. Contrast German finance lessees, who enjoyed practically comprehensive rights and remedies even before the Consumer Credit Act became effective. Under these circumstances, the opportunities to amplify consumer's legal status were relatively limited. Obviously, the time has come to reflect upon whether the similar legal position of merchant finance lessees and consumer finance lessees can be justified. Of course, a well-devised, elaborate, and adequate equilibrium between these groups would affect the high minimum standard of rights and remedies currently available to finance lessees independent of their status as merchant or consumer. Concededly, confining the BGH's approach to consumers would be difficult and frustrating for merchant finance lessees. On the other hand, such an action would be approved by the leasing practice and a great number of legal scholars. The time is ripe to rethink and reorient the theory and method.

D. Role of Finance Lessees

Generally, the role of finance lessors sets the character of trilateral finance lease transactions. These three-party transactions could not be realized without placing the financial resources at the lessee's or supplier's disposal. Finance lessors serve as an indispensable "conduit for a transaction between the supplier and the lessee."448 Although the finance lessor's responsibility, being of utmost importance to the lessee and the supplier, is merely to provide the money, this financing role involves cumulative risks. Unlike the finance lessee or the supplier, only the finance lessor enters into two agreements and
subjects himself to the risks and uncertainties resulting from two contractual relationships.

Both the United States and German approaches strive to equalize this seemingly unequal division of obligations and perils by seeking to extricate finance lessors from any liability unrelated to their financing function. It is not surprising that the legal position of a finance lessor is vested with powers inversely related to the corresponding finance lessee’s legal status. Therefore, the strong position of the United States finance lessors and their far-reaching immunity from liability are manifested in the statutory mainstay, U.C.C. section 2A-407, which presents the “hell or high water” clause.449

In Germany, the leasing practice has used standardized lease contracts to shield itself from liability unrelated to the financing. The Federal Supreme Court’s attitude of strengthening finance lessees’, rather than finance lessors’, legal status, however, has taken considerable wind out of the leasing practice’s sails.450 Furthermore, German finance lessors have to exercise the rights and remedies which arise from the supply contract. This leasing practice, and BGH’s lessee-friendly precedents, extricates itself only partially from warranty liability, but the practice also reserves for itself the entire pecuniary claim recovery derived from supply contracts.451

VI. Conclusion

After contrasting and appraising the United States and German approaches to finance leases one might ask whether the former will prevail, or gain influence abroad, or whether the latter can be sustained any longer. Time will tell, and any predictions are speculative. Thus, one system should not be vigorously encouraged over the other. Today, finance leases of personal property are an accepted part of modern commercial life. German courts, however, have treated these trilateral transactions as a legal hybrid with inconsistent results. On the other hand, U.C.C. Article 2A will not eliminate all litigation concerning finance leases any more than other provisions of the U.C.C. have eliminated other forms of commercial litigation. Nevertheless, U.C.C. Article 2A should be a great help to courts in understanding finance leases and the policies which govern their interpretation.

Recently, the hazy horizon cleared to indicate what the future

449. See supra notes 432-37 and accompanying text.
450. See supra notes 298-310 and accompanying text.
451. See supra notes 308-10 and accompanying text.
might promise for both legal systems. These indications developed into the Unidroit Convention on International Financial Leasing of May 28, 1988 ("Convention"). The Convention was the culmination of extensive efforts initiated in 1974 by the International Institute for the Unification of Law (Unidroit) to develop a body of international law designed to facilitate international financial leasing. It is unclear to what degree the Convention will provide a model for states to develop national law systems for the regulation of domestic finance leases. A glance at both the basic structure and fundamental determinations of the Convention, however, suggests greater similarity to the United States than to the German approach. One should keep in mind, however, that the Convention applies only to international three-party equipment leases concluded for business purposes. As a result, there is no allowance for consumer interests which are normally insignificant in international finance lease transactions.

Unidroit has decided the legal nature of finance leases in favor of an autonomous definition. Thus, trilateral transactions including finance lessor, finance lessee, and supplier qualify as financial leasing transactions if the following characteristics are met:

(a) the lessee specifies the equipment and selects the supplier without relying primarily on the skill and judgment of the lessor;
(b) the equipment is acquired by the lessor in connection with a

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454. The Convention provides: "This Convention applies to financial leasing transactions in relation to all equipment save that which is to be used primarily for the lessee's personal, family or household purposes." Convention, art. 1(4), supra note 453.

455. The reimport of motor vehicles by consumers in the European market could apply this principle. This type of frontier-crossing transaction is largely due to considerable differences in car prices among European countries, which is quite common since the realization of the Single (European) Market of December 31, 1992. Yet, the author cannot appraise how many of these transactions are or would be, based on international finance leases because these transactions involve parties of at least two different countries. Apparently, most motor vehicles are reimported by commercial resellers.
leasing agreement which, to the knowledge of the supplier, either has been made or is to be made between the lessor and the lessee; (c) the rentals payable under the leasing agreement are calculated to account for the amortization of the whole or substantial part of the cost of the equipment.\textsuperscript{456}

Apparently, the Convention emphasizes the lessor's true role as a financier in a leasing agreement.\textsuperscript{457} Like the United States and German approaches, the Convention largely excuses the lessor from responsibility regarding equipment delivery and condition problems. This is not achieved by a statutory assignment of the lessor's rights derived from the supply contract. Rather, the lessee is deemed to be a party to the supply agreement as a beneficiary of the duties owed by the supplier under the agreement.\textsuperscript{458}

Moreover, Article 12(5) largely excludes claims by the lessee against the lessor except to the degree to which the failure in performance results from the act or omission of the lessor.\textsuperscript{459} Finally, this objective is strengthened by the standards for the lessor-lessee rela-

\begin{itemize}
\item \textsuperscript{456} Convention, art. 1(2), \textit{supra} note 453.
\item \textsuperscript{457} This point of view is endorsed by May, \textit{supra} note 454, at 347; and Poczobut, \textit{supra} note 454, at 690, 699, 701, 707. \textit{But see} Cuming, \textit{supra} note 454, at 51 ("The Convention is a skeletal system of law that borrows features from both conceptualizations: the lessor as a financier and the lessor as owner-bailor of the equipment.").
\item \textsuperscript{458} Article 10(1) of the Convention provides:

The duties of the supplier under the supply agreement shall also be owed to the lessee as if it were a party to that agreement and as if the equipment were to be supplied directly to the lessee. However, the supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

Convention, art. 10(1), \textit{supra} note 453.
\item \textsuperscript{459} Article 12 of the Convention provides:

1. Where the equipment is not delivered or is delivered late or fails to conform to the supply agreement:

(a) the lessee has the right as against the lessor to reject the equipment or to terminate the leasing agreement; and

(b) the lessor has the right to remedy its failure to tender equipment in conformity with the supply agreement, as if the lessee had agreed to buy the equipment from the lessor under the same terms as those of the supply agreement.

2. A right conferred by the previous paragraph shall be exercisable in the same manner and shall be lost in the same circumstances as if the lessee had agreed to buy the equipment from the lessor under the same terms as those of the supply agreement.

3. The lessee shall be entitled to withhold rentals payable under the leasing agreement until the lessor has remedied its failure to tender equipment in conformity with the supply agreement or the lessee has lost the right to reject the equipment.

4. Where the lessee has exercised a right to terminate the leasing agreement, the lessee shall be entitled to recover any rentals and other sums paid in advance, less a reasonable sum for any benefit the lessee has derived from the equipment.

5. The lessee shall have no other claim against the lessor for non-delivery, delay in delivery or delivery of non-conforming equipment except to the extent to which this results from the act or omission of the lessor.
\end{itemize}
tionship in Article 8. One does not have to reflect long about these provisions to realize that the supplier-lessee relationship bears the imprint of U.C.C. Article 2A, whereas the lessor-lessee relationship under the Convention resembles the intricate German approach. However, unlike the firm BGH standards, the remedial rights against the lessor the Convention gives to the lessee are easily lost. Even less beneficial to finance lessees, the Convention does not bar the parties from excluding or modifying most of these remedies. As a result, the set of unflinching remedies is rather limited.

The hybrid nature of finance leases is likely to attract the special attention of legal scholars indefinitely. The courts' first judgments may apply U.C.C. Article 2A or the German Federal Supreme Court may include the Consumer Credit Act in the pattern of case law governing finance leases. So far, lawyers must cope with both approaches, which are certainly far from maturity.

Finance lease transactions may become a target of progressive efforts to unify the laws and regulations within the EC. Before then, however, German authorities should reflect upon transforming the current legal patchwork into statutory provisions. Such an attempt

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6. Nothing in this article shall affect the lessee's rights against the supplier under Article 10.

Id. art. 12.

460. Article 8 of the Convention states:

1. (a) Except as otherwise provided by this Convention or stated in the leasing agreement, the lessor shall not incur any liability to the lessee in respect of the equipment save to the extent that the lessee has suffered loss as the result of his reliance on the lessor's skill and judgment and of the lessor's intervention in the selection of the supplier or the specifications of the equipment.

(b) The lessor shall not, in his capacity of lessor, be liable to third parties for death, personal injury or damage to property caused by the equipment.

(c) The above provisions of this paragraph shall not govern any liability of the lessor in any other capacity, for example as owner.

2. The lessor warrants that the lessee's quiet possession will not be disturbed by a person who has a superior title or right, or who claims a superior title or right and acts under the authority of a court, where such title, right or claim is not derived from an act or omission of the lessee.

3. The parties may not derogate from or vary the effect of the provisions of the previous paragraph in so far as the superior title, right or claim is derived from an intentional or grossly negligent act or omission of the lessor.

4. The provisions of paragraphs 2 and 3 shall not affect any broader warranty of quiet possession by the lessor which is mandatory under the law applicable by virtue of the rules of private international law.

Id. art. 8.

461. Cuming, supra note 454, at 54; Goode, supra note 454, at 347-48; Poczobut, supra note 454, at 707-09, 719.

462. Cuming, supra note 454, at 55-63; Goode, supra note 454, at 349; Poczobut, supra note 454, at 699-707, 716-19.

463. Cuming, supra note 454, at 55.
could increase predictability and enhance practical administration, but perhaps at the expense of flexible responses to new leasing practice challenges.

Upon our review of this study we find one question unanswered: Which advice should Polonius give Laertes today? Frankly, this Article lacks a satisfactory answer since Laertes sailed from Denmark to France, thus not even touching Germany, let alone the United States! However, provided that today Laertes (who most probably could be classified as a consumer) wished to travel from Denmark to the United States via Germany, Polonius' paternal advice should be translated: "If you cannot avoid entering into a finance lease agreement, neither a finance lessor in Germany nor a finance lessee in the United States be!"

464. See Herbert Kronke, Finanzierungsleasing in rechtsvergleichender Sicht, 190 AcP 383, 407. Based on a comparative study of decisions published to the present (including Germany, France, the Netherlands, Italy, England, and the United States) those legal systems which partially or entirely created a statutory basis, and which provided a partition into consumer, manufacturer, and other commercial finance leases were subject to fewer legal problems than the German approach.