Since the standards for strict liability and negligence in design enunciated in *Pike* are so similar—unreasonably dangerous design on the one hand and not reasonably safe for intended use on the other—one may ask what the application of strict liability achieves. The plaintiff's primary advantage resides in not having to show that a reasonable manufacturer should have known of the product's unsafe qualities at the time the product was sold. With strict liability applicable, the manufacturer's cognizance, actual or constructive, is immaterial; the unreasonableness of the design may be shown after the accident had occurred.[32] Furthermore, contributory negligence is not a defense in strict liability cases.[33]

The court in *Price* refused to exclude a lessee or bailee from the class of plaintiffs entitled to relief for a defectively manufactured product on a strict liability theory solely because no "sale" had occurred. In *Pike* the court held that a manufacturer is strictly liable for injuries resulting from an unreasonably dangerous design. These applications of strict liability wisely focus on the marketplace realities and the social policies on which the loss allocation theory of *Greenman* and its progeny rest.

*D.R.A.*

## IX

## USURY

### *A. Sale-Loan Dichotomy in Accounts Receivable Financing*

*West Pico Furniture Co. v. Pacific Finance Loans.*[1] The court held alleged purchases of conditional sales contracts by a personal property broker[2] to be disguised loans where the entire risk of nonpayment

32. The defendant may still raise the defense of assumption of risk. Barth v. B.F. Goodrich Tire Co., 265 Cal. App. 2d 228, 243, 71 Cal. Rptr. 306, 314 (1st Dist. 1968); RESTATEMENT (SECOND) OF TORTS § 402A, comment *n* (1965).

33. Keeton, *Products Liability—Some Observations About Allocation of Risks*, 64 MICH. L. REV. 1329, 1336 (1966):

> In order to support recovery ou a negligence theory, it would have to be established that the magnitude of the danger outweighed the usefulnees of the product and that a reasonable man in the position of the maker should have appreciated the imbalance when the product was sold. . . . If strict liability is applicable, there is no necessity for showing that, as a reasonable man, the maker should have had knowledge of his product's unsafe qualities. It is sufficient if, after accidents have occurred, it appears to have been an unreasonably dangerous product.

1. 2 Cal. 3d 594, 469 P.2d 665, 86 Cal. Rptr. 793 (1970) (Sullivan, J.) (unanimous decision).

2. Personal property brokers are defined as:

> [A]ll who are engaged in the business of lending money and taking in the

of the accounts was borne by the seller, daily collections were made by the seller and remitted to the buyer, and the negotiations between the parties reflected the seller's desire to obtain loans. The court however, held the transactions not illegal even though the rates of interest charged were in excess of those permitted by the Personal Property Brokers Law[3] since, under Financial Code section 22053,[4] any loan,

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name of the lender, or in any other name, in whole or in part, as security for such loan, any contract or obligation involving the forfeiture of rights in or to personal property, the use and possession of which property is retained by other than the mortgagee or lender, or any lien on, assignment of, or power of attorney relative to wages, salary, earnings, income, or commission.

CAL. FIN. CODE § 22009 (West 1968).

3. *Id.* §§ 22000-653. Interest rates are set out in sections 22451 and 22453:

Every licensee who lends any sum of money may contract for and receive charges at a rate not exceeding the sum of the following:

(a) Two and one-half percent (2½%) per month on that part of the unpaid principal balance of any loan up to, including, but not in excess of two hundred dollars ($200).

(b) Two percent (2%) per month on that portion of the unpaid principal balance in excess of two hundred dollars ($200) up to, including, but not in excess of five hundred dollars ($500).

(c) Five-sixths of one percent (⅚ of 1%) per month on any remainder of such unpaid principal balance in excess of five hundred dollars ($500).

*Id.* § 22451.

No amount in excess of that allowed by this article shall be directly or indirectly charged, contracted for, or received by any person, and the total charges of the personal property broker and broker and any other person in the aggregate shall not exceed the maximum rate provided for in this article.

*Id.* § 22453.

Loans in excess of these amounts, unless exempted, are void under sections 22650, 22651, and 22652:

No loan made within this State, for which a greater rate of interest, consideration, brokerage, and charges than is permitted by this division has been charged, contracted for, or received, shall be enforced in this State, and every person participating in the making, contracting, or collecting of such loan in this State is subject to the provisions of this division.

*Id.* § 22650.

If any amount other than or in excess of the charges permitted by this division is charged, contracted for, or received, except as the result of an accidental and bona fide error in computation, the contract of loan is void, and no person has any right to collect or receive any principal, charges, or recompense in connection with the transaction.

*Id.* § 22651.

Except as provided in Section 22651, if any provision of this division is violated in the making or collection of a loan, the contract of loan is void, and no person has any right to collect or receive any principal, interest or charges in connection with the transaction.

*Id.* § 22652.

The general usury provision of the California constitution, which provides for a maximum rate of interest of 10% per annum, does not apply to loans made by personal property brokers (among others). CAL. CONST. art. XX, § 22.

Thus the regulation of the fees, charges, and rates which may be charged by a personal property broker is solely a function of the legislature. *Id.* art. XX, § 22; Carter v. Seaboard Fin. Co., 33 Cal. 2d 564, 203 P.2d 758 (1949).

4. CAL. FIN. CODE § 22053 (West 1968); see note 62 *infra*.

regardless of its form, which is of a bona fide amount of five thousand dollars or more, or is made by a duly licensed personal property broker in that amount,[5] is exempt from the interest limitations of the Act, so long as section 22053 is not used for the purpose of evading the Act.[6]

This Note utilizes the *West Pico* decision to update, summarize and analyze the court's approach to California usury law. Part I concentrates on the court's approach to piercing financial devices and transactions in order to reveal disguised loans. The sale-loan dichotomy receives particular attention, with focus on the disguised loan characteristics of full recourse agreements in accounts receivable financing. Part II explores the policy and effect of the large loan exemption on the interest limitations of the Act.

## I. THE SALE-LOAN DICHOTOMY IN CALIFORNIA USURY LAW

For several years prior to the transactions in question West Pico's predecessor (the old company)[7] had been selling furniture at retail on conditional sales contracts. It had been financing these transactions through loans by the Bank of America secured by West Pico's sales agreements. Early in 1963 the old company's president contacted Pacific Finance Loans and began discussion of the financing of its operations. Pacific purchased some of the old company's prime, aged contracts outright without recourse.[8] Negotiations then turned to the sale and purchase of "house accounts": those which had not been acceptable to the bank as security for loans.[9] As to these Pacific demanded a guaranty. The old company agreed to sell these accounts with full recourse. Purchase agreements were drawn up and executed in June and August of 1953.

Later that year, on the advice of legal counsel, the new company was incorporated, and West Pico informed Pacific that it would there-

5. Since all loans of $5,000 or more are exempt from the Act, the further exclusiou for personal property brokers seems unnecessary.

6. The unscrupulous lender might attempt to use section 22053 to evade the Act by forcing the borrower to accept a loan in excess of $5,000 simply to enable himself to charge more interest than would be allowed on a smaller loan, or by adding charges or other amounts to make the loan equal or exceed the $5,000 level.

7. West Pico Furniture Company of Los Angeles, incorporated in California in 1953 is plaintiff here. Its predecessor was the West Pico Furniture Company. The only apparent difference betwcen the two was the incorporation of the plaintiff. *See* 2 Cal. 3d at 597-98, 469 P.2d at 667-68, 86 Cal. Rptr. at 795-96 (1970).

8. A no recourse sale is one in which the seller of accounts, or of any other type of obligation, is not bound to compensate the buyer if the obligor fails in his payments on the debt. Collection is entirely up to the buyer. In an agreement with recourse the seller must pay the buyer if the obligor does not. In essence, the seller becomes the obligor's guarantor.

9. 2 Cal. 3d at 598, 469 P.2d at 668, 86 Cal. Rptr. at 796.

after treat their transactions as loans.[10] Pacific objected and there were further negotiations. On October 23, 1953, the parties executed a "master" agreement to eliminate the necessity of a separate contract for each transaction. Under this agreement West Pico was to collect its customer's installment payments and remit them daily to Pacific. In addition, contracts delinquent for 60 days were to be repurchased by West Pico. It had the option, however, to collect on these contracts in lieu of repurchase.

By February, 1954, West Pico demanded a new agreement because of the large payments it was required to make under the repurchase provisions of the October 23, "master" contract. After negotiations the parties agreed that West Pico's liability in respect to purchases would be limited to ten percent of the aggregate unpaid principal balances, and executed a new contract on March 19, 1954. While this ten percent limitation was to be handled by means of a reserve held in addition to the discounts taken on each sale, the parties apparently agreed that no reserve would in fact be established.[11]

West Pico sold more than 371 bundles of sales contracts to Pacific under this agreement with a total face value of $4,552,200.86. For these, it issued checks totalling $2,971,505.55. Pacific relied solely on West Pico for verification of the conditional vendee's credit but did notify the customers that their contracts had been assigned to it. Pacific serviced all delinquent contracts, and in practice, the aggregate of those repurchased did not exceed the ten percent limitation.

In 1959 West Pico brought the present action alleging that Pacific had violated several provisions of the Act[12] and seeking recovery of the full face value of all conditional sales contracts turned over to Pacific on the theory that the transactions were void.[13]

The underlying question presented by the parties was whether the transactions were loans, or sales of the conditional obligations. If the purchases of contracts were in fact sales there could be no claim of usury.[14] The existence of a loan is a prerequisite to a finding of usury.

10. *Id.* at 599, 469 P.2d at 668, 86 Cal. Rptr. at 796. West Pico's tax attorney and accountant had apparently advised West Pico to treat the financing arrangements as loans in order to defer taxes.

11. *Id.* at 600, 469 P.2d at 669, 86 Cal. Rptr. at 797.

12. CAL. FIN. CODE §§ 22451, 22453 (West 1968). For the text of these sections see note 3 *supra*. West Pico also originally claimed the loans violated the general usury laws. Although no mention was made of the trial court's action on this claim, it was obviously rejected because the California constitution excludes personal property brokers from those provisions. See note 3 *supra*.

13. 2 Cal. 3d at 601, 469 P.2d at 669-70, 86 Cal. Rptr. at 797-98 (1970). Any loan which violates the Act is void and unenforceable. CAL. FIN. CODE §§ 22650-52 (West 1968); see note 3 *supra*.

14. "Contractors are free to buy and sell their property, and this may include

Lenders intent on collecting interest in excess of statutory limits attempt to identify their transactions as sales in all types of situations.[15] The "sale" of accounts receivable is perhaps the most common type of financing device used to avoid the "loan" label.[16] However, "sales" of land,[17] leases,[18] mortgages and deeds of trust,[19] and other promissory notes,[20] many with options to purchase, are also quite prevalent.[21] The characterization of the transaction as a usurious loan or a sale depends on the intent of the parties.[22] Intent is a question of fact and is determined by an examination of the dealings between the parties. The substance of the transaction rather than its form governs.[23]

Although *West Pico* adds little to California law on the sale-loan dichotomy, it is useful as a general summary of the law on this important subject.[24] The court chose to rely primarily on its earlier de-

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promissory notes and other instruments, at a price agreed upon, and when the bona fides of the parties is established the percentage of profit has no relation to the usury law." Milana v. Credit Discount Co., 27 Cal. 2d 335, 340, 163 P.2d 869, 871 (1945).

15. *See id.*

16. *E.g.*, Baruch Inv. Co. v. Huntoon, 357 Cal. App. 2d 485, 65 Cal. Rptr. 131 (1st Dist. 1967); Advance Indus. Fin. Co. v. Western Equities, Inc., 173 Cal. App. 2d 420, 343 P.2d 408 (2d Dist. 1959); Refinance Corp. v. Northern Lumber Sales, 163 Cal. App. 2d 73, 329 P.2d 109 (2d Dist. 1958).

17. *E.g.*, Rosemead Co. v. Shipley Co., 207 Cal. 414, 278 P. 1038 (1929).

18. *E.g.*, Burr v. Capital Reserve Corp., 71 Cal. 2d 983, 458 P.2d 185, 80 Cal. Rptr. 345 (1969); Golden State Lanes v. Fox, 232 Cal. App. 2d 135, 42 Cal. Rptr. 568 (2d Dist. 1965).

19. *E.g.*, Cowles v. Zlaket, 167 Cal. App. 2d 20, 334 P.2d 55 (4th Dist. 1959).

20. *E.g.*, Thomas v. Hunt Mfg. Corp., 42 Cal. 2d 734, 269 P.2d 12 (1954); Janisse v. Winston Inv. Co., 154 Cal. App. 2d 580, 317 P.2d 48 (1st Dist. 1957).

21. One area where the sale-loan distinction is likely to become quite important is in the sale of large obligations by banks, which are exempt from California's usury laws [CAL. CONST. art. XX, § 22], to non-exempt lenders. The purchaser of the loan would probably be able to collect the payments of principal and interest (in excess of the 10% limitation) free of any charge of usury so long as the sale was carried out with no intention on the part of either party to the sale to evade the usury laws. There would be many complex factors involved in finding such an intent, but the transaction would almost surely be characterized as a loan if the bank made the original loan with the later sale of it in mind or if the parties bought and sold such loans on a fairly regular basis.

22. Milana v. Credit Discount Co., 27 Cal. 2d 335, 341, 163 P.2d 869, 872 (1945).

23. *See, e.g.*, Burr v. Capital Reserve Corp., 71 Cal. 2d 983, 989, 458 P.2d 185, 189, 80 Cal. Rptr. 345, 349 (1969); Thomas v. Hunt Mfg. Corp., 42 Cal. 2d 734, 740, 269 P.2d 12, 16 (1954); Wooten v. Coerber, 213 Cal. App. 2d 142, 145, 28 Cal. Rptr. 635, 636-37 (2d Dist. 1963).

24. Although *West Pico* involved the application of the interest limitations of the Act, its application is clearly much wider, encompassing the general usury laws as well. The sale-loan dichotomy is a problem under all usury provisions and the courts have treated all transactions involving this distinction the same regardless of the nature of the lender or the property secured. See cases cited notes 16-20 *supra*. The

cision in *Milana v. Credit Discount Co.*,[25] quoting at length *Milana's* classic delineation of the differences between sales and loans and emphasizing the continuing obligation of the alleged seller as the distinguishing feature of the loan transactions.[26] The creation of a debit and credit relationship, as opposed to the absolute transfer of property for a sum certain with no further obligation on behalf of either party, is the mark of a loan.

Since the continued obligation-absolute transfer dichotomy was recognized as the distinction between a sale and a loan, the court in *West Pico*, as in *Milana*, found that the existence of recourse against the seller of an obligaton was the crucial factor in the finding of a disguised loan.[27]

The court's heavy reliance on the existence of a recourse provision raises two interesting questions. First, it is not clear whether, or to what extent, this represents a change in existing law. Several district court of appeal cases found that, "[T]he giving of a guaranty is simply an item of testimony or evidence which the trial court may

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court's heavy reliance in *West Pico* on *Milana* and several other cases which were decided under the general usury laws indicates the extent of this interrelationship.

25. 27 Cal. 2d 335, 163 P.2d 869 (1945). The facts of this case were similar to those in *West Pico*. Mrs. Milana required immediate funds in order to continue the operation of her business. The Credit Discount Company offered to render financial assistance through a "sales agreement" by purchasing all of her accounts receivable in separate schedules at discounts of 2 and 2½% of face value less any customer's discount. Mrs. Milana was required to unconditionally guarantee payment of every account within 60 days after assignment and a reserve account was held for this purpose. In practice, however, accounts not so paid were returned to Mrs. Milana and "repurchased" by Credit Discount at further discounts. Mrs. Milana gave notice of assignment to her customers and was obligated to transfer all collections to defendant. *Id.* at 337-39, 163 P.2d at 870-71.

26. "A sale is the transfer of the property in a thing for a price in money. The transfer of the property in the thing sold for a price is the essence of the transaction. The transfer is that of the general or absolute interest in property as distinguished from a special property interest. A loan, on the other hand, is the delivery of a sum of money to another under a contract to return at some future time an equivalent amount with or without an additional sum agreed upon for its use; and if such be the intent of the parties the transaction will be deemed a loan regardless of its form."

2 Cal. 3d at 603, 469 P.2d at 671-72, 86 Cal. Rptr. at 799-800, *quoting* 27 Cal. 2d at 339, 163 P.2d at 871.

In *Milana* the court continued:

> In a sale the delivery of the absolute property in a thing and the receipt of a price therefor consummate the transaction. In a loan the initial transaction creates a debit and credit relationship which is not terminated until replacement of the sum borrowed with agreed interest.

27 Cal. 2d at 339, 163 P.2d at 871.

27. In *West Pico* the court stated that the alleged seller's obligations of full recourse, the repurchase of delinquent contracts, and the collection of all sums due under the contracts with daily remittance to the buyer "seem to be unusual if not incongruous in an agreement providing for an outright sale of conditional sales contracts."

consider in determining whether the transaction is in fact a loan, or, what it purports to be, a purchase and sale of a negotiable instrument."[28]

While *West Pico* cannot be read for the proposition that the existence of recourse is *prima facie* evidence of a loan, the heavy reliance of the court on that factor seems to increase its importance beyond the "item of testimony" category. Thus the earlier cases can no longer be regarded as definite authority on this question in the area of accounts receivable financing.

Secondly, it is not clear whether the extra emphasis given to the recourse provision will, or should, be the rule in all cases. *West Pico* and *Milana* both involved transfers of accounts receivable. The rule that the giving of full recourse is simply one item of evidence was established in *O.A. Graybeal Co. v. Cook*[29] in 1931. This case involved not the transfer of accounts receivable, but real estate financing,[30] a substantially different type of transaction. In real estate sales transactions, recourse, in the sense of security devices, is common. In the financing of accounts receivable, however, the traditional purchase

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2 Cal. 3d at 604, 469 P.2d at 672, 86 Cal. Rptr. at 800.

In *Milana* the court held:

> The significant fact is that if the defendants had really purchased the accounts and had taken absolute title there would be no occasion for the provision or practice relating to gnaranties of payment within specified periods, or reversions of title and repurchase in the event of delayed payment by the customer.

27 Cal. 2d at 342, 163 P.2d at 872.

28. O.A. Graybeal Co. v. Cook, 111 Cal. App. 518, 531, 295 P. 1088, 1093 (3d Dist. 1931); *accord*, Advance Indus. Fin. Co. v. Western Equities, Inc., 173 Cal. App. 2d 420, 429, 343 P.2d 408, 413 (2d Dist. 1959); Refinance Corp. v. Northern Lumber Sales, 163 Cal. App. 2d 73, 80, 329 P.2d 109, 113 (2d Dist. 1958).

29. 111 Cal. App. 518, 295 P. 1088 (3d Dist. 1931).

30. Plaintiffs were the owners of a large tract of land subject to a mortgage executed by the previous owner to secure three promissory notes totalling $267,380. These notes carried interest at 6½% per annum and were held by the Associated Oil Co. which refused to go along with plaintiffs' plans for developing the property. Because they had already sold several lots in the tract without Associated's approval, it became urgent for plaintiffs to pay off the prior notes or have them assigned to someone willing to cooperate with them before Associated foreclosed on all the lots, including those already sold.

Defendant was willing to purchase the notes but demanded a $50,000 fee to induce it to do so. In addition, the plaintiffs were required to guarantee the payment of the three notes assigned by Associated and were to pay interest at 7% per annum on all of them as well as on a note for the $50,000 fee. The notes were then purchased from Associated by defendants.

The court did not elaborate on its reasoning in finding that this transaction constituted a sale rather than a loan. It simply inferred that it was satisfied on the facts that it was not the intent of defendants to make a loan in violation of the usury law. *Id.* at 528-29, 532, 295 P. at 1092-93, 1094.

(factoring) has been outright, with no recourse at all.[31] Financing of accounts receivable with recourse is apparently even regarded in the trade as lending.[32] Thus, the existence of recourse in accounts receivable transactions is so unusual that it does offer stronger evidence that the transaction is, in fact, a loan, whereas in the case of real estate sales, a guaranty of payment by the seller is a common occurence. Further, as in *Graybeal*, when the mortgagor or trustor in a deed of trust guarantees a purchaser of the obligation the payment of the debt which he owes to another, there is certainly no question of recourse to the seller of the note. All that has transpired is that the party who owes the debt has reaffirmed his promise to pay. On the other hand, even if the seller does act as the debtor's guarantor a loan cannot be assumed.[33] Such a personal guaranty of a single obligation cannot be equated with a blanket guaranty of hundreds or thousands of individuals with small personal debts.

*West Pico*, then, may be read as support for a distinction between the weight which should be given to a recourse provisions depending on the nature of the transaction at issue.[34] To this extent the decision will serve as a guide to analysis in future cases. It is, however, unfortunate that the court did not hold that the element of recourse is prima facie evidence of a loan in transactions involving accounts receivable. A decision holding that this element is fatal to the "sale" would have introduced some certainty into this area of the law[35] and would be justified by the practice in the trade. However, the court's opinion in *West Pico* does show that full recourse financing is definitely risky even though not per se a loan.

At the very least the element of recourse is strong evidence of the intent to make a loan. Its absence tends to show the absolute transfer of the obligation for a price which consummates the transaction

31. *See* Note, *Accounts Receivable Financing and the California Personal Property Brokers Act*, 14 STAN. L. REV. 520, 520-21 (1962); Boas, *Legal and Economic Aspects of Accounts Receivable Financing and Factoring*, 28 CAL. ST. B.J. 381 (1953).

32. *See* Note, *supra* note 31, at n.6. *But cf.* Boas, *supra* note 31.

33. The guarantor is actually "little more than additional security" for the debt. J. HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS 309 (1970). *See also* Hetland, *Deficiency Judgment Limitations in California—A New Judicial Approach*, 51 CALIF. L. REV. 1, 23 (1963). His function in the transaction is no different than the mortgage or deed of trust and is even more restricted since the guarantor is not protected by California's deficiency statutes. *Id.*

34. This distinction has not been drawn to date. Advance Indus. Fin. Co. v. Western Equities, Inc., 173 Cal. App. 2d 420, 343 P.2d 408 (2d Dist. 1959) and Refinance Corp. v. Northern Lumber Sales, 163 Cal. App. 2d 73, 329 P.2d 189 (2d Dist. 1958) both involved accounts receivable financing and both relied on *Graybeal*.

35. "Accounts receivable financing is an uncertain area in the usury law and no exact tests have been formulated." Baruch Inv. Co. v. Huntoon, 257 Cal. App. 2d 485, 492, 65 Cal. Rptr. 131, 136 (1st Dist. 1967).

and differentiates a sale from a loan.[36] Its presence indicates that the transaction is not yet closed and that the seller may well owe a debt to the buyer.[37]

Another significant factor to consider in the sale-loan cases is the negotiations and prior arrangements of the parties.[38] The facts that West Pico had specifically sought to have the transactions carried out as loans with the sales contracts as collateral,[39] that this was the mode of financing utilized by the old company and the Bank of America,[40] and that Pacific demanded "protection" of its money by requiring full recourse in side letters,[41] all suggest the intentions of both parties to engage in loan transactions.

In the recent case of *Burr v. Capital Reserve Corp.*[42] the negotiations and prior arrangements of the parties were the basis of the court's decision. Capital was in the business of purchasing and leasing personal property. Burr contacted two of Capital's officers seeking help in obtaining equipment needed to open a family billiard parlor. They agreed to purchase the necessary equipment and lease it to Burr under certain conditions. Burr would choose the equipment he desired. Capital would borrow money from a bank with some of Burr's other property as collateral and then would purchase the property in its own name and have it delivered to Burr. Burr would make specified monthly rental payments for a period of months at which time either the lease would expire and the property would be returned to the lessor, or the lease would be renewed, or the lessee would purchase the property. If Burr defaulted on his payments, Capital could immediately terminate the lease, declare all payments under it due and payable, and repossess the property.[43] The parties carried out two transactions under these arrangements.

Burr's desire to expand his business led to a third transaction. In order to obtain money, Burr sold some of his own equipment to Capital and leased it back.[44] Capital told Burr that under such a sale

36. *See* Milana v. Credit Discount Corp., 27 Cal. 2d 335, 339-40, 163 P.2d 869, 871 (1945).

37. *Id.*

38. *See* West Pico Furniture Co. v. Pacific Fin. Loans, 2 Cal. 3d 594, 604, 469 P.2d 665, 672, 86 Cal. Rptr. 793, 800 (1970).

39. *Id.*

40. *Id.*

41. *Id.*

42. 71 Cal. 2d 983, 458 P.2d 185, 80 Cal. Rptr. 345 (1969).

43. *Id.* at 984-86, 458 P.2d at 186-87, 80 Cal. Rptr. at 346-47.

44. Burr was paid $15,075 for this equipment and was to pay back in "rentals" $1,675 on execution of the agreement plus 24 monthly payments of $787.25 each, a total of $20,469. This would yield Capital a rate of return of approximately 17% per

and lease-back arrangement he could get a much higher percentage of the value of the property than if he pledged it as security for a regular loan.[45] The question before the court was whether these arrangements constituted bona fide leases of personal property or were disguised loans.

Basing its opinion upon an "inquiry into the circumstances under which the leases were negotiated,"[46] the court found that the first two transactions were valid leases of personal property with options to purchase but that the third was in fact a disguised and usurious loan.[47] The parties never expected Burr to give up possession of the items.[48] He merely received cash and promised repayment in the form of future rentals. There was no absolute tranfer of goods planned or executed, and a debtor-creditor relationship was created which would not terminate until Burr had repaid the sum paid to him with interest.

*Janisse v. Winston Investment Co.*[49] is another case in which the negotiations of the parties clearly reflected the intention to make a loan. The defendants had orally agreed to lend the plaintiffs $3,055 but desired to do so at an excessive rate of interest.[50] In order to mask this usurious loan both parties agreed that plaintiffs would execute a not secured by a deed of trust to one Gudmundson for a fictitious payment to them of $4,700. Gudmundson then "assigned" the note and deed of trust to defendants who paid the $3,055 which was then transferred to plaintiffs. The court saw through this dummy payee scheme and found that the parties had executed a usurious loan.[51]

There are numerous other cases in which the parties have carried on negotiations and devised schemes to avoid the usury law.[52] In each of them the courts have pierced the form of the transaction and discovered the true intent of the parties through what they said and did prior to the transfer of money.[53]

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annum. Burr retained possession of the property at all times in spite of the "sale" and assigned additional property as "collateral" for the payment of the "rentals." *Id.* at 986-87, 458 P.2d at 187-88, 80 Cal. Rptr. at 347-48.

45. *Id.* at 986-87, 458 P.2d at 187, 80 Cal. Rptr. at 347.

46. *Id.* at 989-90, 458 P.2d at 189, 80 Cal. Rptr. at 349.

47. *Id.* at 994-95, 458 P.2d at 192-93, 80 Cal. Rptr. at 352-53.

48. See note 44 *supra.*

49. 154 Cal. App. 2d 580, 317 P.2d 48 (1st Dist. 1957).

50. *Id.* at 583, 317 P.2d at 50-51.

51. *Id.*, 317 P.2d at 51.

52. *E.g.*, Rosemead Co. v. Shipley Co., 207 Cal. 414, 278 P. 1078 (1929); Harris v. Pollack, 101 Cal. App. 2d 26, 224 P.2d 824 (2d Dist. 1950); Smith v. G. Cavaglieri Mortgage Co., 111 Cal. App. 136, 295 P. 366 (3d Dist. 1931).

53. *See, e.g.*, Smith v. G. Cavaglieri Mortgage Co., 111 Cal. App. 136, 295 P. 366 (3d Dist. 1931), where the parties agreed to "sell" a note at a large discount

Frequently the courts have examined the terms of the alleged sale or the practice of the parties in carrying out the transaction.[54] In *West Pico*, for example, the court considered the plaintiff's obligation to collect all the accounts and remit them daily to Pacific,[55] Pacific's failure to check the credit ratings of any of West Pico's customers,[56] and the disregard of the ten percent limitation on West Pico's liability[57] as indicative of a loan transaction.[58]

Thus, the characterization of a transaction as a loan or a sale involves a balancing of many factors. In many cases the court's finding could probably go either way. If the court can find an intent to make a loan, however, it must restrict the parties to the boundaries of the usury law regardless of the form of the transaction. While it may be argued that in a tight money market lenders should be given leeway in their transactions in order to facilitate the flow of money to those desiring and needing loans, this is a subject for legislative and not judicial control.[59] Manipulative devices, such as the characterization of loans as sales or leases are poor substitutes for allowing lenders to operate freely in the money market without the risk of a charge of usury and its attendant threat of treble damages and criminal sanctions.

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through an intermediate "lender" who was not to pay any consideration for it so that the debtor and the "buyer" could enter into a usurious loan.

54. *E.g.*, Milana v. Credit Discount Co., 27 Cal. 2d 335, 163 P.2d 869 (1945); Rosemead Co. v. Shipley Co., 207 Cal. 414, 278 P. 1038 (1929); Advance Indus. Fin. Co. v. Western Equities, Inc., 173 Cal. App. 2d 420, 343 P.2d 408 (2d Dist. 1959).

55. 2 Cal. 3d at 604, 469 P.2d at 672, 86 Cal. Rptr. at 800.

56. *Id.*

57. *Id.* at 604-05, 469 P.2d at 672, 86 Cal. Rptr. at 800.

58. In cases dealing with the financing of accounts receivable, notification to the conditional vendees of the transfer of the accounts has also been considered a factor of some importance. In Baruch Inv. Co. v. Huntoon, 257 Cal. App. 2d 485, 493, 65 Cal. Rptr. 131, 136 (1st Dist. 1967) the court stated:

> A loan may be found even if the 'buyer' gives notice and collects the debts. . . . But notice of assignment and collection by the 'buyer' are evidentiary factors for the trier of fact to consider in making its determination. Notification normally indicates a sale, and non-notification normally indicates a loan.

In *West Pico* notification was given even though the seller continued to collect the accounts. This factor, however, was not given much weight by the court.

59. The California Legislature responded to this problem by proposing a constitutional amendment which would have exempted loans over $100,000 made to corporations or partnerships from all interest limitations. This measure appeared as Proposition 10 on the November 3, 1970 statewide ballot, but was defeated by a majority of California's voters. S.F. Chronicle, Nov. 5, 1970, at 10, cols. 5-6.

Proposition 19, which changed the present misdemeanor penalty provisions of the general usury law [[1919] Cal. Stat. lxxxiii], to felony provisions for unlicensed or nonexempted persons making loans providing for interest in excess of statutory limits, was also the result of legislative initiative. It was passed by an overwhelming majority at the same election. S.F. Chronicle, Nov. 5, 1970, at 10, cols. 5-6.

## II. THE LARGE LOAN EXEMPTION OF THE PERSONAL PROPERTY BROKERS ACT

After determining in *West Pico* that the transactions involved were disguised loans, the court was faced with the question of whether the rates charged on the loans by Pacific, which were in excess of those permitted by the Act,[60] voided the transactions.[61] The court held that Pacific was exempt from any limitations by virtue of the statutory exemption from the fee limitations of the Act for any "bona fide loan of a principal amount of five thousand dollars" contained in section 22053.[62]

The key issue in this regard was the meaning of the *bona fide* phrase of the statute. West Pico argued that the phrase modified *loan* and that Pacific's use of evasion tactics precluded its reliance on the exception.[63] Pacific argued that the phrase modified the amount of the loan and that " 'the only test of bona fide is whether in fact the borrower received a principal sum of $5,000 or more.' "[64] The court agreed with Pacific that the form in which the transaction is carried out is not important. It relied upon the definition of section 22053 supplied by the Legislature in later enacted section 22054[65] and affirmed

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60. CAL. FIN. CODE § 22451 (West 1968); see note 3 *supra.* Pacific Finance did not dispute the trial court's findings that the rates charged were in excess of those permitted by this section.

61. CAL. FIN. CODE §§ 22650-52 (West 1968) deal with the effects of loans which violate the interest provisions of the Act. For the text of these sections see note 3 *supra.* See also note 13 *supra.*

62. At the time of the transactions involved this section provided that the interest limitation sections (among others) of the Act:

> [D]o not apply to any bona fide loau of a principal amount of five thousand dollars ($5,000) or more or to a duly licensed personal property broker in connection with any such loan, if the provisions of this section are not used for the purpose of evading [the Act] . . . .

CAL. FIN. CODE § 22053 (West 1968).

A 1967 amendment [ch. 533, § 1, 1967 Cal. Stat. 1884] to this section added additional sections of the Act to the list of those made inapplicable under the provisions of section 22053, but these are not relevant to this discussion.

63. 2 Cal. 3d at 607, 469 P.2d at 674, 86 Cal. Rptr. at 802.

64. *Id.* at 607, 469 P.2d at 674-75, 86 Cal. Rptr. at 802-03.

65. CAL. FIN. CODE § 22054(c) (West 1968) clearly encompasses the types of transactions involved in *West Pico.* It provides:

> In determining under Section 22053 whether a loan is a bona fide loan of a principal amount of five thousand dollars ($5,000) or more and whether the provisions of that section are used for the purpose of evading this division, the following principles apply:
>
> . . . .
>
> (c) If a loan made by a licensed personal property broker is in a principal amount of five thousand dollars ($5,000) or more, the fact that the transaction is in the form of a sale of accounts, chattel paper, contract rights, goods or instruments or a lease of goods shall not be deemed to affect the bona fides of the loan or the amount thereof or to indicate that the provisions of Section 22053 are used for the purpose of evading this division.

the construction given to the section in a recent decision by a court of appeal.[66]

This construction is consistent with the obvious purpose and legislative history of section 22053. Section 22053 was enacted primarily to allow parties to relatively large transactions to bargain freely in regard to interest, finance charges and fees.[67] The report of the committee appointed by the California Assembly in 1933 to investigate commercial loans and to recommend legislation shows the Legislature's basic concern with the regulation of small loans only.[68] This report recommended the classification, later adopted by the legislature, of loans by personal property brokers into two categories. Small loans would be subject to regulations and restrictions. Large loans would be exempt.[69]

This classification is consistent with the basic policy of our usury laws. Interest limitations are imposed to protect the needy, who are unable to protect themselves from the superior bargaining power of rapacious lenders.[70] Such laws are not meant to prevent or regulate free bargaining between speculators, real estate developers and other

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As used herein, 'accounts,' 'chattel paper,' 'contract rights,' 'goods' and 'instruments' shall have the same meaning as in the Commercial Code.

This section shall be deemed declaratory of existing law and not amendatory thereof.

This section was enacted in 1967 and would thus govern all transactions of this type after its effective date regardless of the court's holding in the instant case. Although the court could have relied entirely upon the legislature's declaration that section 22054 was to be declaratory of existing law it specifically found this expression not binding on it and chose to treat it as another factor in determining the meaning of section 22053. 2 Cal. 3d at 609-10, 469 P.2d at 676-77, 86 Cal. Rptr. at 804-05.

66. Riebe v. Budget Fin. Corp., 264 Cal. App. 2d 576, 70 Cal. Rptr. 654 (2d Dist. 1968):

> Section 22054, enacted in 1967, makes clear that the terms 'bona fide' and 'purpose of evading this section' used in section 22053 refer to the determination of the amount of the loan and not the character of the security given therefor. Section 22054 is consistent with a prior judicial interpretation of a provision similar to section 22053 contained in the Industrial Loan Law.

*Id.* at 582-83, 70 Cal. Rptr. at 657-58, *citing* Peoples Fin. & Thrift Co. v. Mike-Ron Corp., 236 Cal. App. 2d 897, 46 Cal. Rptr. 497 (4th Dist. 1965) (citations omitted).

67. *See Report of the Assembly Interim Comm. for the Investigation of Small Loans*, ASSEMBLY J., Mar. 22, 1935, at 1304-06 [hereinafter cited as *Assembly Report*]; Carter v. Seaboard Fin., 33 Cal. 2d 564, 578-88, 203 P.2d 758, 767-73 (1949); *cf.* 5 OP. CAL. ATT'Y GEN. 196 (1945).

Proposition 10 [see text at note 59 *supra*] also appeared to be designed for this purpose in regard to loans in excess of $100,000 to partnerships and corporations which are not within the Act.

68. *Assembly Report* 1297.

69. *Id.* at 1298, 1304-06.

70. Wooton v. Coerber, 213 Cal. App. 2d 142, 148, 28 Cal. Rptr. 635, 638-39 (2d Dist. 1963); *see* Carter v. Seaboard Fin., 33 Cal. 2d 564, 588, 203 P.2d 758, 773 (1949).

experienced businessmen and financial institutions capable of making large loans.[71]

The court in *West Pico* rejected the contention that the transactions constituted one loan of $2,971,505.15.[72] However, it did not treat them as entirely separate transactions. Forty-five of the 371 bundles of accounts involved amounts of less than $5,000.[73] These the court regarded as individual advances " 'pursuant to a revolving loan agreement or similar agreement' "[74] by which large amounts were continuously being advanced and owing, and concluded that "as a matter of law each of the loan transactions was a bona fide loan of a principal amount of $5,000 or more."[75] The court could find no purpose to evade the Act in these transactions[76] and thus held they were exempted from the limitations of the Act under section 22053.[77]

This construction of section 22053 unquestionably relieves some of the pressure to evade the usury law through manipulation in form in the personal property area. Duly licensed personal property brokers are free to work out the details of large transactions (those in excess of $5,000) without the worry of the application of the limitations of the Personal Property Brokers Law.

## CONCLUSION

The sale-loan dichotomy will still continue to plague the courts, lenders, and borrowers as the court has chosen to continue its case-by-case analysis rule with the broad standards discussed above.[78] The court might have held that full recourse is a fatal element in order to introduce some certainty into this area of law. In light of the lower appellate courts' rule that recourse is only a matter of testimony,[79] lenders intent on insuring a definite return on their money will undoubtedly continue to use full recourse provisions. However, *West Pico* and *Milana* make such an agreement quite risky.

In today's tight money market the pressure to charge and pay interest rates in excess of the statutory limits is high. With the defeat of

71. *Cf.* Wooton v. Coerber, 213 Cal. App. 2d 142, 148-49, 28 Cal. Rptr. 635, 638-39 (2d Dist. 1963).

72. 2 Cal. 3d at 611-12, 469 P.2d at 678, 86 Cal. Rptr. at 806: "there was a loan for each 'bundle' of contracts transferred and assigned to Pacific."

73. *Id.* at 612, 469 P.2d at 678, 86 Cal. Rptr. at 806.

74. *Id.*

75. *Id.*

76. *Id.* at 613, 469 P.2d at 679, 86 Cal. Rptr. at 807.

77. *Id.*

78. See text accompanying notes 26-58 *supra.*

79. See text accompanying note 28 *supra.*

Proposition 19 at the November 3, 1970 general election[80] there will continue to be no legitimate way for lenders not exempt from the California usury law to make such loans without being subject to its penalties. For this reason the characterization of transactions as sales rather than loans will continue to be a favorite means of attempting to avoid the usury laws. Until at least some definite guidelines are set out in this area the sale-loan dichotomy will continue to be a source of much litigation.

*J.E.M.*

80. See note 59 *supra.*