

ALASKA LEGISLATURE COMMITTEE FILES, 1989-1990
5888 HOUSE LABOR & COMMERCE 8672

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section 8-207(7) we provide that the new shares "shall also be subject to the rights of the registered pledgee."

In one instance, and only one, we departed from our general approach of merely restating the law with respect to certificated shares and purposely extended the coverage of the statute. The rule of present section 8-317, requiring certificate seizure for a valid creditor's lien, is eminently rational when certificates are issued in shareholder name and held by the shareholder. The apparent exclusivity of this remedy is inconsistent with modern security holding practices. To give an extreme, but not uncommon, example, assume that Debtor is the owner of 100 shares of Issuer stock and has asked Broker to hold the stock in street name. Broker has, in turn, deposited certificates for 5,000 shares of Issuer stock with Depository which has credited Broker's account. Depository has then delivered these certificates, together with certificates received from other brokers, to Issuer which has issued to Depository a jumbo certificate, in Depository's name, for 200,000 shares. According to section 8-317, Creditor, wishing to levy upon Debtor's interest in Issuer, can acquire no lien without seizing Debtor's certificate. But Debtor has no certificate unless one conceives that Debtor has an undivided interest in that 200,000 share certificate reposing serenely in Depository's well guarded vault. It is hard to imagine that Depository will voluntarily surrender that certificate to the sheriff or that a court would compel it to do so. Indeed, it is unlikely that Depository will be aware of Debtor's existence. Debtor's interest is known only to Broker. In revised section 8-317, Creditor obtains his lien by garnishment of Broker, thus assuring, as present section 8-317 intends, that Debtor will not be able to transfer his interest to a bona fide purchaser free of Creditor's lien.

It was with some reluctance that we failed to incorporate in the statute provisions for a certified transfer order, suggested by Professor Jolls and others. Such an order would be an instrument, analogous to a certified check, which an issuer would have agreed to honor if timely presented and which could be used in C.O.D. settlements. It was not adopted for two reasons. First, it seemed that a wholly certificateless environment would necessarily have developed commercially acceptable procedures to accomplish the equivalent of the C.O.D. settlement by electronic communication or otherwise. Such mechanisms would make the certified transfer order unnecessary. Secondly, pending the development of the procedures described, it appeared that certificates would necessarily continue to be available to effectuate C.O.D. settlements when they were required.

The Role of the SEC

The Securities Acts Amendments of 1975, for the first time, expressly involve the Securities and Exchange Commission in the regulation of clearance and settlement systems. By amendment to the Securities Exchange Act of 1934, the Commission is empowered to prescribe the form and format of

securities;²⁰ to facilitate the establishment of a national system for clearance and settlement,²¹ to regulate clearing agencies,²² to regulate transfer agents²³ and to "end the physical movement of securities in connection with the settlement among brokers and dealers."²⁴ By these amendments, Congress has assuredly not legislated the stock certificate out of existence. Nor has it, expressly or by implication, provided for any system not already sanctioned under existing law. It has, at the most, empowered the Commission to compel broker-dealers to participate in some form of certificateless system without prescribing either what that system should be or setting a time limit for participation. Beyond that, it has merely invited the Commission to submit "its recommendations, if any, for legislation to eliminate the securities certificate."²⁵

The newly-granted regulatory powers of the Commission, wisely exercised, could do much to encourage the voluntary adoption and expansion of certificateless systems. The establishment of both financial and operational standards for clearing agencies, which are defined to include depositories, should have the effect of instilling confidence in potential participants in that form of certificateless transfer. SEC supervision is not the equivalent of a government guarantee against operational or financial failure, but it may, to some degree, tip the scales toward participation by some. So long as participation is voluntary, however, it will be the depositories' burden, by means of satisfactory performance and demonstrated economy, to attract additional participants.

The Commission's power to prescribe uniform standards for transfer agent capability is particularly crucial to the development of wholly certificateless systems. When certificates exist, the registration of transfer merely confirms the legal relationships already established by delivery. Without certificates, however, the completion of many transactions will necessarily await registration on the books of the issuer. Inadequate transfer agent performance can be injurious to a system based on certificates. In a system without certificates, it could be fatal.

It is apparently the view of Congress that the industry, motivated by incentives of cost minimization and increased efficiency, gives promise of producing satisfactory clearance and settlement system without mandatory federal legislation. In effect, Congress views the Commission as a stimulus to facilitate systems development and to encourage participation, but not as a designer of particular systems or an agent to compel participation therein. It goes without saying that if the industry does not measure up to Congress'

20. *Securities Exchange Act of 1934* § 12(1), 15 U.S.C.A. § 781(1) (Pamphlet 4, 1975).

21. *Id.* § 17A(a)(2), 15 U.S.C.A. § 78q-1(a)(2) (Pamphlet 4, 1975).

22. *Id.* § 17A(b), 15 U.S.C.A. § 78q-1(b) (Pamphlet 4, 1975).

23. *Id.* § 17A(c), 15 U.S.C.A. § 78q-1(c) (Pamphlet 4, 1975).

24. *Id.* § 17A(e), 15 U.S.C.A. § 78q-1(e) (Pamphlet 4, 1975).

25. *Id.* § 23(b)(4)(E), 15 U.S.C.A. § 78w(b)(4)(E) (Pamphlet 4, 1975).

expectations, the propensity for further federal intervention is certain to increase.

The Prospects for Adoption

In the course of its deliberations, the Committee was divided on the issue of whether to recommend legislation by Congress or by the state legislatures. In the end, the state route was espoused on the general principle that corporate and commercial law were areas in which the state legislatures traditionally acted and that this tradition should not be lightly disturbed. The countervailing argument was that federal legislation was the only way to achieve absolute uniformity and probably the best way to assure reasonable promptness. The several years taken by Congress to enact even the limited approach of the 1975 Securities Acts Amendments indicates that promptness at the federal level is far from assured. And, indeed, with respect to amendments to the Uniform Commercial Code, it is possible that promptness, with reasonable uniformity, can be achieved at the state level.

The Permanent Editorial Board for the Uniform Commercial Code provides a unique mechanism for drafting, editing and promulgating commercial statutes at the state level which is perhaps unparalleled in any other area of the law. It is contemplated that a revised Article 8, bearing the imprimatur of the Permanent Editorial Board, might be before the state legislatures as early as 1976. As to the promptness with which the state legislatures will act there is less predictability. On the one hand, the recent amendment to section 8-102(3), proposed initially in 1972, has already been adopted by more than forty states. On the other hand, the current official text which substantially revises Article 9, promulgated in the same year, has been adopted by only fourteen. If the operative distinction between these two proposals is their relative complexity, the prospects for prompt adoption of proposed Article 8 are dim.

There is, however, another important distinction between the two proposals. The 1972 version of Article 9 is intended to displace an earlier statute which addresses the same problems and, in some instances, solves them differently. Secured transactions can, however, still proceed with assurance under the earlier, unamended version. New section 8-102(3) provides for an institution, the non-exchange-owned securities depository, which could not exist under prior law. It was recognized that such an institution might significantly promote the development of comprehensive depository systems and members of the securities industry got behind the amendment and pushed the legislatures for its adoption.

If that is the explanation, the prospects for the prompt adoption of proposed Article 8 are more optimistic. At present there is no statute to govern the attributes of uncertificated stock. By its terms, present Article 8 applies only to "securities" and securities are defined, in section 8-102(1), as "instruments." A share of stock not evidenced by an instrument is without any

legal foundation in the Uniform Commercial Code with the single exception that it would be classified as a "general intangible" for purposes of Article 9.²⁶ If, as we believe, there is a real need for uncertificated stock the attributes of which will be governed by statutory law rather than by fictitious analogy the impetus for pushing the legislatures should materialize. If it does, the Committee's recommendation to amend the commercial law at the state level is justified both by practicality and by principle.

The situation with respect to the corporate law is different. The Model Business Corporation Act does not enjoy the almost uniform acceptance accorded to the Uniform Commercial Code's official text. State corporation statutes vary widely in both form and content and substantive non-uniformity is the rule rather than the limited exception. Each state corporation statute requires an independent analysis and revision, in sharp contrast to the Uniform Commercial Code for which amendments can be centrally drafted and packaged for export. In short, the prospects for the prompt and uniform adoption of the proposed corporate law amendments by the state legislatures are less than great.

Hopefully, the necessity for the prompt and uniform adoption of our recommended corporate law amendments is not nearly so pressing. The adoption of enabling legislation in just a few major commercial states would permit the issuance of certificateless stock by a large number of corporations. If only a handful of enterprising corporations incorporated in the adopting jurisdictions could successfully implement the issuance of uncertificated shares to the mutual benefit of themselves and their shareholders, similarly situated corporations in non-adopting jurisdictions can be counted on to urge adoption by their respective legislatures. Furthermore, on the basis of demonstrated successful implementation, it would be neither unexpected nor unwarranted for the Securities & Exchange Commission to recommend that Congress provide this power for all or some categories of corporations registered under the Securities Acts, thus making state adoption irrelevant.²⁷

Conclusion

However illogical it may seem, I am convinced that the prompt and uniform adoption of a carefully drafted and rigorously edited commercial statute to govern the attributes of uncertificated shares is of far greater importance than the adoption of statutes to authorize their issuance. Even now, uncertificated shares, without express statutory authorization, are being voluntarily

26. Uniform Commercial Code § 9-106. The result of that classification is to require the filing of a financing statement as the exclusive means of perfecting a security interest in uncertificated shares. *Id.* § 9-302(1).

27. Significantly, the two state legislatures that have acted have not granted the power to issue uncertificated shares to all corporations. Michigan has limited the power to issuers of "shares or other securities . . . listed on a national securities exchange" and California to "a corporation which is the issuer of securities registered under the United States Securities Exchange Act of 1934." See note 4 *supra*.

issued in the guise of certificated shares held by the issuer. The adoption of the proposed Uniform Commercial Code amendments will permit these systems to develop with that confidence in the legal consequences of transactions that is so essential to commercial acceptability.

- There is an even more critical consideration. A recurrence of a paperwork crisis in the securities industry is likely to evoke demands to abolish the stock certificate by law and thereby, in effect, compel the issuance of uncertificated shares. I fear that mandatory legislation, enacted under panic conditions, may fail to provide an adequate framework for dealing with the artifacts it creates.²⁸ It would be far better to be prepared for uncertificated shares before they exist than to have them thrust upon us before we are ready for them.

²⁸ Draftsmen of corporate statutes properly do not concern themselves with the solution of nitty-gritty commercial problems. The Michigan statute, note 4 *supra*, delegates that unpleasant task to the securities exchange on which the uncertificated shares are listed. The California statute, note 4 *supra*, is more expansive and defers to its Commissioner of Corporations, the Securities & Exchange Commission or Congress. And Congress, in section 17A(c) of the 1934 Act, blithely tells the SEC "to end the physical movement of securities certificates in connection with the settlement among brokers and dealers."

ARTICLE 8 AMENDMENTS TO THE
UNIFORM COMMERCIAL CODE

Article 8 of the Uniform Commercial Code is entitled "Investment Securities." A "security" is broadly defined as an instrument which:

- (1) is issued in bearer or registered form;
- (2) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment;
- (3) is either one of a class or series or by its terms is divisible into a class or series of instruments; and
- (4) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

The commonest examples are stocks and bonds. They have a market and are bought and sold, as are "goods" under Article 2 of the UCC, and negotiable instruments under Article 3. The UCC sought to cover all the major kinds of markets in its conception of "commercial transactions." Thus, Article 8 provided a fundamental law for the buying and selling of securities.

Note, however, one aspect of this basic definition. It states that a security is an "instrument." It implies a piece of paper with appropriate writing to identify the obligation the security manifests. Therein lies the kernel for the present revision - paper. The new Article 8 contemplates the elimination of the paper. The term instrument will no longer imply the existence of specific pieces of paper which act as evidence of obligations between people.

There are a number of reasons for this anti-paper revolution. In the late 1960s, the brokers and the exchanges became overburdened with paper. The sheer load hampered the markets. Also, automation has progressed far enough to make the revolution feasible. It is easier and faster to record transfers in the computer. It is efficient and more economical. Thus, the nature of the transactions in securities is fundamentally changing.

Under the revised Article 8, an immediate distinction is made between types of securities. There are "certificated" securities and "uncertificated" securities. The "certificated" security is the one we have long known, represented on and by a piece of paper, an instrument. That piece of paper has been, and remains, the means of transfer and the evidence of obligation - when it exists. But it no longer always exists.

The "uncertificated" security is not evidenced by any piece of paper at all. It exists on its issuer's records. Its key characteristics are found in the definition. It "is not represented by an instrument and the transfer of which is registered upon books maintained for the purpose by or on behalf of the issuer.. ." Without the instrument, the mechanics of a transfer change. Also changed are the manners in which obligations are manifested.

Where there is a certificate, it physically participates in any transfer of the obligations it contains. A security passes upon proper endorsement and physical delivery of the instrument. The instrument takes part in pledges made by owners of the security to secure their own debts. It is also the foundation of the warranties each of the parties gives in a transaction involving a security. The paper is fundamental, and when it is eliminated, some changes commensurate with its elimination must take place.

When a transfer, or registration of a pledge, occurs in the case of an "uncertificated" security, it does so only on the books of the issuer. This means that an "instruction" must be given to the issuer by the appropriate person. The "instruction" normally will be in writing, and obligates the issuer to make the necessary entry on the books. The evidence of completion is a statement back from the issuer within two business days after the registration occurs. It goes to transferror, transferee, and any pledgee.

These two items are the only pieces of paper involved in the transfer, and are designed to be much simpler than the "certificated" security. The last of the two, the "Initial Transaction Statement," is the most important. It provides notice of terms, restrictions, and adverse claims to the addressee, and runs against the issuer if it does not. This is a similar function to the written instrument which constitutes a "certificated" security. The rights of purchasers which depend on this information are affected almost exactly as a purchaser's rights are affected by a "certificated" security.

There are differences, however. A purchaser of an "uncertificated" security, in general, can rise no higher than his transferror in terms of his rights. He takes as if he had his transferror's knowledge, even if he doesn't. A "certificated" security does not hold a purchaser to the knowledge of his transferror, but bases his rights on his own

knowledge. That is a distinct difference between the two forms of security.

Further, an Initial Transfer Statement warrants only that the acknowledged owner is so at the time of its issuance. It does not do so for any following time period. In contrast, a purchaser may normally assume that the holder of a "certificated" security is the owner and entitled to transfer it. In these respects, the Initial Transfer Statement does not offer the assurances of a "certificated" security.

It is perhaps anomalous to think of security interests in a security, which itself may represent a debt of the issuer. People who own securities, which are valuable property, may pledge them for their debts. They create a security interest in the creditor by so doing.

A "certificated" security is merely delivered to the pledgee with a proper endorsement. That creates the security interest. Where "uncertificated" securities are concerned, the security interest must be registered. The procedure for doing this is identical to the procedure for a transfer. An instruction is sent to, and a confirmatory statement returned from, the issuer of the security. Once registered, the owner continues all powers with respect to the security except the power of transfer. That belongs to the registered pledgee.

The "uncertificated" security offers a bit more protection to the pledgee than a "certificated" security does. If a pledge of a "certificated" security is not registered, additional securities and dividends will be distributed to the owner, not the pledgee. The procedure relating to "uncertificated" securities precludes the problem. It is also to be noted that perfection of the security interest is by possession of the instrument for a "certificated" security, and by the mere procedure of creating the interest for "uncertificated" securities. Perfection is the means of determining the priority between competing security interests.

Warranties also differ between "certificated" and "uncertificated" securities. The face of the instrument provides a basis of warranties for "certificated" securities. The presenter to an issuer for registration, the transferrer to a purchaser, all warrant aspects of the transaction because of the instrument and its enforcements and signature guarantees. For "uncertificated" securities, the only warranty can be on the part of the originator of an instruction to the issuer. That person warrants that the registration is proper to the issuer, and that the transfer has no defects to a purchaser for value.

Signature guarantees, an essential part of the transfer process for widely held securities, also cannot be the same for "certificated" and "uncertificated" securities. The guarantor of

a "certificated" security warrants that the endorser is an appropriate person acting for the owner. This is evident to the guarantor from the instrument. Without the instrument, the guarantees, are limited to the genuineness of the signature, and that the endorser purports to act for owner or pledgee. There are special, boarder guarantees of an "uncertificated" security which cannot be demanded by an issuer, but which can be made to further secure a transaction.

The difference between a "certificated" security and the items of paper relating to registration of an "uncertificated" security cause a difference in the treatment of a bona fide purchaser for value, also. Essentially, a bona fide purchaser for value is held for only those things on the instrument with respect to a "certificated" security. The bona fide purchaser for value of an "uncertificated" security essentially takes free of what does not appear on the initial transaction statement. Practically, this may expose him to greater liability, but also forces him to seek a clean transaction statement before accepting liability.

Third party claims also provide a difference. For "certificated" securities, notice in writing to the issuer suffices. For "uncertificated" securities, the claim must be in the legal process before the issuer has notice. Judicial liens are also treated differently. Seizure of the security works for "certificated" securities, but not for all the "uncertificated" breed. It is necessary to serve process on the issuer.

These are some of the differences which result from the addition of the "uncertificated" security to the security markets. There has been no need to change the basic pattern of Article 8, which has served its purpose well. The amendments seek to incorporate the "uncertificated" security with the least disturbance possible.

QUESTIONS AND ANSWERS ON THE 1977 AMENDMENTS TO
ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE

Q: What do the 1977 Amendments to the Uniform Commercial Code (UCC) provide?

A: They permit entities creating investment securities (stocks and bonds are the commonest examples) to issue "uncertificated" securities. This kind of security would not be represented by a "certificate" and would not be transferred by passing a certificate from one person to another. Transfer would take place when the issuer creating the security records the transfer on its books.

Q: How does such a transfer take place?

A: In most instances transfers of uncertificated securities will require computerized records and electronic communications systems. In small corporations that have limited numbers of stockholders and are not publicly traded, uncertificated securities might be created without these technical advances. Under the Amendments, a transfer of any kind follows this basic sequence:

1. The current owner (transferor) of the uncertificated security sends an instruction to the issuer to record a transfer to another person (transferee). The instruction must be in the form required by the issuer.
2. The issuer records the transfer on its records.
3. The issuer returns an identical document to both the transferor and transferee confirming the transfer. This document, called an Initial Transaction Statement (ITS), must be returned within two days after the receipt of instruction. Receipt of the ITS assures that the transaction is complete.

Q: How are uncertificated securities pledged as collateral for a debt?

A: A pledge is a type of transfer under the Amendments. It requires the same sequence as any other transfer, such as a sale or a gift, except that the effect is to preserve on the issuer's books the rights of the creditor in the securities as collateral. A pledge can be recorded in two ways. The creditor can be shown on the issuer's records as the owner of the securities, as collateral for the debt. The pledge, itself, can also be recorded without an actual transfer of ownership. In either case, the creditor's

There are issuers, such as mutual funds, that have never made certificates available - their customers do not expect what has never been offered. Most investors who deal through brokers maintain accounts and never see certificates, even though the large bulk of stocks and bonds are currently certificated. The majority of investors don't expect certificates anymore, and it is likely that the demand will be rare, though they will be available.

Q: Aren't computerized records and electronic transfers more open to fraud and deception than certificated transfers?

A: Securities are valuable property and targets of the unscrupulous and dishonest. Certificates are stolen, signatures are forged; paper may be counterfeited, even after the most elaborate precautions. In short, there are risks inherent for certificated securities, and issuers, financial institutions, brokers, and investors have to take precautions to protect rights represented by certificates. The UCC was never concerned with these problems, except to establish certain basic liabilities. The practices of the securities industry, bolstered by the establishment of these liabilities. The practices of the securities industry, the criminal law, have been primarily responsible for protecting these valuable interests. The system has worked very well, though never perfectly.

The Amendments treat uncertificated securities the same way the UCC has treated certificated securities. Certain basic liabilities are established, but the practices of the securities industry, backed by the criminal law, is the primary defense against fraud and deception. The risks are different with computers and electronic transfer systems, but they are not insurmountable. The banking system already operates largely on electronic transfers of money and while no system of transfers will ever be perfect, it appears that a high level of safety is possible and probable. Indeed, if the market place did not have a high level of safety, nobody would enter the market. That is the best guarantee that systems adopted will be very safe before they are utilized.

Q: Do the 1977 Amendments to the UCC affect securities regulation at the state or federal level?

A: The short answer is no. The UCC has provided the basic transfer rules for investment securities. It has never been concerned with issues of regulation, such as registration of securities issues or disclosure to investors. The Amendments make no change in this pattern. Uncertificated securities are subject to the same regulatory requirements as certificated securities, and the existence or non-existence of the certificate makes no difference whatsoever.

A Few Facts About

THE ARTICLE 8 AMENDMENTS TO THE UNIFORM COMMERCIAL CODE

PURPOSE: To provide states with a legal framework for the transfer of uncertificated securities, similar to the rules for certificates found in the original Article 8.

ORIGIN: Completed by the Uniform Law Commissioners in 1977, in cooperation with the American Bar Association and the American Law Institute.

ENDORSED BY: New York Stock Exchange
Securities Industry Association
American Society of Corporate Secretaries

STATE ADOPTIONS:	Arkansas	Maine	Oklahoma
	California	Maryland	Oregon
	Colorado	Massachusetts	Rhode Island
	Connecticut	Michigan	South Dakota
	Delaware	Minnesota	Tennessee
	Florida	Montana	Texas
	Hawaii	Nevada	Utah *
	Idaho	New Hampshire	Virginia
	Illinois	New Mexico	Washington
	Indiana	New York	West Virginia
	Kansas	North Dakota	Wisconsin
	Kentucky	Ohio	Wyoming

1989 INTRODUCTION:	Alaska	Iowa	New Jersey
	District of Columbia	Mississippi	North Carolina
		Nebraska	Vermont

NEED A SPEAKER? These persons are available to provide testimony or give presentations on the Article 8 Amendments:

Martin J. Aronstein
Univ. of Pennsylvania
Permanent Editorial
Board for the UCC

Robert Haydock
Boston, Mass.
Permanent Editorial
Board for the UCC

William E. Hogan
New York University
Permanent Editorial
Board for the UCC

Donald Scott
Philadelphia, PA
Permanent Editorial
Board for the UCC

For information on arranging a speaker, contact John McCabe or Katie Robinson at 312-915-0195.

* 1989 Adoptions

CORRECTION

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rights will be protected from any further transfer, since the issuer cannot record any subsequent transfer that conflicts with, or is superior to, the creditor's interest until that interest is removed from the record.

Q: What happens to securities represented by certificates when the Amendments are adopted?

A: There is no change in the legal status of securities represented by certificates. Issuers can continue to offer existing securities and certificates and new issues can be created with certificated securities. The Amendments do not repeal the existing rules, but establish a parallel set of rules for uncertificated securities. It is intended that the law favors neither certificated nor uncertificated securities. When an issuer considers which option to take, the choice will not be influenced by some inherent advantage or disadvantage built into the law, but only by the issuer's perception of the marketing efficiency to be gained. The Amendments expand choices for creating securities. They do not take away anything that is already available.

Q: Can an issuer create both certificated and uncertificated securities at the same time?

A: Yes. It is anticipated that corporations which convert from certificated to uncertificated securities will make the transition over an extended period of time. They will probably have stock issues that are certificated as well as uncertificated. Many issuers may choose a mixed system indefinitely. The Amendments do not restrict any system that an issuer may want to put into effect.

Q: What if the investor wants to have certificates when issued uncertificated securities?

A: If the issuer has a mixed system, with both certificated and uncertificated securities, an investor may demand, and must receive, certificates. If the issuer issues no certificated securities, they do not have to be created to meet the demand of an individual investor. The investor will have to invest elsewhere. This situation arises primarily with stocks, and investors who feel comfortable with the traditional certificates. In most cases, corporations will have mixed systems, and certificates will be available for those who want them.

There are issuers, such as mutual funds, that have never made certificates available - their customers do not expect what has never been offered. Most investors who deal through brokers maintain accounts and never see certificates, even though the large bulk of stocks and bonds are currently certificated. The majority of investors don't expect certificates anymore, and it is likely that the demand will be rare, though they will be available.

Q: Aren't computerized records and electronic transfers more open to fraud and deception than certificated transfers?

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The Amendments treat uncertificated securities the same way the UCC has treated certificated securities. Certain basic liabilities are established, but the practices of the securities industry, backed by the criminal law, is the primary defense against fraud and deception. The risks are different with computers and electronic transfer systems, but they are not insurmountable. The banking system already operates largely on electronic transfers of money and while no system of transfers will ever be perfect, it appears that a high level of safety is possible and probable. Indeed, if the market place did not have a high level of safety, nobody would enter the market. That is the best guarantee that systems adopted will be very safe before they are utilized.

Q: Do the 1977 Amendments to the UCC affect securities regulation at the state or federal level?

A: The short answer is no. The UCC has provided the basic transfer rules for investment securities. It has never been concerned with issues of regulation, such as registration of securities issues or disclosure to investors. The Amendments make no change in this pattern. Uncertificated securities are subject to the same regulatory requirements as certificated securities, and the existence or non-existence of the certificate makes no difference whatsoever.

Q: How many states have adopted the 1977 Amendments to the UCC?

A: To date, 35 states, including California, Delaware, Massachusetts, New York, Illinois, and Texas - all states that rank high in quantity of securities trading. With the adoption of the Amendments in Delaware and New York, the opportunity for issues of uncertificated securities expanded enormously. No state that wishes to stay current with the fundamental law respecting investment securities can afford to delay adopting these Amendments.

Q: What will a state gain by enacting the 1977 Amendments to the UCC?

A: Corporations, brokers, financial institutions, mutual funds, and others involved in the creation and sale of investment securities will have the most up-to-date law available to them. They will be able to take immediate advantage of these Amendments. Brokers will also be able to deal in uncertificated securities issued by out-of-state issuers of securities without thought as to the validity of such transfers on behalf of local customers.

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	Hawaii	Nevada	Utah *
	Idaho	New Hampshire	Virginia
	Illinois	New Mexico	Washington
	Indiana	New York	West Virginia
	Kansas	North Dakota	Wisconsin
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NEED A SPEAKER? These persons are available to provide testimony or give presentations on the Article 8 Amendments:

Martin J. Aronstein Univ. of Pennsylvania Permanent Editorial Board for the UCC	Robert Haydock Boston, Mass. Permanent Editorial Board for the UCC
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William E. Hogan New York University Permanent Editorial Board for the UCC	Donald Scott Philadelphia, PA Permanent Editorial Board for the UCC
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For information on arranging a speaker, contact John McCabe or Katie Robinson at 312-915-0195.

* 1989 Adoptions

SECURITIES INDUSTRY ASSOCIATION
120 Broadway, New York, N. Y. 10271 - 212 303-1500

RECEIVED

January 31, 1984

John M. McCabe
Legislative Director
National Conference of Commissioners
on Uniform State Laws
645 North Michigan Avenue - Suite 510
Chicago, IL 60611

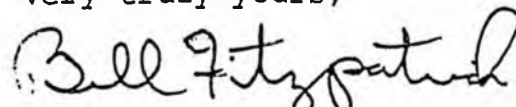
Dear Mr. McCabe:

This is to advise you that the Board of Directors of SIA, through their Executive Committee, at a meeting held on January 18, 1984, passed a resolution endorsing an amendment to the Uniform Commercial Code setting out legal rights and responsibilities for transferring securities without using certificates. The Board endorsed the legislation which is proposed by your Conference and which has passed in the State of New York as well as seven other states.

For your information, because of a rather crowded agenda and a time problem, this matter did not reach the Board's attention in their meeting held in November of 1983. This explains the delay in getting back to you on this matter.

I wish you continued success in your ventures.

Very truly yours,



William J. Fitzpatrick
General Counsel

WJF:es

AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.

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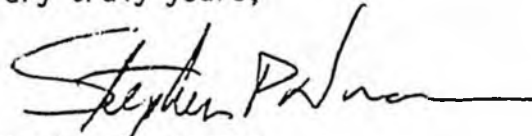
April 25, 1985

Mr. John M. McCabe
Legislative Director
National Conference of Commissioners
on Uniform State Laws
645 North Michigan Avenue
Suite 510
Chicago, Illinois 60611

Dear Mr. McCabe:

The Securities Industry Committee of the American Society of Corporate Secretaries endorsed the 1977 Amendments to Article 8 of the Uniform Commercial Code at its meeting in New York on October 18, 1983. The Society supports the adoption of these Amendments by all states in the near future so that the laws of the various states pertaining to the transfer of securities can be made wholly uniform.

Very truly yours,



Stephen P. Norman
Chairman
Securities Industry Committee
American Society of Corporate
Secretaries Inc.

SPN:ldk

UNIFORM COMMERCIAL CODE
ARTICLE 2A - LEASES

CONTENTS

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Edwin E. Huddleson, III, Esq., from The Journal of
Equipment Lease Financing.

- * A Tradition of Excellence - A History of the Uniform Law
Commissioners

- * Uniform State Laws - How a Uniform Act Is Created

A Few Facts About

THE UNIFORM COMMERCIAL CODE, ARTICLE 2A - LEASES

PURPOSE: To provide states with a legal framework for any transaction, regardless of form, that creates a lease.

ORIGIN: Completed by the Uniform Law Commissioners in 1986.

ENDORSED BY: American Bar Association
American Law Institute

STATE ADOPTIONS: California
Oklahoma
South Dakota*

1989
INTRODUCTIONS: Alaska Mississippi North Dakota
Florida Nebraska Oregon
Illinois Nevada Rhode Island
Maine New Hampshire Utah
Massachusetts New York Washington
Minnesota West Virginia

NEED A
SPEAKER? These persons are available to provide testimony or give presentations on the Article 2A Amendments:

Marion Benfield, Jr.
Champaign, Illinois
Drafting Committee

Fred H. Miller
Norman, Oklahoma
Drafting Committee

For information on arranging a speaker, contact John McCabe or Katie Robinson at 312-915-0195.

* 1989 Adoptions

Old Wine in New Bottles: UCC Article 2A-Leases

Edwin E. Huddleson, III, Esq.

Introduction

Over the past decade, commentators and practicing lawyers have debated the desirability of a uniform state law on equipment leasing. The "statutory codification" movement was a natural reaction to the explosive growth of equipment leasing after World War II. Beginning in 1980, the American Bar Association undertook serious studies to define the scope and substance of a uniform state law on the leasing of goods.

The Commissioners on Uniform State Laws, acting in 1985 after three years of restudy by a drafting committee of law professors and attorneys, approved a proposed state law on equipment leasing: the Uniform Personal Property Leasing Act (UPPLA). UPPLA was then rewritten stylistically to make it a part of the Uniform Commercial Code (UCC). Today a new UCC Article 2A-Leases has been approved by the commissioners and is awaiting approval by the American Law Institute in May 1987. Thereafter, the new statute will be formally presented for enactment to the state legislatures.

Edwin E. Huddleson, III, is a partner in the law firm of Volpe, Boskey and Lyons, which represented AAEL throughout the drafting committee sessions that created new UCC Article 2A-Leases.

Overview of the Statute

UCC Article 2A-Leases is a uniform state law on equipment leasing, with standardized provisions on warranties and remedies that are variable by agreement between the lessor and lessee. The statute expands the scope of the UCC to cover leases of goods. But it is not a comprehensive code. It leaves several areas of state law to be developed by other law, particularly consumer protection statutes and so-called "products liability" case law. To avoid conflict with state certificate of title statutes (which cover automobiles, trailers, boats and other often-leased goods), the new statute defers to those other statutes. Within its own sphere, however, it addresses several issues that are important for equipment leasing.

The statute is divided into six parts: (1) General provisions. These include definitions ("consumer lease," statutory "finance lease,") as well as provisions governing choice of law in consumer leases, unconscionability, and options to accelerate at will. (2) Formation and construction of lease contract. Warranties, both express and implied, are dealt with here. Other Provisions in Part 2 address statute of frauds, when the lessee obtains an insurable interest, risk of loss and the special status of "finance leases" in the law of warranties. (3) Effect of lease contract. Third party rights are

covered here, as are priority disputes between lien creditors or secured parties and lessees, and competing claims in fixtures. (4) Performance of lease contract: repudiated, substituted and excused. One provision here (§2A-404) imposes an automatic "hell or high water" obligation on lessees to pay rent under a statutory "finance lease" that is not a consumer lease. Other sections in Part 4 cover topics such as adequate assurance of performance, anticipatory repudiation, and substituted and excused performance. (5) Default. Outlined in Part 5 are general provisions concerning default (statute of limitations, procedure in event of default), as well as the statutory (not contracted for) remedies of both the lessee and the lessor on the other party's default. (6) "Exhibit A to Article 2A-Leases" contains an amendment to old UCC §1-201(37), clarifying the definition of a true lease.

Within reasonable limits, the new statute preserves the freedom of contract of the lessor and the lessee to write specific lease agreements that vary or differ from UCC Article 2A-Leases.¹ The statute's standardized provisions on warranties and remedies, not affecting the rights of third parties, are variable by agreement between the lessor and the lessee. This is a powerful rebuttal to critics: Lessors and lessees who don't like the standardized provisions in the new statute can write their lease agreement to provide otherwise.

UCC Article 2A-Leases: Its Central Provisions

The core issues covered by UCC Article 2A-Leases include the definition of a true lease, remedies and measure of damages after default, warranties, the special status of "finance leases," "consumer lease" issues, the rejection of mandatory UCC filing (or public notice) requirements for true leases, and fixtures. These provisions, which are the subject of this article, will largely determine the success or failure of the new statute. Threats of stormy opposition to UCC Article 2A-Leases already have arisen, particularly from some vehicle lessors who are engaged in "open-end" "finance leasing" to consumers.² Overall, however, the new statute succeeds remarkably well in capturing the best of earlier commercial law decisions on equipment leasing. To a great extent, UCC Article 2A-Leases simply mirrors the common law on bailments for hire—that classic benchmark of reasonableness and gut equity in the law of equipment leasing.

True Leases of Goods Distinguished from Conditional Sales

One threshold issue confronting the drafters of new UCC Article 2A-Leases was how to define a true lease of goods, as opposed to a conditional sale or disguised security interest. True leases have long been distinguished from sales for many purposes in commercial law, including determining remedies on default, a lessor's rights under §365 of the Bankruptcy Code,³ and whether a transaction is covered by state usury laws.⁴ Moreover, a secured sale, unlike a lease, is subject to UCC Article 9, which sets rules of priority and generally requires the filing of a financing statement for secured interests. True leases henceforth will generally be governed by the provisions of new UCC Article 2A-Leases, while secured sales will be covered by UCC Article 9.

The commissioners on Uniform State Laws, after considering a variety of suggestions, decided to clarify the definition of a true lease with an amendment to old UCC §1-201(37)

suggested by AAEL. The thrust of the AAEL proposal was to preserve common law principles and reaffirm the importance of the residual as a source of potential gain or loss in the business of equipment leasing.

The old common law principles, elaborated in the new amendment to UCC §1-201(37), provide significantly more guidance than current law as to what is the essence of a true lease. True leases are still defined by reference to and comparison with "security interests." The structure of the amended statutory definition is to first state the general rule:

"Whether a transaction creates a lease or security interest is determined by the facts of each case."

Then, several specific factors are identified that will *destroy* true lease status and create a "security interest." Finally, other factors are listed that are consistent with true lease status.

Where the lessee cannot terminate the obligation to pay rents for the lease term, there are two basic factors, either of which will destroy true lease status: (1) where the term of the lease extends for the full economic life of the goods; or (2) where the lessee has an option to become the owner for "nominal" additional consideration. Where either factor exists, the transaction is not a true lease, because the lessor will receive no meaningful residual. The comment emphasizes that "these tests focus on economics, not the intent of the parties."⁵

Other factors are specified, in the final part of amended §1-201(37), which are consistent with true lease status. These include:

- ♦ a "full payout" lease (where the present value of the lessee's payments are substantially equal to the fair market value of the goods at the outset of the lease);
- ♦ typical "net lease" provisions where the lessee assumes the risk of loss, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;
- ♦ the mere existence of an option to renew the lease or buy the goods; and
- ♦ options to renew or buy at a fixed price equal to or greater than reasonably predictable fair market value (as predicted at the outset of the lease).

Moreover, the amended statutory definition deletes all reference to "the parties' intent." The comment explains that most of the criteria that courts have relied upon to show intent—including "typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods"—are "as relevant to true leases as to security interests." Objective criteria, not a search for subjective intention, is the order of the day.

These are significant clarifications of the law. Yet no attempt was made to answer all questions, since the variety of transactions that parties to a "lease" can produce is almost unlimited. The overall general standard is that whether a transaction is a lease, or a "security interest," will be determined on the basis of all the facts and circumstances.

Options to Renew or Buy

One linchpin in the definition of a true lease is the subject of options. Originally, the drafting committee considered tying the definition of an option in a true lease to artificial percentages and formulas for determining what constitutes "nominal consideration" for options to renew or buy. But AAEL objected to this approach. The commissioners then adopted the functional approach suggested by AAEL, tracking the earlier common law.

Where the option price in a lease is "stated to be the fair market value of the goods," the statute creates a safe harbor validating such options as consistent with true lease status. On the other hand, another part of the new statute repeats old UCC §1-201(37) by stating that, where the lessee cannot terminate the lease (simply walk away from it), a transaction creates a "security interest" (and not a true lease) if:

"(d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement."

Transactions are not true leases where the parties anticipate, when they enter into a transaction, that the option will

be irresistible in the sense that the option price is extremely low in comparison to the value of the property.⁶ As noted above, another part of the amended true lease definition validates certain *fixed-price options* as clearly consistent with "true lease" status by stating:

"A transaction does not create a security interest merely because it provides that..."

"(c) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed."

This safe harbor for true leases with fixed-priced purchase options should be helpful to equipment lessors, particularly in bankruptcy and usury cases.

One criticism leveled at the new, amended UCC §1-201(37) is that it fails to validate, as clearly consistent with true lease status, agreements with fixed-price options whenever the fixed-price option

"approximates reasonably predictable fair market value."

But this criticism is unsound. The only purpose of substituting "approximates" for "equal to or greater than" would be to attempt to validate, as clearly consistent with true lease status, agreements with fixed-price options at less than predictable fair market value. This is unwarranted. When the lessor and the lessee agree at the outset to give the lessee a discount on the option price (so that the option is less than reasonably predictable fair market value), they have written a "bargain" option agreement that "tilts the scales" to encourage exercise of the option. That sort of agreement may not be a true lease.

Moreover, it makes no sense to use a vague word like "approximates" in what is supposed to be a bright-line safe harbor test for valid fixed-price options in a true lease. No business justification exists: The safe harbor validating fixed-price options "equal to or greater than reasonably predictable fair market value" covers a wide range of predicted option values.⁷ This should give businessmen all the flexibility they need.

TRAC Leases

"Open-end" leases, with terminal rental adjustment clauses (TRAC), have been widely used in the motor vehicle leasing industry for over 30 years. TRAC motor vehicle leases are specifically recognized as true leases by the federal tax laws. But the case law is divided on whether TRAC leases are true leases under state law. The commissioners decided that amended UCC §1-201(37) would be silent on whether TRAC leases are true leases.

"Open-end" leases also raise the issue of whether TRAC provisions (or some variations of them) are validated by the liberal provisions of new §2A-504 on "liquidation of damages" (see part III b *infra*). Viewed as liquidated damage formulas, some narrowly-drawn TRAC provisions may be reasonable: One common lease provision, according to the comment in new §2A-504, leaves the lessor with potential profits from a residual sale, while essentially making the lessee a guarantor of the estimated residual value set out in the lease. This "one-sided" TRAC provision leaves the lessor with a meaningful interest in the residual. Other kinds of narrowly-drafted TRAC-like provisions, which charge the lessee for excessive use or poor maintenance (as opposed to changes in value due to market trends), also seem consistent with true lease status.

Outspoken critics of new UCC Article 2A-Leases include some motor vehicle lessors who fault the new statute for failing to specifically validate "open-end" TRAC leases as true leases. But the statute mirrors the common law. To this date, the weight of the case law has not recognized broadly-phrased "open-end" TRAC leases as true leases under state law. Moreover, some equipment lessors in the past have opposed according true lease status to "open-end" TRAC leases outside the specific context of motor vehicle leasing. The commissioners acted reasonably in simply preserving the status quo with respect to "open-end" leases.

Remedies

One major impetus for the new statute was dissatisfaction among equipment lessors, and their lawyers, with inconsistent and unpredictable



court decisions on the *remedies* available under a true lease. UCC Article 2A clarifies the law on lease remedies: Ordinarily, the lessor's remedies available for breach of a true lease will be those specified in the lease agreement. Yet UCC Article 2A provides a minimum safety net set of remedies (including a measure of damages for the lessee's breach), which will apply if the lease agreement is silent (or held invalid) on remedies issues.

Repossession and Disposition

Whether a default has occurred, as well as issues about repossession and other post-default rights and remedies under a true lease, are to be decided in the first instance by reference to the lease agreement. (UCC §2A-501, §2A-503). Both judicial and self-help remedies are available (§2A-501). Within wide limits, the statute allows the parties in a true lease to craft their own set of rights and remedies in the lease agreement.⁸

UCC §2A-525 specifically confirms the lessor's right to repossess the goods on the lessee's default. Advance notice of default or enforcement need not be given to the defaulting party (§2A-502). Ordinarily, the lessor is expected to mitigate damages by re-leasing or selling the repossessed goods. But where it proves impractical for the lessor to dispose of the goods at a reasonable price after repossession, he may hold the goods and recover accelerated rentals as damages (§2A-529(1)(b)).

Two types of provisions exist, in UCC Article 2A, on the lessor's damage remedies for the lessee's default: those that apply to contractual liquidated damage clauses; and those provisions that apply where the lease contract is silent (or invalid) on damages.

Contractually specified damages. UCC §2A-504(1) validates liquidated damages clauses that comply with this basic "reasonableness" test:

"Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is

reasonable in light of the then anticipated harm caused by the default or other act or omission."

This validates formulas as well as amounts, and drops some of the limitations on liquidated damage clauses that appeared in the old law of sales.

The comments provide little specific guidance on how the "reasonableness" standard in new UCC §2A-504 should be applied. The courts are left to wrestle with several recurring questions, as best they can, under the general standard of "reasonableness."

Residual risks on lessees. One question concerns the validity of default remedies that essentially push the whole residual risk onto the lessee. This issue may arise particularly for sweeping liquidated damages clauses in short-term consumer leases: especially where the lease runs for only a short time in relation to the expected useful life of the goods, it may not be "reasonable" (§2A-504) to stick the lessee with the risk that the market value of the lessor's residual may drop.

Cumulative remedies. There are some old cases holding that "cumulative remedy" provisions, in and of themselves, may render a liquidated damages clause invalid. But such provisions should pass muster under the new leasing statute so long as the total cumulative remedy sought is simply one satisfaction (not a double recovery) and is "reasonable in light of the then anticipated harm caused by the default or other act or omission" (§2A-504).

Accelerated rentals. Ordinarily, a liquidated damages clause with provision for accelerated rentals is enforceable by the lessor, if coupled with a contractual provision requiring the lessor to mitigate damages by sale or re-lease after repossession.⁹ Without strong proof of reasonableness, however, a liquidated damage clause providing for acceleration of future rentals (without mitigation) is likely to be struck down. Moreover, at least in contested cases, the courts are likely to continue past precedent by holding, under the "reasonableness" test in new §2A-504, that the lessor's recovery for future lost rentals must be discounted to present value.¹⁰ UCC §2A-109 specifies that the lessor can invoke an acceleration clause only when he "in

good faith believes that the prospect of payment or performance is impaired."¹¹

Election of remedies. Where a liquidated damages clause is otherwise valid, the "reasonableness" test in UCC §2A-504 should overrule earlier cases that required a lessor under a true lease to elect between repossessing the equipment, on the one hand, or suing for the accelerated rent and leaving the equipment in place, on the other. These old cases improperly extended the rule against double recovery. But the lessor's repossession and simultaneous recovery of accelerated rents does not necessarily result in double recovery or unjust enrichment. No double recovery results, for example, where a defaulting lessee is credited with proceeds from the sale or re-lease of equipment after repossession.¹²

Partial invalidity. Will the invalidity of part of a liquidated damage clause invalidate the whole clause, throwing the lessor back onto the statutory (non-contract) remedies in UCC Article 2A? Section 2A-504(2) states:

"If the lease agreement provides for liquidation of damages, and such provision does not comply with [the "reasonableness" test in] subsection (1), or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this Article."

Equipment lease liquidated damages clauses often set out alternative damage measures, so that no single alternative is "an exclusive or limited remedy" (§2A-504(2)). For such multipart liquidated damages clauses, partial invalidity may not always be fatal to the whole clause, if the invalid part is written to be reasonably segregable from the rest. This result would be consistent with the new statutory section on "unconscionability" (§2A-108): It states where a court finds a clause unconscionable, it has discretion under §2A-108 to refuse to enforce the whole contract or it may simply "blue pencil" out the offending clause and enforce the remainder of the lease contract.

(b) *Where the lease agreement is silent (or held invalid) on damages remedies*

The only time UCC Article 2A will control measure of damages

remedies is when the lease agreement is silent (or held invalid) on damages remedies. Two basic statutory (not contracted for) measure of damages standards are spelled out for the lessor. These apply in different situations: (1) where the lessor repossesses and then sells or re-leases the goods (§2A-527(2), §2A-528)); and (2) where the lessor repossesses and holds the goods for the lessee for the remainder of the lease term (§2A-529).

1. Where the lessor repossesses and then sells or re-leases the goods, after the lessee's default, the lessor's statutory (non-contract) damages consist of the sum of (1) past unpaid rentals, plus (2) reasonable lost future rentals (measured by the present value of the difference between total scheduled future rentals and the "market rent" for future use of the goods)¹³, plus (3) incidental damages less "expenses saved in consequence of the lessee's default." UCC §2A-507, §2A-528. The concept of "market rent," defined in new §2A-507, is essentially fair market rent as determined "at the time of the default."

One objection to the "rent-to-rent" comparison in this standard is that it makes it difficult to prove damages where the lessor repossesses and then sells the goods. The statutory "rent-to-rent" comparison has been employed in California statutes to measure damages under a lease of goods.¹⁴ Yet the "rent-to-rent" comparison clearly takes a different approach to damages than "finance lease" liquidated damage clauses that define the lessor's measure of damages as the sum of (1) past unpaid rentals, plus (2) the present value of accelerated future rentals, plus (3) the lessor's estimated residual value, minus (4) the net proceeds from a commercially reasonable sale of the goods on the lessor's default, up to the point where such proceeds equal the sum of (2) plus (3). This sort of contract clause puts the risk on the *lessee* (not the lessor) that the value of the goods will drop after one enters into the lease.

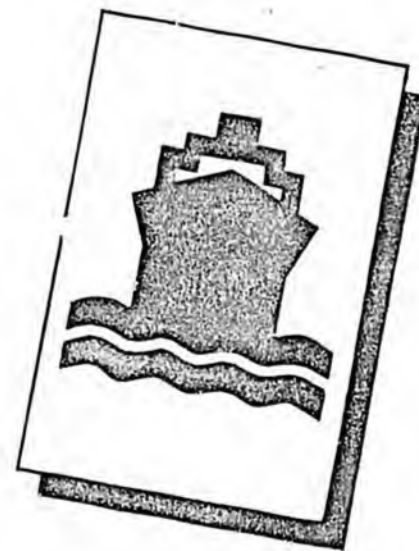
True lessors own the residual and, on the lessee's default, the lessor's remedies should include recovery of the residual or its value. UCC Article

2A's statutory (noncontract) damages scheme clearly allows this recovery. And new §2A-527(5) makes it clear that the "lessor is not accountable to the lessee for any profit made on any disposition." But the new statute puts the burden on the lessor to recover the value of the residual through sale or re-lease. And it puts the risk on the lessor (not the lessee) that the value of the residual might drop after entering into the lease.

The commissioners decided that this is exactly where the risk belongs for statutory (noncontract) measure of damages. Where goods are leased for only a short time in relation to their useful life, it seems unfair (as not in accord with the common expectancies of the parties, in the absence of any agreement at the point) to stick the lessee with the risk that the value of the goods will drop after the lease is transacted. The only situations where it might be fair to saddle the lessee with that risk—by statutory fiat in the absence of any contractual agreement on the point—are those involving "long-term" true leases.¹⁵ This category might be difficult to define in a statute. Moreover, the statutory (non-contract) measure of damages in UCC Article 2A applies only where the contract is silent or is struck down (as unconscionable or otherwise unenforceable) on measure of damages. The commissioners decided that there was no warrant to guarantee "long-term" true lessors a "home run" measure of damages in the statute, when all lessors could readily protect themselves by writing appropriate liquidated damages clauses in their lease agreements.

UCC §2A-528(2) provides an important alternative measure of damages—lost profits "including reasonable overhead" plus incidental damages—for lessors who repossess and then sell or re-lease the goods, but who (under the statutory rent-to-rent measure of damages) would not wind up "in as good a position as performance would have" put them. Though this measure of damages is phrased as an alternative, it may frequently be available to the merchant lessor.

2. Where the lessor repossesses, and it proves impractical to dispose of the goods at a reasonable price, he has the option of holding the goods for the



lessee for the remainder of the lease term, and recovering damages equal to the sum of (1) past rents due, plus (2) the present value of accelerated future rentals, plus (3) incidental damages "less expenses saved in consequence of the lessee's default." UCC §2A-529(1)(b).¹⁶ This statutory (non-contract) measure of damages may be particularly important for "merchant lessors" who have more equipment in inventory than customers.

Over several years, commentators have debated whether such "merchant lessors" should be under a duty to mitigate damages by selling or re-leasing the goods after the lessee's default and repossession by the lessor. UCC §2A-529(1)(b) accords the merchant lessor (or any other lessor) the full present value of accelerated rentals, without offset, where it is impractical for the lessor to dispose of repossessed goods at a reasonable price. Yet the statute tracks earlier law by requiring the lessor to mitigate damages, where practical, before recovery will be allowed for accelerated rentals.

The same statutory (noncontract) recovery for accelerated rentals (without offset) is also generally available to statutory "finance lessors," without special efforts at mitigation of damages, for goods accepted by the lessee. §2A-529(1)(a). This seems appropriate. Typically the finance lessee selects the goods, which often are uniquely suited for the finance lessee's business (and no other).

Warranties

The old common law, as well as UCC §2-314 and 2-315, recognized two implied warranties—merchantability and fitness for a particular purpose—for transactions involving goods. These implied warranties impose strict liability, without regard to negligence or fault. The weight of authority is that these implied warranties apply to merchant lessors, under true leases as well as sales. Well-drafted lease agreements, as a consequence, have long been based on the assumption that these warranties would apply at least to merchant lessors (who dealt in goods), if not to "finance lessors" (who advanced money but had no special knowledge of the goods).

One salutary effect of new UCC Article 2A is to clarify and standardize the law of warranties for true leases. There are special statutory provisions dealing with warranties in the case of statutory "finance leases"—where the lessor does not select, manufacture or supply the goods out of inventory (see part III D *infra*). Otherwise, the new statute tracks the old sales article concerning the creation of express warranties (§2A-210), implied warranties of fitness, title and merchantability (§2A-211 through §2A-213), and accumulation of warranties (§2A-215).

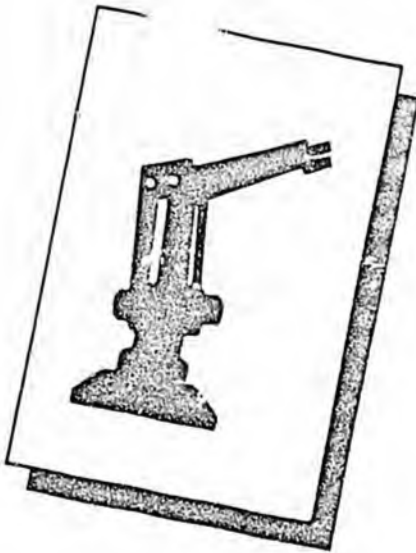
The old sales article's requirements for conspicuous disclaimers of warranties are also repeated in the new leasing statute (§2A-214). Waiver of defense clauses—whereby the lessee agrees not to assert certain types of claims or defenses against the lessor's assignee—are approved by the new leasing statute to the same extent as allowed by old UCC Article 9.

With respect to breach of warranty issues, there are again special provisions for statutory "finance leases" (discussed in part III D *infra*). Otherwise, UCC Article 2A essentially tracks the old sales article. This is true, for example, for the lessee's remedies and damages (§2A-508, 2A-518, 2A-519, 2A-520), and the lessee's rights to reject the leased goods (§2A-509 and 2A-517).

UCC Article 2A's provisions do not spell out the relationship between Article 2A and the case law on strict liability in tort.¹⁷ This reflects the commissioners' recognition that products liability is a rapidly developing field, as well as the view that Article 2A is basically a statement of "contract" (rather than "tort") principles. The whole area of products liability of merchant lessors will be left for the courts to develop.

Treatment of Finance Leases

Traditionally, a finance lessor has been thought of as a passive lessor, whose transactions remain functionally the equivalent of an extension of credit. It is typically the lessee (not the lessor) who selects the goods in a "finance lease," without relying upon the lessor. Moreover, a finance lessor often has neither the opportunity nor



the expertise to inspect the goods to discover any defects in them. Recognizing these special circumstances, the cases and authorities consistently held that finance lessors did not owe implied warranties of fitness and merchantability with respect to the leased goods.

The impact of new UCC Article 2A on "finance leases" is limited. Where a lessor qualifies under UCC Article 2A as a statutory finance lessor, the new statute basically provides him with automatic exemptions by statute from implied warranties of fitness and merchantability. But a lessor always can write a lease contract to exclude warranties, making himself a finance lessor by contract. Where a lessor writes the lease contract to exclude such warranties, and in addition qualifies as a new UCC Article 2A statutory finance lessor, he will have two independent grounds (or double protection) for exempting himself from such warranties. These new statutory provisions, of course, only apply to "finance leases" that are true leases.

Definition of Statutory "Finance Lease."

To create a statutory "finance lease," the lessor essentially must have no function in picking the goods for the lessee's use. The statutory definition in new UCC §2A-103(1)(g) is:

"Finance lease" means a lease in which (i) the lessor does not select, manufacture or supply the goods, (ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease, and (iii) either the lessee receives a copy of the contract evidencing the lessor's purchase of the goods on or before signing the lease contract, or the lessee's approval of the contract evidencing the lessor's purchase of the goods is a condition to effectiveness of the lease contract."

There is no limitation that a statutory finance lessor can supply only money, or that he must not perform maintenance.¹⁸ To ensure the lessee's reliance on the supplier, nor the lessor, the lessor must acquire the goods "in connection with the lease." The scope of this phrase, "in connection with," is to be determined by the courts on a case-by-case basis.

One controversial part of UCC Article 2A is the third requirement in the definition of a statutory "finance lease:" the lessee must receive a copy of (or approve) the lessor's purchase contract with the manufacturer or supplier. No earlier authorities contained this requirement. But its purpose is to ensure that the lessee receives specific notice of the supplier's warranties covering the goods. This seems only fair before cutting off the lessee's warranty rights against the lessor and subjecting the lessee to automatic statutory "hell or high water" clause liability under a statutory "finance lease" (§2A-407). The commissioners decided that—particularly in light of a lessor's ability to make himself a "finance lessor" by contract—the new statute should be conservative in giving lessors an automatic exemption by statute from warranties.

The comments to §2A-103(1)(g) state that the leasebacks in many sales-and-leaseback transactions will qualify as statutory finance leases. Moreover, lessors who are merchants may qualify as statutory finance lessors. The comment to §2A-103(1)(g) also says that "where the lessor is an affiliate of the supplier no special rule applies; whether the transaction qualifies as a finance lease will be determined by the facts of each case." Excluded from statutory finance lessor status are manufacturers and individuals who are regular dealers in the leased asset. Also excluded is the lessor who obtains the asset out of inventory, since he did not acquire the asset for a particular lease transaction. Yet an independent automobile dealer/lessor, who obtains a car for a particular lessee, for example, may be able to qualify as a statutory finance lessor under new UCC §2A-103(g).

Statutory "Finance Leases:" Special Provisions.

UCC Article 2A makes it clear that a statutory finance lessor does not assume any implied warranties with respect to the lease. He is held only to express warranties (§2A-210) and the warranty of title (§2A-211(1)). Moreover, under a statutory finance lease that is not a consumer lease, the lessee's promises (especially to pay rent) are made irrevocable and independent (§2A-407, §2A-508(6)).

Only commercial finance leases (not consumer leases) qualify for the

statutory imposition of automatic "hell or high water" obligations on the lessee under new UCC §2A-407. The comments to §2A-407 leave open the possibility that the parties to a "consumer lease" might agree to a hell-or-high-water clause in the lease agreement. But the comments also make it clear that other "consumer protection" statutes and evolving case law on consumer rights put severe restraints on the enforceability of such clauses in consumer leases.

The statutory finance lessee is the automatic beneficiary of all warranties under the supply contract (§2A-209(1)). But such a lessee generally cannot revoke acceptance of the goods (§2A-516, §2A-517(1)). To have any rights against the lessor, the finance lessee would have to reject goods immediately. Other special rules dealing with statutory "finance leases" include the provision (§2A-219) that risk of loss passes to the lessee (not the lessor).

These special provisions in the new statute, for statutory "finance leases," mirror the provisions commonly found in most finance lease contracts.

Two separate and independent kinds of "finance leases" will exist in the wake of UCC Article 2A: contractual "finance leases" and statutory "finance leases." One effect of this new regime is to short-circuit the courts' development of a common law definition of "finance lease" in the law of warranties. Where the written lease agreement does not cover warranties, a transaction must fall within the narrow Article 2A definition of a statutory "finance lease" to exempt the lessor from warranty liability. But this seems of minimal practical significance: The nearly universal practice of finance lessors is to "contract out" of warranties in their lease agreements.

Overall, the "finance lease" provisions in new Article 2A will provide certainty, and some additional protections, for lessors able to qualify as statutory finance lessors. Other lessors can protect themselves as finance lessors by contract.

"Consumer Lease" Issues

UCC Article 2A-Leases in general does not deal with consumer protec-

tion. This is left to other laws. But the new statute does contain some protections for lessees in "consumer leases," which are defined in new UCC §2A-103(1)(e):

"Consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee, except an organization, who takes under the lease primarily for a personal, family, or household purpose, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed \$25,000.

Whereas the federal Consumer Leasing Act of 1976 defines "consumer lease" in terms of leases "for a period of time exceeding four months" (15 U.S.C. §1667(1)), new UCC Article 2A covers even shorter-term "consumer leases." A lease primarily for an agricultural purpose falls outside the "consumer lease" protections of UCC Article 2A.

The major "consumer lease" provisions in the new statute include new UCC §2A-106 (limiting abusive choice-of-law and choice-of-forum clauses in consumer leases); new UCC §2A-108 (2), (4) (where court finds consumer lease contract or claim collection activity under consumer lease to be "unconscionable," it may grant appropriate relief including attorneys' fees); new UCC §2A-109 (burden on lessor to justify acceleration of rentals in a consumer lease). The commissioners and the drafting committee rejected proposals for including other, more sweeping "consumer protection" provisions.

UCC Filings (or Notice) Not Required for Leased Personal Property

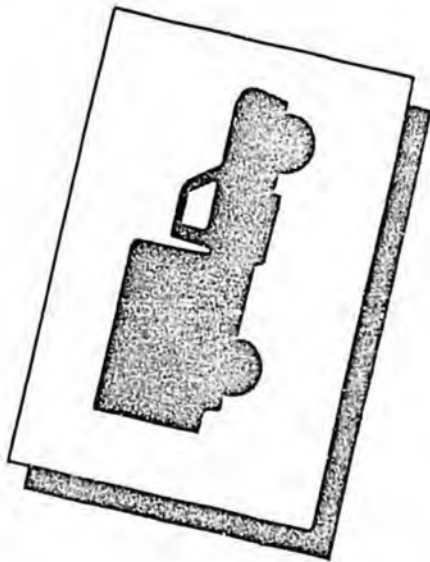
Yet another major issue was whether to establish a mandatory system requiring the filing of UCC financing statements for personal property covered by a true lease. UCC Article 2A was made subject to state certificate of title statutes, with the result that goods covered by those statutes generally must comply only with the filing (or notice) requirements in those statutes. The more general question remained whether there

should be a general filing (or notice) requirement for leased goods, with a list of exceptions covering short-term leases and other "special cases" where filing was impractical.

Traditionally, equipment lessors have not been required to file UCC financing statements, or to give other public notice of their interests in the goods under a true lease.¹⁹ The drafting committee heard conflicting views on whether current law on filing and notice should be changed. But the majority of businessmen and practicing lawyers in the field of equipment leasing seemed to favor the status quo. Technical faults in filing (misdescription of goods or failing to file in all the right places, for example) should not be controlling on a lessor's rights to multimillion dollar equipment, AAEL argued. To be sure, mandatory UCC filings might cut down on litigation concerning the "true lease" status of questioned transactions. But such litigation would not disappear: Even where a true lease was covered by mandatory UCC filings, the true lease/security interest determination would still have to be made by the courts in a variety of contexts (e.g., bankruptcy law, remedies, usury law). Moreover, additional filings of UCC financing statements might overwhelm an already over-burdened UCC filing system. When the issue of mandatory UCC filings for leased goods was discussed within the American Bar Association, the majority of lawyers polled was opposed to the concept.

Taking these factors into account, the commissioners concluded that existing law on UCC filings (or notice) was working reasonably well. There was no compelling reason to overthrow it. UCC Article 2A therefore generally rejects the concept of mandatory UCC filings (or other required notice) for personal property covered by a true lease. The only exception concerns "fixture filings" (discussed below).

"Vendor in possession" doctrine for sales-and-leasebacks abolished. The new statute also abolishes the so-called "vendor in possession doctrine" which has long created state law difficulties for sales-and-leasebacks of equipment. This will be welcome news to lessors. The old "vendor in possession" doctrine (making retention of possession by the vendor fraudulent *per se* or *prima facie* fraudulent) is an ancient anachronism



that has been recognized in one form or another in many states.²⁰ New UCC §2A-308(3) abolishes it for transactions in which the buyer "bought for value and in good faith."²¹ The statute also expressly provides in §2A-302 that separation of ownership and possession *per se* does not affect the enforceability of a lease contract. The old, lamented "vendor in possession" doctrine for leases is no more.

Optional UCC filings permitted. Optional filing of UCC financing statements is still permitted under new Article 2A, as under current law, for any true (or doubtful) lease. Incentives remain for lessors to file UCC financing statements: Though new amended UCC §1-201(37) clarifies the definition of a true lease, it does not eliminate all ambiguities. UCC filings for leases provide protection to the person filing if it is later determined that the "lease" was a secured sale. Moreover, the filing of a UCC financing statement may not be considered as a factor in determining whether or not the transaction is a true lease or a secured sale (see UCC §9-408 (1977)).

Fixtures: Modest Reform

Over the years the subject of "fixtures" has triggered many battles between real estate interests and equipment lessors. New UCC Article 2A attempts to resolve some of the recur-

ring problems in this area by imposing new UCC filing requirements for leased fixtures.

Two basic sets of priority rules are set forth in the new statute to determine the priority of competing interests in fixtures: one for unfilled lessors, the other for lessors who have made a "fixture filing." Traditional common law protections for unfilled lessors of fixtures are generally preserved in §2A-309(5).²² Unfiled lessors obtain the benefit of a very modest reform expanding the category of "readily removable" goods.²³ The statute gives more rights, however, to the fixture lessor who makes a "fixture filing" in the office where a mortgage on the real estate would be recorded. Without such a "fixture filing," the lessor may lose out to real estate interests, since under new UCC §2A-309(7) the priority of the lessor's interest will be determined by real estate priority rules.

This imposes, in effect, a new "fixture filing" requirement for lessors of fixtures. But double filings in both personal property and real estate records have long been industry practice. The statute's new requirement for a "fixture filing" in real estate records implements the views of thoughtful commentators.²⁴ And new §2A-309(8) makes it clear that, where a lessor of fixtures has priority over conflicting real estate interests, the lessor (or the lessee) may *remove* the goods on the lessee's default (as well as in other cir-

cumstances), as long as he pays "the cost of repair of any physical injury."²⁵

The commissioners may well revisit the subject of "fixtures" again in the future. Though the search continues for the most reasonable balance between competing real estate interests and lessors of fixtures, new UCC Article 2A provides some helpful clarification in this overly-technical area of the law.

Conclusion

The impact of new UCC Article 2A-Leases will underline the importance of careful drafting for leases of motor vehicles and equipment. The statute clarifies the differences between a true lease and a "security interest." Moreover, it provides some helpful clarification and uniformity in the law of warranties and lessors' remedies.

Threatened stormy opposition to the new UCC Article 2A seems overstated and unwarranted. Bernard J. McKenna, chairman of AAEL, went to the heart of the matter: "The new statute rejects a simplistic approach which might have blurred the distinction between a true lease and a financing. The short of the matter is that if you can't write a good solid lease agreement, you're in trouble. That's always been true and it always will be true, with or without the new UCC provisions on leasing."

Footnotes:

¹ Other statutes and case law (particularly in the area of "consumer protection") may limit the unbridled "contractual freedom" of the parties, of course. Yet the main limitations on "contractual freedom" in UCC Article 2A-Leases itself is the injunction against unconscionable lease clauses (2A-108). Other well established limits on "contractual freedom"—such as the requirement that contractual waivers of implied warranties be "conspicuous"—are picked up in the new statute (§2A-214). There are also scattered provisions according protections to lessees in "consumer leases," such as §2A-106 (limiting abusive choice-of-law and choice-of-forum clauses in consumer leases) and §2A-109 (placing burden on the lessor to justify acceleration of rentals in a consumer lease). Moreover, the new statute incorporates the general UCC rules that the obligations of good faith, diligence, reasonableness and care are not disclaimable by agreement.

² "THREAT OF NEW UNIFORM PERSONAL PROPERTY LEASING ACT" trumpeted the front-page headline of CAR RENTAL/LEASING INSIDER, Weekly Newsletter (June 9, 1986). "Open-end" vehicle lessors have criticized the new statute's failure to validate "open-end" leases of vehicles as true leases, as well as the provisions in UCC Article 2A-Leases covering "finance leases" and warranties and remedies in leases to consumers. See CAR RENTAL/LEASING INSIDER, Weekly Newsletter (June 16, 1986); AUTOMOTIVE FLEET MAGAZINE p. 130 (August 1986). These issues are discussed in parts III A, C, D and E *infra*.

³ True lessors under §365 of the Bankruptcy Code generally have a better chance than secured lenders of obtaining current payments, as well as repossessing the goods, when the lessee/debtor is in bankruptcy. Under §365 of the Bankruptcy Code, the lessee (or bankruptcy trustee) must assume a true lease or reject it in its entirety, and if

assumed, must give "adequate assurances" that prior defaults will be cured and that performance (payment of rentals) will take place in the future. The secured creditor, on the other hand, is covered by §361-§363 (not §365) of the Bankruptcy Code: The buyer-debtor in bankruptcy has the right to continue to use any of the collateral property, with or without the consent of the seller-lender, so long as the secured lender is given "adequate protection" that the value of the property will be preserved. Cf. *In re American Mariner Industries*, 734 F.2d 426 (9th Cir. 1984.)

⁴ True leases (as opposed to disguised loans or "forebearances" of money) may be exempt from state usury laws.

⁵ Throughout this article, references to the comments denote the Official Comments to new UCC Article 2A-Leases in ALI Council Draft No. 1 (December 1, 1986), now being revised.

- One theme that runs through the cases and authorities is that the owner/lessor in a true lease must have, at the outset, some legitimate possibility for return or other disposition of the leased property before the end of the economic life of the property. See, e.g., *In re Marhoefer Packing Co.*, 674 F.2d 1139, 1143, 1145 (7th Cir. 1982). With respect to options to renew or buy, under state law, the essence of a true lease may be that the original agreement should leave the lessor with a significant economic stake in the residual and should not "tilt the scales" to require or encourage the lessee to exercise the option for the remaining economic life of the property. Cf. *id.* at 1144-1145; Mooney, *True Lease or Lease "Intended as Security"*, in Coogan, Hogan, Vagts & McDonnell, *Secured Transactions Under the UCC* (Matthew Bender 1986).
- This is because the economic uncertainties of life (such as changes in the rate of inflation, and technological obsolescence) are such that a wide range of values should qualify as "reasonably predictable" option prices in any given transaction.
- One important issue for counsel drafting a lease agreement is raised by new §2A-508(5), which authorizes the lessee to sell the goods, if the lease agreement says nothing to the contrary, where the lessee rightfully rejects the goods, or justifiably revokes acceptance.
- DeKoven, *Proceedings After Default By the Lessee Under a True Lease of Equipment in IC* Coogan, Hogan, Vagts & McDonnell, *Secured Transactions Under the UCC*, §29B.06(5)(b) (Matthew Bender 1986).
- See, e.g., *Heller Financial v. Barry*, 633 F.Supp. 706 (N.D.Ill. 1986) [court reduces accelerated future rentals to present value]; *In re Winston Mills, Inc.*, 6 B.R. 587 (Bkrupt S.D.N.Y. 1980) [same].
- With respect to a consumer lease, the burden of establishing good faith is on the party invoking the acceleration clause; otherwise the burden of establishing lack of good faith is on the lessee. UCC §2A-109(2).
- DeKoven, *Leases of Equipment: Puritan Leasing Co. v. August, A Dangerous Decision*, 12 U.San Fran.L.Rev.257,277-278 (1978).
- Where the goods are re-leased "by lease contract substantially similar to the original lease contract and the lease contract is made in good faith and in a commercially reasonable manner," then the lessor's lost future rentals (apart from other damages) are measured by the present value of the difference between the "total rent for the remaining lease term of the original lease" and the "total rent for the lease term of the new lease contract." UCC §2A-527(2).
- California Civil Code §3308 permits liquidated damage clauses in a lease providing that, after the lessee defaults and the lease has been terminated, the lessor may recover the present value of accelerated future rentals minus the "reasonable rental value" of the goods for the remainder of the lease term. Where this measure of damages is selected, it is exclusive.
- Of course, if the original term of the lease runs for essentially the entire remaining economic life of the goods, and the lessee is obligated throughout the term so that he cannot simply "walk away" from the lease, then the transaction is not a true lease at all but a security interest covered by UCC Article 9.
- This statutory measure of damages applies "for goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing." UCC 2A-529 (1) (b). This statutory remedy is optional. At any time before the collection of the judgment for this statutory remedy (accelerated rents), the lessor may choose to dispose of the goods by sale or re-lease, in which case his remedies are limited by the "rent-to-rent" test discussed above. 2A-529 (3). If the lessee pays the judgment for accelerated rents, then the lessee is entitled to "use and possession of the goods not then disposed of for the remaining lease term of the lease agreement." 2A-529 (4).
- One commentator on products liability has explained that the true lease/sale distinction "has no bearing on product liability. Instead, the criterion of superior knowledge of a merchant is the prerequisite to nonconsensual product liability. A merchant-lessor, as one who deals in goods and thus has superior knowledge, should be a target defendant. In contrast, a finance-lessor should remain immune from product liability as one who, in the ordinary course of business, makes advances against goods but is not a merchant." Carlin, *Product Liability for the Equipment Lessor? Merchant-Lessor versus Finance-Lessor* printed in ch 8 of *Equipment Leasing-Leveraged Leasing* (2d ed. Fritch & Reisman 1980) p. 848.
- Where the lessor does perform maintenance, or other functions other than the supply of money, the comment to §2A-103 (1) (g) states that "express warranties, covenants and the common law will protect the lessee." This leaves open the possibility that a statutory finance lessor who performs maintenance, under a so-called "operating lease," may be held liable for negligently failing to discover defects during maintenance.
- See, e.g., *In re Marhoefer Packing Co.*, 674 F.2d 1139 (7th Cir. 1982); *In re Leasing Consultants, Inc.*, 486 F.2d 367 (2d Cir. 1973); *Allen v. Cohen*, 310 F. 2d 312 (2d Cir. 1962).
- See Coogan, *Leasing and the Uniform Commercial Code in Equipment Leasing-Leveraged Leasing* pp. 827-846 (2d ed. Fritch & Reisman 1980).
- The statute states in pertinent part: §2A-308. SPECIAL RIGHTS OF CREDITORS * * *
- (3) A creditor of a seller may treat a sale or an identification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith. [Emphasis added]. The Comment to §2A-308 confirms: "Notwithstanding any statute or rule of law that would treat such retention as fraud, whether *per se*, *prima facie*, or otherwise, the retention is not fraudulent if the buyer bought for value and in good faith. This provision overrides Section 2-402 (2) to the extent it would otherwise apply to a sale-leaseback transaction."
- Thus, for example, new UCC §2A-309 (5)(d) reflects the earlier UCC Article 9 and common law provisions allowing removal of trade fixtures. See UCC §9-313 (5)(b); *Lemmons v. United States*, 496 F.2d 864, 869-872 (Ct.Cl. 1974); see also 3 Witkin, *Summary of California Law, Personal Property* §§60-66, *Real Property* §469-470.
- New UCC §2A-309 (5)(a) gives an unfiled lessor of fixtures priority over competing real estate interests if "the fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable" [new provisions in italics]. The Comment to §2A-309 indicates that, aside from leased equipment that is "integral to the operation of real estate e.g., heating and air conditioning equipment" other "readily removable equipment" constituting fixtures can be repossessed by an unfiled lessor. Owners and encumbrancers of real estate, on the other hand, will be able to rely on the continuing availability of fixtures that are essential to the operation of the land and building itself.
- See Leary, *The Procrustean Bed of Finance Leasing*, 56 N.Y.U.L. Rev. 1061, 1089-1093 (1981); Gilmore, *Security Interests in Personal Property* §30.5 (1965).
- The specific language of new §2A-309(8) gives the lessor or the lessee the right to remove the goods from the real estate, on the other party's default (as well as in other circumstances), but requires that he or she "must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation."

UNIFORM COMMERCIAL CODE. ARTICLE 2A - LEASES

The Uniform Commercial Code (UCC) Article 2A - Leases, governs true leases of goods. In a true lease, the lessor gives possession and right to use the goods to the lessee for a fixed period of time in return for rent. The title to the property and a meaningful residual interest remain with the lessor.

A "finance lease" is a true lease in which the lessor is not the fundamental supplier of the goods leased, but leases goods to lessees as a means of financing their acquisition. UCC - 2A governs "finance leases" as well as other true leases, but "finance leases" are treated differently from other true leases in certain respects. The principal differences in treatment will be discussed in subsequent paragraphs of this summary.

UCC - 2A is largely derived from the sales article of the UCC - Article 2. It provides basic contract rules, including matters of offer and acceptance, statutes of frauds, warranties, assignment of interests, and remedies upon breach of contract. There are five parts to the UCC - 2A: (1) General Provisions, (2) Formation and Construction of a Lease Contract, (3) Effect of a Lease Contract, (4) Performance of a Lease Contract, and (5) Default.

GENERAL PROVISIONS

The General Provisions include the large, general definitions section and general rules pertaining to the construction of leasing contracts, including conflict of law provisions, choice of forum rules, and interpretation of remedies. Most of these provisions are drawn from Article 2 of the UCC.

UCC - 2A creates an entity called the "lessee in the ordinary course of business." The definition parallels the "buyer in the ordinary course of business" in the UCC. Both take property free of prior encumbrances, under the appropriate conditions, and are essential to commercial enterprise.

UCC - 2A also defines "supplier" as "a person from whom a lessor buys or leases goods to be leased under a finance lease." This definition is important because goods in a "finance lease" must come from another source than a lessor.

FORMATION AND CONSTRUCTION OF A LEASE CONTRACT

In a sale transaction, the UCC provides warranties of title and against infringement by any claims of another person. There are similar warranties in UCC - 2A, although title is not

protected, since title remains in the lessor. But the lessor does warrant the lessee's enjoyment of the leasehold interest against "a claim to or interest in the goods that arose from an act or omission of the lessor. " This warranty applies to all lease contracts. Infringement, however, is not warranted against in finance leases, and this warranty only binds a merchant-lessor, who deals regularly in goods of the kind.

Implied warranties are of two kinds, merchantability and fitness for a particular purpose. Both kinds of implied warranty are directly derived from the Article 2 of the UCC. The warranty of merchantability operates between merchants, and assures the resalability of goods. The fitness warranty presumes a purpose and reliance upon the lessor to supply goods fit for the purpose. Both kinds of implied warranties can be excluded or modified by agreement.

Implied warranties of quality (and against infringement) by lessors do not similarly apply to finance leases. UCC - 2A instead passes any implied warranties of the supplier-seller to the lessor-buyer under Article 2, to the lessee under a finance lease. The finance lessor does not directly make such warranties.

EFFECT OF A LEASE CONTRACT

Generally, a lessee's rights under a lease contract or the residual rights of a lessor are freely transferable, unless the contract prohibits the transfer or unless transfer risks the other party's contract rights. An assignment, so-called, of lease rights is treated as any transfer is, and is presumed to transfer both rights and obligation, unless otherwise specified in the agreement.

If a subsequent lease is entered when there is an existing lease, the subsequent lease is subject to the prior lease. However, a subsequent "lessee in the ordinary course of business," who deals with a lessor who is a merchant dealing in goods of the kind leased and to whom the goods are entrusted under the prior lease, will take goods free of the prior, existing lease contract.

Another third party issue dealt with in Part 3 of UCC - 2A is lien priorities. Here, UCC - 2A becomes analogous to provisions in UCC, Article 9. A statutory materialmen's lien has priority over any interest in a lease contract, unless other law sets a different priority. Otherwise, lessee's creditors take subject to the lease contract. Lessor's creditors with prior interests to those arising under a lease contract, generally, take priority over interests arising under the contract.

However, a "lessee in the ordinary course of business" takes free of any prior perfected security interests, unless the lessee

has specific knowledge of their existence. A prior interest of a lessee takes priority over a subsequent interest of a lessor's creditor. But there are special instances in which a creditor of a lessor has priority over a lessee's interest, even though the lease interest is prior in time. Included are instances in which depriving the creditor of possession of the collateral would be fraudulent to the creditor "under any statute or rule of law."

Goods that become fixtures present priority problems when leased. Fixtures are defined as goods "so related to particular real estate that an interest in them arises under real estate law." Who has priority between the lessor and those holding the real estate interests?

Generally, if goods are leased and become fixtures, the lessor with prior interest in them has priority over those with the real estate interests - if the lessor perfects his or her prior interest with a fixture filing under Article 9 of the UCC. A fixture filing is made by placing an appropriate financing statement in the real estate records. There are instances in which a lessor can retain an interest against the real estate holder without filing, but a fixture filing will generally be essential.

"Accessions" also present a special problem. An "accession" occurs when leased goods "are installed in or affixed to other goods." Any existing rights in a lease contract are superior to any rights in the whole in which leased goods become accession after the lease contract is entered. If the lease contract arises at the time goods become accessions or after, earlier interests in the whole have priority. If someone purchases the whole after a lease contract, rights under the lease contract take priority over the purchaser's rights. However, a "buyer in the ordinary course of business," or a prior creditor who makes advances without knowledge of the lease contract, takes priority over a lessor or lessee, even though the lease contract precedes the purchase or advance in time.

PERFORMANCE OF A LEASE CONTRACT

Part 4 of UCC - 2A deals with performance and repudiation of a contract, with substituted performance and with excused performance. If performance is to be impaired, however, UCC - 2A gives contracting parties the latitude to minimize losses.

For example, a party to a lease contract who has reasonable grounds for insecurity as to the performance of the other party, may demand written assurance of performance. Until written assurance is provided, the demanding party may suspend his or her performance. If assurance is not given in a reasonable time, the contract may be treated as repudiated.

When performance is impaired without the fault of either

party, because of such events as failure of an agreed means of transport, a commercially reasonable substitute must be accepted. There are instances in which performance may be excused: "If performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was basic assumption on which the lease contract was made." The lessor must notify the lessee (and the supplier if there is a finance lease) of delay or non-delivery. These are examples of the options open to contracting parties.

DEFAULT

Upon default, UCC - 2A provides remedies in Part 5, including damages and equitable remedies, such as specific performance. UCC - 2A permits cover. That is, a party may seek goods from another source to limit losses. Mitigation of damages is encouraged. The general measure of any damage is actual loss.

LEASE TRANSACTIONS AS SECURED TRANSACTIONS

The last issue of importance addressed in UCC - 2A is an added appendix, consisting of a crucial amendment to Section 1-201(37) of the UCC, which defines the term security interest. If a lease involves a "security interest," it is subject to Article 9 of the UCC. A lease involves a security interest, dependent upon four alternative factors or characteristics.

If the term of the lease is equal or greater than the remaining economic life of the goods; if there is a renewal option for no additional consideration or nominal consideration; if there is mandatory renewal or the lessee becomes owner at the end of the lease term; or if the lessee has the option to purchase at the end of the lease term for no additional consideration, or any combination of these factors, the lease would tend to be treated as creating a security interest and would be subject to Article 9.

CONCLUSION

UCC - 2A is comprehensive, dealing with every phase of leasing transactions. It draws a great share of its concepts from Article 2 of the UCC, but it is adapted to the peculiarities of the leasing form. It is an important advance in commercial law.

WHY STATES SHOULD ADOPT ARTICLE 2A
OF THE UNIFORM COMMERCIAL CODE - LEASES

The leasing of large scale items ranging from oil-drilling platforms to automobiles is big business in this country, with an estimated dollar volume reaching \$150 billion. Yet the laws governing leasing have not kept pace with the intricacies of today's leasing arrangements, resulting in considerable uncertainty for lessors and lessees alike.

To fill this gap, the Uniform Law Commissioners approved a new amendment to the Uniform Commercial Code: Article 2A - Leases. UCC-2A provides for the fundamentals of the leasing contract, including the formation of the contract, provisions for express and implied warranties, and damages for breach of a leasing contract.

Historically, we have thought of financed purchase transactions as conditional sales. As sales, such transactions fall under the UCC, particularly Articles 2 and 9. But a leasing transaction, even though very similar to a conditional sale in many ways, is not clearly subject to the UCC. The rights and remedies of the lessor and lessee, therefore, are not well defined, and courts have characterized these transactions differently from jurisdiction to jurisdiction. Many troubling issues have been extensively and confusingly litigated.

UCC-2A gives leasing transactions an appropriate underpinning in the law. Because of the broad similarities between lease and sales transactions, that underpinning is largely derived from the sales article of the UCC - Article 2. Hence the new article is 2A, indicating its relationship to Article 2. Article 2 has been adopted in every state except Louisiana.

There are a number of reasons all states should adopt UCC - Article 2A, Leases:

LEASES SHOULD BE A PART OF THE UCC

Since leases are an important part of business and commercial law, they should be governed by the Uniform Commercial Code. Further, the leasing business is interstate in character. Uniformity is as important to the conduct of leasing transactions as it is to sales transactions.

LEASES AS SECURED TRANSACTIONS

Perhaps the most important question answered in UCC-2A is when leases are subject to UCC-Article 9 on "Secured Transactions." Certain lease contracts establish what effectively are conditional sales, in which the lessor is no different from a creditor subject to Article 9.

The prior law has never effectively dealt with the issue, and concrete standards are established in UCC-2A and an accompanying amendment to UCC-1-201(37), which is a basic definition section in the UCC. Under these provisions, a secured transaction occurs when the lessor has no meaningful residual rights in goods when the lease expires. In a true lease, the rights to the goods revert to the lessor when the lease term ends. But if the contract terms indicate that the rights to this residue are valueless, then it can be inferred that the lease really amounted to a conditional sale of the goods. Article 9 then should and would apply.

FINANCE LEASES

UCC-2A creates a separate category of leases called "finance leases" to eliminate existing confusion over the rights of parties in such leases. Finance leases are characterized by the unique position of the lessor - as purchaser of goods only for the purpose of delivering them to a lessee pursuant to a lease contract.

Because the lessor is not the real supplier of the goods, and acts merely to finance the goods in the hands of the lessee, certain of lessee's rights are best served by imposing obligations on the real supplier and by limiting some rights against the lessor. UCC-2A does not give a lessee implied warranties against a lessor in a finance lease, but passes the lessor's warranties against the real supplier under Article 2 on the lessee.

UCC-2A also further limits a lessee's already limited rights to reject goods, once accepted under the contract, or to cancel, terminate, modify, excuse or substitute performance under the lease contract. The lessee relies upon warranty rights against the supplier, and the lessor is treated as the financing entity it really is.

REMEDIES

Prior law does not provide clear remedies for leasing transactions. Because the parties to lease contracts share substantial characteristics with the parties to sales contracts,

the full panoply of UCC-Article 2 remedies can easily be translated and applied to lease contracts.

UCC-2A not only provides clear measures of damages upon breach of contract, but also provides: clear standards for anticipatory repudiation by a party to a contract when anticipated performance by another party becomes insecure; for rejection of goods that do not conform to the contract; for excused non-performance of the contract; and for specific performance under appropriate circumstances.

UCC-2A remedies carry over the original Article 2 policies of encouraging cure of default without litigation and of mitigation of damages whenever and wherever possible.

WARRANTIES

UCC-2A establishes and standardizes warranties for true leases. It follows closely Article 2 of the UCC, but it does not protect title, since title remains with the lessor. Rather than title, UCC-2A warrants against infringement with lease rights.

There are two kinds of implied warranties: merchantability and fitness for a particular purpose. Both are directly derived from Article 2 of the UCC. The warranty of merchantability assures the resalability of goods between merchants. The fitness warranty presumes a purpose and reliance upon the lessor to supply goods fit for the purpose. These warranties can be excluded or modified by agreement.

UCC-2A implied warranties do not apply to finance leases. In that case the implied warranties under Article 2 of the supplier to the lessor are passed on to the lessee.

CONSUMER LEASES

UCC-2A defines a consumer lease as a lease in which the lessee takes the lease primarily for a personal, family or household purpose, when the total payments do not exceed \$25,000.

UCC-2A does provide some protection for lessees in a consumer lease. Among other things, there is a burden on the lessor to justify acceleration of rentals in a consumer lease. But most consumer protection is left to other laws.

FIXTURE AND ACCESSION PROBLEM

UCC-2A settles recurring problems of what to do with leased goods that become fixtures and accessions and who has priority in each case.

Fixtures are defined as "goods so related to particular real estate that an interest in them arises under real estate law." Generally, if goods are leased and become fixtures, the lessor with prior interest in them has priority over those with the real estate interests - if the lessor perfects his or her prior interest with a fixture filing under UCC - Article 9.

An accession occurs when leased goods are "installed in or affixed to other goods." Any existing rights in a lease contract are superior to any rights in the whole in which leased goods become accession after the lease contract is entered.

CONCLUSION

The changes in leasing transactions in recent years make it clear that modernization is long overdue. States now depend on the common law to resolve disputes over lease contracts. This creates great uncertainty, particularly for companies that conduct business in more than one state, since case law conflicts from state to state. Additionally, some important issues have never been adequately addressed in the common law, and UCC - 2A answers these immediate needs.



Representative Dave Donley, Chair House Labor & Commerce Committee

SUBJECT OF MEETING:
HB 67

DATE: *4-12-89*

PLACE: *C#17*

NAME	REPRESENTING	BUSINESS/PERSONAL MAILING ADDRESS	ZIP	(H) PHONE	(W) PHONE	DO YOU WANT TO TESTIFY?	WHAT SUBJECT/ WHICH BILL?
<i>Art Peterson</i>	<i>Dept. of Law</i>			3600	3600	<input checked="" type="radio"/> Y <input type="radio"/> N	<i>SB 88 and HB 67</i>
<i>John M McCabe</i>	<i>University of Alaska Commissioner</i>	<i>676 N. St. Clair, #1700, Chicago, IL 60611</i>		<i>312-915-0195</i>		<input checked="" type="radio"/> Y <input type="radio"/> N	<i>SB.88 HB.67</i>
						<input type="radio"/> Y <input type="radio"/> N	
						<input type="radio"/> Y <input type="radio"/> N	
						<input type="radio"/> Y <input type="radio"/> N	
						<input type="radio"/> Y <input type="radio"/> N	
						<input type="radio"/> Y <input type="radio"/> N	
						<input type="radio"/> Y <input type="radio"/> N	
						<input type="radio"/> Y <input type="radio"/> N	
						<input type="radio"/> Y <input type="radio"/> N	

HB

71

HOUSE COMMITTEE REPORT

(5)

Date Referred: January 9, 1989

FURTHER REFERRALS:

Date of Committee Action: 1/31/89

The LABOR & COMMERCE Committee recommends that:

HOUSE BILL NO. 71 [ELEVATOR SAFETY STANDARDS]
"An Act relating to elevator safety standards; and providing for an effective date."

[] be replaced with CS HB 71 (LTC) [] the ~~same~~ title
[] have attached amendment(s) [] a ~~new~~ title

[X] do pass
[] do not pass
[] no recommendation
[] individual recommendations
[] additional referral to the _____ Committee

ADOPTS: _____ letter of intent

ATTACHES NEW FISCAL NOTE(S):

[] fiscal impact
[] zero fiscal note
[] zero with analysis

APPROVES PREVIOUS:

[] fiscal note(s) published: _____
[] zero fiscal notes(s) published: _____

SIGNING DO PASS:

Dave Douley
Maxine [unclear]
[unclear]
[unclear]
[unclear]
[unclear]
[unclear]

SIGNING OTHER THAN DO PASS:

(Do Not Pass, No Recommendation, Amend)

Dave Douley
Chairman's signature

MR. SPEAKER, I'D LIKE TO RISE TO THE FLOOR TO SPEAK ABOUT ELEVATOR SAFETY STANDARDS.

IF YOU INSPECT THIS BILL CAREFULLY, YOU WILL SEE THAT IT IS AN OPEN AND SHU MATTER.

IT WOULD BE UNFORTUNATE IF THE DEBATE ESCALATED INTO A CONTROVERSY.

THIS IS AN UP OR DOWN SITUATION. THERE IS NO IN BETWEEN.

WE SHOULD NOT KEEP THIS BILL DOWN.

THE BILL WAS STUCK BETWEEN FLOORS IN THE LABOR AND COMMERCE COMMITTEE BUT C MEMBERS ROSE TO THE OCCASION. WE ELEVATED THE DEBATE TO THE HIGHEST STANDA AND GOT THE BILL MOVING AGAIN.

IT WOULD BE A SHAME IF HB 71 GOT THE SHAFT.

WE NEED TO MAKE SURE IT DOES'NT GET STUCK ON THE FLOOR.

IF WE ALL RISE TO THE OCCASION, WE CAN HEIGHTEN OUR AWARENESS, LIFT OUR SPIRITS, HOIST OURSELVES UP, AND ADVANCE TO THE RIGHT VOTE.

MR. SPEAKER. HB 71 DESERVES OUR SUPPORT. WE SHOULD RIDE IT ALL THE WAY TC TOP.

Alaska State Legislature



House of Representatives
House Judiciary Committee
February 2, 1989

P. O. Box V
State Capitol
Juneau, Alaska 99811
(907) ~~586-2222~~
465-4986

CS-
File in HB 71
STANDING FILE
G
FYI

MEMORANDUM

To: All House Judiciary Members
✓ All House Committee Chairs
Sen. Jan Faiks, Chair
Senate Judiciary
Bob Evans, Governor's Office

From: Rep. Max F. Gruenberg, Jr. *MFG*
Co-Chair, House Judiciary

Re: Delegation of Legislative Authority in Statute

Attached are Deborah Behr's January 25 memorandum on HB 71, elevator safety standards, and Dick Bradley's January 26 memorandum on HB 70, prescription drugs. Both deal with the same issue--the delegation of legislative authority in statute.

The draft of HB 71 delegated legislative authority to future editions of the elevator safety standards inspection manual. A draft of HB 70 delegated legislative authority to the Code of Federal Regulations.

Both memoranda indicate this practice is unconstitutional and unwise public policy. The reasons are explained fully.

Because this issue comes up regularly in draft legislation, I though you might be interested in receiving these memoranda.

Attachments

STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

January 26, 1989

SUBJECT: Delegation of legislative authority
(Work Order No. 6-0661)

TO: Representative Max Gruenberg
Co-Chairman, House Judiciary Committee

FROM: Richard A. Bradley
Legislative Counsel *RB*

Mark Handley has asked that we comment on the question presented by the adoption of federal law or regulations by reference in state statutes. An example of this is found in a Governor's bill: HB 70. Sec. 3 of the bill provides that the department "shall pay for prescribed drugs under AS 47.07.030(b) in accordance with 42 C.F.R. 447.331 -- 447.334.

Perhaps the best argument for not incorporating Federal references, particularly to regulations but also to laws, is that the Federal authorities may change the Federal laws. If they do, the references are either disregarded ("we know what was intended by the law") or they cripple the law.

A good case can be made that such an adoption is unconstitutional as a delegation of legislative authority. Whether it is, or not, may be unimportant because we believe that it is done frequently and necessarily in many areas where state officers operate under Federal regulations that have a habit of changing frequently.

But the solution to the problem presented in HB 70 can be easily addressed quite constitutionally by granting the commissioner of health and social services the authority to adopt by regulation whatever formula the state wants-- as, for example, by saying that the department "shall pay for prescribed drugs under AS 47.07.030(b) under regulations adopted by the commissioner in conformity with applicable federal regulations." The regulatory framework permits rapid amendment of the regulations and yet a state officer with

possibly unconstitutional

Solution

Representative Max Gruenberg
Page 2
January 26, 1989

expertise in the area is monitoring the developments and is able to keep the law current.

If federal laws or regulations are amended in a fashion unacceptable to state officers, the assistance of the legislature can be requested.

If I may be of further assistance, please advise.

RAB:kb:gc
wkk1/075

MEMORANDUM

State of Alaska
Department of Law

Comm	
Deputy	
So Asst	
Sp Asst	
Info Off	
Adm Asst	
Int Aud	
ASD	
ESD	
LS&S	
W/C	
cc:	
cc:	

TO: The Honorable Jim Sampson
Commissioner
Department of Labor

DATE: January 25, 1989

RECEIVED

FILE NO: 465-3603

JAN 23 1989

FEC. NO. 465-3603

OFFICE OF THE COMMISSIONER

SUBJECT: HB 71 - "An Act relating to elevator safety standards; and provided for an effective date"

Deborah E. Behr

FROM: Deborah E. Behr
Assistant Attorney General
Human Services-Juneau

In response to a House Labor and Commerce Committee inquiry, you have asked whether the latest edition of elevator standards code or inspection manual should be enacted in the statute, instead of naming a particular edition by year. I understand that this information is needed for a committee meeting to be held Thursday, January 26, 1989.

It is our opinion, that the incorporation of all future editions of the code or manual by reference cannot be adopted in law by inclusion of the phrase "latest edition." We reach this conclusion for the following reasons.

Problem

First, under Article II, Section 14 of the Constitution of Alaska, the Alaska State Legislature has been assigned the function to enact bills into law. In this situation, the legislature would be delegating the development of the content of future legislation to a non-state agency, the American Society of Mechanical Engineers which presently develops the code in question. We believe this delegation to be impermissible under these circumstances, since the legislature would be unaware of the contents of ~~future~~ amendments at time of enactment of the bill into law. Second, contents of future editions of the code may be contrary to state law or violative of the state constitution. There would be no legislative review to avoid such law taking effect. Third, the adoption of a future code by reference may violate Article II, Section 15 of the Constitution of Alaska, since the Governor would have no meaningful way to exercise his veto power over future unknown amendments, which may be contrary to law or not in the best interest of Alaska. Finally, the adoption of the latest edition may cause confusion to the courts and the general public as to which standards apply. Under such a situation, the Department of Labor may find difficulty enforcing compliance with the standards under AS 18.60.820.

Reason

The Honorable Jim Sampson
Commissioner
HB 71 - elevator safety

January 25, 1989
Page 2

If the legislature wishes to avoid having frequently to amend the statute to keep pace with current editions of the code or manual, one approach might be to authorize the Department of Labor to adopt standards in regulation. By giving regulatory authority, the department could have the flexibility to adopt standards to changing conditions, without having to seek legislative modification. Since the legislature has the power to annul regulations, the legislature could still perform its oversight of these functions. See AS 44.62.320.

Solution.

If you have further questions, please do not hesitate to contact me.

DEB:jh

cc: Arthur H. Peterson
Assistant Attorney General

Bob Evans
Legislative Liason

STATE OF ALASKA

DEPARTMENT OF LABOR

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

P.O. BOX 21149
JUNEAU, ALASKA 99802-1149
PHONE: (907) 465-2700

FAX: (907) 465-2784

January 27, 1989

The Honorable Max Gruenberg
House of Representatives
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Attn: Andy Hemenway *AHWA*

Dear Representative Gruenberg:

This is in response to the questions your office has posed with respect to differences between 1984 and 1987 elevator code provisions dealing with communications.

The 1987 amendment to Rule 211.1(a)(2), which stipulates that the means to activate the two-way conversation system does not have to be provided in the car, is for clarification only. Activation of the system inside the elevator is not required under the 1984 code, either. Apparently, some confusion has resulted from the 1984 code's silence in this regard, and the 1987 amendment serves only to clarify it. The alarm required under 211.1(a)(1) is used to signal persons outside the elevator that it is "stuck" and the alarm must be able to be activated from inside the elevator. The communications system then permits persons inside and outside the elevator, who by virtue of the alarm already know there is a problem, to communicate.

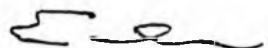
It is important to note also that a communication or signaling system, which can be activated from within the elevator is required under both the 1984 and 1987 codes if the elevator is in a building which does not have persons available around the clock, Rule 211.1(b). The Capitol building, in

which your office is located, and our Department of Labor building here are examples of buildings which must have a system which can be activated from inside the elevator during periods when the building is closed. Hospitals, large hotels, and other such 24-hour facilities, on the other hand, need not have communication systems which can be activated from inside the elevator.

The 1987 amendment to Rule 211.1(b) is likewise no less stringent than the 1984 code. In fact, the 1987 code could be said to strengthen the emergency signaling/communications requirements in that it requires a system capable of making a positive contact with someone outside of the building, whereas one of the options of the 1984 code, under 211.1(b)(2), is simply to have an alarm outside the building to attract passersby. Under the 1987 code, the system would have to be capable of communicating with or signaling an answering service, fire/police department, or other place continuously staffed by someone who can render assistance or contact someone who can.

I appreciate the opportunity to clarify these requirements for you, and please do not hesitate to contact us if we may be of further help. We appreciate your interest.

Sincerely,



Eileen Plate
Legislative Liaison

EP/gd

STATE OF ALASKA

DEPARTMENT OF LABOR

OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

P.O. BOX 21149
JUNEAU, ALASKA 99802-1149
PHONE: (907) 465-2700

FAX: (907) 465-2784

January 26, 1989

The Honorable Dave Donley
Chairman
Labor and Commerce Committee
House of Representatives
P.O. Box V
Juneau, AK 99811

Dear Representative Donley:

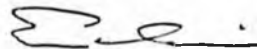
As you will recall, at the January 24, 1989, Labor and Commerce Committee meeting, Representative Gruenberg asked if the Department had any statistics on the incidence of people being stranded in elevators in the State.

In checking with the staff, I find that such incidents are not reported to the Department; and we, therefore, do not have the information.

We have also checked with representatives of the five major elevator companies in the State, and they do not keep a formal record of incidents either. However, these companies, which collectively have approximately 1300 elevators in the State, estimate that last year they received 150 reports of persons being stranded in elevators.

I am sorry we are not able to provide more definitive information to you.

Sincerely,



Eileen Plate
Legislative Liaison

EP/gd

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: CSHB 71 (L&C)
PUBLISH DATE: _____

FISCAL NOTE

REQUEST:

Revision Date: _____ Agency Affected: Labor
Title: " An Act relating to elevator
safety standards; ... " BRU: Labor Standards & Safety
Sponsor: Rules Committee Components: _____
Requestor: House Labor & Commerce Mechanical Inspection

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL						
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REVENUE						
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Tom Stuart Phone: 254-2452
Division: Labor Standards & Safety Date: 1/25/89
Approved by Commissioner: Jim Sampson Date: 1/25/89
Agency: Department of Labor

Distribution (by preparer) :
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION : HB 71
PUBLISH DATE : _____

FISCAL NOTE

REQUEST:

Revision Date: _____ Agency Affected: Labor
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safety standards; ... " BRU: Labor Standards & Safety
Sponsor: Rules Committee Components: _____
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EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
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LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL						
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REVENUE						
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Tom Stuart Phone: 254-2452
Division: Labor Standards & Safety Date: 1/19/88
Approved by Commissioner: Jim Sampson Date: 1/19/88
Agency: Department of Labor

Distribution (by preparer) :
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

A M E N D M E N T

OFFERED IN THE HOUSE

TO: CSHB 71(L&C)

BY THE LABOR AND
COMMERCE COMMITTEE

Page 1, following line 24:

Insert a new bill section to read:

"* Sec. 3. AS 18.60.800 is amended by adding a new subsection to read:

(f) Notwithstanding (a) and (c) of this section, the Department of Labor may, whenever the department determines it to be necessary and appropriate, adopt by regulation under the Administrative Procedure Act (AS 44.62) all, part, or a modified version of all or part of the latest edition of

(1) the American National Standards Institute Safety Code for Elevators and Escalators (ANSI/ASME A17.1), published by the American Society of Mechanical Engineers, as the minimum elevator safety code in the state;

(2) the Inspector's Manual for Elevators and Escalators - ANSI/ASME A17.2, published by the American Society of Mechanical Engineers, as the manual governing the procedures under which elevator inspections by the department shall be performed."

Renumber the following bill section accordingly.

Page 2, following line 2:

Insert a new bill section to read:

"* Sec. 5. Section 3 of this Act takes effect July 1, 1989."

Renumber the following bill section accordingly.

Page 2, line 3, before "Act":

Delete "This"

Insert "Except for sec. 3, this"

go0729hE
Bannister
1/24/89

Original sponsor: Rules/Governor

1 IN THE HOUSE

BY THE LABOR AND
COMMERCE COMMITTEE

2 CS FOR HOUSE BILL NO. 71 (L&C)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SIXTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to elevator safety standards; and
7 providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 18.60.800(a) is amended to read:

10 (a) Except as provided in this subsection, the 1987 [1984] edi-
11 tion of the American National Standards Institute Safety Code for
12 Elevators and Escalators (ANSI/ASME A17.1) published by the American
13 Society of Mechanical Engineers is adopted as the minimum elevator
14 safety code in the state. Section [111.12, RESTRICTED OPENING OF
15 HOISTWAY DOORS AND/OR CAR DOORS ON PASSENGER ELEVATORS, AND SECTION]
16 1001.1, Inspection and Test Periods of the American National Standards
17 Institute Safety Code for Elevators and Escalators, is [ARE] not
18 adopted as a part of the minimum elevator safety code in the state.

19 * Sec. 2. AS 18.60.800(c) is amended to read:

20 (c) Inspections of elevators by the department shall [MUST] be
21 performed in accordance with the procedures set out in the [NATIONAL
22 SAFETY PRACTICE FOR THE INSPECTION OF ELEVATORS AND ESCALATORS()]
23 Inspector's Manual for Elevators and Escalators - ANSI/ASME A17.2 []]
24 as approved in 1988 [1982].

25 * Sec. 3. Under AS 18.60.800(a), as amended by sec. 1 of this Act,
26 Section 111.12, Restricted Opening of Hoistway Doors or Car Doors on Pas-
27 senger Elevators, which is found in the 1987 edition of the American
28 National Standards Institute Safety Code for Elevators and Escalators
29 (ANSI/ASME A17.1) published by the American Society of Mechanical

1 Engineers, applies to elevators installed on or after the effective date of
2 this Act.

3 * Sec. 4. This Act takes effect immediately under AS 01.10.070(c).
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Original sponsor: Rules/Governor

1 IN THE HOUSE

BY THE LABOR AND
COMMERCE COMMITTEE

2 CS FOR HOUSE BILL NO. 71 (L&C)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SIXTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

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25 * Sec. 3. AS 18.60.800 is amended by adding a new subsection to read:

26 (f) Notwithstanding (a) and (c) of this section, the Department
27 of Labor may, whenever the department determines it to be necessary
28 and appropriate, adopt by regulation under the Administrative Proce-
29 dure Act (AS 44.62) all, part, or a modified version of all or part of

1 the latest edition of

2 (1) the American National Standards Institute Safety Code
3 for Elevators and Escalators (ANSI/ASME A17.1), published by the
4 American Society of Mechanical Engineers, as the minimum elevator
5 safety code in the state;

6 (2) the Inspector's Manual for Elevators and Escalators -
7 ANSI/ASME A17.2, published by the American Society of Mechanical
8 Engineers, as the manual governing the procedures under which elevator
9 inspections by the department shall be performed.

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12 senger Elevators, which is found in the 1987 edition of the American
13 National Standards Institute Safety Code for Elevators and Escalators
14 (ANSI/ASME A17.1) published by the American Society of Mechanical Engi-
15 neers, applies to elevators installed on or after the effective date of
16 sec. 1 of this Act.

17 * Sec. 5. Section 3 of this Act takes effect July 1, 1989.

18 * Sec. 6. Except for sec. 3, this Act takes effect immediately under
19 AS 01.10.070(c).

HB

72



Alaska State Legislature

House of Representatives
COMMITTEE ON STATE AFFAIRS

March 23, 1989

TO: Rep. Dave Donley
Chairman, Committee on Labor and Commerce

FM: Rep. H.A. "Red" Boucher
Rep. Loren Leman
Rep. Ann Spohnholz

RE: Subcommittee on Solid Waste Utilities

The Subcommittee on Solid Waste Utilities has met to consider two questions.

I. Should solid waste utilities be deregulated by the APUC.

II. Should the Committee introduce legislation regulating recovery and recycling of solid waste.

Regarding Question I, the subcommittee has reviewed the past and current record on the issue of deregulating refuse utilities. Appendix One to this memorandum contains the legislative history of bills introduced in the eleventh legislature. There is no bill in the current legislature concerning deregulation of refuse utilities.

In addition, the subcommittee members met with representatives of the refuse industry, and also with Susan Knowles of the APUC, to ascertain their views on this issue.

The subcommittee has concluded that current statute requires the APUC to regulate refuse utilities (A.S. 42.05.720(F)). The fact that the legislature has considered and declined to change the statute affirms the prescribed public policy for APUC to follow.

The subcommittee is disconcerted by information from the refuse utilities that the APUC is de facto deregulating refuse utilities by encouraging applicants to apply for "certificates of public convenience

and necessity" in areas where existing refuse utilities are operating. This practice is not in conformance with the statute and should be changed in favor of stricter regulation.

The subcommittee's conclusion in favor of strict regulation is based on traditional economic theory of regulation that holds that the public interest is best served by allowing economies of scale to accumulate for capital and operational cost recovery. In exchange for the preferred monopolistic position enjoyed by most utilities, they are regulated in order to prevent public abuse in the form of excessive profits and substandard or discriminatory service. The practice of regulation saves the public from inconstancy that is the by-product of competitive markets. Regulation of utilities is especially applicable in thin markets, like most Alaskan communities, that need reliable service from fundamental utilities.

In addition, the subcommittee is persuaded that regulation of refuse utilities is necessary to protect public health and the environment. The commonplace occurrence of hazardous waste and toxic substances in our communities requires, in the opinion of this subcommittee, a measure of control and planning that can be achieved only by regulation. Issues regarding waste products and disposal methods are of increasing urgency in communities throughout the country. These issues deserve to be scrutinized more rather than less in order to preserve public health and the aesthetic values cherished in most Alaskan communities.

For the aforementioned reasons the subcommittee recommends that a letter of legislative intent be attached to HB 72 (APUC sunset bill) that reaffirms APUC's statutory mandate to regulate refuse utilities until the legislature chooses to change the statute. Suggested language follows:

The legislature finds that the APUC's practice of regulation of refuse utilities as required under A.S. 42.05.720 is inconsistent with that statute. It is the intent of the legislature that APUC should strictly regulate refuse utilities consistent with A.S. 42.05. 720.

Regarding the second question, i. e., should the Committee sponsor legislation requiring regulation of solid waste recovery and/or recycling. The subcommittee is of the opinion that the merits of the proposed legislation, Appendix Two, cannot be satisfactorily determined without public hearings. Consequently, the subcommittee supports introduction of the legislation so that public process will be available to determine its viability.

Work session

2-2-89

Present: Nonley
 Collins: ~~Present~~
 Lemar
 Boyer
 Boucher
 Spokholz

Absent: ~~Present~~

000

Jim Fisher
 6645 N. Douglas
 Juneau AK

AK. Legal Services
Supports

HB 48: Concept Lower rates for lower income
 parties

094 Dave Hutchins Ex Dir REC

HB 72 Submitted amendments

Limited Competition

Fixed Overhead

Continuing Property Rights

add subsection

Does it suppd. be tax exempt
 due to Lobbying

Comments of Lee Num:

exclude Liberally Constructed

Print + ...

Teleconference

APUC
#72

Mike Downs Wasilla

① Commercial Refuse license

② Unable to obtain till Sunset Bill
deregulate
of Waste
disposal
reviewed.

③ Suggest APUC check into persons
wishing to
allow open competition

336 Leman: Concern of APUC regulation of
solid waste disposal

APUC felt one way to reduce costs - disallow
having to regulate solid waste at all.

Mr. Downs felt some control was needed.
Didn't think state should control
who can obtain license & who
can't. Should be put out to a
competitive bid process.

370 Paul Robison Valley Refuse
Would like deregulated so
there could be competitive bidding.

Incl. ^{Refuse} Bus. regulated to size of building
by APUC.

PUC Ties hands of om. Business.

409 Leman proposed which company

Brough. Landfill used for dumping

Leman: Are rates you're charged same for everyone?

No charge to anyone - Limits on what you can dump.

Number 457 Case against APUC

Private carrier could not be carrier of last resort.


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* DELIVER TO: LIOCLON
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* ORIGINAL
* SENT: 02/02/89 TIME: 15:33
* FROM: LIOCFBX
* SUBJECT: HL&C; PL#1; HB71; 2-2
* PRINT DATE: 02/02/89 TIME: 15:33
*
*****

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T/C NO: 89-01-89

DATE: FEBRUARY 2, 1989
SPONSOR: HOUSE LABOR & COMMERCE
SUBJECT: HB 72: EXTEND PUBLIC UTILITIES COMMISSION
MODERATOR: FRAN
SITE: FAIRBANKS

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PARTICIPANT LIST
FINAL STATS

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*****
TESTIFIED

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NAME/REPRESENTING	ADDRESS	PHONE	BILL NO.
1.			
2.			
3.			
4.			
5.			

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*****
OBSERVED

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NAME/REPRESENTING	ADDRESS	PHONE	BILL NO.
1. REBECCA GRAY - GOLDEN VALLEY ELECTRIC			
2.			
3.			
4.			
5.			

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TESTIFIED:
UNABLE:
OBSERVED:

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* DELIVER TO: LIOCLON *
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* ORIGINAL *
* SENT: 02/02/89 TIME: 15:16 *
* FROM: LIOCDAY *
* SUBJECT: H L&C;APUC: ANCH. PL #1 *
* PRINT DATE: 02/02/89 TIME: 15:17 *
*

*** ANCHORAGE PARTICIPANT LIST ***

TO: ALL TELECONFERENCE SITES
FROM: DAVID ----> ANCHORAGE

SUBJECT: _____HOUSE LABOR AND COMMERCE COMM. _____
DATE: _____FEBRUARY 3, 1989 _____

TO TESTIFY:

- 1.) SUSAN KNOWLES - HB 72
- 2.) GORDON PARKER - HB 72
- 3.)
- 4.)
- 5.)
- 6.)

TO OBSERVE:

- 1.) W.B. FRANCIS
- 2.) STEVE HAMLIN
- 3.)
- 4.)
- 5.)
- 6.)

EOM DJ

26

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: An Act continuing the existence
of APUC
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Commerce & Econ. Dev.
BRU: APUC
Components: Operations

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

The proposed legislation referenced above continues the APUC as it is currently configured for an additional four years. As such, the bill has no direct incremental or decremental effect on the agency's operating budget.

Prepared by: T.S. Moninski II, Executive Director Phone: 276-6222
Division: Alaska Public Utilities Commission Date: _____

Approved by Commissioner: [Signature] Date: 1/2/88
Agency: Commerce & Economic Development

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

STATE OF ALASKA
THE LEGISLATURE

FOUCH - STATE CAPITOL
JUNEAU, ALASKA 998 01
707 AND 3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

February 21, 1989

SUBJECT: Intrastate competition in telecommunications
(Work Order No. 6-0689)

TO: Senator Steve Frank

FROM: Teresa B. Cramer *TBC*
Legislative Counsel

You have requested a sectional analysis of the above described bill.

As a preliminary matter, note that a sectional analysis or summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1 makes findings concerning telecommunications services in the state.

Sections 2 - 4 exempt utilities and services that are exempt under AS 42.13, enacted by section 5 of the bill, from regulation by the Alaska Public Utilities Commission (APUC) or by municipalities to the extent of the exemption granted under AS 42.13.

Section 5 adds a new chapter concerning regulation of intrastate exchange or interexchange telecommunications service.

Sec. 42.13.010 permits entities that did not hold APUC certificates of public convenience and necessity to provide intrastate telecommunications service on January 1, 1989, and that are not affiliated with a certificated entity, to provide interexchange service without being certificated. The entity must first file a notice concerning services and rates. Entities providing service under this section are not subject to regulation by the APUC. The definition section, sec. 42.13.300, defines "interexchange service" and "intrastate service."

Sec. 42.13.020 requires in subsection (a) that the APUC deregulate telecommunications services if an interested party requests and the requirements of the section are met. The commission may also act on its own motion to deregulate a service. The section applies to public utilities holding certificates of public convenience and necessity to provide intrastate telecommunications service. The commission must provide notice of the application and an opportunity for a hearing. The service is deregulated if the commission finds that the entity or affiliate of the entity does not have market power in that telecommunications service and is not affiliated with an entity having market power in that telecommunications service.

Under the rest of the section, the exemption applies only to the services exempted under (a). The APUC is directed to determine the fully distributed cost of the exempted and regulated services provided by the entity. The rates for regulated services may not include recovery of any of the costs of the exempted service. Rates for regulated services may increase only if the direct costs of the regulated service increase.

Sec. 42.13.030 sets out the notice that entities must file before providing an exempted service. The contents include the entity's name, address, a description of services and prices, and proof of the purchase of a bond required by the chapter. The notice must be kept up to date.

Sec. 42.13.040 permits the APUC to require that an entity that has been exempted under the chapter begin complying with regulatory requirements of AS 42.05 if the APUC finds that the entity has gained market power in a telecommunications market. The reimposition of regulation applies only to the extent a service or entity has market power.

Sec. 42.13.050 directs the APUC to establish a system for access charges to be paid by interexchange service providers to local exchange carriers. The local exchange carriers set the amounts by a tariff filing.

Sec. 42.13.060 directs the APUC to establish an intrastate telecommunications service universal service fund. The local exchange carriers maintain the fund. The purpose of the fund is to provide financial support as necessary to ensure that interexchange service is provided throughout the state at reasonable rates. The fund is to be used to reduce

exchange access charges and surcharges. The APUC may approve a tariff that reduces the charges and surcharges to zero if necessary to accomplish the purpose of the fund. The commission may change the method by which money from the fund is distributed if the change is necessary to achieve the purposes of the section. However, under section 8 of the bill, the commission must wait for two years after the fund is established before it may make changes.

Sec. 42.13.070 permits the APUC to authorize the local exchange carriers to form an association to help administer the access charges and the universal service surcharges.

Sec. 42.13.080 requires entities providing or proposing to provide interexchange service to post a surety bond payable to the local exchange carrier association or the carriers themselves. The bond is to be in an amount equal to 90 days estimated intrastate exchange access charges and surcharges.

Sec. 42.13.090 prohibits an entity from putting limitations on the resale of a telecommunications service. If a service is resold, the reseller receives credit for applicable exchange access charges if the credit is necessary to prevent double payment of the charges.

Sec. 42.13.100 prohibits entities from discriminating among customers or entities in providing access, service, or interconnection and requires entities to permit connection or the furnishing of a service when the public convenience and necessity require and the result will not cause substantial injury or a substantial detriment to the service.

Sec. 42.13.200 directs the APUC to refer to decisions of courts interpreting state and federal laws concerning monopolies and restraints of trade when determining whether an entity has market power under the chapter.

Sec. 42.13.300 defines terms used in the chapter.

Section 6 changes the current exemption from regulation under the state antitrust laws. The exemption for all public utilities holding certificates of public convenience and necessity is changed to remove utilities providing interexchange telecommunications service. The antitrust laws will apply to the provision of interexchange telecommunications service.

Senator Steve Frank
Page 4
February 21, 1989

Section 7 extends the termination date of the Alaska Public Utilities Commission to 1993.

Section 8 limits the APUC's power to change the method for distribution of the universal service fund for two years after the establishment of the fund.

Section 9 directs the APUC to adopt the regulations to establish the exchange access charges and the universal service fund on or before January 1, 1990.

Section 10 sets an effective date of January 1, 1990, for the sections creating the exemptions from APUC regulation and reimposition of regulation, requiring bonding, and prohibiting restrictions on resale of services and for the limitation of the exemption from the antitrust laws.

Section 11 makes the exchange carrier association section and the extension of the termination date of the APUC take effect immediately.

The remaining parts of the bill do not have a special effective date.

If I may be of further assistance, please advise.

TC:lmb
L7/021

STEVE FRANK
DISTRICT K
SEAT A

119 N. Cushman. Rm. 213
Fairbanks, Alaska 99701

While in Juneau
P.O. Box V

Juneau, Alaska 99811
(907) 465-3709

Capitol Rm. 514

Alaska State Legislature



Senate

MEMBER
Finance Committee
Resources Committee
Legislative Council
Special Committee on Banking &
Economic Development

VICE-CHAIR
Community & Regional
Affairs Committee

HB 12

TO: All Senators

FROM: Senator Steve Frank

RE: Intrastate Long Distance Telephone Competition

DATE: March 6, 1989

I am introducing legislation to allow competition in the long distance telephone industry within Alaska because I believe that due to changing technologies, competition is now feasible, and therefore in the Alaskan consumers best interest.

In free market economies we rely on competition as the most efficient mechanism to protect the consumer with regard to the price and availability of goods and services. However, when a monopoly evolves due to the basic nature of an industry, society has recognized the need for regulation to serve the public interest. But if fundamental technological changes in an industry occur and it is no longer a natural monopoly, that monopoly should not be perpetuated through protection from competition by regulations. To do so would be counter to our basic philosophy that competition is preferable to regulation.

The telecommunications industry has experienced this kind of fundamental technological change, especially in the delivery of long distance telecommunications. Satellite technology has replaced capital intensive land lines, drastically reducing costs and making the delivery of long distance service feasible on a competitive basis.

To understand the change in technology and why it has allowed the feasibility of competition, one must examine the basic elements of a single long distance telephone call. A long distance phone call is routed through the phone lines to the local phone company (local exchange carrier) and from there to the long distance carrier (interexchange carrier). It is the interexchange carrier that sends the message via satellite to an earth station in the distant city. From there it is routed to the local exchange company in the community that is being called and through the phone lines to the receiving telephone. It is important to keep in mind, the legislation would allow competition only on the long distance service (interexchange). Local Exchange Companies, which remain natural monopolies, would still be regulated by the

APUC for their portion (exchange tariff) of the total long distance rate.

An often used argument against competition in Alaska involves the myth that Alaska is unique and that it has higher costs, particularly in rural regions. The argument follows that those higher rural costs require a monopoly to provide service to the entire state, with huge subsidies flowing from urban to rural areas. In fact, we are unique. We are uniquely suited to competition because of our use of satellite technology rather than land line based technology. All that is required to provide competition in a community is a relatively inexpensive earth station and switch.

In addition, the assumption that the urban areas support the rural areas does not appear to be true as evidenced by information that Alascom has filed with the Alaska Public Utilities Commission (APUC), showing that there is not a significant subsidy flowing from urban to rural Alaska - if one exists at all.

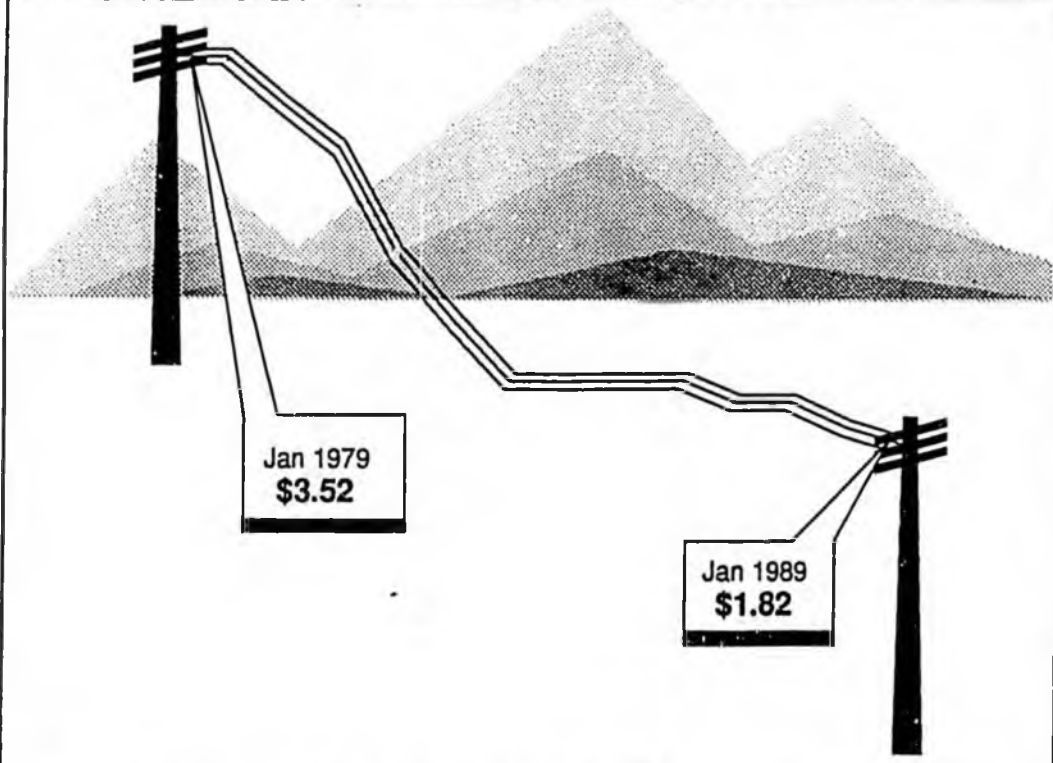
To protect rural consumers on routes not served by competition, the legislation specifically prohibits the dominant carrier (now Alascom) from raising rates on routes not served by competition. To further protect rural consumers, this legislation also provides for a universal service fund to protect telephone service throughout Alaska and to insure that rural rates remain reasonable.

History has shown in both the national and Alaskan experience, that competition has reduced long distance telephone rates. Since the Federal Communications Commission (FCC) opened the national interstate market to competition, American Telephone & Telegraph (AT&T) has reduced its rates by over 50%. Moreover, the assertion that monopolists cannot reduce their costs has been proved false as evidenced by the fact that, during the same period, AT&T has reduced its costs by over 30%. This reduction in costs has been achieved through a combination of operating efficiencies and improved technology. As a result of their competitively induced lower rates, AT&T has seen its total traffic volume increase. These three factors together; technological advances, operating efficiencies and increased demand, have allowed AT&T to remain healthy and thriving in the face of competition. Similarly, since the introduction of interstate competition in Alaska in 1982, long distance rates on interstate calls have decreased by roughly 50% while volumes have doubled, allowing Alascom to maintain its volume and profits. The dire predictions by Alascom about the effects of competition have not come true.

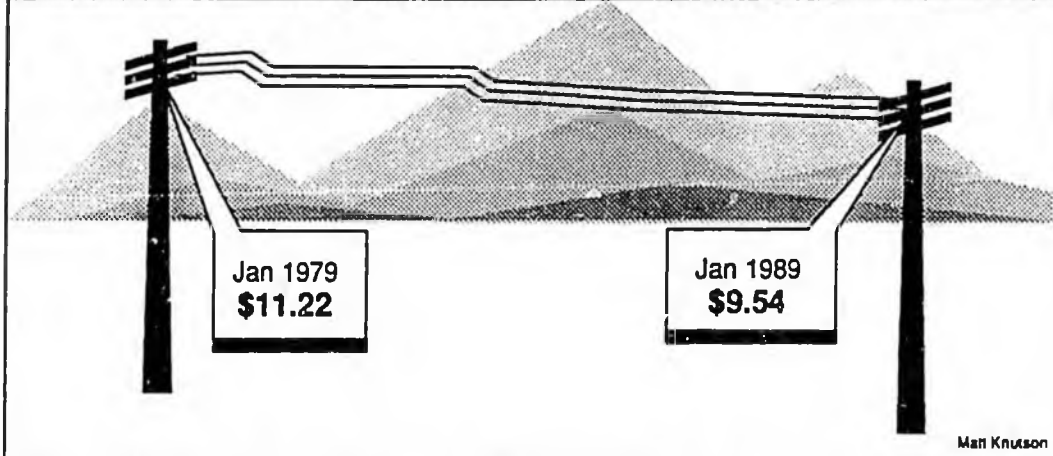
Therefore, based on both competitive economic theories and historical experience, it is reasonable to conclude that competition will result in lower long distance phone rates in the intrastate market for Alaskans.

Thank you for your consideration.

Out-Of-State With Competition



In-State Without Competition



Matt Knuson

Note: Alascom rates based on a \$10.00 call placed in January 1969

STATE OF ALASKA
THE LEGISLATURE

POUCH Y STATE CAPITOL
JUNEAU, ALASKA 99811
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

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TC:lmb
L7/021

HOPKINS, SUTTER, HAMEL & PARK

(A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS)

888 SIXTEENTH STREET, N.W., WASHINGTON, D.C. 20006 (202) 835-8000
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CHICAGO OFFICE THREE FIRST NATIONAL PLAZA CHICAGO 60602
DALLAS OFFICE 545 EAST JOHN CARPENTER FREEWAY 75062

JOE DIXON EDGE
(202) 835-8242

MEMORANDUM

TO: The Honorable Steve Frank
P.O. Box V
Juneau, Alaska 99811

FROM: Joe D. Edge
Hopkins, Sutter, Hamel & Park

DATE: February 21, 1989

RE: Senate Bill 206 and the Impact of Intrastate
Competition on Universal Service in Rural Alaska

You have asked me to examine the impact of SB 206 ; "An Act relating to intrastate competition in telecommunications" . . . , on the provision of intrastate long distance service at reasonable rates throughout Alaska. In discussing this issue, I will also address a number of questions which have been raised from time-to-time regarding the introduction of competition in Alaska long distance services.

In looking at this question, I have assumed that the central objective of the bill is to provide for a flourishing competitive intrastate long distance market while ensuring the availability of universal service at reasonable rates. I believe the bill will accomplish these objectives. SB 206 removes existing regulatory and structural barriers to competition in the Alaska market. At the same time, the bill provides for continuing regulation by the Alaska Public Utilities Commission ("APUC") in those areas where competition is not yet fully effective thus ensuring universal service at reasonable rates. Finally, the bill provides for a system of access charges and a Universal Service Fund administered by the Alaska telecommunications industry, under APUC supervision, which will ensure nondiscriminatory access to local exchange facilities and provide

support, where necessary, to ensure the provision of universal service at reasonable rates.

INTRODUCTION

Today competition in long distance service is permitted nationwide in the interstate market and in forty-five of the states. Interstate long distance competition began over a decade ago in the lower 48 and has been a reality in Alaska since 1982.

Since the FCC opened the national interstate market to competition, long distance rates have declined by over 50% and many new services have been introduced. AT&T, which had a monopoly before the advent of competition, has lost some of its market share to competition but its traffic volumes have increased and it is a healthy and thriving company.

These same competitive benefits have been realized even in lower-48 rural interstate markets not yet reached by the networks of competing carriers such as MCI and Sprint. When competition appeared in interstate markets over a decade ago, AT&T vigorously opposed it arguing, among other things, that competition could lead to "deaveraging" of AT&T's toll rates with calls between urban areas priced lower than calls in rural areas. In more than ten years of competition in interstate markets, this has never happened. Not only has AT&T continued to "average" its rates throughout the country but so have MCI and Sprint even though the latter companies' rates are not regulated. Rural long distance rates have declined by over 50% just as urban rates have.

Alaska has also experienced the benefits of interstate competition. Although Alaska interstate competition was opposed with the same arguments made in the lower-48, none of the predicted harms have occurred. Interstate rates have declined by over 50% throughout Alaska. Today, Alascom, while losing market share to GCI, is carrying more traffic than when GCI entered the market. An enormous increase in calling has occurred as a result of lower rates and the stimulation resulting from the intensive marketing efforts of GCI and Alascom. And service has been improved as well. SB 206 will extend these benefits to the Alaska intrastate market.

The Structure of the Alaska Market

Under the existing noncompetitive structure, the in-state long distance telephone market is served by a monopoly long distance carrier (Alascom) connecting with over two dozen local telephone companies. In order to provide long distance service,