

**REPORT AND RECOMMENDATIONS
RELATING TO CONSUMER
LEASES OF PERSONAL PROPERTY**

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INTRODUCTION AND SUMMARY

Consumer leases have become a popular form of financing the possession and use of personal property. Leasing accounts for a large percentage of consumer transactions, and provides an attractive alternative to the purchase of consumer goods. While leases serve an important commercial purpose by expanding access to the market, the technical language of the contract often conceals pitfalls for the consumer.

The leasing industry generally uses standard contracts to facilitate the lease transaction. The standard contract contains few protections for the lessee. A lessee cannot negotiate the terms of the lease agreement other than the price and method of payment. The agreements reached, therefore, typically are "contracts of adhesion" and contain onerous clauses. Existing law does not comprehensively address the problems with consumer leases arising from the use of standard contracts. The Commission concluded that additional consumer legislation is necessary to protect the public and fill the gap in existing law for lease transactions.

The consumer protection problems in lease transactions are similar to the problems that arose in secured transactions. Court decisions and legislation have gradually eliminated the most egregious abuses in secured transactions. Leases of personal property and secured transactions are very similar from the consumer's point of view, which may lead consumers to assume incorrectly that the protections afforded them in secured transactions apply to leases. Though the business setting may justify some differences in legal treatment between leases and secured transactions, the Commission believes that abuses which are not tolerated in secured transactions should not be allowed in lease contracts.

The Commission has identified a number of specific problems in consumer lease contracts. A primary problem involves the measure of damages upon the lessee's default. In some cases, a lessee is charged the full amount of all future payments due on the lease without recognition of the economic benefit to the lessor of early payment. In cases where the lessee receives some credit, it is substantially less than full reduction to present value. The lessee is also not given credit for the early return of the leased goods. Thus, a lessor receives more profit from a default than from a completed performance of the lease contract. In contrast, damages in a secured transaction are limited by law.

The limitation on damages in secured transactions also applies to early termination of the contract. The buyer in a secured transaction can terminate the contract early by selling the goods and paying the remaining principal on the debt. Because a lessee does not own the leased property, the lessee cannot freely dispose of it by sale. The only way the lessee can terminate the lease contract early is to default and pay the full amount of damages. This difference in result makes the measure of damages in a lease an important subject for consumer protection legislation.

The issue of insurance further complicates the measure of damages problem. A consumer may believe that insurance provides full coverage against loss or damage to the leased property. However, under most leases, the consumer is liable for damages in excess of the amount paid by insurance when the leased property is damaged or destroyed. For example, in an automobile lease, if the car is damaged and the insurance proceeds are used to repair it, the consumer may still be liable to the lessor at the end of the term for a reduction in the value of the car. If the car is destroyed, the consumer may be liable for damages in addition to the insurance recovery. In both situations, the consumer may not foresee this financial exposure.

Several laws in New Jersey affect consumer lease transactions: see, Consumer Fraud Act, C. 56:8-1 et seq.; Retail Installment Sales Act, C. 17:16C-1; Lemon Law, C. 56:12-29; Plain Language Law, C. 56:12-1; Fair Credit Billing Act, C. 56:11-1; Truth-in-Consumer Contract, Warranty and Notice Act, C. 56:12-14; Motor Vehicle Rental Statute, C. 45:21-1. Consumer leases are also governed by the Federal Consumer Leasing Act and its implementing Regulation M, 15 U.S.C. §1667 and 12 C.F.R. §213 (1989). The Uniform Commercial Code Article 2A (hereinafter referred to as Article 2A on Leases) applies to leases, but contains few consumer protections. See, U.C.C. 2A-106, 2A-108(1) and (2), 2A-108(4), 2A-221, 2A-309, 2A-406, 2A-504, 2A-516(3) (1987). Neither New Jersey consumer law nor Article 2A on Leases contain provisions solving the problems in consumer lease transactions identified by the Commission.

Although the Consumer Fraud Act inadequately regulates consumer leases, the Commission nevertheless advises adoption of the Consumer Lessee Protection Act as an amendment to the Consumer Fraud Act. This alternative has several advantages over a free-standing act. The Consumer Fraud Act gives the state and private individuals the authority to enforce the Act and obtain damages and penalties. The Consumer Lessee Protection Act presently does not provide for state enforcement and, if enacted as an amendment to the Consumer Fraud Act, would provide the advantage of state enforcement and regulation that it would not have as an independent statute. If the Consumer Lessee Protection Act is adopted, but not as an amendment to the Consumer Fraud Act, penalty and enforcement provisions must be added.

The Commission also considered consumer problems raised by rent-to-own transactions. It decided that the problems raised by these contracts were distinct from those raised by other forms of consumer leases because rent-to-own contracts are more analogous to sales. The problems raised by these transactions can best be dealt with in a sales context. Therefore, the Commission recommends an amendment to the Retail Installment Sales Act to include rent-to-own contracts within the definition of retail installment contracts.

SECTION 1. Title.

This Act shall be known and may be cited as the "Consumer-Lessee Protection Act."

COMMENT

This section states the title of the Act.

SECTION 2. Findings.

The Legislature finds that consumer lease contracts account for a large percentage of consumer transactions. Most consumer lease contracts contain provisions that are unfair to the consumer. Individual consumers generally have less economic power than lessors and cannot negotiate the terms of the lease contract. The terms of the lease contract are established by the lessor and submitted to the consumer on a "take it or leave it" basis. Consumer lease contracts are therefore contracts of adhesion. Existing law does not protect lessees adequately. This legislation establishes standards of conduct in the marketplace for consumer lease transactions.

COMMENT

This Act recognizes that important differences exist between a commercial transaction and a consumer transaction. A commercial transaction implies parties of comparable knowledge and economic position and an agreement negotiated at arm's length. Conversely, a consumer transaction implies parties of unequal economic position, whereby the party with the greater knowledge and economic position dictates the terms of the contract. The standardized mass contract is "typically used by enterprises with strong bargaining power, and the weaker party is frequently not in a position to shop around for better terms." Kessler, *Contracts of Adhesion-Some Thoughts About Freedom of Contract*, 43 Colum. L. Rev. 630, 632 (1943). Standardized contracts are usually "contracts of adhesion," that is they are not subject to negotiation. Consumer leases are prepared by lessors and designed to protect its interests. They are therefore "contracts of adhesion."

"Adhesion contracts" perform an important role in modern society. These contracts reduce transaction costs and facilitate the transfer of goods from the producer to the consumer. However, because "adhesion contracts" are not subject to the bargaining process, a discrete set of principles must apply to them. The purpose of this Act is to establish such principles and correct market inequities resulting from the use of adhesion contracts in consumer lease transactions.

SECTION 3. Definitions.

a. A "consumer lease" is a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee who is a natural person and takes under the lease primarily for a personal, family or household purpose.

b. "Present value" is the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time of the transaction.

COMMENT

The definition of consumer lease is identical to the definition of "consumer lease" contained in the version of Article 2A of the Uniform Commercial Code proposed by the Commission. Unlike federal consumer legislation and the official text of Article 2A, the definition of consumer lease in this Act does not contain a maximum dollar limitation for a lease of personal property primarily for personal, family, or household purposes. The Consumer Leasing Act and the official text of Article 2A do not apply to leases with a total lease obligation more than \$25,000. See, 15 U.S.C.  1667-1667(e) (1982), and Regulation M, 12 C.F.R.  213 (1988); U.C.C. 2A-103(e).

The definition of "present value" in subsection (c) follows the definition of "present value" in Article 2A on Leases. See, U.C.C. 2A-103(u). The second sentence of the Article 2A definition is excluded; a consumer lease is not allowed to specify the interest rate of the discount.

SECTION 4. Waiver; agreement to forego rights.

Any term of a lease agreement inconsistent with the provisions of this Act, and any waiver of the protections of this act shall be unenforceable.

COMMENT

Section 4 makes this Act applicable to all lease agreements that fall within the definition of a consumer lease. Consumer lease agreements are usually form contracts drafted by the lessor and the terms of the contract are presented to the consumer. Since consumer leases are not the product of arm's length negotiations, it is inappropriate to allow them to supersede the provisions of this Act.

SECTION 5. Three-day grace period; refund of payment.

a. A lessee has the right to cancel an executed lease contract within three business days from the date the lease contract is executed, provided:

(1) The lessee has not taken possession of the property; or

(2) The lessor has not specially manufactured, adapted, or purchased the property for the lessee.

b. Any payment made by a lessee to a lessor pending the execution of a lease contract shall be refunded to the lessee in the event the lease contract is not executed. Any payment made by a lessee to a lessor, whether before or after the execution of a lease contract, shall be refunded if the contract is cancelled pursuant to subsection (a).

c. The lessor shall give written notice to the lessee of his rights under this section.

COMMENT

Section 5 gives the consumer an option to cancel an executed lease contract within three business days. The option to cancel enables the consumer to reconsider the decision to enter into a lease contract. The consumer has the right to cancel the lease contract within the three-day period providing the consumer has not taken possession of the leased property.

The three-day cancellation clause derives from the "Door to Door Retail Installment Sales Act of 1968," C. 17:16-61.5; the "Door to Door Home Repair Sales Act of 1968," C. 17:16C-99; and the attorney review clause in contracts of sale of real property, N.J. State Bar Ass'n. v. N.J. Realtor Bds. Ass'n., 93 N.J. 470, 475 (1983), supplemented, 94 N.J. 449 (1983).

Section 5(b) requires the lessor to refund any payments made by a lessee who exercises the right to cancel the lease contract. This section derives from the California Vehicle Leasing Act. See, Cal. Civ. Code §2985.7-§2990, §2986.13 (West Supp. 1989).

SECTION 6. Warranties.

In a consumer lease, a disclaimer of any warranty is unenforceable.

COMMENT

Section 6 corrects the failure of Uniform Commercial Code Article 2A to protect the consumer against disclaimers of warranties. Article 2A permits the lessor to exclude both express and implied warranties. See, U.C.C. 2A-214. While such an option may be appropriate in contracts between businesses of equal bargaining power, "[l]imitations on the methods of disclaiming ... warranties of quality illustrate the significant failing of the U.C.C. as a consumer protection statute." Miller, *Consumer Leases Under Uniform Commercial Code Article 2A*, 39 Ala. L.Rev. 957, 961 (1988).

Section 6 prohibits the disclaimer of any express or implied warranty made to the lessee. Once a warranty arises either by operation of law or otherwise, the warranty is irrevocable. However, this section is not intended to displace remedies a consumer may have to enforce warranties under other law. See, e.g., C. 56:12-19.

SECTION 7. Liens.

Any provision in a consumer lease that gives the lessor a lien on property, other than the leased property or a security deposit, is unenforceable.

COMMENT

Section 7 prohibits the lessor from taking a security interest in the lessee's property, other than the leased good itself, to secure the lessee's performance under the lease contract. Consumer protection policies justify the limitation on free alienation of property that results from this section. Upon default by the lessee, the lessor can obtain a judicial lien against other property owned by the lessee. Section 7 derives from the California Vehicle Leasing Act, which contains a similar prohibition for lease contracts of motor vehicles. See, Cal. Civ. Code §2986.6 (West. Supp. 1989); see also, C. 17:16C-39.1.

SECTION 8. Assignment of consumer leases.

With prior consent of the lessor, a lessee may assign a consumer lease with a term of one year or more by giving notice of the proposed assignment to the lessor. The lessor shall not unreasonably withhold his consent to the assignment. The original lessee and the assignee are jointly and severally liable under the assigned lease. If the lessor unreasonably withholds his consent, the lessee has the option to terminate the lease without liability for future rental payments, lost profits, penalties or other charges.

COMMENT

Most lease contracts prohibit the lessee from assigning the lease contract to another person. This bar to assignment prevents the lessee from avoiding an anticipated default or mitigating damages upon default. Section 8 gives the lessee a right to assign a lease before the end of its term so that the lessee can avoid an anticipated default under the lease. For example, assume that the lessee enters into a lease contract for an automobile, and the lease term is for a period of 48 months. After two years, the lessee, who resides in New Jersey, relocates to Europe. Section 8 enables the lessee to assign the lease to another person and avoid having to choose between defaulting on the contract or continuing to pay for an automobile he can no longer use. A lessee who cannot afford the rental payments would also be able to avoid a default by assigning the lease contract.

In a secured transaction, the buyer has the option to avoid a default or mitigate damages upon early termination of the lease agreement. The purchased goods can be sold and the remaining balance of the debt paid off. A lessee does not have this option because the lessee does not own the leased property. The lessee's right to assign the lease is thus the equivalent to the buyer's right to sell the goods.

When the lease contract is assigned, both the original lessee and assignee are jointly and severally liable to the lessor. The contractual obligations of the original lessee are continued after the assignment is made to strike a balance between the lessor's rights to receive performance under the lease contract and the lessee's right to terminate the contract early. While the original lessee is allowed to assign the lease, the lessor can demand performance from both the original lessee and assignee upon default.

The lessor can disapprove an assignment, but must set forth specific facts that show the assignment actually increases the risk to the leased property or materially changes the contract. An assignment of the lease is not a factor that alone increases risk to the leased property or materially changes the terms of the contract. This section is intended to facilitate the assignment of lease contracts by the lessee while at the same time protecting the interests of the lessor. If the lessor's disapproval of the assignment is unreasonable, the lessee has the option to terminate the lease contract without further obligation to the lessor.

SECTION 9. Assignee subject to claims and defenses.

An assignee of the lessor's rights is subject to all claims and defenses of the lessee against the lessor arising from the lease limited only by the amount of the lessee's total payments under the lease.

COMMENT

Section 9 makes the lessor's assignee of a consumer lease contract subject to the claims and defenses the lessee had against the original lessor. The consumer is thus protected from the harshness of the holder in due course doctrine, and financial institutions that take assignments of lease contracts are held accountable for the original lessor's violation of this Act. Section 9 is modeled upon the Uniform Consumer Credit Code, 1974 Act, (U.L.A.), §3.404(1) [cited as U.C.C.C.].

Unlike U.C.C.C. §3.404(2), however, the lessee has no duty under Section 9 to obtain satisfaction from the original lessor. Rather, the lessee has the right to assert the claim or defense directly against the assignee. The amount of the claim that the lessee has against the lessor's assignee is limited to the unpaid balance of the lease contract, plus actual damages, and penalties provided by Section 19 of this Act. No prior notice of asserting the claim or defense against the assignee is required. Cf., U.C.C.C. §3.404(2). The phrase "arising from the lease" refers to claims

and defenses resulting from a breach of contract, including but not limited to fraud, breach of warranty, failure of consideration and consumer lease disclosure claims. The phrase does not include tort claims.

SECTION 10. Liability of dealers and remote lessors.

In a finance lease, in addition to the lessor named on the lease, a person who negotiates the lease with a consumer lessee is a lessor for purposes of this Act.

COMMENT

Section 10 addresses the problem that arises when a person other than the lessor named in the lease contract negotiates the lease contract with the lessee. For example, a dealer engaged in the business of leasing or selling personal property to consumers often negotiates the lease contract on behalf of a bank that is the lessor named in the lease contract. In this situation, the bank may claim it is not bound by the representations made by the dealer, or is not bound by this Act, if it is not a lessor regularly engaged in the business of leasing or selling personal property. Similarly, the dealer may claim that since it is not the lessor named in the lease, it is not liable to the consumer.

Section 10 closes this potential loophole for dealers and remote lessors. The dealer who negotiates the lease contract is considered a lessor for purpose of this Act. Likewise, any subsequent person named in the lease contract as lessor is considered an assignee of the original lessor. The net effect is to make both the initial dealer and subsequent lessor subject to the terms of this Act.

SECTION 11. Specificity of payment terms.

a. For any "consumer lease" defined in this Act that is not subject to the federal regulations regarding disclosure of lease terms, the lessor shall state the date any payment is due and shall:

- 1) specify the amount of the payment, or
- 2) provide a formula which allows the amount to be calculated arithmetically.

b. A requirement that makes the lessee responsible for damage to the leased property shall not be construed to be a violation of subsection (a) of this section, and shall be permissible to the extent allowed by Sections 12 and 13 of this Act.

COMMENT

The Consumer Leasing Act, and its implementing regulation, Regulation M, mandate the disclosure of certain terms of consumer leases of personal property. See, 15 U.S.C. §1667-1667(e) (1982); 12 C.F.R. §213 (1988). However, the disclosure requirements apply only to consumer leases defined within the Act. The term "consumer lease" in the federal statute means a contract for the use of personal property by a natural person for a period exceeding 4 months, primarily for personal, family, or household purposes, and for a contractual obligation not exceeding \$25,000. Since the definition of "consumer lease" in this Act is broader than the one in the federal statute, disclosure requirements are needed for consumer leases not covered by federal law.

Section 11 requires the lessor to disclose in the lease contract all payments the lessee is obligated to make and to set forth the dates by which the payments must be made. All regular required payments must be disclosed in the lease contract. In addition, payments contingent upon the happening of an event, such as default and damage, also must be disclosed. The purpose of this provision is to give the lessee a complete statement of his liabilities under the lease contract.

Section 11(b) makes any clause in the lease contract requiring the lessee to make a required payment when the leased property is damaged before the end of the contract subject to Sections 12 and 13.

SECTION 12. Risk of loss.

The lessor bears the risk of loss of the leased property unless the lease specifies the nature and extent of the risk allocated to the lessee.

COMMENT

Section 12 states the general rule that the lessor bears the risk of loss or damage to leased property. However, if the lease so specifies, this section allows the lessor to transfer particular risks to the lessee.

SECTION 13. Insurance.

a. This section applies when the lessee bears risk of loss for the leased property, and the goods are in the possession of the lessee, and the consumer lease provides for insurance against this risk.

b. If the leased property is damaged, and can be restored to its condition prior to damage, the lessor shall elect one of the following options:

(1) apply the amount of the damage as determined by the insurance company (the proceeds of the insurance plus any deductible amount as provided in the insurance policy owed by the lessee) to repair the leased property, and continue the lease, or

(2) retain the amount of the damage as determined by the insurance company and terminate the lease contract.

c. The lease shall be suspended, and the lessee need not make any required payments during the period that the leased property is repaired pursuant to this section. The lease term shall be extended for a period equal to the period of suspension.

d. If the leased property is damaged, and cannot be restored to its condition prior to damage, the lessor shall retain the amount of the damage as determined by the insurance company and terminate the lease.

e. Damage or loss to the leased property does not constitute a default on the part of the lessee, and if the lease is terminated pursuant to this section, the lessor may not recover future rental payments, lost profits, penalties, or other charges.

f. If the lease requires the lessee to carry insurance, and the lessee fails to comply with this requirement, this section shall not apply.

COMMENT

Section 13 contains the rules governing insurance, damage and loss of leased property. The rules for insurance limit the measure of damages the lessor receives when insured property is damaged or destroyed. The lessee does not incur any liability on account of the damage or loss to the insured property, except for payment of the deductible amount of the insurance policy.

When the insured property is damaged and can be repaired, the lessor must select one of two options. First, the lessor can elect to apply the proceeds of the insurance policy to repair the leased property. Second, the lessor can elect to retain the insurance proceeds and terminate the contract. Under the first option, the risk of applying the proceeds to the leased property is placed upon the lessor. The lessor cannot decide to repair the leased property, and then, at the end of the contract, demand that the lessee pay an additional sum for reduced residual value. Under the second option, where the lease is terminated, the lessee has no further obligation to the lessor.

If the lessor decides to have the leased property repaired, the lease contract is suspended for the duration of the repair period. The lessee does not make any required payments while the lease is suspended. Rather, when the leased property is returned to the lessee, the lease continues, and the term of the lease is extended for the duration of the suspension.

When the insured property is damaged, and cannot be restored to its prior condition, the lessor does not have any options. The lessor must accept the insurance payment and terminate the contract. The lessee is obligated to pay only the deductible amount of the insurance policy.

Section 13(d) clarifies that damage to property covered by insurance is not a default by the lessee. Similarly, Section 13(e) clarifies that, in the event of damage to insured property, the rules governing damage upon default do not apply. The lessor's recovery is limited to the options set forth in this section.

SECTION 14. Late fees.

a. A late payment fee of no more than five percent of the monthly payment in default may be charged by the lessor for the lessee's failure to make a payment on time.

b. A payment is made on time if made within ten days of the due date set by the lease contract.

c. Any late payment fee not claimed by notice in writing within 40 days from the date of default is waived.

COMMENT

Section 14 is modeled upon a similar provision in the Retail Installment Sales Act limiting late payment of fees. C. 17:16C-42. The differences between the two provisions reflect structural differences between a lease contract and a retail installment contract. The provision in the Retail Installment Sales Act allowing the creditor attorney's fees was omitted deliberately. C.17:16-42(b). Given the possibility of large deficiency claims, a provision allowing the lessor attorney's fees based upon the amount of the default has the potential to produce unjust results.

SECTION 15. Notice of consumer's right to cure.

a. After a lessee has failed to make a required payment for ten days, the lessor may declare a default by giving the lessee written notice of the default and the right to cure the default. The notice shall contain: the name, address, and telephone number of the lessor to whom payment should be made; the amount of the payment; the right to cure the default, and the date by which the payment must be received to cure the default.

b. For twenty days after the notice is given, the lessee may cure all defaults consisting of a failure to make a required payment by paying all unpaid sums due at that time.

c. If the lessee does not make payment within the time allowed to cure the default, the lessor may exercise his rights under the law.

COMMENT

Section 15 allows the lessee to cure a default for failure to make a required payment without impairing the contractual relationship with the lessor. Section 15(a) requires the lessor to send a written notice to the lessee upon default for failure to make a required payment. A default occurs when the lessee fails to make a required payment on the due date of the payment. The notice informs the lessee of his right to cure a default by making the required payment and sets the date by which the default must be cured. Section 15(a) is modeled upon the U.C.C.C. §5.110.

Section 15(b) delineates the consumer's right to cure the default for non-payment of rent. The lessee cures a default by paying all unpaid sums due the lessor within twenty days from the date the notice is given to the lessee. The lessor may not exercise any remedy for default until the twenty day time period has expired and the lessee has failed to make the required payment. The term "all unpaid sums" is limited to unpaid rent payments and late fees permitted by this Act. If the lessee cures the default by making the required payment, the lease contract continues as if the default never occurred. Section 15(b) is modeled upon the U.C.C.C. §5.111.

SECTION 16. Default by lessee.

a. If the lessee defaults or wrongfully terminates a consumer lease, the lessor may cancel the lease, repossess the leased property and recover no more than the following damages:

(1) Any payments due at the time of default plus interest at prevailing rates on those payments;

(2) The present value at the time of default of any payments due in the future;

(3) The reasonable cost of repossession;

(4) Any damage allowed by the Act for loss or injury to the leased property; and

(5) The value of the leased property at the end of the lease term reduced to the present value as of the time of default.

b. The lessor's damages are reduced by the value of the leased property at the time of default.

COMMENT

This section is designed to provide a fair result for both parties in the event that a lessee defaults. The formulas for the calculation of damages sometimes found at present in consumer lease contracts provide damages far in excess of the actual economic loss to the lessor due to default. This section is designed to prevent this kind of overreaching.

Section 16 is patterned after the provisions on default found in Article 2A on Leases. However, Article 2A allows the measure of damages to be varied in the lease contract. See, U.C.C. 2A-503 and 504. The option to vary the measure of damages is inappropriate in consumer transactions. Like its source provisions, this section provides that damages are based on unpaid past and future rents, the cost of repossession (compare U.C.C. 2A-529), and any damage to the leased goods (compare U.C.C. 2A-532).

This section differs from Article 2A on the issue of credit against damages for the economic value of the early return of the leased goods. In Article 2A, this credit is based on the rental value of the goods returned. See, U.C.C. 2A-527(2) and 528(1). While the Article 2A standard is reasonable for commercial leases, it is not practical in consumer leases where there is no market value for the re-rental of the goods. In lieu of this standard, Section 16 provides a credit based on the value of the goods. This credit reflects that the goods will have a higher value at the time of default than they would have had at the end of the lease term, and that the lessor gains an economic advantage from early realization of that value. The standard used by this section is similar to that now used in calculation of damages in consumer leases.

As an illustration of the way the measure of damages on default works, assume a five-year lease of an automobile with a retail price of \$13,000. The lease provides for a \$1,000 down payment, sixty monthly payments of \$210, and an option to purchase the car at the end of the lease term for \$5,000. Assuming a default at the end of the twenty-fourth month, the damages would be:

\$6605

the present value of thirty-six monthly payments of \$210 (assuming 9% interest).

\$3846

the present value of \$5,000 (assuming 9% interest compounded yearly).

(\$8557)

the credit for the value of the car (assuming the 150% declining balance method).

\$1894

net damages.

From the lessee's standpoint, the \$1894 damages plus the \$6040 paid in the down payment and twenty-four monthly rental payments amounts to \$7934 for the use of the automobile for two years. From the lessor's standpoint, the value of the car, damages and the amount already paid add up to over \$1000 more than the \$13,000 retail price of the automobile with interest over

two years. Although this measure of damages can be considered favorable to a lessor, it is far less so than any currently in use.

SECTION 17. Calculation of value of leased property.

For determination of damages on default of a lessee, the value of leased property shall be determined in the following manner:

a. The value at the beginning of the lease term is the retail sales price of the leased property. This price shall be stated in the lease contract.

b. The value at the end of the lease term is the option price established for the purchase of the leased property at the end of the lease term. If no option price is stated in the lease, the value is the average retail market price for similar property.

c. The value at any other time within the lease term is the option price established for the purchase of the leased property exercisable at that time.

d. If the value at default is not defined by subsection (a), (b), or (c), it shall be determined by interpolation between the retail sales price and the value at the end of the lease term or by subsection (f) if specified in the lease contract. The interpolation shall be done by use of the straight-line method unless the lease provides for the use of the 150% declining balance method in which case that method shall be used.

e. When the straight-line method is used, the value at default shall be equal to the retail sales price less the product of: 1) the difference between the retail sales price and the value at the end of the lease term and, 2) the number of months from the beginning of the lease term to the time of default, divided by the number of months of the lease term.

f. When the 150% declining balance method is used, the value of the leased property shall be determined for each month beginning with the first month of the lease and continuing through the month of default. The value in the second month of the lease is equal to the retail sales price established prior value less 1.5 times the amount of decline in value for one month under the straight-line method. The value in any subsequent month shall be determined by multiplying the value for the prior month by the declining balance fraction. The declining balance fraction is equal to the value in the first month divided by the retail sales price.

COMMENT

The determination of damages upon default requires the calculation of the value of the leased goods at any time during the period of the lease. The purpose of this section is to provide a basis for that calculation. Traditionally, the sale price of the goods at the time of default has been used. The difficulty has been that repossessed goods are sold at a price that the consumer thinks is unfairly low. Often that price is lower than the price set in the lease contract for the consumer's option to buy the goods at the end of the lease. Regulation in the nature of the sale applicable to credit sales transactions has not been particularly effective in bringing the actual sales price closer to what is considered appropriate, and there is no reason to think that similar regulation will be

more effective in regard to leases. The consumer has an option in a credit sale situation to avoid a sale by the secured party by selling the goods and paying off the principal balance. This option is unavailable in the lease transaction. As a result, the problem caused by low sales prices of goods repossessed after default can be expected to be more frequent and less avoidable by the consumer.

The value of the goods at the end of the lease is often set in the lease contract in the form of an option to purchase. This option price is subject to negotiation and can be considered as a fair judgment of the value of the goods at that time. As a result, it can serve as a firm starting place for calculation of value at other times. To provide a second point from which value can be determined, this section requires that the lease contract specify the retail price of the goods at the beginning of the contract. Economic considerations should result in this price also being relatively accurate. A low initial retail price would be an advantage to the lessor in the event of default, but marketing considerations should prevent the specification of an unrealistically low price.

Finding prices during the lease contract becomes then a matter of interpolation. Two options are provided, the straight line method and the 150% declining balance method. Each is set out in words in this section. An equation for each form of interpolation is as follows:

Where V_d = value at the time of default, and T_d = time of default in months; V_p = retail sales price, and T_p = time in months from the beginning of the lease term; V_s = value at the end of the lease term, and T_s = time in months to the end of the lease term.

STRAIGHT LINE:

$$V_d = V_p - \frac{(V_p - V_s)(T_d - T_p)}{(T_s - T_p)}$$

Where V_{m1} = value at the end of the first month; V_{mn} = value at the end of the n^{th} month; and V_{mn-1} = value at the beginning of the n^{th} month.

150% DECLINING BALANCE:

$$V_{m1} = V_p - 1.5 \frac{(V_p - V_s)}{(T_s - T_p)}$$

$$V_{mn} = V_{mn-1} \frac{V_{m1}}{V_p}$$

An example of the application of the standards for setting value can be seen using the same example set out in the comment to Section 16. If the retail price is \$13,000, the value at the end of the lease is the \$5,000 option price, and the time of default is the twenty-fourth month:

By the straight line method, the \$13,000 prior value is reduced by the difference between the two values (\$8,000) multiplied by 24/60 (the number of months to default divided by the number of months to the option price). The value by this method is \$9,800.

By the 150% declining balance method, the value at the end of the first month is \$12,800 or \$13,000 less \$200 (1.5 times the first month reduction under the straight line method). The value for each month thereafter is produced by multiplying the value for the previous month by .9844 (\$12,800 divided by \$13,000). By this method, the value at the end of the twenty-fourth month is \$8957.

A third course is open to a lessor if he considers that neither of these two interpolation methods accurately reflects depreciation of the leased goods. The lessor may provide options to purchase the leased goods at other times during the lease. If these options are provided, they are taken as dispositive of the value of the goods at those times. See subsection (c). Again, economic factors should guarantee that the option prices will be accurate. A low option price would be an advantage to the lessor in case of default, but an unrealistically low option price could be exercised by the lessee terminating the lease.

SECTION 18. Lessor's right to take possession after default.

a. Upon default by a lessee, and compliance by the lessor with Section 15, the lessor is entitled to possession of the leased property. The lessor may take possession of the property without judicial process only if possession can be taken without trespass and without the use of force or other breach of the peace.

b. The lessor is liable to the lessee for any damages arising out of any repossession in violation of this section.

COMMENT

Section 18 limits the right of the lessor to repossess leased goods upon the lessee's default. Section 18(a) permits the lessor to take possession of leased goods without judicial process in two situations only: (1) the repossession can take place without any trespass upon the property of the lessee, or (2) the lessor obtains the consent of the lessee. Section 18 prohibits all self-help methods of repossession that involve a trespass upon the lessee's property, the use of force, or a breach of the peace.

Section 18 specifically rejects the standard for repossession established for secured creditors under Article 9 of the Uniform Commercial Code. See, U.C.C. 9-503. That standard, which permits trespass upon the property of the lessee, is inappropriate for dwelling places, where many leased goods are kept. The Article 9 standard is also inconsistent with the consumer protection purposes of this Act.

SECTION 19. Supplementary General Principles of Law Applicable.

Unless displaced by the particular provisions of this Act, other principles of law relative to contracts and consumer protection shall apply to lease contracts.

COMMENT

This section indicates the continued applicability to consumer lease contracts of all supplemental bodies of law except insofar as they are displaced by this Act. The particular practices prohibited by the Act are not intended to define an exhaustive list of unconscionable commercial practices.

Amended section:

17:16C-1. Definitions

In this act, unless the context otherwise requires, the following words and terms shall have the following meanings:

(a) ...

(b) "Retail installment contract" means any contract, other than a retail charge account or an instrument reflecting a sale pursuant thereto, entered into in this State between a retail seller and a retail buyer evidencing an agreement to pay the retail purchase price of goods or services, which are primarily for personal, family or household purposes, or any part thereof, in two or more installments over a period of time. This term includes a security agreement, chattel mortgage, conditional sales contract, or other similar instrument. [and any contract for the bailment or leasing of goods by which the bailee or lessee agrees to pay as compensation a sum substantially equivalent to or in excess of the value of the goods, and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming, the owner of such goods upon full compliance with the terms of such retail installment contract.] **Any lease of goods which includes an option to purchase and in which the payments prior to the option to purchase are equal to, or more than, the cash price of the goods plus interest at prevailing commercial rates for the term of the lease, whether or not the lessee is permitted to terminate the contract early without penalty, is a retail installment contract. For purposes of this act, a series of leases is a single lease if:**

(1) the leases are of the same goods and to the same lessee; and

(2) the goods remain in the possession of the lessee.

* * *

(v) Option to purchase means a term of a lease, or an understanding by the parties to a lease created by advertising or any oral or written representations made by the lessor, which provides that the lessee has the right to acquire ownership of the leased goods.

COMMENT

The amendment of Section 1(b) makes rent-to-own (RTO) lease transactions subject to the Retail Installment Sales Act. A RTO lease transaction is a series of short term (usually weekly) agreements to rent an appliance or other good to the consumer. Since the parties usually intend that the lessee will purchase the product, most RTO lease transactions in essence are contracts of sale of personal property. The RTO contract may not be governed by existing law applicable to other types of consumer financing because of the form of the RTO transaction. This amendment brings RTO leases within the scope of this act, and treats the RTO lease agreement as a secured transaction.

The principal abuse of some RTO lease transactions is the exorbitant price charged for the goods. For example, assume a consumer rents a \$200 appliance under an RTO lease which

provides for 87 weekly payments at \$11.55 per week. The consumer who makes all payments under the contract will pay \$1004.85 to own the \$200 item. This represents an annual percentage rate of 298%, a percentage rate that is unlawful in this state. By contrast, a consumer who bought the same appliance under a credit sale which provided for 20 monthly payments of \$12.83 would only pay \$256.60 for the appliance. The finance charge of \$56.60 represents an annual percentage rate of 30%. The gross disparity in price and annual percentage rate between some RTO leases and credit sales is unfair to the consumer and not justified by any benefit the consumer may receive from the RTO lease. Therefore, an RTO lease transaction should be deemed a sale and governed by the Retail Installment Sales Act.