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Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference 154-D

Dear Mr. Lucas:

As promised in my January 16th letter to you, enclosed herewith is Attachment II to that letter which further discusses some of our concerns with respect to the proposed accounting for certain leasing transactions. Please add this attachment to our January 16th letter. Thank you for your consideration.

If you have any questions, please contact Sharyn Handelsman ([212] 239-6356) or me.

Yours truly,

Frank T. Vayda

cc: R. Bossio

Attachment II

LEASING TRANSACTIONS

As an arranger of and investor in many complex leasing transactions, we are concerned with the guidance in Example 5 of Appendix B. The following is a summary of specific concerns we have identified with the exposure draft relating to leasing transactions:

1. The proposed guidance in Example 5 appears to rest on a premise that lessees create special purpose leasing entities (SPLE) , and that lessees are the primary beneficiary of the SPLE's. It is our experience that SPLE's are almost always created by lessors for their own business purposes. Lessees have generally been indifferent to the legal form or capitalization of their lessors, provided that the lessee has the right to quiet enjoyment of the leased asset during the lease term and the duties and obligations of the lessee and lessor are clearly defined in the lease contract.

   Historically, lessors have used SPLE's to isolate real or personal leased property from the rest of their assets for business and legal reasons that are unrelated to the lessee. For example, many lessors create an SPLE to own a leased asset in order to isolate the lessor's total credit exposure to environmental claims or other liabilities that may attach to them as the legal owners of a specific property. In addition, lenders whose loans are secured by a pledge of specific property and a related lease often require that such assets be segregated in an SPLE from the other assets of the lessor/borrower as a condition to make the loan. This insulates the lender's collateral from the lessor/borrower's other creditors in the event of a bankruptcy by the lessor/borrower. In addition, lessors often isolate a leased asset in an SPLE in order to achieve a specific tax effect for the lessor, in a manner that has no impact on the lessee's rights or obligations regarding the leased asset.

2. The proposed guidance in Example 5 contradicts the Boards' previous well-reasoned conclusions on this subject. The proposed guidance indicates that the lessee's accounting for a lease transaction should be a function of the capitalization or legal structure of the lessor. However, the FASB thoroughly considered this issue during its deliberations concerning accounting for leases and articulated its conclusions clearly in paragraph 82 of SFAS No. 13 which states:

   > "The Board considered the argument advanced by some that, if the lessor has no economic substance, the lessor serves merely as a conduit in that the lender looks to the Lessee for payment and thus, it is asserted, the lessee is, in fact the real debtor and purchaser... The Board finds unpersuasive the argument that the lessee's accounting for a leasing transaction should be determined by the economic condition of an unrelated lessor. If a lease qualifies as an operating lease because it does not meet the criteria in paragraph 7, the Board finds no justification for requiring that it be accounted for as a capital lease by the lessee simply because an unrelated lessor lacks independent economic substance. In such a case, it probably means that someone else, presumably the lender, is in substance the lessor, but this circumstance, per se, should not alter the lessee's accounting. Accordingly, the Board rejected this criterion."

3. The scope of transactions covered by the proposed guidance should be clarified if the Board goes forward with this portion of the exposure draft.

The first paragraph of SFAS No. 13 defines a lease as "an agreement conveying the right to use property, plant and equipment ... usually for a stated period of time. " Therefore, it would appear that all lease agreements, by definition, provide the lessee with "control" in some sense, over the used of the leased property for the duration of the lease.

In addition, lease contracts often include residual sharing rights and/or residual guarantees designed to limit the lessor's risks and rewards as owner of the leased property and increase the lessee's risks and rewards as user of the leased property. Such rights may take a variety of forms. For example, a fixed-price purchase option is indistinguishable economically from the provision, cited in paragraph 197 of the exposure draft, entitle the lessee to receive residual disposition proceeds in excess of the stated option amount. Such options appear in many lease contracts and they provide lessees with control over "all of the potential residual benefits from the ultimate sale of the property" as discussed in paragraph 201 of the exposure draft.

The proposed consolidation guidance would indicate that all leased assets subject to a fixed price purchase option (which includes many leveraged leases), owned by an SPLE, would consolidated in the financial statements of the lessee. As noted above, legal ownership of most large-ticket leveraged leases is vested in an SPLE (typically a trust) formed primarily for business reasons that benefit the lessor. If these entities are subject to the proposed guidance of the exposure draft, then it appears that a lessee would automatically consolidate the net investment in a leveraged lease with the lessor's equity in the leveraged lease shown as a non-controlling interest in the equity section of the lessee's balance sheet.

The proposed accounting for a leveraged lease transaction as described above does not appear to enhance the information conveyed by the financial statements of the lessee, and may actually confuse the users of the financial statements. We believe that more guidance is needed in order for preparers of financial statements and their auditors to determine what terms and conditions of a complex leasing structure, contained in an SPLE, will result in "control" for purposes of applying the consolidations standard to lease transactions.

4. The proposed retroactive transition requirements would impose a significant burden on existing lessees. Since the EITF adopted its consensus on Issue 90-15 in early 1991, lessees have entered into billions of dollars worth of leases with SPLE's. Such transactions have been structured carefully (often with significant assistance from legal and accounting professionals) to comply with the requirements of that consensus, as interpreted in a letter sent from the acting Chief Accountant of the SEC to the Task Force Chairman and discussed with the Task Force at its July 11, 1991 meeting. Many of these transactions were negotiated and structured with the full knowledge of all participants that the lessee could not enter into a transaction that would (1) be classified as a capital lease or (2) be consolidated under the EITF 90-15 consensus without violating covenants under its existing credit agreements or indentures.

It appears from the description of transaction terms in paragraph 197 of the Exposure draft, that the proposed guidance would result in lessee consolidation of SPLE's that are not required to be consolidated under existing EITF and SEC guidance. Thus, if the Board were to require retroactive consolidation of these SPLE's as part of a new consolidation standard, it would cause some companies retroactively to be in violation of their debt covenants even though they negotiated the terms of their transactions in good faith to comply with such covenants under then-existing GAAP.

It is impossible to quantify the effect of such covenant violations on lessee companies in advance; but we believe that the consequences of requiring companies to be in default of their debt agreements as a result of retroactively applying a new accounting standard would be significant. At the extreme, such standard-induced defaults could force some companies to seek protection from their creditors under the bankruptcy laws.

A similar situation was addressed with respect to the adoption of EITF Issue 90-15, where the Issue was applied on a prospective basis only. This prospective application was a practical and equitable solution in that it avoided requiring lessees and lessors to incur the potentially significant monetary costs and time commitments to restructure and/or refinance lease transactions which had been structured to comply with applicable GAAP. Alternatively, if the Board feels that it must cause all existing lease transactions to conform with the new standard then it should be guided by it's application of SFAS No. 13. As discussed in paragraphs 115-119 of SFAS No. 13, the Board concluded at that time that prospective application of the new standard with mandatory retroactive application to pre-existing leases only after a four-year transition period would balance the need of financial statement users for comparability with the need of financial statement preparers for time to negotiate modifications to their credit agreements, indentures or lease contracts, if necessary. If the Board decides to go forward with a requirement that such controlled SPLEs be consolidated by lessees, we believe that prospective application only would be the best approach or, if retroactive application is deemed necessary, an adequate transition period to restructure should be included.