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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

N O T E

for the attention of
the restricted exploratory working group
of the Governing Council
on the leasing contract

Rome, March 1977

1. - The Secretariat of the International Institute for the Unification of Private Law (UNIDROIT) was first seized of the question of the leasing contract by the Governing Council of the Institute at its 53rd session in February 1974. At this session the Council gave priority to the study of the possibility of preparing uniform rules on the leasing contract for the 1975-1977 triennium.

2. - On this basis the Secretariat prepared a preliminary report illustrating the working of this new contract, the legal problems it gives rise to in general and at the level of international operations in particular. This report was submitted to a small working group of the Governing Council in April 1975 which, apart from excluding the leasing of real estate, ships and aircraft from the scope of any future measures, decided that attention should be focussed on international as opposed to internal operations. To this end it authorised the Secretariat to circulate its preliminary report amongst experts and to seek more detailed information regarding international leasing.

3. - In March 1976 the Secretariat distributed a questionnaire designed to clarify certain problems peculiar to leasing in general and to obtain more detailed information regarding the nature of cross-border operations. Replies came from all corners of the world and these were analysed in a paper laid before the Governing Council at its 55th session held in September 1976. One of the major facts to emerge from the Institute's inquiry was that the successful mounting of truly international leasing operations, as opposed to indirect international operations concluded through subsidiaries, is as yet a quite rare occurrence, in large measure owing to the disparate legal treatment of effectively the same leasing contract from one country to another, and that interest would accordingly seem to lean towards a uniform international regulation for the leasing contract in general rather than rules cast with international leasing specifically in mind. Added strength inured to this argument when one looked at the rare and piecemeal attempts made by national legislators to regulate this new contract, at times on the fiscal front, at others from the accounting angle but only rarely from the strictly legal standpoint. This virtually ubiquitous lack of a basic legal framework for the leasing contract, notwithstanding what commentators agree to be its qui generis characteristics as against existing contractual models, provided a dual impetus in the minds of most of those replying to UNIDROIT's questionnaire to the preparation of uniform international rules on leasing, in the interest, first, of clarifying the legal situation at the national level and, secondly, of encouraging the use of this particularly flexible source of credit in international trade transactions by virtue of the specially uniform character which would be the objective of the said rules.

4. - In the light of the Secretariat's paper embodying this analysis, the Governing Council at its 55th session decided to set up an exploratory working group drawn from amongst its own membership and assisted by experts from the world of leasing practice, to report back to it at its 56th session, which will be held in Rome this May, with a view to its then taking a final decision as to the convening of a Study Group empowered to draft uniform rules on leasing. The primary tasks of this working group are to examine two problems which gave rise to doubts in the minds of members of the Governing Council at its last session regarding the advisability of proceeding to a uniform regulation of the leasing contract: first, whether it is feasible to disentangle the private law aspects of leasing from its fiscal aspects, in view of the generally agreed unsuitability of the last-mentioned aspects for unification, and, secondly, whether it is desirable to deal with the leasing contract independently from security interests, particularly in view of the work which UNCITRAL has now begun on the establishment of a uniform security interest for international commercial transactions.

5. - The Secretariat's inquiries would seem to confirm the case for proceeding to the preparation of some basic uniform private law rules for the leasing contract, quite independently, and appropriately so, of the corresponding situation in revenue law which precisely because of the continuing uncertainty and indeed confusion about the exact legal nature of the leasing contract and the appropriate system of contractual rights and duties to be applied thereto has tended virtually to supplant private law in this field, thus delaying clarification of the particular legal concept or concepts at the root of leasing. It is submitted that the emergence of these legal concepts has hitherto been suffocated by the pervasiveness of the revenue authorities' activity in this field. There can in this connexion be no doubting the considerable favour bestowed on the activity of leasing by revenue authorities, in the form of investment tax credits and accelerated depreciation, but this is no ground for seeing in leasing a massive corporate fraud on revenue authorities; rather is Government determined, through the politico-economic leverage offered by its fiscal policy, to enhance the investment capacity of industry in an economic climate in which the basic premises of yesterday are fast yielding to fresh imperatives, one of which is the emphasis on use rather than property in respect of industrial equipment in the interest, inter alia, of preserving competitiveness and another of which is the constant search for sound financing in the context of a viable investment policy. The fact that the mechanism of leasing has been so successful in meeting these pressing needs, notwithstanding competition from the more classical methods of financing offered by banking houses, has undoubtedly been facilitated by its peculiar structure, encouraging industry to invest in the use of vital but often prohibitively expensive equipment by means of a staggered debt the creditor-financier of which is able to cover thanks to the enlightened industrial investment policies which Governments invariably pursue through their

fiscal policy. The financing mechanism represented by leasing, and par excellence by full-pay-out leasing, is so relatively simple and flexible in its basic structure, modelled to a large extent on hire, as to favour the emergence of ever more hybrid varieties of this already hybrid creature of the financial world. As a result its success cannot be considered as something ephemeral, but must rather be seen as an implement of infinite capacities in the service of trade.

6. - The investment potential of the leasing operation in the context of the crisis-ridden economic situation of to-day should not, however, blind one's otherwise admiring eyes to the fiscal abuses that have of late been practised on this basic theme, particularly in the United States through leveraged leasing; however, it is respectfully submitted that this can be seen rather as the consequence of the fiscal and accounting confusion which has been allowed to go unchecked on this subject than as the exploitation of a fundamental propensity of the leasing mechanism to fiscal fraud. It is further submitted that the results of this fierce activity by the revenue authorities in the continuing absence of a basic private law concept of leasing, framed with leasing in mind rather than in the context of often inappropriate approximations to pre-existing contractual schemata, has been disastrous. Thus many countries have drawn up specific revenue rules without even pausing to seek a definition of the concept at work in leasing, as opposed to the various schemata to which it has been likened over the years, so that these rules are now applied so differently from one country to another that it seems virtually impossible to see them any longer as being related to a common basic concept. The result of this confusion has been the tragic stillbirth of the many efforts hitherto directed toward the mounting of truly direct international leasing, a sacrifice which an already credit- and export - starved industry can ill afford.

7. - In the foregoing we have attempted to draw attention to some of the rich fiscal overlay which has hitherto thwarted the development of an autonomous private law concept of leasing. It is submitted that the clarification of this concept is nevertheless a matter for urgent concern in view of the growing number of legal problems deriving from the special character of "full-pay-out" leasing in particular. It is further submitted that an additional fruit of such a clarificatory process could well be to resolve some of the confusion reigning on this score in the fiscal domain, and this by conferring on leasing an autonomous private law character as opposed to the conflicting schemata between which individual leasing contracts have been hitherto torn, above all for fiscal purposes. In perceiving the cleavage that exists between the private law concept at the root of the financing mechanism involved in leasing and the aspects of this mechanism which attract the attention of revenue authorities everywhere, it is important to bear in

mind the traditional sphere of activity reserved to these last-mentioned, namely the regular replenishment of the Treasury by the taxation of any discernibly taxable activity, irrespective of whether or not such activity has been legally baptised. The scope of this voracious activity leaves little time for the revenue authorities to fill such voids by dint of their own exertions: such is the prerogative of the legislator in the private law field. The efforts of the legislator in this last field to clarify the legal basis of new contracts have not previously fallen foul of the concomitant regime established in respect of such contracts by the revenue authorities and it is submitted that there is no reason to believe that, just because an advanced start has been made in this field by the latter, it should not prove perfectly feasible to establish an autonomous private law basis around the quite particular characteristics of the leasing contract.

8. - Regarding the second difficulty which troubled the Governing Council at its last session, namely whether or not it is expedient to treat leasing independently of security interests, various factors lead the Secretariat to believe that, whilst it may be justified in certain cases to see in a lease the essential qualities of a security interest (those cases that the Uniform Commercial Code of the United States refers to as leases intended as security) - and such leases should of course be treated as security interests for the purposes of any registration system designed for security interests - the essential nature of a lease does in no way bring it automatically into the category of security interests, any more than it justifies its being fitted into the various other pre-existing contractual schemata that have been suggested. The great majority of the replies to UNIDROIT's questionnaire stressed the importance of clarifying the legal basis of leasing independently of the vaster subject of security interests in general. Indeed the undertaking of such a clarification of the legal basis of the leasing contract, in particular having regard to the characteristics which distinguish it from the various models to which it has been consistently likened, would in its turn clarify the question as to when a lease is in fact a security interest. It is submitted that the absence of such an autonomous private law basis for leasing has been a considerable contributory factor to the continuing lease conditional sale controversy in this field.

9. - Moreover, non-dispossessory security interests are closely tied to an underlying sale contract whereas, notwithstanding the all-too-frequent over-emphasis given to the purchase option phenomenon with which leasing is identified in the eyes of so many, leasing is neither a sale nor serves to accomplish the same, being essentially a contract of hire the predominant objective of which for the lessor is to secure the use of extremely expensive equipment for what can reasonably be pre-estimated as its economic working life, legal ownership counting for increasingly less economically in modern business (see in this connexion the decision of the Frankfurt Oberlandesgericht of 23 June 1976, RJE 1977, 200, holding that normal bill-out financial leasing is generally a contract of hire).

10. - One should also draw attention to the inappropriateness of the application of the whole security interest apparatus contained in Article 9 of the Uniform Commercial Code to leases. Mr. Peter F. Coogan, an United States' authority in this field, points out that "unless the transaction closely approximates one traditionally handled as a security device, a lease transaction is not amenable to the application of the remedy provisions which might reasonably be regarded as the raison d'être of Article 9. It is obvious that a secured party cannot enforce his debtor's obligations by selling the 'collateral' where the 'collateral' is already owned by the secured party" (cfr. "Leases of Equipment and Some Other Unconventional Security Devices", Equipment Leasing 1976, p. 9 at p. 77). One American lessor commented: "Lessors need a remedies framework that recognizes lessor ownership, enables immediate recovery of possession in the event of default, and precludes all claims of lessee equity."

11. - It is submitted in the light of the foregoing that the scope for an exercise in clarification would appear to be fertile and that moreover such an exercise is urgently called for in the interest of encouraging the expansion of this valuable tool of modern international trade within a clearly defined legal framework of its own. It is suggested that the Working Group may care to examine some of the basic elements of such a work of clarification, thereby indicating to the Secretariat the particular matters on which it considers that its energies should be concentrated.