

# HOUSE BILL REPORT

## SB 5032

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### As Reported by House Committee On: Judiciary

**Title:** An act relating to specifying when a transaction in the form of a lease does not create a security interest for purposes of the uniform commercial code.

**Brief Description:** Specifying when a transaction in the form of a lease does not create a security interest for purposes of the uniform commercial code.

**Sponsors:** Senators Pedersen and O'Ban.

#### **Brief History:**

##### **Committee Activity:**

Judiciary: 3/12/15, 3/19/15 [DP].

#### **Brief Summary of Bill**

- Provides that a security interest is not created merely because a transaction in the form of a lease contains a terminal rental adjustment provision.

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### HOUSE COMMITTEE ON JUDICIARY

**Majority Report:** Do pass. Signed by 13 members: Representatives Jinkins, Chair; Kilduff, Vice Chair; Rodne, Ranking Minority Member; Shea, Assistant Ranking Minority Member; Goodman, Haler, Hansen, Kirby, Klippert, Muri, Orwall, Stokesbary and Walkinshaw.

**Staff:** Brent Campbell (786-7152).

#### **Background:**

The Uniform Commercial Code (UCC) controls commercial transactions between merchants, such as equipment sales and leases. Washington laws follow the UCC.

A lease is a contractual arrangement whereby a lessee pays a lessor for the use of real or personal property. A security interest is a property interest over assets to secure the performance of a debt. In some circumstances, a transaction may be in the form of a lease,

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but in fact create a security interest. Under the UCC, whether a transaction in the form of a lease creates a lease or is in fact a sale security interest is determined by the facts of each case. Determining whether a transaction is a lease or a sale subject to a security interest has implications for both bankruptcy and tax law.

A transaction in the form of a lease creates a security interest if: (1) the consideration that the lessee is to pay the lessor for the right to use the goods is an obligation for the term of the lease and is not subject to termination by the lessee; and (2) the transaction is subject to one of the following:

- the original term of the lease is equal to or greater than the remaining economic life of the goods;
- the lessee is bound to renew the lease for the remaining economic life of the goods;
- the lessee has an option to renew the lease for the remaining economic life of the goods for no, or for nominal, additional consideration; or
- the lessee has an option to become the owner of the goods for no, or for nominal, additional consideration.

One type of commercial lease term allows rental payments to change based on the sale amount when the leasing company sells the equipment. These leases are commonly called terminal rental adjustment, or TRAC leases.

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**Summary of Bill:**

A transaction in lease form does not create a security interest merely because it contains a TRAC provision.

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**Appropriation:** None.

**Fiscal Note:** Not requested.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) Three years ago the Legislature revised Article 1 of the Uniform Commercial Code with a comprehensive rewrite of that chapter. That rewrite was seen as a technical change to address ambiguities, but, though the revisions were extensively reviewed, the TRAC lease provision was inadvertently omitted. This change made Washington the only state in the country that does not have a TRAC lease provision. The change went unnoticed until last summer, and probably won't become an issue unless there is an insolvency or bankruptcy problem. But if that happens, then this could be a very real problem.

The only purpose in this bill is to fix that mistake and reinstate language that was unintentionally deleted.

The TRAC leases are at the very core of the business model for the business-to-business leasing industry. More than 4,000 trucks and 27,000 automobiles are estimated to be under TRAC leases in Washington alone. The TRAC vehicle leasing is a decades old process that is common and is accepted everywhere except Washington. The TRAC provisions allow for a modification of rent, either upwards or downwards, at the end of a lease. This provides an incentive to keep leased equipment in good repair. The TRAC leases also offer protection for customers in instances of bankruptcy by allowing the leased equipment to go back to the bank, and not be used to satisfy any debt.

The TRAC leases are a benefit to all parties and banks and customers both agree that restoration of the TRAC lease provision is important.

(Opposed) None.

**Persons Testifying:** Senator Pedersen, prime sponsor; Jessica Fortescue, Washington Bankers Association; Olen Hunter, PACCAR Leasing Company; and Malcolm Lindquist, Washington State Bar Association.

**Persons Signed In To Testify But Not Testifying:** None.