III.
COMMERCIAL LAW

UNRUH ACT COVERAGE EXTENDED TO LENDER WITH CLOSE CONNECTION TO INSURANCE BROKER

King v. Central Bank. The California Supreme Court ruled that a bank extending credit for the purchase of insurance by a consumer may be liable, as a "provider" of insurance, for violations of the Unruh Act and Federal Truth in Lending Act provisions pertaining to credit sales of goods or services. Relying on liberal pleading rules and the doctrine of substance over form, the court ruled that allegations that the lender is "intimately linked" to the insurance purchase transaction through its close connection with the broker, its direct role in arranging and supervising the transaction, its dictation of the terms of the insurance policy, and its retention of substantial control over and an interest in the insurance policy sold would sustain a consumer complaint under these laws on the basis that the transaction was a credit installment sale despite its documentation as a loan.

The substance over form approach to consumer credit transactions is not new. It has been regularly applied by the California courts in consumer credit cases in recent years. King, however, is the first case addressing the

1. 18 Cal. 3d 840, 558 P.2d 857, 135 Cal. Rptr. 771 (1977) (Richardson, J.) (unanimous decision).
4. 18 Cal. 3d at 843, 558 P.2d at 858, 135 Cal. Rptr. at 772.
5. Id. at 847, 558 P.2d at 860, 135 Cal. Rptr. at 774.
6. Id. at 845, 558 P.2d at 859, 135 Cal. Rptr. at 773.
7. Id. at 846-47, 558 P.2d at 860, 135 Cal. Rptr. at 774. In emphasizing substance over form and finding that an adequate cause of action had been stated by plaintiffs, the court effectively vitiated the rule of Washer v. Bank of America, 21 Cal. 2d 822, 829-30, 136 P.2d 297, 302 (1943), overruled on another point, MacLeod v. Tribune Publishing Co., 52 Cal. 2d 536, 551, 343 P.2d 36, 44 (1959), when consumer credit contracts are at issue. The Washer doctrine stated:

The general rule is that when a written instrument which is the foundation of a cause of action or defense is attached to a pleading as an exhibit and incorporated into it by proper reference, the court may, upon demurrer, examine the exhibit and treat the pleader's allegations of its legal effect as surplusage.

Id. In King the court of appeal did just that, discounting plaintiff's claim that the bank "provided" insurance under the contract, in the absence of allegations connecting the bank or broker with the insurer. King v. Central Bank, 127 Cal. Rptr. 487 (1st Dist. 1976).
responsibilities of a related lender extending credit directly to the consumer.\textsuperscript{9} Despite the unique characteristics of insurance premium financing transactions that might otherwise narrow the import of King, the court rendered its opinion in broad language accompanied by a sweeping dictum opening the possibility that all loans extended for the purchase of consumer goods or services will be held to be within the Unruh Act.\textsuperscript{10}

This Note first summarizes the King opinion, describing the background of the transaction and the history of the case. It then analyzes the court’s construction of “providing” under the Unruh Act in light of earlier California cases protecting consumer interests. An attempt is made to flesh out the analysis of the allocation of risks and benefits, suggesting that in the context of the Unruh Act, the search for substance should be a search for the source of the party’s profits. The Note then discusses the court’s expansive dictum, and concludes with an analysis of how recharacterization of an insurance premium financing transaction affects the major goals of consumer protection.

I. Summary of the Case

The parties in King entered into an insurance premium financing transaction. This type of transaction developed in response to rapidly rising insurance costs coupled with the reluctance of most insurers to allow payment in monthly installments,\textsuperscript{11} and now constitutes a substantial industry in California.\textsuperscript{12} The Insurance Premium Financing Act regulates premium finance agencies and industrial loan companies that make such transactions.\textsuperscript{13}

\textsuperscript{9} For a discussion of the previous cases, see notes 30-40 infra and accompanying text.

\textsuperscript{10} 18 Cal. 3d at 844-45, 558 P.2d at 858-59, 135 Cal. Rptr. at 772-73. As discussed below, see text accompanying notes 17 & 48 infra, the facts in King involve allegations of a close connection between the bank and the broker. There were no allegations of connection with the insurer. If a lender can be held liable as a provider/seller for its close connection with only the broker, however, it follows that a close connection with the seller would also result in liability. Hence, the holding in King is directly applicable to buyer-seller-lender transactions not involving brokers.


\textsuperscript{12} As of December 31, 1976, $17,497,878 in loans were outstanding from California's insurance premium financing companies. CALIFORNIA DEP’T OF CORPORATIONS, 1976 ANNUAL REPORTS FOR CALIFORNIA CONSUMER FINANCE LAWS 40 (1976). Amicus curiae, Chartered Bank of London, estimated the amounts outstanding from commercial banks, whose figures are not included in the state reports, to be at least twice that of the insurance premium finance agencies. This estimate was based on the 1974 Report, which listed almost $35,000,000 outstanding. Brief of the Chartered Bank of London as Amicus Curiae in Support of Respondent at 5 n.1, King v. Central Bank, 18 Cal. 3d 840, 558 P.2d 857, 135 Cal. Rptr. 771 (1977).
loans. Banks are not covered by the Act, but the transaction into which Central Bank’s subsidiary had entered was, with the exception of claims concerning control and finance charges, substantially similar to the standard insurance premium financing transaction governed by that act.

The plaintiffs in *King* alleged that the financing transaction contained the following elements:

1) Borrower paid Bank a 20% downpayment;
2) Bank held the policy, with the right to cancel, as security;
3) Borrower paid installments directly to Bank;
4) Bank supplied printed contract forms to Broker;
5) Broker required its credit customers to finance through Bank;
6) Bank exercised substantial control over Broker in determining the types, conditions, and terms of policies that would be purchased on credit;
7) Bank established the terms of the policy and the credit sale;
8) Broker was a conduit for installment contracts with Bank;
9) Bank shared the profits from its contracts with Broker;
10) Bank paid a fee to Broker for all purchases procured by him that met its requirements;
11) Bank and Broker engaged in the retail sale of insurance for credit;

13. CAL. FIN. CODE §§ 18560, 18565, 18594 (West Supp. 1977). The Act provides a comprehensive set of regulations for such transactions. In addition to extensive disclosure requirements, *id.* §§ 18589, 18605-18606, it specifies minimum and maximum finance charges and default charges. *Id.* §§ 18626-18627, 18631. Many other lenders are precluded from insurance premium financing because of legislative restrictions on the types of security they may hold. *See* e.g., *id.* §§ 21000 (pawnbrokers), 22009 (personal property brokers) (West 1968).

14. 18 Cal. 3d at 847, 558 P.2d at 861, 135 Cal. Rptr. at 775. *See* CAL. FIN. CODE §§ 29000-29003 (West Supp. 1977) covering insurance premium financing, but not limited to premium finance agencies and industrial loan companies.

15. The main differences were the claims that the bank controlled the transaction and the terms of the insurance policy, and that the finance charge was excessive. The complaint alleged that the finance charge exceeded the Unruh Act limit. 18 Cal. 3d at 842, 558 P.2d at 858, 135 Cal. Rptr. at 772. In addition, the plaintiffs argued to the supreme court that the finance charge exceeded the somewhat higher, though not controlling, Insurance Premium Financing Act ceiling. *Reply of Appellants to Amicus Curiae Brief of the Chartered Bank of London at 6, King v. Central Bank, 18 Cal. 3d 840, 558 P.2d 857, 135 Cal. Rptr. 771 (1977).*

16. In the standard insurance premium financing transaction, the consumer pays a substantial downpayment (usually 20%) to the lender and agrees to pay the balance of the amount financed plus a finance charge to the lender in installments. The lender takes a security interest in the policy with the right to cancel it in the event of nonpayment. Any payment by the insurer is applied first to the balance owed to the lender, with any remainder refunded to the insured. In the event of default by the consumer, the lender cancels its obligation to the insurer for the unearned premiums. In California and the other states that regulate this industry, there are comprehensive provisions requiring notice to the consumer upon default, and refund of the unearned premiums and finance charges. CAL. FIN. CODE §§ 18630-18631 (West Supp. 1977); CAL. INS. CODE § 778.1 (West 1972); *see* e.g., LaBarre, *The Mortgage Bank-Industrial Loan Company: An Anomaly in the Usury Law*, 11 CAL. W. L. REV. 562 (1975); Comment, *Insurance Premium Financing*, 19 BUFFALO L. REV. 656 (1970).
12) Plaintiffs purchased an insurance policy from Bank and Broker;

13) Broker engaged in selling insurance on credit.\(^\text{17}\)

The trial court sustained a demurrer by Central Bank and overruled a demurrer by the broker to two causes of action alleging violations of the disclosure and maximum finance charge provisions of the Unruh Act and violations of the credit sale provisions of the Unruh Act and the Federal Truth in Lending Act (TILA).\(^\text{18}\) The court of appeal affirmed, stating that although its inquiry was not restricted to the written contract, it would not ignore the plain terms of the "Insurance Premium Financing Installment Note, Security Agreement and Disclosure Statement" in the absence of allegations that plaintiffs' agreement with the bank consisted of something more than what the written document contained.\(^\text{19}\) It went on to say that while a lender may be subjected to applicable disclosure and liability statutes if sufficient facts are alleged to show a close relationship between the lender and the seller, no such facts could be found in the complaint.\(^\text{20}\)

\(^{17}\) 18 Cal. 3d at 842, 844-47, 558 P.2d at 857-60, 135 Cal. Rptr. at 771-74. Certain of the allegations are presented ambiguously in the supreme court opinion. For clarification see the First Appellate District Court's opinion at 127 Cal. Rptr. 487 (1976).

\(^{18}\) Disclosures had been made to comply with the Truth in Lending disclosure requirements for consumer loans but not with the stricter credit sale provisions. King v. Central Bank, 127 Cal. Rptr. at 491 n.2 (1st Dist. 1976). Plaintiffs also disputed whether the disclosures met the consumer loan standard. Plaintiff's Petition for Hearing at 23-24, King v. Central Bank, 18 Cal. 3d 840, 558 P.2d 857, 135 Cal. Rptr. 771 (1977).

A second ground for the trial judge's ruling was his determination that "the sale of insurance by installment payments is not a transaction within the purview of the Unruh Act."\(^\text{127}\) Cal. Rptr. at 489. This conclusion resulted from the lack of punctuation in the clause in CAL. CIV. CODE § 1802.2 (West 1973) that reads "'Services' means work, labor and services, for other than a commercial or business use, including services furnished in connection with the sale or repair of goods as defined in Section 1802.1 or furnished in connection . . . with the improvement of real property [ ] or the providing of insurance, . . ." [brackets added to indicate lack of comma]. The lack of a comma had led to an opinion from the legislative counsel to the author of the Act expressing his opinion that as phrased, the Act applied to services provided in connection with the providing of insurance, but not to the providing of insurance itself. The court of appeal disagreed, relying on an opinion of the California Attorney General reasoning that the costs of any service offered in connection with the providing of insurance would be so small that installment payment for the service would be highly unlikely. Hence it was unreasonable to conclude that the language did not include the provision of insurance itself. Otherwise the language would be virtually meaningless. 127 Cal. Rptr. at 491; 50 Op. CAL. ATT'Y GEN. 110, 113 (1967). See note 78 infra.

\(^{19}\) 127 Cal. Rptr. at 492.

20. The court of appeal stated that under Glaire v. La Lanne-Paris Health Spa, Inc., 12 Cal. 3d 915, 528 P.2d 357, 117 Cal. Rptr. 541 (1974), a lender alleged to be closely related to the seller could be "treated as a party to the sales transaction and subjected to applicable disclosure and liability statutes thereby." 127 Cal. Rptr. at 492. It concluded, however, that even though the complaint contained conclusory allegations that the defendants were retail sellers, it was fatally defective for failing to allege facts indicating that the defendants sold insurance to plaintiffs, and for failing to allege any relationship between the defendants and the insurer. It held that in the absence of allegations of agency between the defendants and the insurer, it would not presume such a relationship, noting that insurance brokers (as opposed to insurance agents) are generally the agents of the insured rather than the insurer. Id. at 492 n.3; CAL. INS. CODE § 33 (West 1972).
The supreme court reversed, expressing its concern that the transaction would be unregulated unless put within the purview of the Unruh Act. It found the allegations sufficient to infer that the bank and the broker were "jointly engaged in the business of 'providing' automobile insurance within the meaning of section 1802.2," using the substance over form and close connection doctrines to reach this conclusion. In addition, it suggested that insurance premium financing in general might constitute a "service" under the Act. Finally, the court held that a cause of action was stated under TILA, relying on TILA's definition of credit sale as "any sale with respect to which credit is extended or arranged by the seller," and on the Fifth Circuit's disposition of a similar case.

Justice Mosk concurred, repudiating a California Attorney General's Opinion issued when he held that office, which stated that the activities of a lender engaged in insurance premium financing did not fall within the Unruh Act. The portion of the Attorney General's Opinion mentioned by the majority dealt only with the issue of whether the word "services" should be construed to include such extensions of credit. The court had left this question open in its dictum on the point. The tone of its remarks, however, and Justice Mosk's specific statement that the Attorney General's Opinion was incorrect suggests that the court is moving toward the conclusion that such extensions of credit are "services" even in the absence of allegations of close connection.

II. The Court's Construction of "Providing" Insurance

The court stated that the plaintiffs' allegations would, if proven, support a finding that "defendant Roberts [the broker] and bank were jointly engaged in the business of 'providing' automobile insurance within the meaning of section 1802.2." This statement could be read as merely establishing a very liberal pleading rule for consumer complaints, for the

21. 18 Cal. 3d at 845-46, 558 P.2d at 859, 135 Cal. Rptr. at 773.
22. Id. at 844-45, 558 P.2d at 859, 135 Cal. Rptr. at 773.
23. Id. at 848, 558 P.2d at 861, 135 Cal. Rptr. at 775.
25. Stefanski v. Mainway Budget Plan, Inc., 456 F.2d 211 (5th Cir. 1976). Stefanski involved a transaction much like King, with the exception that the customer dealt directly with the insurance company, rather than through an insurance broker. The district court had held that the insurance premium financing transaction consisted of a sale of insurance by the insurer followed by a completely independent loan by the lender. The Fifth Circuit reversed, noting that the plaintiff had alleged that the insurer "arranged" the loan, which if proved would require the insurer to make "credit sale" disclosures. Id. at 212; 15 U.S.C. § 1602(g) (1970). The court noted that such facts as overlapping ownership, requiring customers to finance their premiums only through that specific financier, or substantial profit rebates from the financier to the insurer might establish that the insurer had arranged the credit.
27. See note 72 infra and accompanying text.
28. 18 Cal. 3d at 849, 558 P.2d at 859, 135 Cal. Rptr. at 771.
King complaint actually alleged that the broker and bank "provided" insurance. The breadth of the court's opinion, however, indicates that it intended to do more than state a rule of pleading. Rather, it appears that the court construed the term "providing" in the Unruh Act to encompass a broader category of parties than does the term "sellers" in its traditional sense. To reach this construction the court borrowed two doctrines from previous consumer protection cases—the rule of substance over form and the close connection doctrine.

The rule of substance over form establishes an orientation for examining the problem; it frees the court from the strictures of the parties' documentation in determining the practical effects of a transaction. Alone, however, it lacks any analytical framework for determining how a particular transaction should be characterized. To decide particular cases requires an analysis of the economic results of the specific transaction involved.

In determining that the bank had participated in providing insurance to the consumer, the court referred to a line of precedent beginning in 1950 with Commercial Credit Corp. v. Orange County Machine Works, progressing through Morgan v. Reasor Corp., Vasquez v. Superior Court, Thomas v. Wright, and culminating in Glaire v. La Lanne-Paris Health Spa, Inc. Three of these cases, Commercial Credit, Morgan, and Vasquez, involve preservation of defenses against assignees. In each, the court's concern was with preventing the separation of the buyer's obligation to pay the finance company from the buyer's rights against the seller. Thus the question presented was whether the assignee was sufficiently involved in the original transaction to be charged with knowledge of the customer's claims and defenses.

Thomas and Glaire are somewhat different. Both involved transactions structured and documented to avoid falling within regulatory schemes,
which the courts recharacterized on the basis of their allocation of economic risks and benefits—their substance rather than their form. In *Thomas*, the question was whether an automobile lease was in fact a sale, and thus within the Rees-Levering Act. Because the “lessor” had received benefits equivalent to those involved in an outright sale, and the “lessee” had been saddled with an obligation similar to that of a buyer, the court recharacterized the lease as a sale. *Glaire* involved the recharacterization of a disguised credit transaction for the purpose of subjecting it to the federal Truth in Lending Act and state usury laws. A dance studio sold dance contracts to customers either for a lump sum or on an installment plan, charging the same amount for both the cash and the credit prices. The contracts were systematically discounted to a commonly owned and controlled finance company. The studio and finance company claimed that no credit was involved, because the “time price” was the same as the cash price. The court found that where the vast majority of the customers used the installment plan, the systematic discounting of the seller’s installment contracts to its interlocking finance company constituted a credit transaction “functionally equivalent to extending loans directly to La Lanne’s [the seller’s] customers at a defined rate of interest . . . .” In so doing it noted that the credit risk was shifted to the financer, while the seller obtained a lump sum. The difference between the two was found to constitute the cost of credit to the consumer. The court used the same reasoning, along with the rather opaque usury rule that the “good faith” of the parties is a crucial requirement for the “insulation of discount transactions from usury consideration,” in finding that a usury claim had been stated. Thus, the finance company was recharacterized as a direct lender on the basis of the credit risks and benefits taken in the transaction.

36. The “lessor” had taken a security interest in the “lessee’s” house—a security arrangement prohibited in sales transactions by Rees-Levering. 21 Cal. App. 3d at 922-23, 98 Cal. Rptr. at 875; CAL. CIV. CODE § 2984.2.
37. 21 Cal. App. 3d at 924-27, 98 Cal. Rptr. at 876-78.
38. 12 Cal. 3d at 924, 528 P.2d at 363, 117 Cal. Rptr. at 547.
39. Id. at 927, 528 P.2d at 365, 117 Cal. Rptr. at 549.
40. It remains to be seen how much importance the courts will place on the interlocking structure of the defendants in *Glaire*, i.e. whether they will recharacterize without it. A strict economic approach would dictate recharacterization any time the financer took the credit risk along with the discount. In the previously cited three-party preservation of defenses cases the question of usury claims by a customer did not come up. Commercial Credit was a suit between the seller and financer only; *Morgan* and *Vasquez* did not involve claims of violation of the Unruh Act finance charge limit (which is equal to or lower than the usury limit except in some situations when the monthly charge is less than twelve dollars—see CAL. CIV. CODE § 1805.1 (West 1973)). There are, however, usury cases between sellers and financiers that have addressed the issue of economic shifting. Where financiers have bought installment sale contracts, notes, or accounts at a discount from sellers, yet shifted the credit risk back to the sellers by requiring recourse or buy-backs in the event of delinquency, the court has been quite willing to recharacterize ostensibly financer/purchasers as lenders liable to the seller for any usury law violations. See, e.g., West Pico Furniture Co. v. Pacific Fin. Loans, 2 Cal. 3d 594, 469 P.2d 665, 86 Cal. Rptr. 793 (1970); Milana v. Credit Discount Co., 27 Cal. 2d 335, 163 P.2d 869 (1945).
Even though the cases cited in King involve widely differing facts, they often use the same broad language, failing to articulate why a given test is being employed or its precise limits. Their results, however, generally reflect a differentiation between the lesser degree of connection necessary to preserve defenses and the greater interconnectedness required to recharacterize a party.

Logically, the type of inquiry should depend on the type of restriction being invoked. When preservation of defenses is the issue, it seems fair to bind the assignee if the arrangements for that transaction or a prior course of dealing tend to give notice of the defenses. When disclosure is involved, a crucial fact is the position the party occupies in transmitting information about the transaction to the customer. In contrast, when a statute that regulates the finance charges a seller may impose, such as the Unruh Act, is in issue, the test should encompass a search for the source of the profits taken by the party. This approach is based on the supposition that the varying, and generally higher, interest ceilings allowed consumer lenders in comparison to the Unruh Act ceiling for sellers reflect a recognition that sellers’ primary profits come from the markup of the items sold, whereas lender’s profits are limited to their charges for the use of their money, i.e., finance charges or interest. If that is the case, then it is necessary to ascertain the source of a party’s profits when determining its character for purposes of a statute that limits finance charges.

With the exception of one case not cited by King, Brewer v. Home Owners Auto Finance Co., this approach can be reconciled with the

Yet, the time-price differential doctrine has permitted a seller to charge a much higher credit price than cash price for goods, without the transaction being usurious. Verbeck v. Clymer, 202 Cal. 557, 261 P. 1017 (1927); 50 Op. Cal. Att’y Gen. 110, 111 (1967); see generally, Lowell, A Current Analysis of the Usury Laws A National View, 8 San Diego L. Rev. 193, 220-24 (1971). Glaire may have changed this rule where the seller then discounts to a closely connected financer and receives the price just as if the financer had lent directly to the consumer. See also Legal Problems in Consumer Credit, supra note 2, at 336-41 (noting a similar result in some other jurisdictions). For an historical analysis and criticism of the time-price fiction, see generally Comment, A Comprehensive View of California Usury Law, 6 Sw. U.L. Rev. 166, 215-19 (1974); Note, Commercial Law—Usury and the Time-Price Differential, 1975 Wis. L. Rev. 246, 248-51.

41. Other economic factors can be shifted, and should be addressed when they arise. None appear to have occurred, however, in the King transaction. For example, there were no allegations of an attempt to shift insurance loss liability to the bank, or credit loss exposure to the insurer. Nor were there any shifts with respect to the consumer (a good example of which is described in Thomas, discussed in notes 36 and 37 supra and accompanying text). Therefore, this Note will direct the bulk of its economic analysis to profit shifting—the benefit most clearly implied by the allegations that the bank “engaged in the retail sale of insurance for credit” and that the plaintiffs purchased a policy from it. 18 Cal. 3d at 845, 558 P.2d at 859, 135 Cal. Rptr. at 773.

42. Although the constitutional usury ceiling is similar to the Unruh Act ceiling, most consumer lenders are exempt from the usury restriction and their statutory ceilings, if any, are generally higher than the usury ceiling. See note 113 infra.

43. 10 Cal. App. 3d 337, 89 Cal. Rptr. 231 (2d Dist. 1970). There the court of appeal recharacterized a party in the absence of economic shifting. In Brewer the financing company
results of the cases preceding King. The following section thus first examines whether King can be justified on the basis of the allocation of the economic risks and benefits in the specific transaction. It then examines King's antecedents in the preservation of defenses cases, concluding that neither inquiry uncovers sufficient basis for King's determination that Central Bank was "providing" insurance. Finally, it explores an alternative to the close connection doctrine, focusing on the plaintiff's claims that the bank controlled the terms of the policy.

a. The Allocation of Economic Benefits

Although the court's opinion in King properly invoked the substance over form doctrine, it failed to follow up with any risk-benefit analysis. This failure led the court to find a close connection with the broker sufficient to recharacterize the transaction where it should not have, and resulted in a holding that provides no guidelines for future behavior.

In deciding whether one who is nominally extending credit should be characterized as a lender or as a seller, the inquiry should focus on the source of the profits that the party receives. If its profits are attributable to a markup over the production or wholesale cost of a consumer good or service, the party is actually in the position of a seller. But if the profits obtained by the extender of credit are instead generated solely from the money advanced, it is, in fact, a lender and should not be treated as a seller.

took a security interest in the consumers' improved real property to secure payment on an automobile installment contract, which the financer had purchased from the dealer the same day the consumer entered the original contract. The Rees-Levering Act prohibits taking a security interest in anything but the vehicle sold in any "agreement in connection with a conditional sale of a motor vehicle" and any "agreement between a buyer and a seller." CAL. CIV. CODE § 2984.2 (West 1974). The court affirmed summary judgment for plaintiffs, stating that the sale was made "jointly" by the financer and dealer as "Sellers," and the consumers as "Buyers." It is unfortunate that the court recharacterized the financer as a seller. The financer did not take the risks and profits of a seller. Nor, as the court noted, was the second sentence of § 2984.2 quoted above, from which it apparently drew its reference to buyers and sellers, in effect when the parties entered into the contracts. 10 Cal. App. 3d at 340 n.2, 89 Cal. Rptr. at 232 n.2. Finally, recharacterization was probably not necessary for the result the court reached, because the security agreement taken by the finance company was clearly "in connection" with the sale of the automobile, and thus covered by the first sentence of § 2984.2, which was in effect when the contracts were entered. There is a statutory exemption, added in 1969, for supervised financial organizations other than sellers who make loans to consumers. The financer in Brewer, however, did not rely on this exemption. 10 Cal. App. 3d at 340 n.2, 89 Cal. Rptr. at 232 n.2. The exemption permits such institutions to take security in addition to the vehicle from the consumer even if the seller has referred the consumer to the lender. See CAL. CIV. CODE § 2982.5 (West 1974).

44. Often the terms "sales" and "seller" refer to transactions involving goods, while "providing" or "furnishing" are used with respect to the sale of services, but the characteristics of a "seller" and a "provider" for purposes of Unruh Act coverage are the same. See CAL. CIV. CODE §§ 1802.2-.5 (West 1973).

45. See caveat at note 41 supra.

46. The amount, as opposed to the source, of profits is irrelevant to this analysis (except, as in Thomas, where the amount taken from the consumer and retained by the party is the
The plaintiffs in *King* did not allege any markup profits flowing from the insurer to the bank, so it is difficult to characterize the "substance" of the bank's position as that of a seller. Furthermore, the bank was not in a position to generate profits through dealing in property previously subject to its security interest that had been obtained through the borrower's default. An automobile insurance policy has no resale value; the bank could not refinance it to another customer. Since the bank could recover only unearned premiums by cancelling the policy, it could not derive "sale" profits from the transaction through resale after default.

The allegations concerning the bank's relationship with the broker also fail to supply an economic basis for recharacterizing the bank, for the broker in the sale of an insurance contract does not usually have the attributes of a seller with respect to its ability to shift profits. The broker does not enjoy direct access to the profits accruing from the difference between premiums taken in and claims paid out because, unlike an insurance agent, it is not a part of the insurer.

Under some circumstances a broker might take on the character of a retailer. If a broker received a fee from the customer resulting in a higher cost for the insurance than had it been purchased directly from the insurer, the fee might be analogized to a retail markup, making the broker a seller. Similarly, a fee from the insurer to the broker might also represent a markup if the cost were passed on to the customer by the insurer. If the broker then funneled a portion of such fees to the lender, the lender would have indirectly participated in the profits generated out of the insurance itself, and recharacterization as a seller might be justified. But there were no allegations of this sort in *King*. The plaintiffs did allege that the bank shared its profits from the transaction with the broker. Such claims are irrelevant to the question whether the bank is taking a seller's profit indirectly through the broker; the money is going from the lender rather than to it. Furthermore, an insurance broker does not buy the insurance contract from the insurer nor acquire any other interest in it. The broker merely locates an insurer willing to contract with the consumer and handles the intermediary paperwork. The resulting contract is between the insurer and the insured; the broker takes no equivalent of the purchase price and the issue is whether a "lease" is in fact a sale). If the market permits, an exempt lender might well charge an unconscionable amount of interest; that, however, does not make it a seller. See also Peoples Fin. & Thrift Co. v. Mike-Ron Corp., 236 Cal. App. 2d 897, 46 Cal. Rptr. 497 (4th Dist. 1965).

47. *King* does not mention whether the broker received a fee from the insurer. If such a fee were paid, it is conceivable that it might be passed on by the insurance company in the form of an increased policy price to those who purchase through brokers. On the other hand, the insurer might offer the same price to the customer regardless, much as airlines do with travel agencies. A court might choose to recharacterize if the fee amounted to a substantial portion of the retail cost, and thus appeared to be an attempt to pass on profits, yet not do so if the fee were nominal and clearly tied only to limited services rendered by the broker.

48. Such fee payments are expressly permitted by CAL. FIN. CODE § 29003 (West Supp. 1977), provided that appropriate records are maintained.
interest in the policy premiums or proceeds and no part in drafting the terms of the contract. Thus the broker can shift neither the credit nor the insurance risk. Finally, the broker is generally, by statute, the agent of the insured, not the insurer.\(^{49}\)

In light of these characteristics of the broker's participation in the creation of an insurance contract, one would expect that no matter how close a connection existed between the lender and the broker, the lender could not be held responsible as a seller so long as no profits from the production or markup of the insurance accrued to the lender. Nevertheless, the supreme court's opinion implicitly holds that a broker is a seller; close connection with it alone charges the lender with retail seller, or "provider" liability under the Unruh Act.\(^{50}\) It is suggested that this conclusion cannot be supported by any attempt to establish the substance of the transaction via its economic allocations.

b. Preservation of Defenses

Although the \textit{King} case did not involve questions of preservation of defenses, it relied partly on the preservation cases in reaching its decision. For the most part, the close connection doctrine and preservation of defenses have developed in the same cases. This section examines whether the preservation of defenses cases and the principles underlying them offer support for the result in \textit{King}, and the impact of \textit{King} in the preservation area.

The original battle in consumer credit was to dismantle the insulation that surrounded assignees of notes and contracts as a result of the "holder in due course" rule.\(^{51}\) The close connection doctrine was developed by the

\(^{49}\) CAL. INS. CODE § 33 (West 1972).

\(^{50}\) 18 Cal. 3d at 842, 844-47, 558 P.2d 857-60, 135 Cal. Rptr. at 771-74.


Many other states have, through legislation or judicial action, prevented the cut-off of consumer defenses by assignment. 3 \textit{NATIONAL CONSUMER LAW CENTER, CONSUMER LAW HANDBOOK} 526-42, 545-49 (1972). The courts in several states have employed the same analytical techniques utilized by the California courts to deny holder in due course status to assignees who are related to the seller or to the original sale. See \textit{FTC Rule, supra}, at 816-17, 821.

The Federal Trade Commission has also adopted a trade regulation preserving consumers' claims and defenses against assignees. 16 C.F.R. §§ 433.1-2 (1977). For an excellent critique of this rule see \textit{FTC Rule, supra, passim}. The FTC has issued an advisory letter stating that the sale of insurance and the financing of premiums for its purchase are not "goods or services;" hence, the rule does not apply to them. FTC Staff Advisory Letter, Oct. 28, 1976, 5 CONS. CRED. GUIDE (CCH) ¶ 98,272.
courts to charge the assignee of a consumer installment contract who claimed holder in due course status with notice of the consumer's claims where the assignee had a close, ongoing business relationship with the seller. Legislative action has followed through with automatic preservation of defenses in some areas, eliminating the need to prove a connection in individual cases.

As the availability of holder in due course status was curtailed, the attractiveness of the direct consumer loan increased. The direct consumer loan offers many of the benefits of holder in due course status, particularly for those financial institutions exempt from interest rate limitations. And until very recently, most judicial and legislative efforts made no attempt to preserve consumer defenses arising out of a sale for use against a direct lender. Thus, lenders could arrange extremely close relationships with sellers, even controlling the sales transactions to a large degree, and the

The problem with the states' attempts has been a lack of uniformity, with resulting inconsistency of results and lack of predictability. Attempts to resolve these differences have resulted in model acts proposed by the National Conference of Commissioners on Uniform State Laws and by the National Consumer Law Center, the Uniform Consumer Credit Code and the Model Consumer Credit Act. For discussion of the proposals, and their consideration by the California legislature, see Comment, The Consumer-Retailer-Financing Agency Triad In California—Status, Outlook, and a Comprehensive Solution, 7 U.S.F. L. REV. 130, 138 (1972) [hereinafter cited as Triad in California].

52. Consumer contract assignees took subject to equities and defenses existing at the time of assignment, CAL. CIV. CODE § 1459 (West 1954), CAL. CIV. PROC. CODE § 368 (West 1973), even before the enactment of similar provisions in the Unruh Act. CAL. CIV. CODE § 1804.2 (West Supp. 1977). Creditors responded by requiring clauses waiving claims and defenses, but California courts have refused to enforce such clauses for quite some time. See, e.g., American Nat'l Bank v. A. G. Sommerville, Inc., 191 Cal. 364, 370, 216 P. 376, 378 (1923). Sellers therefore required buyers to execute promissory notes, often attached to the installment contract, which were then detached and negotiated to the financer, who then asserted holder in due course status. See, e.g., the facts in Commercial Credit. One of the Unruh Act provisions helps prevent separation of consumers' obligations to pay from their claims and defenses arising out of the contract by requiring the note and contract to be contained in a single document, thus imparting notice to any purchaser. CAL. CIV. CODE § 1803.2 (West 1973).

Many of the proposals discussed in this section also preserve "claims" and "equities," as well as "defenses." For ease of discussion they, too, will be referred to as "preserving defenses." It appears that these terms are included to prevent impairment of the consumer's right to rescission or setoff against the lender by a narrow construction of what relief constitutes a "defense." The defendants' arguments in Vasquez demonstrate this problem. 4 Cal. 3d at 823, 484 P.2d at 979, 94 Cal. Rptr. at 811. These terms should not be construed to subject assignees or lenders to product liability suits. See id. at 824 n.23, 484 P.2d at 979 n.23, 94 Cal. Rptr. at 811 n.23. The lender's liability should be limited to the amount of the debt owed it, at least in the absence of overlapping ownership and control with the seller or a substantial sharing of the profits arising from the production or retail sale activity, for if liability were not so limited, the lender would face risks—e.g., damages for breach of contract—for in excess of the gain it could anticipate from its advancement of the purchase price.


seller’s failure to deliver or to live up to warranties would not affect the lender’s legal right to payment from the consumer.

Where the seller finds the customer, handles the preparation of the loan application, and presents the customer’s completed loan application to the lender, the lender’s claim to insulation from defenses arising out of the consumer contract between the seller and the customer is unrealistic. The lender in this situation has had little or no contact with the customer. Rather, its dealings are primarily with the seller. The economic position it fills is much like that of an assignee who finances the seller by buying its consumer contracts or notes at a discount—a function that the courts and legislatures have already decided should not be insulated. The loan has actually been prepared by the seller and merely transferred to the lender, despite the absence of the seller’s signature on the loan contract. The similarity to an assignee is even more obvious when the seller urges that purchases be financed by a certain lender and even accompanies the consumer to that lender’s premises, where the loan advancement is paid directly to the seller or a check to the consumer is immediately endorsed over to the seller.55

Nevertheless, until recently consumer lenders have maintained their insulation from consumers’ complaints against sellers simply because the contract that the lender is enforcing has only two parties, the lender and the consumer/borrower. Only when one looks past that transaction to see the context in which it was executed is there a basis for subjecting the lender to defenses arising from what appears to be an entirely separate contract of sale existing between the seller and buyer.56 Just as in the case of assignees, however, the close connection doctrine can be used to analyze the context in which the consumer loan is made.

A number of rationales were developed to justify the preservation of defenses against closely connected assignees of consumer installment contracts or notes;57 they can be employed against direct lenders as well. In some instances, the financer was an integral part of the seller’s business, and the financing helped perpetuate fraudulent sales practices. In others, the connection provided the financer with notice of the defenses.58 In appropriate cases, each of these rationales could be used to preserve defenses against direct consumer lenders.

55. Direct Loan Financing, supra note 54, at 1418.
56. "In the eyes of the law, the two transactions are separate, and where lender sues buyer, the buyer will not be able to assert any defense based on the fact that his transaction with the merchant has been less than satisfactory." Littlefield, supra note 54, at 476. See Direct Loan Financing, supra note 54, at 1410; Triad in California, supra note 51, at 145.
57. FTC Rule, supra note 51, at 820-21.
58. In California notice was found in Commercial Credit, where the financer had actually supplied the installment contract forms, yet claimed to be a stranger to the original transaction. 34 Cal. 2d at 771, 214 P.2d at 822. Later, after passage of the Unruh Act, constructive notice was deemed sufficient. Morgan v. Reasor Corp., 69 Cal. 2d 893, 447 P.2d 646, 73 Cal. Rptr. 406 (1968).
A third rationale developed in the holder in due course battle—the policing theory—appears to have influenced the recent Federal Trade Commission and model code proposals for preserving defenses against direct lenders. These proposals preserve defenses against some direct lenders who are clearly not an integral part of the seller’s business operation, and who may not have actual knowledge of defenses arising from a particular transaction. The policing rationale is based on the notion that lenders are in a better position to curb seller misconduct than are consumers, and will do so if the cost of seller misconduct is shifted to them in the form of setoffs or defenses to collection of their loans. Consumers, who deal in small volumes and, generally, on a single transaction basis, have extreme difficulty policing the practices of a seller. On the other hand, lenders who have at least some connection with the seller are in a better position to enforce proper behavior as a result of their much greater volume and continuity of business with the seller and the greater access to information that may accompany this connection.

The preservation of defenses against direct lenders might also be supported on a fourth rationale. The allocation of costs theory puts the loss on the lender in those situations in which the cost of seller misconduct cannot be put on the seller. This situation arises when the seller has gone bankrupt or has fled the jurisdiction, and when the transaction costs of securing recourse are too high in relation to the amount at stake. In such

59. Littlefield, supra note 54, at 493-94.
61. UNIFORM CONSUMER CREDIT CODE § 3.405 (1974); MODEL CONSUMER CREDIT ACT § 2.603 (1973); REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 37-38 (1972).
62. The proposed FTC relatedness test is met by either "referral" or "affiliation." Referral consists of cooperative or concerted effort by the seller and creditor to channel customers to that lender on a continual basis. Affiliation occurs where there is common control, or concerted activity in connection with the sale or the financing. Examples of this include: seller maintains or prepares loan documents, creditor pays seller for referrals, creditor participates in sales program, or joint advertising. 41 Fed. Reg. 34594, 3495-96 (1976). In addition to these elements, the various model proposals, supra note 61, list additional facts that establish a connection sufficient to preserve defenses: e.g., lender knows loan will be used for consumer purchase, lender advances the credit directly to seller, lender has recourse agreement with seller, or either party channels customers to the other.
63. Littlefield, supra note 54, at 493-94; Direct Loan Financing, supra note 54, at 1417-32; FTC Rule, supra note 51, at 826-29; cf. Morgan v. Reasor Corp., 69 Cal. 2d at 890, 447 P.2d at 644, 73 Cal. Rptr. at 404 (use of policing rationale to preserve defenses against assignees). Some commentators suggest that lenders be permitted to require recourse agreements from sellers to recompense the lender for any loss occasioned by assertion of consumer defenses regarding the seller against it. See, e.g., FTC Rule, supra note 51, at 828. Thus, the lender would not ultimately be out of pocket for the seller’s transgressions, provided that the lender has not become involved with a fly-by-night or insolvent seller. Arguably, this should not be viewed, for purposes of recharacterization, as a shifting of the credit risk, since it is tied to seller misbehavior, and not simply to default of the customer. The Unruh Act provides assignees with recourse against sellers. CAL. CIV. CODE § 1804.2(b) (West Supp. 1977).
situations, the cost is viewed as a "real cost of the consumer goods distribution industry which should be reflected in the price of consumer goods . . ."64 Thus, when the burden must fall on one of two innocent parties, the lender or the consumer, it is theorized that it should be put on the lender, which can disperse the cost in its charges for credit, rather than on the consumer, who can do no shifting of costs. The allocation of losses theory permits an even looser standard of "connection" than the policing theory would allow, for where simply allocating costs of the industry is the object, whether the lender is close enough to actually supervise the seller in any meaningful fashion becomes relatively unimportant.65

In light of the historical development of the close connection doctrine for preservation of consumer defenses against assignees, and the California precedents, it would be a logical step to extend that doctrine to direct consumer lenders in an appropriate case.66 Such an extension would not require recharacterization as a seller or provider, because the question involved is not whether the lender is actually a seller or provider, but whether the lender has some relationship with the seller sufficient to support a policing and cost allocation rationale. King, however, attempted to use the close connection/preservation case to support the close connection doctrine of a party. The court did not just perform the remedial function of assuring the consumer that whoever collects the monthly payments will be subject to the same defenses as the seller, but also imposed a set of legal requirements governing the terms on which the recharacterized party may conduct its

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64. Direct Loan Financing, supra note 54, at 1411; see Littlefield, supra note 54, at 494-96; cf. Morgan v. Reasor Corp., 69 Cal. 2d at 890, 447 P.2d at 644, 73 Cal. Rptr. at 404 (comparable remarks with respect to preservation against assignees).

65. One writer would preserve defenses under this theory against lenders with no connection at all with sellers. See Direct Loan Financing, supra note 54, at 1422. This takes the allocation theory to its logical conclusion. Arguably, such an approach would support a blanket preservation of defenses against all consumer lenders, whether connected with the seller or not, much as the Unruh Act does with respect to all assignees of consumer installment contracts. Cal. Civ. Code § 1804.2 (West Supp. 1977). This approach would expand lender liability beyond that explicitly required by the Insurance Premium Financing Act, which preserves the rights and obligations of a premium finance agency on assignment, but does not provide for assertion of defenses arising from the insurance contract against the premium agency. Cal. Fin. Code § 18588 (West Supp. 1977).

Interestingly, California has adopted legislation preserving consumer defenses in some credit card transactions regardless of connection. The Song-Beverly Credit Card Act of 1971 allows consumers' claims against retailers to be raised as defenses or setoffs against claims by the card issuer for original purchases exceeding $50.00 and made within the state. Written notice and demand for settlement from the retailer is a prerequisite. Cal. Civ. Code §§ 1747, 1747.90 (West 1973).

66. For example, many of the allegations in King (e.g., provision of forms, payment of a fee for referrals, and existence of a referral system) would support a finding of relatedness between the bank and the broker under any of the current proposals. The bank would probably not be insulated from defenses arising against the insurer either. Because the broker's activities—referring customers to an insurer and handling the insurance application—make it related to the insurer, defenses asserted against the insurer would likely be preserved through the broker to the bank.
future business. Since recharacterization also preserves defenses, King took two steps in common law development at once, but failed to differentiate the degrees of connection necessary for each step.

c. Dictation of the product

Given the weakness of the analytical support for recharacterizing the lender on the basis of its connection with the broker, the court may instead have relied on the allegations that the bank dictated the terms of the product in holding that the bank had provided insurance. It is not at all clear from the opinion that this is what the court did, but it is arguable that such a view of the allegations would support the result reached. The dictation of the product approach changes the focus from the lender’s relationship with the seller to its relationship with the product offered. Although the close connection doctrine is probably flexible enough to encompass such an approach, it has not previously been used in precisely this manner. Focusing on dictation of the product, however, presents even more line-drawing problems than does traditional close connection analysis.

The plaintiffs in King alleged that the bank dictated not only the terms of credit, but also the terms and conditions of the insurance policy, by determining which policies could be purchased on credit. In addition, the allegations implied that by sharing profits from the loan contracts with the broker and by paying the broker a fee for each purchase that met its approval, the bank had persuaded the broker to require all who purchased policies on credit to finance through the bank. Customarily, the consumer expects the broker to search for and present the policy best suited to the consumer’s needs. According to the allegations in King, the broker’s relationship with the consumer was largely controlled by the bank, contrary to this customary expectation.

It could be argued that the court ruled that if a lender dictates a substantial portion of the characteristics of the insurance policy offered to the consumer, controls the terms on which credit will be offered, and achieves the broker’s cooperation in routing all his credit business through the lender, thus usurping the broker’s duty as an agent of the consumer, then

67. Prior cases occasionally have referred to the connection of the extender of credit with the “transaction.” E.g., Commercial Credit Corp. v. Orange County Mach. Works, 34 Cal. 2d at 771, 214 P.2d at 822. They have done so, however, with reference to preservation of defenses through notice, not recharacterization. In some cases the financer supplied the installment contract forms yet claimed holder in due course status. Id. (discussed at length in Morgan v. Reasor Corp., 69 Cal. 2d at 893-96, 447 P.2d at 646-48, 73 Cal. Rptr. at 406-08). In King the furnishing of the credit contract would tend only to reinforce its lender status. There were no allegations that it supplied the insurance contract forms, but rather that it dictated the insurance terms nevertheless, by its control of the entire transaction.

68. See note 17 supra and accompanying text.

69. The complaint alleged that the broker required purchasers to finance through the bank. See note 17 supra and accompanying text.

70. See note 49 supra and accompanying text.
the lender has participated in the transaction to such a degree that it must, realistically, be considered a "provider" of insurance to the consumer.

To the extent that the content of the product offered reflects the lender's decisions rather than those of the producer (here, the insurer), it can be seen as having taken the producer's place. This approach may be buttressed by the fact that achieving substantially complete control over both the terms of credit and the contents of the good or service financed, as well as control over the broker, could well result in economic benefit to the lender.

In some situations the lender's control over the seller/producer might allow it to force the seller/producer to take a lower cash price in its credit transactions. If this reduction is then offset by a comparable raise in the finance charge by the lender, the item is left in the same market position as before, that is, at the same price to the credit purchaser and hence in the same position relative to credit competitors. Yet benefits have been shifted from the seller/producer to the lender without a direct payment, justifying recharacterization under the economic analysis sketched above.

A second possible benefit of control, possible only in an inelastic market, would result from an agreement by the lender and seller to structure the seller's product to give the lender better security at the expense of the buyer without a corresponding reduction in either the cash price or the finance charge. In the insurance premium financing context this might occur if an insurer normally offered a redemption period to cash customers, but at the demand of a lender omitted that provision from financed policies without a corresponding reduction in the premiums charged.

This arrangement would not suffice to recharacterize the lender under a narrow application of the above economic analysis, because the benefits are not shifted from the seller to the lender. Yet, because it shifts benefits from the consumer to the lender, the court might wish to prevent, or at least impose the price of Unruh Act coverage upon, this type of lender control over the product.

In contrast, the lender might receive economic benefits in the form of an increased volume of business resulting from cooperation or coordination between the lender and seller. Such a benefit would not justify recharacterization, because it alone does not indicate any shifting of benefits from the seller or consumer to the lender.

The court did not articulate whether the allegations of lender control of the policy's terms specifically provided the rationale for its holding. Yet, even if the "dictation of the product" approach were more fully developed, it might be extremely difficult to determine both whether specific provisions

71. The injection of a broker between the lender and issuer raises the same barriers to control of the terms of the policy as it does for the transfer of profits unless one posits either a broker with control over the terms or a relationship between the lender and insurer, independent of the broker, through which the control is exercised.
were included by the insurer on its own or were dictated by the lender, and where the line between reasonable precautions and impermissible control should be drawn. The problems involved with the channelling or "conduit" aspects of this approach may be particularly difficult to resolve. Lenders and brokers can be expected to establish standardized courses of dealing with each other for the relative security and efficiency of dealing on a repeat basis with a familiar party. It seems reasonable for them to do so. Economic incentive in the form of a fee to the broker for services performed or for referral of a customer is a logical "glue" for encouraging this standardized relationship. For similar reasons, lenders might prefer the broker to use credit forms designed by the lender. Using the same forms for each credit extension, regardless of which broker or agent is involved, is more efficient for the lender and helps assure consistent TILA disclosures. Finally, it may be perfectly reasonable for a lender to pick and choose the insurers and policies it is willing to finance. Who issues the policy is particularly important, because the lender's security is only as good as its ability to retrieve the unearned premiums from the insurer. Yet, each of these mechanisms would assist a lender bent on controlling the entire transaction, including the content of the product offered to the consumer.

How reasonable business practices and precautions should be distinguished from a "conduit" through which the lender has, by persuasion or force, substantially controlled the terms of the policy and prevented the broker from fulfilling its duties to the customer is an open question. There appears to be no precedent or commentary on this approach. Given its novelty, and the lack of empirical evidence that dictation of the product by lenders is a widespread problem, any development in this direction by the court should be made with care, and should be tied strictly to situations where the control actually has been used to shift economic risks or profits.

III. Definition of "Services" under the Unruh Act

Perhaps the most interesting and potentially far-reaching point in *King* is the court's assertion that: "by reason of the act's interlocking definitions of 'retail installment contract,' 'seller,' and 'services' . . . it is at least arguable that an agreement to finance an automobile insurance policy through installment payments constitutes a 'service' transaction covered by the act."72 This dictum raises the possibility that consumer financing in general could be considered to be a "service" within the scope of the Unruh Act.

The meaning of the court's statement is not clear, but three interpretations seem possible. First, the court may have determined that insurance premium financing transactions contain sufficient service components, aside from the fact that money is lent, to be characterized as a service under the

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72. 18 Cal. 3d at 844, 558 P.2d at 859, 135 Cal. Rptr. at 773.
Act. The court went so far as to say early in the opinion that:

We conclude, as developed below, that, under the facts alleged in this case, Bank's furnishing of financing services in close connection with plaintiffs' installment purchase of automobile insurance may reasonably be construed to lie within the definition of "services" under section 1802.2 and, accordingly, may be subject to regulation under the act.73

As discussed above, the bank's transaction was very similar to the standard transaction under the Insurance Premium Financing Act, at least as regards its service components.74 Hence, it may not be distinguishable from standard insurance premium financing transactions. These in turn may not be distinguishable from other forms of consumer financing. It is not at all clear that other consumer financing transactions do not have similar "service" features, for example, direct payment to the seller, mixed in with the loan. The court relied heavily on the reference in Civil Code section 1802.2's definition of services to "services furnished in connection with . . . the providing of insurance."75 Yet that section defines services very broadly as "work, labor and services, for other than a commercial or business use, including services furnished in connection with . . . the providing of insurance."76 Thus no definitional ground for distinguishing insurance premium financing from other types of consumer financing is readily apparent.

Another possibility is that the court read the Unruh Act's dichotomy between "services" and "goods" to imply that loans of money would fall naturally into one category or the other,77 regardless of any other features of

73. Id. at 844, 558 P.2d at 858, 135 Cal. Rptr. at 772. Despite the court's promise of later discussion, the quoted passage is the only indication that part of the court's holding was based on a construction of "services."

74. See notes 15 and 16 supra and accompanying text.

75. 18 Cal. 3d at 844, 558 P.2d at 858, 135 Cal. Rptr. at 772.

76. CAL. CIv. CODE § 1802.2 (West 1973).

77. In one recent case involving allegations of unfair business practices in connection with a loan the court said, "Whether a loan of money is a sale or a service, the language of section 17500 is sufficiently broad to include false or misleading statements made to the public by banking institutions in connection with their loans." Chern v. Bank of America, 15 Cal. 3d 866, 875-76, 544 P.2d 1310, 1316, 127 Cal. Rptr. 110, 116 (1976). The section in question, CAL. BUS. & PROF. CODE § 17500 (West Supp. 1977), prohibits false advertising in connection with the disposition of real or personal property or services. It is broader than the Unruh Act, which is limited to goods and services.

Generally, money is not considered a "good." F. MANN, THE LEGAL ASPECT OF MONEY 25-26 (3d ed. 1971); see A. CORBIN, CONTRACTS § 479 (1950). Nevertheless, there is a great deal of confusion over the legal classification of money. See generally F. MANN, supra; A. NUSBAUM, MONEY IN THE LAW (1939); A. KEMP, THE LEGAL OUTLINES OF MONEY 10-11 (1956). Most statutes eliminate some of the confusion by expressly excluding money from the category of goods. E.g., CAL. COMM. CODE § 2105 (West 1964). The Unruh Act has no such explicit exclusion. Nevertheless, at least one California legislative committee has assumed that money is not within the Unruh Act definition of goods. See note 79 infra.

Many other states' retail installment sale statutes do not mention loans as such, explicitly exclude money from the category of goods, and like California define "services" as "work, labor, or services" (with various specific inclusions and exclusions which shed no light on this question). See, e.g., ALASKA STAT. § 45.10.220(2) (13) (1962); ARIZ. REV. STAT. § 44-6001(2),
the loan. Under this interpretation, too, all consumer loans would fall within the Unruh Act. There is, however, no direct indication that the legislature intended the word "services" to include consumer financing.\textsuperscript{78} The legislative history of the Unruh Act contains no clues, except through negative implication. Even those are inconclusive.\textsuperscript{79}

The third possible interpretation lies in the definitions of "retail installment contract"\textsuperscript{80} and "retail installment sale"\textsuperscript{81} in the Unruh Act. Both are

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\item[(12)] (West Supp. 1977-78); COLO. REV. STAT. § 5-2-105(1), (3) (1974); CONN. GEN. STAT. ANN. § 42a-9-105(1)(h) (West Supp. 1978) (no reference to services). \textit{But see} DEL. CODE tit. 6, § 4301(1) (1975) (like California, defines goods as tangible chattels, with no mention of money); GA. CODE ANN. § 96-902(a)(1), (3) (Supp. 1977) (goods include all personalty).
\item[(7)] The Uniform Consumer Credit Code is similar to many states in that it excludes money from goods and gives a broad definition of services. \textbf{UNIFORM CONSUMER CREDIT CODE} § 1.301(21), (40) (1974). The Code is, however, specifically designed to cover loans as well as sales, and has separate provisions for each. \textit{See, e.g.}, \textit{id.} § 1.301(21). \textit{Compare} \textit{id.} § 2.201 with \textit{id.} § 2.301. In addition, the Code classifies insurance premium financing as a loan. \textit{Id.} § 1.301(22) and Comment.
\item[(78)] \textit{See also}, 50 CAL. OP. ATT'Y GEN. 110, 112 & n.4 (1967). Interestingly, this opinion concluded that insurance should be construed to be under the Unruh Act because it could conceive of no "service[s] furnished in connection with the providing of insurance" that would be financed in a time sale contract; \textit{i.e.}, a loan of money apparently was not considered a service:
\begin{quote}
Here it would appear that a construction of section 1802.2 of the Civil Code to include "services furnished in connection with the providing of insurance" but not the "providing of insurance" would be relatively meaningless. No such service comes to mind for which in the ordinary course of business one receives compensation, the payment of which would be financed in a time sale contract. An insurance broker or agent performs such services but his compensation therefor is generally paid directly by the insurer as commission, and such services or payment therefor by the insurer do not become part of retail installment contracts.
\end{quote}
\textit{Id.} at 113.
\item[(79)] The committee reports did not discuss whether loans were included under the Unruh Act. One of the proposed versions of the Act specifically excepted money from its coverage, but this reference was omitted from the final version. Senate Bill 520 (1959). There is no indication whether the reference was considered superfluous, or if the deletion was designed to bring loans of money within the Act. \textit{See also} REPORT TO THE SUBCOMMITTEE ON JUDICIARY OF THE ADVISORY COMMISSION ON THE UNIFORM CONSUMER CREDIT CODE (SENATE RESOLUTION 133) at 61-62 (1972) [the California Comment to proposed § 2105 (which excluded money from the definition of goods) indicated the Commission's belief that § 2105 was "substantially the same" as the definition of goods under the Unruh Act].
\end{itemize}

Following the decision in \textit{King} an amendment to the Unruh Act was proposed. Its purpose was to clarify that:
\begin{quote}
direct loans to borrowers by supervised financial organizations, as defined in Section 1802.20, are not within the coverage of the Unruh Act. It is further the intention of the Legislature that if a supervised financial organization making a direct loan is found to be a 'retail seller', as defined in Section 1802.3, then it shall be within the coverage of the Unruh Act.
\end{quote}
S.B. 767. This bill passed the Senate by a vote of 29-1, but failed passage in the Finance, Insurance & Finance Committee in the Assembly on August 25, 1977. Senate Weekly History, Part 2, Sept. 15, 1977, at 387. The bill would have mooted the court's speculation about the nature of loans for purposes of the Unruh Act. It would not, however, have clarified what degree of connection triggers recharacterization as a provider or seller.

\begin{itemize}
\item[(80)] CAL. CIV. CODE § 1802.6 (West 1973).
\item[(81)] \textit{Id.} § 1802.5.
\end{itemize}
worded to apply to consumer contracts in which the price is payable in installments. These definitions have been assumed to cover only those situations in which the seller received the installments. Arguably, however, the language could be read to apply to any transaction involving a deferred price payable in installments by a consumer to any party.

Although the Unruh Act could thus be interpreted to encompass consumer loans, the Act has existed for over fifteen years without any movement in this direction. If the court were working with a clean slate, classification of consumer loans as services within the Unruh Act might seem reasonable. But to do so given the current framework would involve extensive interference with the multitude of regulatory schemes the legislature has explicitly imposed on various lenders and transactions. Among other things, inclusion of all consumer financing under the Unruh Act would apply a uniform ceiling on finance charges to all consumer lending. This would affect both those lenders whose charges are not currently regulated and those who are regulated under higher ceilings than those allowed by the Unruh Act. Some extensions of credit which are economical under the current limits of such lenders may be uneconomical under the lower Unruh Act limits. To the extent that the court is not equipped to determine the relative desirability of various consumer transactions or their profitability under any particular ceiling, the task of large scale alterations of the consumer credit industry should be left to the legislature. Interpreting "services" to encompass all consumer loans thus seems an unwise move for the court.

IV. Consumer Interests

Central to a resolution of the question whether the concepts of "provider" and "close connection" should be expanded to recharacterize an insurance premium financing transaction, and, if so, where lines should be drawn, is the extent to which recharacterizing the lender and bringing the transaction within the Unruh Act will afford consumers additional protection. Judicial recharacterization should be employed only when substantial interests cannot be protected in any other way. California consumer credit protection law emphasizes four major concerns: 1) preventing separation of the consumer's obligation to pay from the consumer's rights versus the seller, 2) providing meaningful disclosure of the cost and terms of cred-

82. See, e.g., 50 CAL. OP. ATT'Y GEN. 110 (1967), which discusses a number of different insurance premium financing arrangements.
84. Compare the statutory ceilings of the sections cited in note 113 infra with the Unruh Act ceiling in CAL. CIV. CODE § 1805.1 (West 1973).
85. See notes 113-120 infra and accompanying text.
86. E.g., Glaire v. La Lanne-Paris Health Spa, Inc., 12 Cal. 3d at 922, 927, 528 P.2d at 361, 364-65, 117 Cal. Rptr. at 545, 548-49; Thomas v. Wright, 21 Cal. App. 3d at 924-25, 98 Cal. Rptr. at 876.
it,\textsuperscript{87} 3) regulating the terms on which security interests are taken and foreclosed and preventing overreaching,\textsuperscript{88} and 4) controlling the maximum interest charged by certain lenders and in certain transactions.\textsuperscript{89} As mentioned above, preservation of defenses could be achieved against lenders without bringing the transaction within the Act by utilizing existing close connection theory.\textsuperscript{90} Moreover, as discussed below, adequate disclosure of credit terms can be achieved through TILA without recharacterization, and Unruh Act coverage appears to provide the consumer with no greater protection in the area of security than does the typical insurance premium financing transaction. Finally, regulation of credit charges is an area generally considered within the legislative rather than the judicial purview.

### a. Providing Meaningful Disclosure of Credit Terms

Consumers need sufficient information in insurance premium financing transactions to determine the competitiveness of three different parties: the insurer, the broker, and the lender. Unless disclosures are required, they may have a difficult time acquiring the needed data. Unlike other situations in which the consumer deals with the lender already knowing the "cash price" of the good or service involved, when dealing through a broker or similar middleman who locates the insurer and presents the policy, the customer is not so likely to know what the insurance company charges for the particular policy.

The disclosure issue in \textit{King} was not whether the federal Truth in Lending Act (TILA) covered the transaction,\textsuperscript{91} but whether TILA required it


\textsuperscript{89} See note 113 infra.

\textsuperscript{90} See notes 55-66 supra and accompanying text.

\textsuperscript{91} See \textit{Stefanski v. Mainway Budget Plan, Inc.}, 456 F.2d 211 (5th Cir. 1972) (which assumes implicitly that insurance premium financing transactions are not exempt from TILA). \textit{But cf. Gerlach v. Allstate Ins. Co.}, 338 F. Supp. 642 (S.D. Fla. 1972); and excerpts from Federal Reserve Board letters of June 3, 1969, and May 27, 1969, [1969-74 Transfer Binder] \textsc{Cons. Cred. Guide} (CCH) § 30,051, § 30,041. The Federal Reserve Board and one federal district court have taken the position that if the customer may simply cancel at any time, TILA does not apply. Their theory is that the essence of a debt is the obligation to pay; absent that obligation, there is no debtor-creditor relationship. Hence TILA, which regulates only creditors, does not apply. Faced with that situation, a California court would probably employ a \textit{Glaire} analysis, looking at whether the lender counts on the vast majority of insureds not cancelling, and the actual frequency of cancellation, in determining whether the transaction is a credit transaction.

to be disclosed as a credit sale or as a consumer loan.\textsuperscript{92} The court was probably correct in finding the credit sale provisions applicable to insurance premium financing transactions.\textsuperscript{93} The cash price and itemized downpayment disclosures reported for credit sales and not for consumer loans enable the consumer to separate the costs of the insurance policy and any broker’s fee from the cost of credit,\textsuperscript{94} giving the consumer the information about each party needed to comparison-shop.\textsuperscript{95} Although it would be possible to calculate the missing terms from consumer loan disclosures in most cases,\textsuperscript{96} putting the burden of making those calculations (which, as a practical matter, requires reference to the Code of Federal Regulations) on the consumer vitiates the benefits of disclosure.\textsuperscript{97} Thus, the consumer has a

Allstate Ins. Co., 338 F. Supp. 642, 649 (S.D. Fla. 1972); Krischer, supra note 11, at 976, criticizes Gerlach in light of the “focus” test for McCarran-Ferguson Act coverage announced in SEC v. National Sec., Inc., 393 U.S. 453 (1969). In any event, where the state’s regulation of insurance premium financing transactions does not cover the transaction in question, as was the case in King, it is unlikely that TILA would be held inapplicable.


93. See 18 Cal. 3d at 848, 558 P.2d at 861, 135 Cal. Rptr. at 775. Yet the cases relied upon by the court did not involve brokers. In Stefanski v. Mainway Budget Plan, Inc., 456 F.2d 211 (5th Cir. 1972) the consumer dealt directly with the insurer rather than through a broker. Joseph v. Norman's Health Club, Inc., 532 F.2d 86 (8th Cir. 1976) is almost identical to Glaire, discussed at notes 38-40 supra and in accompanying text. Mourning v. Family Publications Service, Inc., 411 U.S. 356 (1973) similarly dealt with the problem of hidden finance charges, upholding the validity of the Federal Reserve Board’s “four installment” rule (12 C.F.R. § 226.2(s) (1977)) as a proper means for insuring that finance charges would not be hidden in the cash price of merchandise.

94. TILA requires a core set of disclosures for both consumer loans and credit sales. 12 C.F.R. § 226.8(b) (1977). Subsection (c) then imposes further requirements for credit sales; subsection (d) requires further disclosures for loans. The following terms are disclosed for credit sales but not for consumer loans: “cash price,” \textit{id.} § 226.8(c)(1); “cash downpayment,” \textit{id.} § 226.8(c)(2); “unpaid balance of cash price,” \textit{id.} § 226.8(c)(3); “deferred payment price,” \textit{id.} § 226.8(c)(8)(ii). Generally, the cost of the premiums would be disclosed as the cash price. It appears that brokers' fees would be treated as finance charges under § 226.4, which are itemized under § 226.8(c)(8)(i). \textit{Cf.} Excerpts from Federal Reserve Board Letter No. 667, March 8, 1973, [1969-74 Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 30,955 (loan broker charges).

95. As a practical matter, the cost of premiums may be listed in the security agreement’s description of security taken; there does not, however, appear to be any requirement assuring such specificity.

96. For example, the components of the “deferred payment price” disclosed under the credit sale provisions, 12 C.F.R. § 226.8(c)(8)(ii) (1977), consist of the cash price, plus the finance charge, plus all other charges included in the amount financed. This is paralleled under the loan disclosure provisions if one adds the “amount financed,” the “total prepaid finance charge and required deposit balance,” and the “finance charge.” \textit{id.} § 226.8(d)(1)-(3).

Similar calculations with respect to many, perhaps all, of the other missing terms appear to be possible, though they are complicated by the existence of a downpayment.

97. See Krischer, supra note 11, at 959, noting the lack of uniformity of disclosure in the industry, and calling for consistent “credit sale” disclosures for insurance premium financing transactions.
substantial interest in receiving credit sale disclosures.

Recharacterizing the lender for purposes of the Unruh Act would require the lender to make Unruh Act credit sale disclosures. Such disclosures can also be obtained, however, through TILA itself. TILA can be interpreted to require brokers and, in certain cases, lenders, to make credit sale disclosures in addition to the lenders' consumer loan disclosures.

TILA's credit sale provisions can be imposed on brokers by treating them as "sellers" within the meaning of TILA. Although no court has yet addressed the status of brokers under TILA, the Federal Reserve Board seems to support treating them as sellers for purposes of disclosure. Because the broker stands in the insurer's place in communicating the terms of the insurance to the customer, it seems logical to impose the seller's disclosure requirements on the broker. In the typical insurance premium financing transaction, the consumer may never deal directly with either the insurer or the lender. The broker, who is constantly dealing with the insurer and the lender with regard to the cost of premiums and credit, is thus the

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98. See Cal. Civ. Code § 1803.3 (West 1973). Most of the Unruh Act requirements are the same as the TILA provisions. The Unruh Act also contains some additional requirements, not required by TILA but apparently consistent with it: e.g., including entire agreement on one document, print in at least eight point type, date, title, notice in ten point type that buyer is entitled to completely filled-out copy, notice that disclosure of amount of refund on prepayment in full is available on request, names and addresses of buyer and seller, identification of the goods or services, identification of balloon payments. Id. §§ 1803.1-3.

State provisions are preempted by TILA to the extent that they require disclosures or actions by creditors inconsistent with those required by TILA. 15 U.S.C. § 1610(a) (1970). The Unruh Act recognizes this with the following statement:

Nothing contained in this chapter shall be deemed to prohibit the disclosure in such contract or other document of additional information required or permitted under Regulation Z, as in effect at the time such disclosure is made.


99. This responds to your letter...which inquired as to what type of disclosures an insurance broker or agent who handles the insurance and finances the premiums should make. In our opinion, an insurance agent is "selling" insurance. Consequently, when he also provides consumer credit for premium financing he is making a credit sale under § 226.2(n) and disclosures under §226.8(b) and (c) would be required.


100. Assuming a broker to be a seller under TILA is not inconsistent with refusing to consider the broker one under the Unruh Act. It is not uncommon for a word to acquire differing meanings in federal and state statutes. For example, the Federal Trade Commission has adopted a rule requiring a "cooling-off" period for door-to-door sales. It covers any "sale, lease or rental of consumer goods or services." 16 C.F.R. § 429 Note 1(a) (1977). Insurance is not a good or service within the regulation. 37 Fed. Reg. 22948 (1972); 16 C.F.R. § 429.1 Note 1(a)(6) (1977). See also note 51 supra (FTC advisory letter states that the sale of insurance is not a good or service under preservation of defenses regulation). On the other hand, King leaves no doubt that insurance is a service under the California statutory scheme for purposes of the Unruh Act. It makes sense to classify a broker one way for purposes of a statute designed to regulate disclosures only, such as TILA, because of its position as communicator of price and terms to the customer, yet classify it another way, as a result of its inability to shift profits, for purposes of a statute that controls interest charges as well.
logical source for the information. Because of the broker’s function in conveying information from the insurer to the consumer, the preliminary authority for considering a broker a seller for the purpose of requiring disclosure will probably be followed and reinforced in the future.

In addition, TILA will sometimes require the lender to make credit sale disclosures. The King court found that the allegations of close connection were sufficient to charge the lender with responsibility under TILA for making credit sale disclosures. Given the extensive claims of control of the transaction by the bank, the information pertaining to the cost of the insurance was probably within the bank’s “purview,” thus triggering its obligation under TILA to make credit sale disclosures.\(^{101}\) It does not follow, however, that lenders with some degree of connection with a broker or seller must always make “credit sale” disclosures. The overlapping definitions of “consumer loan” and “credit sale”\(^{102}\) may well require the same transaction to be disclosed as a consumer loan by the lender and as a credit sale by the broker.\(^{103}\) The lender in this situation must make credit sale disclosures, in addition to consumer loan disclosures, only to the extent that they are within its knowledge and purview. To the extent that a close connection exists between the lender and the broker, all of the additional credit sale terms may be within the lender’s purview; it depends on whether the business arrangement between the two generally brings the additional terms within the knowledge of the lender. In this regard, the court’s conclusion that the very close connection alleged between the bank and the broker would charge the bank with credit sale disclosure responsibilities is accurate. It should be noted, however, that it is the lender’s knowledge rather than its close connection with the broker that triggers the requirement.\(^{104}\)

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101. “If there is more than one creditor or lessor in a transaction, each creditor or lessor shall be clearly identified and shall be responsible for making only those disclosures required by this Part which are within his knowledge and the purview of his relationship with the customer or lessee.” 12 C.F.R. § 226.6(d) (1977). See Manning v. Princeton Consumer Discount Co., Inc., 533 F.2d 102 (3d Cir. 1976). “Purview” is not defined in TILA or in its regulations, but appears to refer to matters within the party’s knowledge as a result of its normal course of dealing in a transaction.

102. “Credit sale” is defined to be any transaction in which “credit is extended or arranged by the seller,” 12 C.F.R. § 226.2(t) (1977), whereas “consumer loan” is defined merely as “one type of ‘consumer credit,’” id. § 226.2(p). Thus, they overlap whenever a loan is arranged by a seller.

103. The allegation in King that the broker received a fee from the bank for referrals would make the broker an “arranger of credit.” 12 C.F.R. § 226.2(h) (1) (1977). The allegations that the bank’s forms were supplied to the broker suggests that the broker had knowledge of the credit terms and participated in the preparation of the documents. That too would establish it as an “arranger of credit.” Id. § 226.2(h)(2). Furthermore, the allegations that the referrals were made on a regular basis would make the broker a “creditor” under § 226.2(s), responsible for disclosures under the multiple creditor provision, § 226.6(d).

104. For example, under some of the current proposals a close connection for purposes of preserving defenses can be established merely by referrals or the payment of a fee. This alone would not suffice to put all the cash price information in front of the lender.
However the circumstances that give rise to the lender’s obligation under TILA are characterized, that obligation coupled with the broker’s probable duty to make credit sale disclosures should sufficiently protect the consumer’s interest in the disclosure of specific price information. Thus the disclosure interest does not justify the more radical step of recharacterizing the lender for purposes of the Unruh Act.105

b. Overreaching in the Security Interest

Another goal of consumer protection has been the prevention of overreaching in the security interest. Such overreaching may involve the type of security taken, the degree of control acquired by the lender, or the methods used to foreclose on default.106

The security interest taken in King seems similar to that described in the Insurance Premium Financing Act as characteristic of premium financing transactions.107 The bank acquires the power to terminate the insurance

105. Furthermore, given the definitional differences between a “credit sale” under TILA, and a “retail installment sale” under the Unruh Act, a transaction could fall within the former yet not within the latter. As discussed above, see note 102 supra, a transaction involving a consumer loan may nevertheless be a “credit sale” as well for purposes of TILA disclosure. For purposes of the Unruh Act, however, a credit transaction either involves a loan by a third party (in which case it is outside the Act), or is a “retail installment sale,” which is defined as “the sale of goods or the furnishing of services by a retailer to a retail buyer for a deferred payment price payable in installments.” CAL. CIV. CODE § 1802.5 (West 1973). Thus, there is no common ground between the Unruh Act definition of installment sale and a loan by a nonseller third party.

106. For example, the Unruh Act prohibits taking an interest in goods previously paid for, in goods not sold by the seller (except where the contract is for the provision of services), or in real property, as security for a retail installment sale contract. CAL. CIV. CODE § 1804.3 (West 1973). It further provides that in the event of default, the creditor may sue without retaking the security, or may repossess for sale or in satisfaction. In the event of repossession, notice and a redemption period are required. Id. § 1812.2. The Act also prohibits certain contractual waivers related to repossession, confession of judgment, and assignment of wages. Id. § 1804.1. The Insurance Premium Financing Act provisions are described at note 107 infra. The Rees-Leevering Act prohibits the seller from taking an interest in anything but the motor vehicle sold, CAL. CIV. CODE § 2984.2 (West 1974), but allows supervised lenders to do so. Id. § 2982.5. It provides for a notice and redemption period in the event of a repossession and election to sell. Id. § 2983.2 (West Supp. 1977).

107. See 18 Cal. 3d at 845, 558 P.2d at 859, 135 Cal. Rptr. at 773; CAL. FIN. CODE §§ 18563, 18564, 18608 (West Supp. 1977). The Insurance Premium Financing Act describes the transactions it regulates as follows: the premium financer advances money directly to the insurer at the request of the insured, pursuant to the terms of a premium financing agreement in which the insurer has assigned the unearned premiums, accrued dividends and loss payments as security for this payment on insurance contracts. The amount of the advancement must bear a reasonable relation to the premium being financed. CAL. FIN. CODE § 18553 (West Supp. 1977). The agreement may contain a power of attorney or other authority to cancel the insurance contract in the event of a default by the insured. A ten-day notice must be given before cancellation. Id. § 18608. Upon cancellation the insurer must return whatever unearned gross premiums or accrued dividends are payable under the insurance contract to the company. Any return in excess of the amount due the lender must be returned to the insured. Id. § 18610. If the insured pays in full in advance or the insurance contract is cancelled by the insured or the insurer, a statutorily calculated refund of the unearned finance charge must be returned to the insured. Id. §§ 18629-18630.
contract in the event of default; thus, the bank’s interest in the policy is limited solely to a security function. By terminating the insurance contract, the bank would terminate its obligation to the insurer for future premiums that have already been collected by the insurer, but are “unearned.” If the bank calculates its downpayment and finance charges on such a loan appropriately, it will have received enough from the insured to be fully secured at any given point for the amounts advanced and outstanding, provided that it cancels relatively promptly should the consumer default.

The right to terminate the insurance contract is both adequate and appropriate security. It simultaneously limits the risk to the lender of insufficient security and the exposure of the consumer to a deficiency judgment. The lender’s monetary interest in the policy is limited solely to the refunds of unearned premiums, accrued dividends, and loss payments made under the policy. Moreover, since all returns to the lender in excess of the amount due it must be turned over to the insured, the lender can receive no profit from the policy beyond the amount of its finance charge. Unlike a good that can be resold, the final months of an insurance contract cannot be auctioned off. Since insurance is an intangible, the fact that the bank takes an assignment and control of the policy has little effect on the consumer’s enjoyment except in the event of default. Thus, assuming an arrangement paralleling the statutory provisions of the Insurance Premium Financing Act, using this kind of security does not involve overreaching, and it should not be necessary to seek the protection of the Unruh Act because of the nature of the security interest.

There are two potential problem areas for consumers that neither the Insurance Premium Financing Act nor the Unruh Act remedy. The first is redemption after default. If the customer falls into temporary default on the installments, there is no right to reinstate the financing. Such a right might be very important to a defaulting consumer who has sufficient money to cure the default, but not enough to pay a downpayment to another financer. The hardship caused by denying the right to cure is aggravated in the insurance financing situation by the difficulties of arranging for other coverage on

108. 18 Cal. 3d at 845, 558 P.2d at 859, 135 Cal. Rptr. at 773.
109. It appears that premium finance lenders generally do not take additional security from insureds. Given the adequacy of the security provided by the power to terminate the insurance contract, the taking of additional security would serve only an “in terrorem” purpose in discouraging default. A court faced with the taking of additional security by a lender might read the provisions of the Insurance Premium Financing Act that describe security to limit permissible security to that described. See CAL. FIN. CODE §§ 18563, 18564, 18608 (West Supp. 1977).
short notice, the possible lack of an agreement or right to continuation of coverage pending resolution of disputes, and the limitation of creditor liability (at least in transactions under the Insurance Premium Financing Act) to the amount of principal balance unless the failure to notify was willful. The Unruh Act does have a redemption provision, but it is limited to redemption of goods, and makes no provision for reinstating service contracts.\textsuperscript{111}

The other potential problem would arise when there is a dispute over whether a payment has been made—for example, when the consumer's payment has been delayed in the mail or lost in the lender’s accounting department. Apparently, coverage may be cancelled for nonpayment despite the consumer's contrary assertions. In this case, what the consumer really needs is a mechanism to insure the continuation of coverage for a reasonable period while the problem is being resolved.\textsuperscript{112} Such a mechanism is not available, however, under either statutory scheme.

c. Limiting Charges for Credit

In California a plethora of statutory and constitutional provisions limit the maximum amount that numerous classes of consumer lenders may charge for credit.\textsuperscript{113} The state constitution specifically exempts banks from its usury provision.\textsuperscript{114} Although the legislature could impose interest ceilings on banks by statute, it has not chosen to do so. Thus, as long as the insurance premium financing transaction involved in King is found to be a loan, the bank may charge what the market will bear, despite the fact that insurance premium financing companies making similar extensions of credit are limited to 1 3/4% per month on principal balances to $700, and 5/6% per month on any remainder in excess of that figure.\textsuperscript{116}

The King court was clearly concerned that insurance premium financing transactions involving banks would be unregulated if not subjected to the Unruh Act.\textsuperscript{117} The lack of an interest ceiling on bank credit charges was

\begin{itemize}
  \item \textsuperscript{111} CAL. CIv. CODE § 1812.2 (West 1973).
  \item \textsuperscript{112} The creditor, of course, has an opposing interest in assuring rapid and uncomplicated cancellation of the policy on default, since that is the only way it can terminate its obligation to pay the insurer. Any delay in cancellation cuts into its margin.
  \item \textsuperscript{113} CAL. CONST. art. XV, § 1 (added 1976) (formerly CAL. CONST. art. XX, § 22); CAL. FIN. CODE § 14901 (West 1968) (credit unions); id. § 18212 (West Supp. 1977) (industrial loan companies); id. §§ 18625-18627 (insurance premium finance companies); id. §§ 21200, 21200.5 (pawnbrokers); id. §§ 22451, 22451.1, 22451.5 (personal property brokers); id. §§ 24451, 24452 (West 1968) (small loan companies) (though the finance charge ceiling for small loan companies is 10%, the allowance of additional charges for actual services and expenses means that the consumer may pay well over 10%).
  \item \textsuperscript{114} CAL. CONST. art. XV, § 1 (added 1976) (formerly CAL. CONST. art. XX, § 22); see 50 OP. CAL. ATT’Y GEN 110, 113 n.8 (1967).
  \item \textsuperscript{116} CAL. FIN. CODE § 18626 (West Supp. 1977).
  \item \textsuperscript{117} 18 Cal. 3d at 847, 558 P. 2d at 861, 135 Cal Rptr. at 775.
\end{itemize}
probably a primary reason for that concern. The appropriateness and fairness of permitting different financers different ceilings, or no ceiling at all, for similar credit transactions is open to serious criticism.\textsuperscript{118} Nevertheless, the structuring of the credit system is generally conceded to be a legislative concern.\textsuperscript{119} The legislature could have extended the Insurance Premium Financing Act, including its credit charge ceilings, to cover banks.\textsuperscript{120} Its failure to do so does not, however, demonstrate an intention to apply Unruh Act credit ceilings to all insurance premium financing transactions not regulated by the Insurance Premium Financing Act. The legislature’s treatment of banks may just as well evidence a desire to leave the regulation of bank interest charges to the market.

\textit{Conclusion}

With the exception of one case, the precedents of \textit{King} can be rationalized by recognition that the inquiry in the search for the substance of a transaction varies with the question sought to be answered. Preservation of defenses requires only a loose connection—just enough to assure that a financer totally unaware of the nature of the original transaction is not penalized. But recharacterization requires that the parties have shifted the risks and profits among themselves in a fashion that thwarts the legislative scheme.

Thus traditional close connection theory does not support the court’s conclusion in \textit{King}, because the plaintiffs failed to allege that insurance profits had been diverted to the bank, and there was no suggestion of interlocking ownership or other shifting of benefits or risks between the bank and the insurer. If the court is discarding that requirement, rather than just liberalizing pleading rules, the move is unsound. Once the substance over form doctrine is separated from review of the economic risks and profits, it contains no test with which to discover the substance of a transaction.

Because the traditional close connection doctrine does not support the result in \textit{King}, this Note has speculated that the allegations pertaining to dictation of the product might provide justification for \textit{King}’s conclusions. This justification is appropriate from the perspective of a consumer, who does not care how profits and risks are distributed between the other parties, but does care about the options—in terms of characteristics and quality—

\textsuperscript{118} The lack of a finance charge ceiling is difficult to justify in light of the relatively low risk involved for a lender in this type of transaction—at least until \textit{King}. In the absence of preservation of defenses, the primary risks the lender faced were faulty notice and cancellation on default, and possible insolvency of the insurer (provided it had calculated the downpayment and monthly payments properly to assure that it was paid enough in advance of the time at which the insurer earned the premiums, that upon default, notice and cancellation could be effected before that margin ran out).


\textsuperscript{120} \textit{Id.}