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Equipment Leasing Association of America

January 15, 1996

Financial Accounting Standards Board File Reference 154-D 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

## Dear Sirs:

I am writing on behalf of the members of the Equipment Leasing Association of America ("ELA"), the trade association representing the \$140 billion a year U.S. equipment leasing industry. We urge the Financial Accounting Standards Board to reconsider the use of the concept of effective control of assets through a lease as a criterion for consolidation as stated in the Proposed Statement of Accounting Standards entitled Consolidated Financial Statements: Policy and Procedures ("Exposure Draft").

The members of the ELA feel strongly that control of the underlying leased assets of a special purpose entity (SPE) by a lessee should not result in consolidation of that special purpose entity by the lessee. The primary reasons are: the Exposure Draft as proposed would create inconsistencies in the treatment of identical operating lease transactions; and all leases contractually provide a significant element of control of the leased asset to the lessee and the proposed guidance does not provide a clear basis for distinguishing between those leases that trigger consolidation and those that do not. Furthermore, we believe that any attempt to infer consolidation-level control out of a lease contract has little or no foundation in accounting theory.

The Exposure Draft would create accounting inconsistencies in the treatment of operating lease contracts of identical terms and conditions. A lessee could lease two identical assets under identical terms but from two different lessors, one with a SPE as the lessor and the other with a leasing company as the lessor. The presence of a SPE would cause the lessee to consolidate the same asset that under the other lease would be accounted for as an operating lease.

It is reasonable and customary business practice in leasing for lessors to create a special purpose lessor vehicle for each large lease transaction. Often there is at least one SPE for each lessor/equity investor in the lease. The leasing community utilizes SPEs for the following reasons:

- to facilitate placement and funding of the transaction with third party investors,
- to isolate the assets from other assets (bankruptcy risk),
- to streamline titling of the leased assets (common in fleet vehicle leases),
- to protect the lessor from environmental risk associated with ownership of the assets (common in real estate leases),
- to maximize the equity investors' tax benefits, and
- to protect the equity investors' legal and economic interests.

Further, as a result of the nature and business purpose of the SPEs, they do not have other business activities or a board of directors.

A lease agreement provides the lessee control of the leased asset via the contractual right to quiet enjoyment of the asset for the lease term. Quiet enjoyment is the right to use the leased asset in the lessee's business as he sees fit, provided there exists no event of default. Moreover, most lease agreements contain terms that also afford elements of control through renewal options and purchase options ranging from right of first refusal purchase options to fixed price non-bargain purchase options to purchase options coupled with partial residual guarantees (which is the case in Example 5 in the Exposure Draft). As a result, a significant number of large ticket operating leases with a SPE as the lessor could be required to be consolidated by the lessee due to the lessee's being deemed to have effective control of the assets of the SPE.

In paragraph 82 of FAS 13 the Board considered and rejected the notion of capitalizing a lease on the lessee's books because the lessor lacked economic substance. The conclusion was that if the lease qualifies as an operating lease, the lessee's accounting should not be affected by the economic condition of an unrelated lessor (Example 5 in the Exposure Draft incorrectly portrays the lessee as creator of the SPE; rather, investment bankers, equity investors/lessors or lenders create the entity). Paragraph 82 further suggests some other party, possibly the lender, is in substance the lessor. We do not believe there is any reason to reconsider the Board's conclusion on this subject.

In any case, the provisions of Exposure Draft should not be applied retroactively as that would cause serious repercussions for some lessees. The capitalization of assets and liabilities on the books of some lessees would cause them to be in default of credit agreements. Some companies might be considered technically insolvent due to the change in accounting rules. Therefore if the Board decides to go forward with this guidance we believe that transition provisions similar to those adopted in 1976 for FAS 13 would be more appropriate for those transactions for the same reasons discussed in paragraph 115 through 119 in FAS 13.

The ELA strongly recommends reconsideration of the provisions of this Exposure Draft. Whatever the objectives of the Exposure Draft, the results will not be as planned.

Respectfully,

Michael J. Fleming

President