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GEORGE DEUKMEJIAN
Attorney General

OPINION	:	No. 81-401
of	:	SEPTEMBER 22, 1981
GEORGE DEUKMEJIAN Attorney General	:	
Rodney O. Lilyquist Deputy Attorney General	:	

THE HONORABLE JIM ELLIS, MEMBER OF THE CALIFORNIA SENATE, has requested an opinion on the following question:

May a “supervised financial organization” make a dealer-referred home improvement loan without complying with the provisions of the Unruh Act?

CONCLUSION

A “supervised financial organization” may make a dealer-referred home improvement loan without complying with the provisions of the Unruh Act, unless (1) the organization is related to the home improvement dealer by common ownership and control and such relationship is a material factor in the transaction, (2) the organization shares with the dealer in the profits and losses, of the transaction, or (3) the transaction is otherwise in substance a credit sale rather than a loan.

ANALYSIS

The Legislature has enacted a comprehensive statutory scheme (Civil Code §§ 1801–1812.20)[1] known as the "Unruh Act" (§ 1801) governing retail installment sales of various goods and services. Among its provisions, the Unruh Act (1) allows a buyer to assert against any assignee of the sales contract all equities and defenses assertable against the seller (§ 1804.2, subd. (a)), (2) requires contracts providing security interests in real property to inform the buyers of such facts in boldface type (§ 1803.3, subd. (b)), (3) prohibits deficiency judgments (§ 1812.5), (4) allows a buyer to refinance "balloon payments" (§ 1807.3), (5) establishes finance charge rates (§ 1803.1), (6) prescribes limitations on collection costs and late charges (§ 1803.6), (7) prohibits certain contract provisions such as allowing the seller to commit a breach of the peace in repossessing goods (§ 1804.1), and (8) requires all terms to be contained in a single document (§ 1803.2).

The question presented for analysis is whether a "supervised financial organization"[2] may make dealer-referred home improvement loans without complying with the provisions of the Unruh Act. We conclude that it may, unless the organization is related to the home improvement dealer in the manner specified in section 1801.6 or the transaction is otherwise in substance a credit sale rather than a loan.

Preliminarily, we note that consumers of goods and services have basically two choices for obtaining financing of their purchases. Sellers typically extend credit, either on an open-end account basis (usually involving a seller issued credit card) or a closed-end contract basis. The other source of financing is an institutional lender, such as a bank, finance company, savings and loan association, or credit union. These institutions generally finance consumer purchases by extending closed-end loans, providing open-end credit (usually involving a bank issued credit card), or buying closed-end contracts originating with the sellers. This opinion deals with an institutional lender entering into a transaction with a consumer in the form of a loan, where the consumer has been referred to the lender for financing by the seller.

The Unruh Act applies to any "retail installment contract" (§ 1802.6) between a "buyer" (§ 1802.4) and a "seller" (§ 1802.3). While these terms do not expressly cover institutional lenders financing consumer purchases of goods and services, several

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[1] All section references hereafter are to the Civil Code.

[2] A "supervised financial organization", is one that is "organized, chartered, or holding a license at authorization certificate to make loans pursuant to the laws of this state at the United States who is subject to supervision by an official or agency of the state or the United States." (§ 1801.6, subd. (c)(1).)

court decisions have ruled that characterization of a "loan" or "sale" transaction is dependent upon its substance rather than its form. These decisions have disregarded how the transaction has been represented by the parties, and the Legislature has now incorporated the holdings of these cases into the Unruh Act. Section 1801.6 states as follows:

> "(a) The Legislature finds that the decisional law of this state regarding the characterization of credit transactions as either loans or credit sales has been made unclear by the holding in *King* v. *Central Bank*, 18 Cal. 3d 840. *It is the purpose of subdivision (b) to clarify such law by establishing standards for determining whether a transaction is subject to the Unruh Act. However, subdivision (b) is not intended to abrogate the judicial principle that the substance of a transaction rather than its form is determinative of its characterization as a loan or credit sale as exemplified by such decision as Verbeck v. Clymer, 202 Cal. 557, Milana v. Credit Discount Co., 27 Cal. 2d 335, and Boerner v. Colwell Co., 21 Cal. 3d 37. Subdivision (b) also is not intended to abrogate the decision in Morgan v. Reasor Corp., 69 Cal. 2d 881, to the extent such decision has not been modified by Chapter 554 of the Statutes of 1969 or other legislative amendments to the Unruh Act.*
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> "(b) The provisions of this chapter shall not apply to any transaction in the form of a loan made by a supervised financial organization to a buyer of goods or services where all or a portion of the loan proceeds are used to purchase such goods or services, whether or not the seller of such goods or services arranges the loan or participates in the preparation of the loan documents, unless the supervised financial organization and the seller:
>
> "(1) Are related by common ownership and control and the relationship was a material factor in the loan transaction; or
>
> "(2) Share in the profits and losses of either or both the sale and the loan.
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> "(c) For purposes of this section:
>
> "(1) The term "supervised financial organization" means a person organized, chartered, or holding a license or authorization certificate to make loans pursuant to the laws of this state or the United States who is subject to supervision by an official or agency of this state or United States.

"(2) Receipt of a loan commission, brokerage or referral fee by a seller from a supervised financial organization shall not constitute a sharing of profits of the supervised financial organization, provided that such payment (i) is reasonable under the circumstances existing at the time the loan is consummated, and (ii) is not refundable or is wholly or partly refundable only if the loan is voluntarily paid in full prior to its scheduled maturity. For purposes of this paragraph, a loan commission, brokerage or referral fee not exceeding the greater of 1 percent of the amount financed (as that term is defined by Regulation Z with respect to loans), or twenty dollars ($20), is reasonable under the circumstances existing at the time the loan is consummated.

"(3) Payment of money by a seller to a supervised financial organization pursuant to an actual or alleged contractual or statutory obligation to indemnify a supervised financial organization for losses incurred as a result of the assertion by a buyer of claims or defenses with respect to goods or services purchased with loan proceeds shall not constitute participation in or sharing of loan losses by the seller." (Italics added.)

We are asked to determine the meaning of these statutory provisions. Several well-established principles of construction are applicable to an analysis of section 1801.6. The fundamental rule is to " ' "ascertain the intent of the Legislature so as to effectuate the purpose of the Law." ' " (*California Teachers Assn.* v. *San Diego Community College Dist.* (1981) 28 Cal. 3d 692, 698.) "That construction of a statute should be avoided which affords an opportunity to evade the act, and that construction is favored which would defeat subterfuges, expediencies, evasions employed to continue the mischief sought to be remedied by the statute, or to defeat compliance with its terms, or any attempt to accomplish by indirection what the statute forbids." (*Freedland* v. *Greco* (1955) 45 Cal. 2d 462, 477.) "Moreover, the various parts of the statutory enactment must be harmonized by considering the particular clause or section in the context of the statutory framework as a whole." (*Moyer* v. *Workmen's Com. p. Appeals Bd.* (1973) 10 Cal. 3d 222, 230.)

Particularly helpful in understanding the provisions of section 1801.6 is an examination of the holdings of the California Supreme Court cases to which it refers.

In *Verbeck* v. *Clymer* (1927) 202 Cal. 557, 563, the court held that "the sale of one's own property is not a loan whatever be the terms or conditions of purchase" since 'the owner of property, whether real or personal, has a perfect right to name the price on which he is willing to sell, and to refuse to accede to any other. He may offer to sell at a designated price for cash or at a much higher price on credit. . . .' " With this language the credit sale principle or "time-price" doctrine was adopted in California as an "exception" to the usury laws.

In *Milan* v. *Credit Discount Co.* (1945) 27 Cal. 2d 335, 339, the court stated, “A sale is the transfer of the property in a thing for a price in money. The transfer of the property . . . is the essence of the transaction. . . . A loan, on the other hand, is the delivery of a sum of money to another under a contract to return at some future time an equivalent amount with or without an additional sum agreed upon for its use.” Significantly, the court went on to conclude that in determining whether a particular transaction was a loan or sale, “ ‘No case is to be judged by what the parties appear to be or represent themselves to be doing, but by the transaction as disclosed by the whole evidence . . . .’ All of the negotiations, circumstances and conduct of the parties surrounding and connected with their contracts may be material. . . .” (*Id*. at p. 341.)

In *Morgan* v. *Reasor Corp.* (1968) 69 Cal. 2d 881, 893–896, the court ruled that if a finance company and a seller were “closely intertwined,” knowledge of the seller’s noncompliance with the provisions of the Unruh Act could be imputed to the finance company for purposes of barring the collection of finance charges from the buyer under section 1812.7.[3] In *King* v. *Central Bank* (1977) 18 Cal. 3d 840, 846, the court ruled that for purposes of the Unruh Act, “ a ‘close connection’ between the seller of goods and the finance company to which the installment contract is assigned may result in treating the finance company *as a party to the original transaction* . . .” The court thus focused on the relationship between the seller and the institutional lender rather than on the relationship between the buyer and the seller to determine whether the transaction was a loan or a credit sale.

In *Boerner* v. *Colwell Co.* (1978) 21 Cal. 3d 37, 53, the court rejected the King rationale, stating: “While the relative ‘closeness’ of the relationship between the seller and the financing institution may have a significant effect on whether the latter’s rights are to be considered subject to the defenses and claims of the purchasers [citations], we hold that it is without significance in itself in the determination whether the, subject transactions,

[3] The statutory modification of *Morgan* referred to in section 1801. 6 concerns exclusions from the purview of the Unruh Act of contracts for the sale of real property or the construction and sale of residential or commercial buildings. (See *Vasquez* v. *Superior Court* (1971) 4 Cal. 3d 800, 822, fn. 20.) Section 1812.7 states: “In case of failure by any person to comply with the provisions of this chapter, such person or any person who acquires a contract or installment account with knowledge of such noncompliance is barred from recovery of any finance charge or of any delinquency, collection, extension, deferral or refinance charge imposed in connection with such contract or installment account and the buyer shall have the right to recover from such person an amount equal to any of such charges paid by the buyer.”

considered from the point of view of substance rather than form, are to be characterized as . . . loans rather than bona fide credit sales."

Taken as a whole, these cases summarize the legal principle that "The law respects form less than substance." (§ 3528.) How the parties characterize their transaction is irrelevant; what is important is the function of the arrangement. An objective standard is applied to determine the actual intent of the parties.

In enacting section 1801.6, the Legislature (1) noted the confusion caused by the "close connection" language of the *King* decision, (2) approved the basic legal concept of "substance over form," and (3) spelled out guidelines for determining whether the Unruh Act applies to certain transactions in the form of loans.

Under subdivision (b) of section 1801.6, a seller may "arrange" the loan, participate in the preparation of the loan documents, and receive a referral fee of $20.00 or 1 percent of the amount financed without necessarily turning a true loan into a credit sale transaction.

On the other hand, subdivision (b) makes clear that a transaction in the form of a loan will be found to be covered by the Unruh Act where the institutional lender and the seller share in the profits and losses of the transaction or are related by common ownership and control and such relationship is a material factor in the transaction.

We see no conflict between the Supreme Court cases as a whole and the various provisions of section 1801.6. Moreover, sections (a) and (b) of the statute may be reconciled and harmonized together. The Legislature has amply demonstrated its intent in setting forth the statutory guidelines.

A detailed set of facts has been presented to us for consideration in analyzing the distinction between a credit sale and a loan transaction. In essence, (1) a homeowner requires financing for a home improvement, (2) the home improvement dealer has an agreement with a lender to refer customers for financing, (3) the homeowner is assured by the dealer that he can arrange financing from the lender, (4) the dealer acts as an intermediary between the homeowner and the lender, supplying the loan forms and assisting in their preparation and submission to the lender, (5) the contract between the dealer and the homeowner specifies full cash payment which the lender pays to the dealer directly, and (6) virtually all of the dealer's customers finance their home improvements through arrangements made between the dealer and lender.

Examining all of the relevant factors, we believe that a court would find the above described transaction to be in substance a credit sale and thus covered by the Unruh

Act. The dealer's purpose is to obtain financing for his business, and the homeowner's objective is to obtain the home improvement. The facts are strikingly similar to those found by the Supreme Court in *Boerner* v. *Colwell*, *supra*, 21 Cal. 3d 37, 41–42, 30–51 to be a credit sale. (See also *Hernandez* v. *Atlantic Finance Co.* (1980) 105 Cal. App. 3d 65, 73–74; *Fox* v. *Federated Department Stores, Inc.* (1979) 94 Cal. App. 3d 867, 882–884.)

Although we believe that this particular transaction happens to be covered by the Unruh Act, under different circumstances a dealer-referred home improvement loan may be found to be excluded under the provisions of section 1801.6. Each case must be examined on its own peculiar facts. We cannot make an unequivocal statement dealing with all circumstances.

In answer to the question presented, we conclude that a supervised financial organization may make dealer-referred home improvement loans without complying with the provisions of the Unruh Act, unless (1) the organization is related to the home improvement dealer and such relationship is a material factor in the transaction, (2) the organization shares with the dealer in the profits and losses of the transaction, or (3) the transaction is otherwise in substance a credit sale rather than a loan.

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