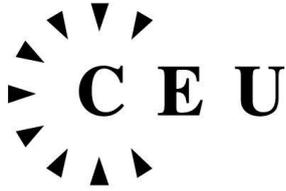


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**LEASING CONTRACT IN AZERBAIJAN IN COMPARISON TO
UNITED STATES**

by

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ABSTRACT

This research is dedicated to the leasing contract in Azerbaijan Republic in comparison with the situation in United States of America. The aim of this research is to study how is leasing contract regulated and how is it developing in Azerbaijan. At the beginning I will give an overview on history of development of leasing, then the present legal status of leasing in Azerbaijan and finally will describe the situation with leasing in United States. After achieving set objectives I will make comparison between Azerbaijan and United States based on what was discussed in this thesis.

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INTRODUCTION

Nowadays the question of renewal of the main assets and equipment of Azerbaijani enterprises is very important. Unfortunately, the main assets of the entities of the business activity are outdated and they have reached their maximum almost in all spheres of our economy, what leads to disastrous consequences for the population. Most of the enterprises do not have enough financial assets for the renewal of their material-technical base. There is also no chance to transfer these expenses on shareholders, employees of these enterprises or to rely on state aid.

Traditionally business owners used three sources for financing their activity: their own capital (authorized capital of the legal person or personal funds of the individual entrepreneur), debt capital and profit coming from securities. Recently investment activity worldwide became one of the main tools for the attraction of funds to the economy. Investment helped post-war Germany and Japan, whose economies were destroyed after World War II, to become countries with highly developed economies. Investments help business owners to cope with one of the main tasks in the business sphere – providing permanent support to the means of production and holding them on proper level, which helps them compete and survive in the conditions of a dynamically developing market.

One of the main types of financing form is “leasing”. Instead of taking loan at interest from the bank to purchase the equipment which is necessary for his business activity, the entrepreneur addresses to the investor (lessor) who buys this equipment and leases it to him. Here the entrepreneur is not obliged to prove his solvency or to care about loan guarantee, while investor in practice is not taking risk financially, because in case of entrepreneur’s non-payment situation, the property returns to the owner, who can cover his costs by leasing or selling it to someone else.

Leasing activity is quite new for Azerbaijan. Before the 1990s there was no such expression as “leasing”. It started to develop after the collapse of Soviet Union. Now the economy is developing and business market is growing day-to-day. Azerbaijan is an oil country, so more and more investments are made to its economy by representatives of external business markets.

The interest in leasing is continuing to grow in Azerbaijan. The number of leasing companies is increasing, the existing ones are widening their scope of activities and foreign leasing companies are entering into Azerbaijan market. The observation on the leasing market in Azerbaijan is conducted by ALCA¹ (Azerbaijan Leasing Companies Association), Azerbaijan Leasing Portal² and IFC WB (International Finance Corporation – World Bank). For example leasing turnover³ was 168.8 million \$ in 2007, where in 2006 it was only 71 million \$. The number of leasing contracts concluded in 2007 is 1659; it is twice more in comparison to 2006 and 22 times more than in 2003. The international organizations are also investing money for the purpose of leasing development in Azerbaijan, for example EBRD⁴ (European Bank for Reconstruction and Development) signed contract aimed to the implementation of the first leasing project in Azerbaijan in March 2007. The project is aimed “to support one of the most growing leasing companies (Unileasing) in Azerbaijan - agreement to acquire a 33-1/3 per cent-equity stake in and to provide a \$3 million loan to Unileasing”⁵. The information about leasing is appearing regularly at the local printed media and business and law reviews, where

¹ Official website of Azerbaijan Leasing Companies Association at - <http://www.azerbaijanleasing.com> - last visited on 29 March, 2009.

² Official website of Azerbaijan Leasing Portal at <http://www.azerileasing.com> - last visited on 29 March, 2009.

³ See the data of the International Finance Corporation (World Bank Group) at - <http://www.ifc.org/ifcext/acalf.nsf/Content/AZHome> - last visited on 29 March, 2009.

⁴ See EBRD official website - <http://www.ebrd.com/new/pressrel/2007/070314.htm> - last visited on 29 March, 2009.

⁵ See EBRD official website - <http://www.ebrd.com/new/pressrel/2007/070314.htm> - last visited on 29 March, 2009.

the topical problems of the leasing business are analyzed. The legislative and methodical bases of leasing activity are also improving.

Still, very few publications have been devoted to the specific topic of leasing. This paper remedies this by making research on regulations of leasing contract in Azerbaijan. I made the comparison analysis with the situation in United States – the country where leasing had its first roots. Overview of the development of leasing in US and then its comparison to present situation in Azerbaijan is also made.

The aim of this thesis is to make research on leasing in Azerbaijan; legal regulation of the leasing contract. Analyze its legal nature, normative legal basis which regulates the leasing relationships. Make output on conclusions and practical suggestions on further development of leasing, on modification and objection of the existing legislation which regulates leasing contract. Conduct the practical comparisons of leasing in Azerbaijan with the development of leasing in United States and world leasing market.

As the sphere is quite new, not too much has been written about it. There are good books and materials related to theory of leasing in Azerbaijani, Russian and foreign literature which I have used in my research. I have also used Civil Code⁶, Tax Code of Azerbaijan Republic and some other legal acts to emphasize legal regulation of leasing in Azerbaijan. I have used the help and recommendations of my teachers at previous university who are specializing in business and civil law spheres. I have also used up-to-date information and statistical materials in my thesis work – for example annual statistics on leasing portfolio provided by Azerbaijan Leasing Companies Association and International Finance Corporation (World Bank). Of course my current supervisor at CEU will support me also in my research

⁶ Please note that I have used the Articles of the Civil Code from different sources in this work. Most of the English Translation of the Articles was cited from Azerbaijan Leasing Companies Association (www.azerbaijanleasing.com) website where the translation in English is provided. I have also used www.lawyer.az website where the texts of codes are provided in both Azerbaijani and Russian languages.

by giving me directions and recommendations and observing the progress of my thesis writing.

The given research aim will be achieved by: defining the essence of leasing, overview of the history of the development of leasing and existing Azerbaijani legislation which regulates the leasing legal relationships, defining the legal status and content of the leasing contract, it's parties and subject, examination of the grounds for modification and termination of the leasing contract, definition of the subleasing relationships, security of the lease subject and transfer of the rights and obligations to the third parties by the contracting parties, classification of the leasing legal relationships by types, making output on suggestions for improvement Azerbaijani legislation on leasing.

By describing the above stated issues, I will be able to define the status of the leasing in Azerbaijan and based on this make a comparison with the situation in United States.

Concept of leasing and its historical formation

Essence and functions of leasing

The term “leasing” itself has appeared in Azerbaijan recently. “Leasing” is an English word which comes from the verb “lease”, which is expressed in Black’s Law Dictionary as “a contract by which one owning such property grants to another the right to possess, use and enjoy it for specified period of time in exchange for periodic payment of a stipulated price, referred to as rent”⁷.

In the worldwide understanding, leasing – is a contract where lessor, who is the owner of the property, transfers to the lessee the right to use his property during the agreed period of time for a defined lease price. There are two main lease categories⁸:

- operation lease – “is essentially a rental contract for, usually, the short-term use of an asset by the lessee. The maintenance and insurance responsibilities (and most risks associated with the ownership of the asset) remain with the lessor, which recovers its costs and profits from multiple rentals and the final sale of the asset”⁹;
- financial lease – “is a contract that allows the lessor, as owner, to retain ownership of an asset while transferring substantially all the risks and rewards of ownership to the lessee. A finance lease is also known as a full payout lease; because payments made during the term of the lease amortize the lessor's costs of purchasing the asset (there could be a residual value that usually does not exceed 20% percent of the cost). The payments also cover the lessor's funding costs and provide a profit. Despite the legal form of the

⁷ Black. H.C., “Black’s Law Dictionary”, *Thomson/West*, p.889, St. Paul, MN, 2004.

⁸ Kovalev V.V., “Introduction to financial management”, p.593, Moscow, 1999 (Kovalev V.V., “Vvedeniye v finansoviy menedjment”, Moskva, 1999).

⁹ Cited from Official website of Azerbaijan Leasing Companies Association at - <http://www.azerbaijanleasing.com/> - last visited on 29 March, 2009.

transaction, the substance of a finance lease transaction is one of bank financing and not a mere rental”¹⁰.

“Conditional sale” in USA, “hire-purchase” in England, “leasingvertrag” in Germany, “credit-bail” in France, “operazioni di locazione finanziaria” in Italy and “arrendamiento financiero” in Belgium are all the synonyms of “leasing”¹¹ in Azerbaijan. All these terms define not just the traditional rent, but the lease of the equipment which is purchased especially by the lesser for the lessee. That is why when somebody uses the term “leasing” in Azerbaijan law, it means of the financial rent, which is called financial leasing worldwide. According to Article 1 of UNIDROIT Convention on International Financial Leasing¹², financial leasing is the legal relationship in which the lessee of the equipment chooses the equipment and supplier from whom this equipment is purchased, while the lesser is someone who buys this equipment and gives it on the defined conditions for the use to the lessee. The same legal relationships are called “leasing” in Azerbaijan law. Based on this, it can be stated that “leasing” in Azerbaijani law is identical to “financial lease” worldwide term, in other words – “financial rent”. It should be noted that the majority of leasing transactions in Azerbaijan are concerned only with financial leasing on which the main accent will be made in this research.

Leasing and traditional rent have different economic bases. The main basis of rent relationships is the act of transfer of the thing for rent, “which is the act of order over this thing aimed to get the profit¹³”. Leasing is the result of different economic situation. The entrepreneur, who needs the property for use, applies to another entrepreneur who has necessary financial assets and asks him to purchase the required property from the seller (or supplier) which is chosen by him. In this case, the main essence for the purchaser of the property (lessor)

¹⁰ Cited from Official website of Azerbaijan Leasing Companies Association at - <http://www.azerbaijanleasing.com/> - last visited on 29 March, 2009.

¹¹ Translated from Azerbaijani Language – “lizing”

¹² UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) - <http://www.unidroit.org/english/conventions/1988leasing/1988leasing-e.htm> - last visited on 29 March, 2009.

¹³ Sukhanov.E.A., “Civil Law”, Vol 2, p.408, Moscow, 2000 (Suhanov.E.A., “Grajdanskoje Pravo”, Tom 2, Moskva, 2000).

is the act of control over his financial assets as the form of the investment. It can be stated then that leasing is not just traditional rent, but rent which is based on investment of financial assets, or in other words – financial rent.

According to the essence of leasing, its functions can be highlighted. It has many functions, but the four main ones are:

1. Financial function – is expressed with the exemption of the commodity producer from one-time payment of the whole price of the required production assets and providing him long-term credit opportunity.
2. Production (industrial/equipment) function - the way of achieving the production goals by “temporary use” (not purchase) of the expensive machines. This is an effective way of material-technical procurement of the production and access to the newest technology and results of scientific-technical progress. The transfer of the property can be followed by various services: technical service, insurance, supply of the raw materials and etc.
3. Marketing (sales) function - widening the circle of consumers and developing new spheres of market, attraction to the leasing sphere those who cannot purchase property at once.
4. Using the tax and amortization benefits function - support from government in the way of providing the tax and amortization benefits to the participants of leasing transactions in order to decrease expenses¹⁴.

So the main feature of leasing is that by executing financial goals, it also saves the lessee from having one-time expenses for the purchase of the property which is necessary to him for his business activity and which is chosen and bought by his initiative.

¹⁴ Egorova P.V., Kurilo. V.V., “Some aspects of the legal regulation of the leasing contract”, *Lawyer Magazine*, #2, p.35-36, 2000 (Egorova P.V., Kurilo. V.V. “Nekotoriye aspekti pravovogo regulirovaniya dogovora lizinga”, *Jurnal Yurist*, #2, 2000).

History and development of leasing

Many materials from legal literature dedicated to leasing describe that leasing bargains (operational lease) were conducted even in the ancient times of Shumers¹⁵, dated 2000BC. The pottery which was found in 1984 in the Shumer's Ur city tells us about the lease of the agricultural tools, land, water resources and animals, where the lessors were local church priests who were conducting contracts with farmers.¹⁶ The first officially registered leasing bargain was conducted in 1248, when crusaders, while preparing for the next march, got their ammunition – one of the knights officially formed contract for lease of the ammunition with further right to buy it for the value of his plunder. In England, operations which are similar to the modern leasing were used in the Middle Ages¹⁷ and their subjects were farm equipment and horses.

Some regulations regarding leasing could be found in Hamurappi's Laws accepted around 1775BC-1750BC, while the one of the first specially accepted laws about the rent of the equipment was Statute of Wales dated 1284. The term "leasing" itself was first brought into the international economic dictionary in 1877 by American Telephone Company "Bell", which was first implementing leasing as the long-term property rent deciding not to sell, but to give for rent their telephone devices¹⁸.

But leasing in its modern understanding appeared only in the middle of 20th century. The first company which implemented leasing operations was American "United States Leasing

¹⁵ Egorova P.V., Kurilo. V.V., "Some aspects of the legal regulation of the leasing contract", *Lawyer Magazine*, #2, p.35-36, 2000 (Egorova P.V., Kurilo. V.V. "Nekotoriye aspekti pravovogo regulirovaniya dogovora lizinga", *Jurnal Yurist*, #2, 2000).

¹⁶ "Inter-regional leasing company SFG Leasing" ("Mejregionalnaya lizingovaya kompaniya SFQ Lizing" - http://www.sfgleasing.ru/about_leasing - last visited on 29 March, 2009.

¹⁷ Kabatova E.V., "Leasing – legal regulation and practice", p.13, Moscow, 1998 (Kabatova E.V., "Lizing pravovoye regulirovaniye, praktika", Moskva, 1998).

¹⁸ Kabatova E.V., "Leasing – legal regulation and practice", p.22, Moscow, 1998 (Kabatova E.V., "Lizing pravovoye regulirovaniye, praktika", Moskva, 1998).

Corp.” (today called “United States Leasing International Inc.”), which was created by Henry Shonfeld in San-Francisco, USA in 1952. After this Shonfeld got many followers who were convinced by the advantage of getting profit from such leasing operations¹⁹.

European leasing companies started to appear in the middle of the 1950s as a result of the influence of the American ones. The first leasing company in France “Sepafites” was created in 1957, “Mercantile Leasing Company” in 1960 in England and “Locallease Mietfinanzierung GmbH” in 1962 in Germany. By the end of the 1960s, leasing reached Japan where in 1969 “Century Leasing System” company was created.

We can draw conclusion that leasing, as a novel method of financing and complex transaction, appeared only in the 1950s of last century in US. At the present time, US is the leader in the implementation of leasing transactions, which is growing every day. That is why I have decided to make comparison of leasing development in Azerbaijan to the country where it has first appeared and is highly developed nowadays.

Distinction of leasing from rent and credit contracts

Leasing has some similarities with rent and credit²⁰. For example, in case of traditional rent of the property, renter transfers his property for the temporary usage and defined reward to the tenant in the same way.

Credit is based on three principles: urgency, because it is given for the exact time; recurrence, as it should be returned in defined time; payment, interest is counted for using

¹⁹ Medvedkov S. U., “Leasing in US economy”, p.16, 1980 (Medvedkov S.U., “Lizinq v ekonomike SSHA”, 1980).

²⁰ Allakhverdiyev S., Selimov S. and others, “Civil Law of Azerbaijan Republic”, *Digesta*, p.237, Baku, 2003 (Allakhverdiyev S., Selimov S. ve bashqalari, “Azerbayjan Respublikasinin Mulki Huququ”, *Digesta*, Baki, 2003).

credit. These principles are also used in leasing²¹. The main difference between leasing and credit is that in leasing parties use property, not financial assets.

Leasing is an independent type of contract relationships and has several features which distinguish it from rent and credit. First of all, there are three people who are involved in the leasing contract: lessor, lessee and seller (supplier) of the property. In the usual rent contract there are only two parties, renter and tenant. *Secondly*, the subject of the contract is usually specially manufactured or purchased property in the leasing contract, while in the rent contract it is the property which the party owns at the moment of the conclusion of the contract. *Thirdly*, the choice of the necessary property and its supplier is executed by the lessee. *Fourthly*, obligations of the parties – in the leasing contract an obligation on transfer of the property to the lessee is on the supplier, not on the lessor. In case of any damages to the property, lessor is not liable and lessee can bring claim only to the supplier. Upon transfer of the property the risk of damage is also passing to the lessee²². *Fifth*, there is non-possibility of making any changes to the period of leasing contract. It is reasoned on the basis that the term of the contract is commensurate with the service term of the leased property. *Finally*, right of purchase – in leasing contract the lessee has a right to purchase the property after the end of the term of leasing contract for the price which is set beforehand²³. This is not possible in the rent contract.

On the other hand, leasing and credit differ mostly by the different rights of the parties to the property which is subject of the contract²⁴. Creditor has the right of ownership on the property only before the moment of the discharge of debt by the debtor. The right of

²¹ Borovinskaya N. A., Komarova S.V, “Concept of the leasing contract”, p.54, 2000 (Borovinskaya N. A., Komarova S.V, “Ponatiye kontrakta lizinga”, 2000).

²² Sakharchuk V., “Types of leasing operations”, *Law and economy*, #4, p.26, 1998 (Saharchuk V., “Vidi lizingovix operaciy”, *Xozyaystvo I pravo*, #4, 1998).

²³ Civil Code of Azerbaijan Republic, Article 747.3 at - <<http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

²⁴ Afandiyev E., “Civil Code of Azerbaijan Republic”, *Law Literature*, p.174, Baku, 1999 (Afandiyev E., “Azerbaijan Respublikasinin Mulki Mejellesi”, *Huquq Edebiyyati*, Baki, 1999).

ownership passes to the debtor with the last payment on credit. In the leasing the lessor has the full right of ownership over the property. He gives the lessee only the temporary use right over the property which belongs to him. Upon the end of the contract, lessee has to give back the property to the owner. Lessee can redeem and get the right of ownership over the property, only if such option was mentioned in the contract beforehand²⁵. The last point is that the debtor can use the property which is bought by credit contract in the way he wants and he can get the whole profit for himself. The lessee cannot get an additional profit, which was gained as a result of “improper” usage if it is not fixed in the leasing contract.

To sum up, it can be stated that leasing can be easily differentiated from rent and credit contracts by its special features which were briefly discussed above.

Concept of leasing contract in Azerbaijan law

In this part I want to emphasize on how is leasing defined and regulated in Azerbaijan law.

Realization of leasing by business people can be done with the existence of the joint obligations which come from the leasing contract. That is why the basis of the leasing legal relationships is the leasing contract, which sets, changes and ends the rights and obligations of the parties participating in the leasing operation.

According to the Civil Code of Azerbaijan Republic, leasing contract is a contract where lessor is obliged to buy the property from the seller which is selected by the lessee and then

²⁵ Civil Code of Azerbaijan Republic, Article 747.3 at - <<http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

provide this property to the lessee for temporary use (Article 747 of the Civil Code of Azerbaijan Republic²⁶).

The concept of financial lease is also expressed in the Tax Code of Azerbaijan Republic²⁷, where it is said that the rent of the property can be considered as financial leasing in the cases when a contract has a condition which states that the leased property will be transferred with ownership rights or the lessee will be given a right to purchase the property for the defined price by the end of the lease period; the period of lease exceeds 75% of the period of its service; by the end of the lease period residual value of the property constitutes less than 20% of the property market price before the beginning of the lease; the amount of lease payment is not less than 90% of the market price of the property before the beginning of the lease; the leased property is manufactured by lessee's order and nobody except him has right to use it during the period of leasing contract²⁸.

In order to find out what is leasing contract, let us try to define its legal nature. To begin with, let us highlight the characteristics of leasing contract. There are six of them²⁹. In the first place, lessee gets object which is specially purchased by leasing company for the lessee by his request. *In the second place*, leasing contract is usually concluded for the defined period fixed by the contract. This is long period which covers the whole period of effective service of the leased equipment that is coming near to “jour de règlement³⁰” of its full amortization. *In the third place*, the whole amount of leasing payments for the use of the leased equipment includes its value with regard to amortization, interest for loan (if there is a credit) and payment for

²⁶ Legislation of Azerbaijan Republic - <http://www.lawyer-az.boxmail.biz/cgi-bin/guide.pl?action=article&id_razdel=67596&id_article=91109> – last visited on 29 March, 2009.

²⁷ Official website of Azerbaijan Leasing Companies Association - <<http://www.azerbaijanleasing.com/>> - last visited on 29 March, 2009.

²⁸ Tax Code of Azerbaijan Republic, Article 140 - <<http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

²⁹ Braginskiy M.I., Vitranskiy V.V., “Contract law. Second book. Contracts on transfer of property”, p.389, Moscow, 2000 (Braginskiy M.I., Vitranskiy V.V., “Dogovornoye pravo. Kniga vtoraya: Dogovori o peredache imushchestva”, Moskva, 2000).

³⁰ Translated as “compulsory liquidation” at Collins Dictionary - <http://dictionary.reverso.net/french-english/r%C3%A8glement> – last visited on 29 March, 2009.

lessor's services. Thereby the capacity of lease payments must exceed equipment's purchase price, where the difference will make up lessor's profit. *In the fourth place*, by the end of the leasing contract lessee usually gets the right to purchase the leasing subject for its residual price. *In the fifth place*, there is distribution of rights between the parties in the leasing contract where the lessor is set free from most obligations which are inherent to the renter. This feature highlights the financial nature of his obligations. *In the sixth place*, lessee obtains some rights and obligations with regards to the seller of the property for obligations on sale-purchase; despite the fact that beneficiary here is lessor. The listed characteristics give us an idea about the legal nature of leasing contract.

Leasing contract has definite features which mark out it as separate type of contract³¹.

First of all, it is the active role of the lessee in the leasing legal relationships. Lessee has a right to select the seller and to point out on the property which should be bought by lessor. Lessor in this case is not liable for selection of the leasing subject and the seller. As the last feature of the leasing contract I want to point out the fact that the transfer of the leased property in leasing contract is usually done not by lessor, but by the seller of the property, with whom the lessee does not have any legal relationships. Nevertheless, lessor carries liability for non-execution of this obligation.

While mentioning this, it cannot be denied that maybe in the future there will be new "nominated contract" (independent type of contract like sui generis) added to Civil Code. This idea more and more frequent is observed in the works of Russian and Azerbaijani authors who specialize in the legal sphere.

According to the definition of leasing contract given above, it can be concluded that the parties of leasing contract are: lessor, lessee and the seller of the property. In addition, in many materials from the legal law it is stated that leasing is a three-sided contract. This opinion

³¹ Allakhverdiyev S., Niyazov S., "Civil Law of Azerbaijan Republic", *Digesta*, p.622, Baku, 2001 (Allakhverdiyev S., Niyazov S., "Azerbaijan Respublikasinin Mulki Huququ", *Digesta*, Baki, 2001).

is supported by E.V.Kabatova, M.I.Braginskiy, V.V.Vitranskiy, S.N.Allahveriyev, E.I Afandiyev and others³². This question is discussed very often in the modern law. In order to try to find the answer to this question, let us make an overview on the relationships of the subject parties of the leasing contract.

The fact that the seller has obligations towards the lessee coming from the sale-purchase contract is explained that from the very beginning the leasing contract was constructed from the model of the contract in the benefit of third party.³³ According to the Civil Code of Azerbaijan Republic (Chapter 29), the contract in the benefit of third party is a contract where the parties have concluded that debtor has to perform towards not creditor, but towards the third person which has a right to request the execution of the performance in his benefit from the debtor. These special rules of leasing are meant by Azerbaijan legislation, when it is said that seller is obliged to transfer the leasing subject to the lessee who is not the party of the sale-purchase contract, but who is given a right of the buyer on this contract³⁴.

There are also other views on this question in the legal literature. For example, it is said that leasing relationships are formed with two contracts and include the whole complex of relationships between participants: lessor, lessee and seller of the property. Leasing contract has two-sided nature, but leasing as a system of the relationships between the parties is three-sided bargain³⁵. So again the question regarding how many parties are there in the leasing contract is described differently in different sources.

³² Kabatova E.V., "Leasing – legal regulation and practice", Moscow, 1998; Braginskiy M.I., Vitranskiy V.V., "Contract law. Second book. Contracts on transfer of property", Moscow, 2000; Allahverdiyev S., Selimov S. and others, "Civil Law of Azerbaijan Republic", *Digesta*, Baku, 2003; Afandiyev E.I., "Civil Code of Azerbaijan Republic", *Law Literature*, Baku, 1999.

³³ Braginskiy M.I., Vitranskiy V.V., "Contract law. Second book. Contracts on transfer of property", p.394, Moscow, 2000 (Braginskiy M.I., Vitranskiy V.V., "Dogovornoye pravo. Kniga vtoraya: Dogovori o peredache imushchestva", Moskva, 2000.

³⁴ Aghazade F., "Civil Code of Azerbaijan Republic", *Law*, p.312, Baku, 2000 (Aghazade F., "Azerbaijan Respublikasinin Mulki Mejellesi", *Qanun*, Baki, 2000).

³⁵ Konnova T. A., "Leasing (financial rent) contract", *Legislation*, #9, p.16, 1998 (Konnova T.A., "Dogovor finansovoy arendi (lizinga)", *Zakonodatelstvo*, #9, 1998).

The conclusions of the researches made on this question of defining the number of the parties in the leasing contract, should be based on existing legislation. The Civil Code of Azerbaijan Republic interprets leasing contract as a three-sided contract. In my opinion the point of view on leasing contract being a two-sided contract is not persuasive from the present Azerbaijani legislation notion and the fact that financial leasing is widely used in the country. This idea is also supported by Article 1 of UNIDROIT Convention on International Financial Leasing³⁶ where lessor, lessee and seller (supplier) are all named as parties of the leasing contract.

As conclusion of this chapter, by generalizing the Civil Code and Tax Code of Azerbaijan Republic, the following are several indicators of leasing contract:

- 1) Lessor has an aim to invest financial assets to the property which then is leased and in result the income is got in the form of lease payments. It is obvious that the lessor doesn't need the property which he purchases as it is purchased only for the transfer of it to the lessee for the given award in return.
- 2) Which and from whom the property should be bought by lessor is selected by lessee.
- 3) Transfer of the leasing subject to the lessee both for the use and for possession. While In the rent contract it is permitted to transfer the property either for use and possession or only for temporary use, it is mandatory to transfer the property both for the use and for possession in leasing contract.
- 4) The transfer of the property is done for the exact period of time, usually for the period which is close to the time of the full amortization of the leasing subject.
- 5) Opportunity to redeem the leasing subject for the ownership through the way of conducting the leasing payments. This should be specified in the contract beforehand.

³⁶ UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) - <http://www.unidroit.org/english/conventions/1988leasing/1988leasing-e.htm> - last visited on 29 March, 2009.

Legal regulation of leasing contract in Azerbaijan

This chapter will be dedicated to the research on the main components of leasing contract: parties of the contract, subject of the contract, form and content of the leasing contract. Besides this, much attention will be given to the allocation of risks and insurance in leasing, subleasing, transfer of the rights and obligations to the third parties by the contracting parties, security of the lease subject, procedures of alteration and rescission of the leasing contract and types of leasing and this will show how leasing is regulated in Azerbaijan. The structure of this Chapter was built in this way based on two things: such structure can be usually found in the legal literature and it also follows the logical order of the things.

Parties of the leasing contract

In legal literature devoted to any kind of contracts, parties of the contract are usually described first. I have decided not to break tradition and start with the same section.

As it was mentioned above, there are minimum three participants (subject parties) in leasing contract: lessor, lessee and seller (supplier). This is stated in the Article 747-1 of the Civil Code of Azerbaijan Republic³⁷. Pledger (mortgagor), bailer and other participants who are executing onerous services to the parties of the leasing contract can participate in leasing transactions According to the Article 747-1.5 of the Civil Code of Azerbaijan Republic, “any resident or non-resident of Azerbaijan Republic can be subject party of the leasing contract”³⁸.

First of all, let us take an overview on each participant of the leasing contract.

Lessor “is an individual or legal entity who, either using his own capital or external funds, acquired the asset which is transferred to the lessee for the specified fee, specified term

³⁷ Civil Code of Azerbaijan Republic , Chapter 38, Article 747-1.2, entered into force on 1 September, 2000

³⁸ Civil Code of Azerbaijan Republic , Chapter 38, Article 747-1.5, entered into force on 1 September, 2000

and other conditions (including transfer of ownership title to lessee or otherwise) on the basis of leasing agreement for temporary ownership or use.³⁹ Lessors are usually the parties who own or who have access to big financial assets. Those are⁴⁰:

- universal leasing companies created by banks as a subsidiary companies (AGLeasing⁴¹ (AzeriGazBank), UniLeasing⁴² (UniBank), “Joint Leasing⁴³” (International Bank of Azerbaijan), AtaLeasing⁴⁴ (Atabank));
- specialized leasing companies created by the big manufacturers of the cars and machines (equipment) (Lukoil-Leasing⁴⁵ – company which was created and is owned by Azerbaijani businessman Vahid Alekperov, who is the founder of LukOil company; “Joint Leasing”)
- foreign leasing companies (“ParexLeasing⁴⁶” - Latvia)

As it can be observed, all companies which execute the functions of lessor are commercial.

Lessee “is an individual or legal entity accepting the object of leasing for temporary ownership or use on the basis of the leasing contract for specified fee, specified term and other conditions⁴⁷”. By practice lessee has to use the subject of the leasing contract only for business purposes. Not only business people, but also non-commercial legal persons can act as lessees, if it is stated in their internal constitutions that they can deal with investment activity for the achievement of their goals. The lease of the medical equipment by hospital and clinics can be showed here as an example.

³⁹ Civil Code of Azerbaijan Republic, cited from Official website of Azerbaijan Leasing Companies Association at - <http://www.azerbaijanleasing.com/> - last visited on 29 March, 2009.

⁴⁰ Kharitonova. U. S., “The essence of financial rent (leasing)”, *Legislation*, #1, p.24, 2000 (Kharitonova U.S “Ponatiye finasovoy arendi (lizinga)”, *Zakonodatelstvo*, #1, 2000).

⁴¹ Official website of AzeriGazBank - <http://www.agbank.az/index.php?lang=en&link=view&id=159> – last visited on 29 March, 2009.

⁴² Official website of UniLeasing - <http://www.unileasing.az/?lang=en> - last visited on 29 March, 2009.

⁴³ Official website of Joint Leasing - <http://www.jointleasing.az/?lang=en> - last visited on 29 March, 2009.

⁴⁴ Official website of AtaLeasing - <http://www.atalizing.az/index.php?lang=eng> - last visited on 29 March, 2009.

⁴⁵ Official website of LK-Leasing - <http://www.lk-leasing.ru/en/> - last visited on 29 March, 2009.

⁴⁶ Official website of ParexLeasing - <http://www.parexleasing.az/ru/> - last visited on 29 March, 2009.

⁴⁷ Civil Code of Azerbaijan Republic, cited from Official website of Azerbaijan Leasing Companies Association at - <http://www.azerbaijanleasing.com/> - last visited on 29 March, 2009.

Seller (supplier) “is an individual or a legal entity selling object of leasing to lessor on the basis of purchase agreement”⁴⁸. Seller can transfer the property to either lessor or lessee depending on the conditions of the contract, but usually it is transferred to the lessee, as lessor does not need this property because he has purchased it exclusively for the lessee. According to the sale-purchase contract (regulated by Chapter 29 of the Civil Code of Azerbaijan Republic⁴⁹) which is concluded with the lessor (in the benefit of the third party - lessee), seller is a debtor in front of both lessor and lessee.

These are the main definitions and overview on legal regulation of parties of the leasing agreement in Azerbaijan. It can be seen that Azerbaijani legislation provides concrete definitions with regard to the parties of the leasing contract.

Allocation of risks and insurance in the leasing contract

While talking about the parties of the leasing contract such important thing as allocation of risks which is connected with implementation of leasing contract should be mentioned for sure.

In correspondence with Article 748.7 of the Civil Code of Azerbaijan Republic, “Lessee is responsible for insurance of the object of lease against all kinds of damage to property, destruction, loss, deterioration, malfunctioning before the end of useful life, mistakes during installation and operation, unless otherwise is specified in the leasing agreement”⁵⁰. This is

⁴⁸ Civil Code of Azerbaijan Republic, cited from Official website of Azerbaijan Leasing Companies Association at - <<http://www.azerbaijanleasing.com/>> - last visited on 29 March, 2009.

⁴⁹ Legislation of Azerbaijan Republic at - <http://www.lawyer-az.boxmail.biz/cgi-bin/guide.pl?action=article&id_razdel=67596&id_article=91109> - last visited on 29 March, 2009.

⁵⁰ Cited from the Civil Code of Azerbaijan Republic, Article 748.7 at - <<http://www.azerbaijanleasing.com/>> - last visited on 29 March, 2009.

explained with the fact that the property is under the possession of the lessee during the term of the leasing contract, so he should be responsible for all consequences.

In case of seller's insolvency the party who chooses him should be held liable, sure if another rule is not specified by the contract⁵¹. As lessee is usually the one who is choosing the seller, he should be liable in such case. The liability for the risks connected with incompliance of the leasing subject with the aims of the leasing, should be held by the party which have selected the object, if another rule is not specified by the contract⁵².

The risks of the parties can be decreased to minimum if they are insuring business (financial) risks and risks of loss and damage of the subject of the leasing contract. Such insurance is implemented in accordance with Article 748.6 of the Civil Code of Azerbaijan Republic. The question of who will be insured and who will be beneficiary and also the term of the insurance is defined by the parties of the leasing contract⁵³. Insurance of the business (financial risks) is not mandatory and can be carried out by the agreement of the parties. This rule is regulated by Article 748.6.2 of the Civil Code of Azerbaijan Republic. Only in the cases provided by Azerbaijan legislation, the lessee should insure his responsibility for the breach of the leasing contract in favor of the lessor⁵⁴. "Lessee shall, in instances prescribed by legislation of Azerbaijan Republic, insure its responsibility for liabilities concerning damage to human lives, health or property in the process of use of object of lease"⁵⁵.

To sum up, it can be stated that according to Azerbaijan legislation and if such case is not mentioned in the leasing contract, in most cases the risk is carried by the lessee.

⁵¹ Article 748.7.2 of the Civil Code of Azerbaijan Republic at <www.lawyer.az> - last visited on 29 March, 2009.

⁵² Article 748.7.3 of the Civil Code of Azerbaijan Republic at <www.lawyer.az> - last visited on 29 March, 2009.

⁵³ Article 748.6.3 of the Civil Code of Azerbaijan Republic at <www.lawyer.az> - last visited on 29 March, 2009.

⁵⁴ Article 748.6.5 of the Civil Code of Azerbaijan Republic at <www.lawyer.az> - last visited on 29 March, 2009.

⁵⁵ Cited from the Civil Code of Azerbaijan Republic, Article 748.6.4 at - <<http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

Subject of the leasing contract

The subject of the contract is one of the most important features of the contract itself and that is why it should be also discussed on the first roles.

The subject of the leasing contract is a property which is transferred to the lessee for the temporary ownership and use by the lessor. According to Article 747-2 of the Civil Code of Azerbaijan Republic, object of leasing - “is movable or immovable property related to fixed assets in accordance with classification set up by appropriate legislation with exception of goods without free civil turnover or goods with limited civil turnover”⁵⁶. Property such as enterprises, buildings, constructions can also be subjects of the leasing contract.

Besides this, the subject of the leasing agreement should be inconsumable thing⁵⁷ – things which cannot be destroyed and which are serving for its purpose for a long period in conditions of normal use, for example: cars, equipment, buildings, and construction. If the subject of the leasing contract is consumable thing, (for example raw materials) then such contract should be valued as usual rent or sale-purchase contract.

Article 748-2.1 of the Civil Code of Azerbaijan Republic states that the lessor has the right of ownership over the property which is leased to the lessee. However, this right is not absolute and is usually limited by conditions of the contract.

“Ownership rights and the right to use the object of leasing shall fully be transferred to lessee, unless otherwise is specified in the leasing agreement” (Article 748-2.2 of the Civil Code of Azerbaijan Republic). The subject of the leasing contract should be transferred with all accessories and documents (for example technical certificate). The right of ownership can

⁵⁶ Civil Code of Azerbaijan Republic, cited from Official website of Azerbaijan Leasing Companies Association at - <<http://www.azerbaijanleasing.com/>> - last visited on 29 March, 2009.

⁵⁷ Aghazade F., “Civil Code of Azerbaijan Republic”, *Law*, p.312, Baku, 2000 (Aghazade F., “Azerbaijan Respublikasinin Mulki Mejellesi”, *Qanun*, Baki, 2000).

be transferred to the lessee in case all leasing payments are made according to the conditions of the leasing contract (Article 748-2.5).

Registration of the immovable property – subject of leasing, leasing contract by which this subject is regulated, should be done in the order which is defined by the legislation. The right of ownership over the subject of the leasing contract should be registered by the appropriate State Agencies in conformity with this Code and other legal acts. This provision is regulated by Article 748.5 of the Civil Code of Azerbaijan Republic.

There are not too many provisions related to the subject of the leasing contract in Azerbaijani legislation, but those which are presented give the reader clear definition regarding the topic.

Form and content of the leasing contract

Any contract which is concluded between parties should have the form which is required by the type of transactions it is coming from. There are also special rules regarding leasing.

It is clearly stated in the Article 748.1 of the Civil Code of Azerbaijan Republic that leasing contract should be concluded in the written form⁵⁸. The legal form of the leasing transaction is either leasing contract concluded between lessor and lessee and sale-purchase contract between lessor and seller, or three-sided contract between these parties in accordance with Article 747.5.3 and other articles of the Civil Code which regulate leasing.

The content of the leasing contract is the aggregate of rights and obligations which are following from this contract. It contains obligations of lessor, lessee and seller and also the

⁵⁸Azerbaijan Legislation, Civil Code of Azerbaijan Republic at - <www.lawyer.az> - last visited on 29 March, 2009.

obligations of other subject parties, if there are such presented. The legislation defines that it is mandatory to state the information by which the property which is going to be transferred from lessor to lessee, can be defined. This condition is mandatory and if it not stated in the contract, then it is considered that the parties have not agreed on this term and as a result leasing contract is not concluded⁵⁹.

It is also mandatory to state in the leasing contract the

“Scope of rights transferred in respect to object of leasing; place and procedures of transfer of object of leasing; duration of leasing agreement; accounting procedures of the object of leasing; maintenance and operation of object of leasing; total amount of lease payments and the amount of bonus of the lessor; schedule of leasing payments; procedures of calculating leasing payments in case of prepayments on lease; responsibilities of parties regarding insurance against risks to object of lease related to leasing agreement, unless otherwise is specified in the leasing agreement; leasing agreement may specify extension of leasing agreement with amending or not of the conditions of the leasing agreements.”⁶⁰

Leasing contract can include additional conditions for providing additional services which are done by the lessee before the start of use the leasing object and also during the use of leasing object. This is stated in the Article 748.2.8 of the Civil Code of Azerbaijan Republic.

Now I would like to describe the rights and obligations of each party of the leasing agreement. Lessor is obliged to purchase the defined property from the seller and then transfer it to the lessee according to the conditions of the leasing contract⁶¹; inform seller that the property purchased from him is going to be transferred to the lessee as the subject of the leasing contract and state also to whom he should transfer it; to maintain the capital repairs of the subject of the leasing, if it is not mentioned in the contract; execute other duties which are stated

⁵⁹ Khuduoglu S., “The commentaries on the Civil Code of Azerbaijan Republic”, *Legal Literature*, p.47, Baku, 2003 (Khuduoglu S., “Azerbaijan Respublikasinin Mulki Mejellesine Sherhler”, *Huquq Edebiyyati*, Baki, 2003).

⁶⁰ Cited from the Civil Code of Azerbaijan Republic, Article 748 at - <<http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

⁶¹ Article 748.1.1 of the Civil Code of Azerbaijan Republic.

in the leasing contract⁶². Lessor has a right to check how the leasing subject is used by the lessee; require the payment for delay if the lessee has not returned at all or has not returned in time the subject of the leasing contract⁶³; get back money and subject of leasing and at the same time rescind the contract in the case stated by Articles 748.1.12-748.1.2-4, 748-12.1 of the Civil Code of Azerbaijan Republic.

Lessee is obliged to accept the subject of the leasing agreement for temporary use and ownership; use the subject of the leasing in accordance with the leasing contract; make leasing payments in the order and at the time specified in the leasing contract; inform lessor how he uses the leasing subject; keep safe, conduct maintenance and technical service of the subject of the leasing contract for his own costs; inform lessor in case there transferred property is damages or is not of good quality; not to transfer the property for subleasing without the written approve of the lessor; return the subject of leasing in the same conditions as he has received it at the beginning taking into consideration the conditions of normal depreciation. If it mentioned in the contract purchase the property which is the subject of the leasing contract; execute other duties which are stated in the leasing contract⁶⁴. “Following legal effectiveness of the leasing agreement, lessee (or respectively lessor) is entitled to request lessor (or lessee) to fulfil its obligations under the leasing agreement and, in case of failure of another party to do so, is entitled to initiate judicial proceedings to compensate a damage made to it in preparation of acceptance of the object of lease (if this damage implied material cost)”⁶⁵. This rule is applicable to both lessor and lessee, depending from the situation.

⁶² Allakhverdiyev S., Selimov S. and others, “Civil Law of Azerbaijan Republic”, *Digesta*, p.262, Baku, 2003 (Allakhverdiyev S., Selimov S. ve bashqalari, “Azerbaijan Respublikasinin Mulki Huququ”, *Digesta*, Baki, 2003) and Articles 748.1.13 and 748.1.7(second sentence) of the Civil Code of Azerbaijan Republic.

⁶³ Article 748.1.9 of the Civil Code of Azerbaijan Republic.

⁶⁴ Allakhverdiyev S., Selimov S. and others, “Civil Law of Azerbaijan Republic”, *Digesta*, p.264, Baku, 2003 (Allakhverdiyev S., Selimov S. ve bashqalari, “Azerbaijan Respublikasinin Mulki Huququ”, *Digesta*, Baki, 2003) and Articles 748.1.2, 748.1.8 and 748.1.7(first sentence), 748-12.3 of the Civil Code of Azerbaijan Republic.

⁶⁵ Cited from the Civil Code of Azerbaijan Republic, Article 748.1.5 at - < <http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

These are the main rights and responsibilities of lessor and lessee which are regulated by Azerbaijan legislation.

Subleasing, transfer of the rights and obligations to the third parties by the contracting parties, security of the lease subject in the leasing contract

Despite the fact that lessee needs the subject of the leasing contract for his activity, there is a possibility for such cases when he will not be able to make leasing payments or he wants to quit from leasing contract. For such cases Article 747-4 of the Civil Code of Azerbaijan Republic, gives permission to transfer the leasing subject to subleasing or transfer the rights and obligations to the third parties by the contracting parties.

Subleasing is a type of under-lease, where lessee transfers the leasing subject, which was given to him before by the lessor according to the leasing contract, to the third parties (to the lessee according to the subleasing contract) for the temporary ownership and use for the specified term and payment in return. In subleasing, the person who executes subleasing (sometimes called sublessor) accepts the leasing subject from the lessor (according to the leasing contract) and transfers it for the temporary use and ownership to the lessee according to the subleasing contract⁶⁶. “In providing object for subleasing, right to make claims to supplier is transferred to lessee on the basis of subleasing agreement”⁶⁷. It seems like the right to claim stays with the person who has possession over the subject. “Written agreement of lessor is

⁶⁶ Gazman V.D., “How to conclude financial leasing contracts in the right way”, *Law and Economy*, #3, p.117, 1997 (Gazman V.D., “Kak pravlno zakluchat dogovori finansovogo lizinga”, *Xozyaystvo i Pravo*, #3, 1997).

⁶⁷ Cited from the Civil Code of Azerbaijan Republic, Article 747-4.3 at - < <http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

obligatory for subleasing the object of leasing”⁶⁸. Then subleasing cannot be implemented without lessor’s permission.

The content of subleasing agreement is similar to leasing contract with addition of corresponding subleasing conditions. In subleasing, reassignment of the obligation on making leasing payments is not allowed without lessor’s agreement. Subleasing at the same time is considered to be a sub rental and that is why several authors in the law literature do not support the idea of using term “subleasing”. Vitranskiy for example says that “term “subleasing” assumes that lessee, by transferring the property for the use and ownership to the third parties, is acting at the same time in role of lessor. This is not possible, because he is not responsible to purchase the leasing property from the defined seller by this person’s (new lessee’s) request. That is why the whole story here is about sub rental⁶⁹. If we follow this theory, it can be stated that in such case the legal relationships connected with subleasing should be regulated by general rules which are applicable for traditional rent. There is no way for this in Azerbaijan, because subleasing is regulated by Article 747-4 of the Civil Code of Azerbaijan Republic. This is the most important information dedicated to regulation of subleasing in Azerbaijan. Next part is dedicated to the transfer of the rights and obligations to the third parties by contracting parties.

The parties of the leasing contract can transfer their rights and obligations to the third parties on temporary or permanent basis, by their mutual agreement. In this case, they fully quit from leasing legal relationships and discontinue any kind of rights and obligations coming out from leasing contract.

⁶⁸ Cited from the Civil Code of Azerbaijan Republic, Article 747-4.4 at - < <http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

⁶⁹ Braginskiy M.I., Vitranskiy V.V., “Contract law. Second book. Contracts on transfer of property”, p.401, Moscow, 2000 (Braginskiy M.I., Vitranskiy V.V., “Dogovornoye pravo. Kniga vtoraya: Dogovori o peredache imushestva”, Moskva, 2000).

Lessor can transfer fully or partially his rights and (or) obligations to the third parties without the concern of the lessee.⁷⁰ However this does not release him from execution of additional obligations which are mentioned in the leasing contract: for example additional services provided for the subject of the leasing contract. At replacement of the owner of the leased property which is the subject of the leasing contract, leasing contract continues to operate, but this time with new lessee. It is also good to mention that the transfer of rights and obligations is done in the simple written form⁷¹. The last topic which is left at this section is the cases when the leasing subject can be used as security.

In some cases parties of the leasing contract need to use the subject of leasing or any right on claim on leasing contract in the capacity of guarantee on security contract. Article 748-4.2 of the Civil Code of Azerbaijan Republic states that lessee can use the subject of the leasing contract as a security with an aim of attraction of financial assets. Security contract should contain information about: subject of security and its value; the content, capacity and term of the execution of obligations which are guaranteed by security⁷². The security contract is concluded only in the written form. Security contract on immovable property and also rights on rent should be gone through the registration processes defined by the legislation⁷³. That is the information related to the issue of security.

⁷⁰ Article 748-4.1 of the Civil Code of Azerbaijan Republic.

⁷¹ Khuduoglu S., "The commentaries on the Civil Code of Azerbaijan Republic", *Legal Literature*, p.52, Baku, 2003 (Khuduoglu S., "Azerbaijan Respublikasinin Mulki Mejellesine Sherhler", *Huquq Edebiyyati*, Baki, 2003).

⁷² Khuduoglu S., "The commentaries on the Civil Code of Azerbaijan Republic", *Legal Literature*, p.54, Baku, 2003 (Khuduoglu S., "Azerbaijan Respublikasinin Mulki Mejellesine Sherhler", *Huquq Edebiyyati*, Baki, 2003).

⁷³ Qeyushov. R.A., "Pledge law in the modern legislation of Azerbaijan Republic", *Bulleten of notarial practice*, #5, p.45-47, Baku, 2005 (Qeyushov. R. A., "Qirov huququ Azerbayjan Respublikasinin Muasir Qanunverijilikde", #5, Baki, 2005).

Alteration and rescission of the leasing contract

In this subchapter I will make an overview on grounds for alteration and rescission of the leasing contract.

As it was mentioned before, leasing contract is concluded for a specified period. Accordingly, leasing legal relationships stop at the end of the period of leasing agreement and when the parties execute their all obligations on the contract. There are also such cases when one of the parties cancels the contract ahead of time. I want to examine below the basis for the rescission and alteration of the leasing contract.

There are no such regulations in Azerbaijan legislation dedicated to the alteration and rescission of the leasing contract. The only thing which is dedicated to the termination of the leasing contract is stated in the Chapter 38 of the Civil Code of Azerbaijan Republic and it is related to the lessor. But in accordance with the fact that leasing is related to the rent, the rules regarding alteration and rescission are described in the Articles 700-705 of Civil Code of Azerbaijan Republic, which are related to the rent⁷⁴. So the rules which are applicable for the rent should be also applicable to the leasing⁷⁵.

Leasing contract can be terminated or modified by any party in cases described below: in case of substantial violations made by one party (substantial is such violation, under which the party has a loss, where he is deprived from something what he was estimating to get while concluding contract); in case of substantial change of circumstances under which the parties were originating while concluding the contract (substantial change of circumstances – is such changes under which the parties, if they have known or could predict such changes, would

⁷⁴ Articles 700-705 of the Civil Code of Azerbaijan Republic.

⁷⁵ Afandiyev E., “Civil Code of Azerbaijan Republic”, *Law Literature*, p.174, Baku, 1999 (Afandiyev E., “Azerbaijan Respublikasinin Mulki Mejellesi”, *Huquq Edebiyyati*, Baki, 1999).

never have concluded contract or if concluded, with different conditions); in other cases specified by the contract⁷⁶.

Leasing contract can be terminated in one-sided order in case of existence of circumstances and existence of the below listed conditions: at the moment of the conclusion of the contract the parties were estimating that such changes would not appear; the changes happened because of the reasons that the interested party could not prevent after its appearance, taking into consideration his level of care which was required from him by the contract and the conditions of the business intercourse; the execution of the contract without making changes to its conditions would violate the ratio of ownership rights and bring the interested party such damage, that this party would have been deprived from what he was estimating to get at the moment of the conclusion of the contract.⁷⁷

As it was mentioned at the beginning, the only Article related to the termination of the leasing contract is termination of the contract by lessor (or by the court with lessor's initiative), which is Article 748-1.12 of the Civil Code of Azerbaijan Republic. It states that the lessor can terminate the contract in cases: if the lessee is using leasing subject in the other way that is mentioned by the leasing contract or in the other way that the subject should be used for; if the subleasing is done by the lessee without lessor's agreement; if the lessee is not taking care of the subject of the leasing contract and as a result its quality is decreased; if the leasing payments are not made at the specified time consecutively twice⁷⁸. After the termination of the contract, the lessor has a right to require lessee to immediately return the leased property.

The leasing contract can be terminated by the lessee (or by the court with lessee's initiative) in these cases:⁷⁹ the lessor is not providing or creating obstacles to lessee for use of

⁷⁶ Afandiyev E., "Civil Code of Azerbaijan Republic", *Law Literature*, p.192, Baku, 1999 (Afandiyev E., "Azerbaijan Respublikasının Mulki Mejllesi", *Huquq Edebiyyati*, Baki, 1999).

⁷⁷ Afandiyev E., "Civil Code of Azerbaijan Republic", *Law Literature*, p.194, Baku, 1999 (Afandiyev E., "Azerbaijan Respublikasının Mulki Mejllesi", *Huquq Edebiyyati*, Baki, 1999).

⁷⁸ Article 748-1.12-748-1.12.4 of the Civil Code of Azerbaijan Republic.

⁷⁹ Article 691 of the Civil Code of Azerbaijan Republic.

the property; the transferred property has defects which prevents lessee to use it normally; the lessor is not making the capital repair of the property, if such condition was mentioned in the contract; the property becomes unusable because of the circumstances which are not under lessee's control. The same Article 691 states that the lessee has a right to terminate the leasing contract immediately and claim damages if the leasing subject is not transferred to him at the time specified in the contract.

In case of international leasing, the problem of the termination of the leasing contract and withdrawal of the property in case of non-performance is regulated by Article 13.2 of UNIDROIT Convention on International Financial Leasing. It is said there that:

“Where the lessee's default is substantial, the lessor may also require accelerated payment of the value of the future rentals, where the leasing agreement so provides, or may terminate the leasing agreement and after such termination: (a) recover possession of the equipment; and (b) recover such damages as will place the lessor in the position in which it would have been had the lessee performed the leasing agreement in accordance with its terms”⁸⁰

The agreement on termination or alteration of the leasing contract is done by the parties' mutual agreement in the same form as leasing agreement. In case of alteration of the leasing contract the obligations of the parties are kept in the contract in modified view. In case of termination of the leasing contract, the parties' obligations on the contract are stopped. In case of alteration or rescission of the leasing contract the obligations of lessor and lessee are considered to be modified or stopped accordingly from the moment of the conclusion of the agreement between the parties on alteration (rescission) of the leasing contract. In case of the court decision, when the decision is coming into force. It is also good to mention the fact that one of the parties can claim the alteration or rescission of the contract at the court, only after he

⁸⁰ UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) - <http://www.unidroit.org/english/conventions/1988leasing/1988leasing-e.htm> - last visited on 29 March, 2009.

receives the refusal from other party to do it based on mutual agreement or, if he does not receive response in time (usually 30 days)⁸¹.

If the basis for the alteration or rescission of the contract was one of the parties' violations, the other party has a right to claim damages which have occurred as a result of alteration or rescission. According to the Article 18 of the Civil Code of Azerbaijan Republic, the damages are considered both real harm (the costs which party has or will have to restore the violated right) and lost profit (the profit which the party could gain if the contract would be realized).⁸²

This is how the procedure of alteration and rescission is regulated in Azerbaijani legislation. At this step I want to finish with the topic of legal regulation of leasing contract and move to the part dedicated to the types of leasing.

Types of leasing

There is no yet exact classification of types of leasing in Azerbaijani literature. The legislation separates leasing into domestic and international leasing⁸³. As there are no kinds of prohibitions on other types of leasing, it can be assumed that the parties of the leasing agreement can use any type of leasing which is known worldwide⁸⁴.

⁸¹ Khuduoglu S., "The commentaries on the Civil Code of Azerbaijan Republic", *Legal Literature*, p.72, Baku, 2003 (Khuduoglu S., "Azerbaijyan Respublikasinin Mulki Mejellesine Sherhler", *Huquq Edebiyyati*, Baki, 2003).

⁸² Khuduoglu S., "The commentaries on the Civil Code of Azerbaijan Republic", *Legal Literature*, p.74, Baku, 2003 (Khuduoglu S., "Azerbaijyan Respublikasinin Mulki Mejellesine Sherhler", *Huquq Edebiyyati*, Baki, 2003).

⁸³ Articles 747-3 of the Civil Code of Azerbaijan Republic.

⁸⁴ Khuduoglu S., "The commentaries on the Civil Code of Azerbaijan Republic", *Legal Literature*, p.77, Baku, 2003 (Khuduoglu S., "Azerbaijyan Respublikasinin Mulki Mejellesine Sherhler", *Huquq Edebiyyati*, Baki, 2003).

By summarizing legal literature and legislation, the leasing can be divided into these types. Depending on sector of the market where the leasing transactions are executed (or as it is described in the Civil Code) leasing can be divided in: domestic and international leasing⁸⁵. In domestic leasing, lessor and lessee are both residents of Azerbaijan Republic⁸⁶. In other words, the whole complex of leasing transactions is implemented on the territory of Azerbaijan Republic. “Under international leasing either lessor or lessee (or both of them) are non-residents of Azerbaijan Republic”⁸⁷. The international leasing where the lessor is the resident of Azerbaijan Republic, in other words the subject of the leasing is under the ownership of the resident of Azerbaijan Republic is regulated by Civil Code of Azerbaijan Republic. If the lessor is not the resident of Azerbaijan Republic, that is the subject of the leasing is owned by foreign person, the contract is regulated by the standards of international law (particularly by UNIDROIT Convention).⁸⁸

International leasing itself can be divided into several types⁸⁹: export; import, straight; transit leasing. In the export international leasing, lessor purchases leasing property from the national seller, and then gives it abroad to the foreign lessee. In the import international leasing, lessor purchases property from overseas seller and grants it to the domestic lessee. In straight leasing, all operations are made between the parties from two different countries. Transit leasing is possible in such cases when lessor from one country purchases property from the seller in another country and transfers it to the lessee to the third country.

⁸⁵ Articles 747-3.1 of the Civil Code of Azerbaijan Republic.

⁸⁶ Articles 747-3.2 of the Civil Code of Azerbaijan Republic.

⁸⁷ Cited from the Civil Code of Azerbaijan Republic, Article 747-3.3 at - < <http://www.azerbaijanleasing.com>> - last visited on 29 March, 2009.

⁸⁸ Allakhverdiyev S., Niyazov S., “Civil Law of Azerbaijan Republic”, *Digesta*, p.648, Baku, 2001 (Allakhverdiyev S., Niyazov S., “Azerbaijan Respublikasinin Mulki Huququ”, *Digesta*, Baki, 2001).

⁸⁹ Kabatova E.V., “Leasing – legal regulation and practice”, p.14, Moscow, 1998 (Kabatova E.V., “Lizing pravovoye regulirovaniye, praktika”, Moskva, 1998).

The next classification of leasing is by the level of cover of expenditures: leasing with full cover of expenditures and leasing with partial cover of expenditures⁹⁰. Leasing with full cover of expenditures is the most widespread type of leasing. The term for which the subject of leasing is transferred to the lessee is commensurable or even more than its term of full amortization. In this type of leasing, the right of ownership over the leased property transfers to the lessee upon the end of the term of leasing contract and full coverage of all leasing payments provided by the contract (of course if other condition is not specified by the contract). In the leasing with partial cover of expenditures, lessor purchases the property at his own risk and then transfers it to the lessee for the period which is lesser the term, by which the lessor can compensate his costs on the leasing contract. By the end of the term of the leasing contract, the leased property is returned to the lessor and lessee does not have a right to claim the transfer of the right of ownership to him. In such type of leasing lessor, in order to compensate his investments, has to lease the property repeatedly during the term of full amortization of this property.

Depending on the period for which leasing contract is concluded leasing can be⁹¹: long-term – for three or more years; medium-term – from one and a half to three years or short term – for less than one and a half years.

Next classification of leasing transactions is separation of leasing by composition of participants⁹²: direct; indirect; returning; group. In direct leasing the leasing contract is realized only by the parties without mediators. If there are mediators, then it is considered as indirect. In the cases when only two parties are presented in the leasing contract (when one person acts as a lessee and seller at the same time), such leasing is called returning leasing. It turns out that

⁹⁰ Kabatova E.V., “Leasing – legal regulation and practice”, p.16, Moscow, 1998 (Kabatova E.V., “Lizing pravovoye regulirovaniye, praktika”, Moskva, 1998).

⁹¹ Vitranskiy V.V., “Leasing contract and its types”, p.87, Moscow, 1999 (Vitranskiy V.V., Dogvor lizinga i ego vidi”, Moskva, 1999).

⁹² Vitranskiy V.V., “Leasing contract and its types”, p.92, Moscow, 1999 (Vitranskiy V.V., Dogvor lizinga i ego vidi”, Moskva, 1999).

lessee sells the property to the lessor, who then gives him this property for the use and possession by the leasing contract. Returning leasing gives opportunity to refinance capital investments with less expenditure than with the bank loan. From a financial point of view, this type of leasing is very close to loan operation, where the leasing payments are made according to the agreed schedule. It is also somehow similar to the pledge. The only difference is that in case of pledge the main goal is not financing, but the guarantee of obligations. The case where the lessor is represented by several persons, for example when several leasing companies merge in a group for the large leasing contract, is described as group leasing.

Another classification of leasing contracts is by the type of leasing subject: lease of movable and immovable property⁹³. The types of leasing of immovable property are divided to: industrial leasing of enterprises; industrial leasing of buildings and constructions; leasing of warehouses and other placements; leasing of aircrafts, boats and etc. Leasing of immovable property can be described as leasing for: production purposes; construction purposes; lease of different types of equipment.

One of the next classifications is by the value of the leased property⁹⁴: large; standard; small. Plains and vessels are considered to be the subjects of the large leasing. Standard leasing contains objects like small plants, bakeries and technological equipment. Computers, security systems, telephone stations and other non-industrial things are related to small leasing.

Division by the capacity of provided services is also another basis for classification of leasing on⁹⁵: net leasing; wet leasing; general leasing. In the net leasing, lessee is taking responsibility on all costs related to use, repair and insurance of leasing subject. These costs are not included to the leasing payments. The leasing is considered as wet leasing, when the lessor takes all costs

⁹³ Gazman V.D., "How to conclude financial leasing contracts in the right way", *Law and Economy*, #3, p.194, 1997 (Gazman V.D., "Kak pravlno zakluchat dogovori finansovogo lizinga", *Xozyaystvo i Pravo*, #3, 1997).

⁹⁴ Gazman V.D., "How to conclude financial leasing contracts in the right way", *Law and Economy*, #3, p.201, 1997 (Gazman V.D., "Kak pravlno zakluchat dogovori finansovogo lizinga", *Xozyaystvo i Pravo*, #3, 1997).

⁹⁵ Gazman V.D., "How to conclude financial leasing contracts in the right way", *Law and Economy*, #3, p.204, 1997 (Gazman V.D., "Kak pravlno zakluchat dogovori finansovogo lizinga", *Xozyaystvo i Pravo*, #3, 1997).

on himself and as a result increases the amount of lease payments. General leasing is possible in case of permanent and stable cooperation between lessor and lessee. Here the parties make an agreement for providence of the leasing line by which the lessee can take additional equipment each time without concluding new leasing contract.

As it was already mentioned in this work, lessee makes leasing payments to lessor for providence of the leasing subject for the use and possession⁹⁶. Depending on the type of these payments they are divided to: monetary; compensatory; mixed⁹⁷. Monetary leasing – is when all leasing payments are made in the monetary form. The amount, form and periodicity of leasing payments are defined by the parties⁹⁸. Compensatory leasing - is when the leasing payments are made in the form of goods which are produced by the leased equipment. In this case money is not involved, what reminds me about the barter form of payments. In the cases when the leasing payments are made in the form of produced goods (in-kind payments), price for the goods are determined by parties' mutual agreement and should be fixed in the contract⁹⁹. Combination of monetary and compensatory payments is considered to be mixed leasing.

These are the main types of leasing which are known worldwide and which can be used in Azerbaijan Republic.

This chapter has analyzed the current legal status of leasing in Azerbaijan and gave the readers the main idea on how the leasing contract is concluded, changed and terminated; who are the parties of the leasing contract and what are their rights and obligations and what types of leasing can be implemented in Azerbaijan. Now I want to move to next chapter by giving and

⁹⁶ Article 748-10 of the Civil Code of Azerbaijan Republic.

⁹⁷ Vitranskiy V.V., “Leasing contract and its types”, p.96, Moscow, 1999 (Vitranskiy V.V., Dogvor lizinga i ego vidi”, Moskva, 1999).

⁹⁸ Article 748-10.2 of the Civil Code of Azerbaijan Republic.

⁹⁹ Article 748-10.2 of the Civil Code of Azerbaijan Republic.

information of leasing in United States and then based on what was described in the previous chapters make comparison analysis on situation with leasing in US and Azerbaijan.

Leasing in United States

Stages of leasing development in United States

Financing of different types of rent transactions was always widely implemented in USA. The first rent contract on personal property was registered in North-American United States at the beginning of eighteenth century. In 1940s trade agent named Zolly Frank was suggesting customers the cars available for the rent. After fifty years, the profit coming from the leasing of vehicles exceeded fifty billion dollars. The real revolution in the rent transactions happened in US at the beginning of 1950s. Right after this, consumption equipment was leased more and more and included technological equipment, machines, vessels, planes. US government highly valued this phenomenon and has prepared and implemented program for its development¹⁰⁰.

As it was already mentioned in this work, the first joint stock company which's main activity was focused on leasing transactions, was United States Leasing Corporation, created in 1952 in San-Francisco. At the beginning, founder of USLC Henry Shonfeld has created the company only for one exact contract. Later he has realized that leasing business has perspectives to become very profitable and that is how the United States Leasing Corporation appeared. The leasing operations have moved over the border of United States very quickly and as a result new "international leasing" term has appeared.

In 2006 US had 34.7% of leasing transactions from the whole leasing turnover in the world. It seems like this tendency is going to grow intensively by active advancement of leasing to the markets of the developing countries. More than 9/10 of the whole North

¹⁰⁰ Gazman V.D., "Market of leasing services", p.48, Moscow, 1999 (Gazman V.D "Rinok Lizingovix Uslug", Moskva, 1999).

American market is dedicated to US. Leasing in US is one of the main financing tools, which has 30% of all investments and equipment circulated in US economy. In the period from 1986-2006, 27%-42% of all investments made into equipment and vehicles in US were made through leasing¹⁰¹.

At the first step of development of the leasing business, US banks were banned on acting as a lessor in leasing transactions. Despite this fact banks were trying not to move away from leasing sphere and acting in a role of creditors for leasing companies. Leasing transactions gave opportunity to implement flexible payment schedules and this factor promoted the fast development of leasing in US. Besides this, state was also supporting leasing by providing tax, finance and amortization benefits. Having realized the advantages of leasing, big manufacturers of equipment such as IBM, General Motors, Xerox, Hewlett-Packard and others started to create subsidiary leasing companies. In the middle 1990s the overall annual capacity of leasing portfolio was varying from 1.2 to 26.8 billion dollars. Some of these companies have entered to Azerbaijan leasing market and were represented in a role of subsidiary companies or providers of the equipment¹⁰².

According to the Uniform Commercial Code¹⁰³ of USA which was adopted in 1952 (the criteria described here is with the latest additions made in 2004), leasing (financial leasing) is defined as contract where: lessor buys equipment and provides lessee with a copy of the leasing contract by which equipment is transferred to the lessee for the use and possession; lessor has to show the person who will deliver the equipment to lessee, except the cases when

¹⁰¹ Butenina N., "Development History of Leasing Relationship in United States of America", *Leasing Review*, Vol 5-6, 1999 at <http://www.businesspress.ru/newspaper/article_mId_2_aId_51073.html> - last visited on 29 March 2009.

¹⁰² Butenina N., "Development History of Leasing Relationship in United States of America", *Leasing Review*, Vol 5-6, 1999 at <http://www.businesspress.ru/newspaper/article_mId_2_aId_51073.html> - last visited on 29 March 2009.

¹⁰³ Uniform Commercial Code at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

lessee himself chooses the seller and asks lessor to purchase the defined property from that seller; inform the lessee that he can contact the supplier and get from him the whole information on rights, obligation and guarantee lessor does not choose, produce or transfer the equipment. These were one of the first characteristics given to the leasing contract¹⁰⁴.

There were three types of leasing companies in US at the beginning of 1960s: independent leasing companies, bank filial and manufacturer subsidiaries¹⁰⁵. Banks got a permission to deal with leasing transactions in 1963. Later in 1970 Bank Holding Company Act gave permission to acceptable amount of operations at the national level, which made leasing very attractive to the banks and bank holding companies. Nowadays many bank holding companies are managing leasing departments and possessing the banks with leasing departments. Preservation of both types of activities till nowadays, is explained with fact of providing of tax benefits and requirements to capital and their financial securing¹⁰⁶.

By decision of the FRS (Federal Reserve Service) made in 1972, bank holding companies were given permission to act as broker-agent or consultant in connection with paid leasing. The scope of the subsidiary companies has broadened at the expense of giving the property to the rent for defined conditions. Bank holding companies have a right to implement leasing of both movable and immovable property, national banks – only leasing of movable property¹⁰⁷.

In 1980 the Agency on Standardization of Fiscal Accounting made a resolution, by which the “real leasing” and “purchase by leasing” meanings could be differentiated. Before this decision, companies were able to buy equipment by leasing without reflecting its amount at

¹⁰⁴ Gazman V., “Leasing Abroad. Part IV”, *Expert Online*, 31 March 2008 at <http://www.expert.ru/printissues/equipment/2008/03/lizing_za_rubezhom/> - last visited on 29 March 2009.

¹⁰⁵ Parkes R., “Equipment leasing: an industry in transition”, *Business Credit*, 1 February 1994.

¹⁰⁶ Can be viewed at Federal Deposit Insurance Corporation website at – <<http://www.fdic.gov/regulations/laws/rules/6000-1000.html>> - last visited on 29 March 2009.

¹⁰⁷ Official web-site of Federal Reserve Service - <www.federalreserve.gov/boarddocs/press/bcreg/2003/20030825/attachment2.pdf> - last visited on 29 March 2009.

their balances and hold journal-to-order bookkeeping, not showing the amount of debts. These rules were listed in the decision: the right of ownership transfers to the lessee at the end of the term of the leasing contract; the leasing contracts allows to purchase the equipment after the end of the term of the contract for price which is less than the market price; the period of the contract is equal or more than 75% of the possible service of the property; the existing amount of lease payments is more or equal to 90% of the normal market price of the equipment¹⁰⁸.

In 1985 USA has adopted Act on Reforms in Taxation System, which has listed the criteria by which the contracts could be referred to the leasing ones. Besides this, the permission was given to conduct the contracts on transfer of the tax benefits to another party¹⁰⁹.

The term “financial leasing has appeared in US in 1986 in the Act on Taxation. The main idea was that at the leasing contract lessee gets the equipment for mostly the whole term of equipment’s service life; lease payments are fully transferred to the lessor; lessee is responsible for providing technical service, tax payments and insurance of the equipment; the lease payments which are received by the lessor are covering the price of the equipment and provides him with investment capital¹¹⁰.

Beginning from 1990, the situation with leasing from tax aspect started to change. The most part of tax benefits are shortened from amortization mechanism. At that time in order to be called “financial leasing” these features should have been presented in the contract: the minimum financing to the leased property made by lessor should be 20% of its price; lessee does not have a right to purchase the leased equipment for the price less than the market price;

¹⁰⁸ Medvedkov S. U., “Leasing in US economy”, p.22, 1980 (Medvedkov S.U., “Lizing v ekonomike SSHA”, 1980).

¹⁰⁹ Gazman V., “Leasing Abroad. Part IV”, *Expert Online*, 31 March 2008 at <http://www.expert.ru/printissues/equipment/2008/03/lizing_za_rubezhom/> - last visited on 29 March 2009.

¹¹⁰ Gazman V., “Leasing Abroad. Part IV”, *Expert Online*, 31 March 2008 at <http://www.expert.ru/printissues/equipment/2008/03/lizing_za_rubezhom/> - last visited on 29 March 2009.

lessee cannot invest to the leased equipment, except the case with separable perfection parts; lease period should not exceed 80% of its service term; at the end of the leasing contract the price leased property should not be less than 20% of its primary price; not depending from tax benefits, lessor has to receive positive money flow from the whole profit coming from the contract¹¹¹.

The legislation which regulated leasing activity was continuing to improve at the end of 1990s. The State Agency on Internal Profits of US has accepted new rules which were regulating the transactions of cross-border leasing. It should be mentioned that tax legislation on leasing is changing very rarely for the last years. The last change is the introduction of more flexible mechanism for the discharge of tax for the property in the frame of true lease¹¹².

The significant role in the regulation of leasing business in United States plays the legislation of each state. Each state defines its own tax rates for the participants of the leasing business. For example the tax for the rent charge in different states varies from zero to seven percent. The changes which were observed in the property structure which is transferred to leasing during the period from 1996 to 2000 were presented by Association of Equipment Leasing of United States. According to these statistics the structure of priority was: truck and trailers 11%, computers 10.6%, construction equipment 8.5%, aeronautical engineering 8.2%, medical equipment 7.4%, office equipment 6.2% and agricultural equipment 5.3%. As it seems the most popular type of leasing in US is leasing of vehicles. The turnover of annual truck renting business in 2005 made twenty six billion dollars¹¹³.

¹¹¹ Belakov O.A., "Leasing", p.27, 1999 (Belakov O.A., "Lizing", 1999).

¹¹² Vasilyev N.M., Katyrin S.N., Lepe L.I., "Leasing as mechanism for development of investments and entrepreneurship", p.32, Moscow, 1997 (Vasilyev N.M., Katyrin S.N., Lepe L.I., "Lizing kak mehanizm razvitiya investitsiy i predprinimatelstva", Moskva, 1997).

¹¹³ Gazman V., "Leasing Abroad. Part IV", *Expert Online*, 31 March 2008 at <http://www.expert.ru/printissues/equipment/2008/03/lizing_za_rubezhom/> - last visited on 29 March 2009.

Among the companies-lessors which's business turnover was higher than three billion dollars in 2000s I would like to highlight General Electric (GE) Capital with 44.7 bln.usd, Citi Capital 20,6 bln.usd., IBM Global Financing 18,6 bln.usd, CIT Group 17,1 bln.usd, John Deere Credit 9,0 bln.usd, Navistar Financial 5,9 bln.usd, Caterpillar Financial Services 5,9 bln.usd., Banc of America Leasing & Capital Grp. 5,0 bln.usd, Fleet Capital 4,7 bln.usd., CNH Capital 4,6 bln.usd., Hewlett Packard Tech Finance 3,9 bln.usd., International Lease Finance 3,1 bln.usd and Key Equipment Finance 3,0 bln.usd¹¹⁴.

The size of the leasing contracts in US in the period between 2002-2006 was expressed in this way: micro bargains (value till 25000 USD), 9% from the whole leasing trnasactions turnover; small bargains (from 25000 til 250000 USD), 21% from the whole leasing trnasactions turnover; medium bargains (from 250000 till 5 mln. USD), 38 % in 2002 and 58% in 2006; large bargains (more than 5 mln. USD), decreased from 32% in 2002 to 12% in 2006. Another indicator which proves the high level of developoement of leasing transactions in US is the existence of many assocations, which unite the companies interested in the development of leasing business. Unification in association is implemented both on federal (for example Equipment Leasing Association) and on regional (state) levels (California Association of Equipment Lessors) and also by the type of equipment (Truck Renting and Leasing Association National). There 15 main associations in US nowadays: Equipment Leasing Association, Western Association of Equipment Lessors, Eastern Association of Equipment Lessors, National Vehicle Leasing Association, Truck Renting and Leasing Association, American Automotive Leasing Association, The Computer and Leasing Remarketing Association¹¹⁵.

¹¹⁴ Gazman V., "Leasing Abroad. Part IV", *Expert Online*, 31 March 2008 at <http://www.expert.ru/printissues/equipment/2008/03/lizing_za_rubezhom/> - last visited on 29 March 2009.

¹¹⁵ Gazman V., "Leasing Abroad. Part IV", *Expert Online*, 31 March 2008 at <http://www.expert.ru/printissues/equipment/2008/03/lizing_za_rubezhom/> - last visited on 29 March 2009.

One of the most famous types of leasing in USA is equipment and vehicle leasing. This type of leasing is usually used by banks where they are acting as lessors. There are two main types: open and closed leasing. Open leasing has these features: leasing is implemented for the period from twenty four to thirty six months; the risk of damage or loss of the property is on lessee; before the acceptance, lessee has to insure the vehicle and indicate the lessor as a beneficiary; lessee takes responsibility on repair and maintenance of the vehicle; lessee is obliged to pay all lease payments in time by the end of leasing contract; lessee does not have advantageous right on purchase of the vehicle after the end of the leasing contract¹¹⁶.

Despite the fact that lessee does not have the privilege on purchase of the vehicle, he can pay off the residual value by himself. In this case, vehicle is transferred to him, or to the person who is mentioned by him. Another option is to suggest the vehicle to deductible dealer from whom it is purchased. If the dealer refuses to buy it, bank can sale it to another dealer by wholesale price or if the vehicle is much depreciated, transfer it again to leasing. The main difference between open and close leasing is that in close leasing, lessee does not guarantee the residual value of the leased vehicle at the end of the period of the leasing contract and lessor accepts this risk. Many leasing contracts on the internal combustion engines are implemented via open leasing¹¹⁷.

The term of the leasing cannot exceed forty years, while the time during which the bank holding company can possess the property after the end of the leasing contract is limited by two years time.

This was the general overview on the history and development of leasing in United States. The next chapter will give the information regarding the legal regulation of leasing contract in United States.

¹¹⁶ Belakov O.A., "Leasing", p.34, 1999 (Belakov O.A., "Lizing",1999).

¹¹⁷ Belakov O.A., "Leasing", p.36, 1999 (Belakov O.A., "Lizing",1999).

Legal regulation of leasing contract in United States

The main source of legislation which regulates leasing relationships in United States is Article 2A of Uniform Commercial Code (UCC)¹¹⁸. This Article gives us information on definition of the leasing contract, its parties and subject, formation, modification and rescission of the leasing contract and other relevant descriptions by which one can define the legal nature of the leasing contract in US law.

In respective articles of UCC lease, lease agreement and lease contract are expressed separately:

“Lease means a transfer of the right to possession and use of goods for a term in return for consideration”¹¹⁹. “Lease agreement means the bargain, with respect to the lease, of the lessor and the lessee”¹²⁰, while “Lease contract means the total legal obligation that results from the lease agreement as affected by this Article and any other applicable rules of law”¹²¹.

According to Azerbaijan law leasing contract is described with one expression:

“Lessor is obliged to give certain things in use of lessee for a specified fee, specified term and other conditions (including the right of the lessee to buy-out the asset) stated in the agreement. Lessee is obliged to pay a rent according to the agreed terms. Lessor is responsible for acquisition and manufacturing of the object of leasing specified in the leasing agreement”¹²².

In my opinion the provision given in Azerbaijan Law is more clear than in US, because there it seems like parties are not limited to set their rights and obligations.

¹¹⁸ Can be viewed at Cornell University Law School website at <<http://www.law.cornell.edu/ucc/2A/>> - last visited 29 March 2009.

¹¹⁹ Cited from UCC Article § 2A-103.1 (j) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited 29 March 2009.

¹²⁰ Cited from UCC Article § 2A-103.1 (k) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹²¹ Cited from UCC Article § 2A-103.1 (l) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹²² Cited from Article 747 of the Civil Code of Azerbaijan Republic at <www.azerbaijanleasing.com> - last visited on 29 March 2009.

The definition given to the parties of the leasing contract is expressed in UCC in such way:

“Lessor means a person who transfers the right to possession and use of goods under a lease” and “Lessee means a person who acquires the right to possession and use of goods under a lease”¹²³. “Supplier means a person from whom a lessor buys or leases goods to be leased under a finance lease”¹²⁴.

In general terms these provision are similar to those which are mentioned in Azerbaijani legislation. The only difference is that in Civil Code of Azerbaijan Republic, the difinitions are given in more detailed manner.

“Lessor is an individual or legal entity who, either using his own capital or external funds, acquired the asset which is transferred to the lessee for the specified fee, specified term and other conditions (including transfer of ownership title to lessee or otherwise) on the basis of leasing agreement for temporary ownership or use”. “Lessee is an individual or legal entity accepting the object of leasing for temporary ownership or use on the basis of the leasing agreement for specified fee, specified term and other conditions”. “Seller (supplier) is an individual or a legal entity selling object of leasing to lessor on the basis of purchase agreement”¹²⁵.

In general terms these provision are similar to those which are mentioned in Azerbaijani legislation. The only difference is that in Civil Code of Azerbaijan Republic, the difinitions are given in more detailed manner than in UCC.

The next significan part to which the attention should be given is the subject of the leasing contract. In UCC it is given under the “Goods’ name where it is said that:

“all things that are movable at the time of identification to the lease contract, or are fixtures (Section 2A-309), but the term does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also includes the unborn young of animals”¹²⁶.

¹²³ Cited from UCC Article § 2A-103.1 (n,p) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹²⁴ Cited from UCC Article § 2A-103.1 (x) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹²⁵ Cited from Articles 747-1.2, 1.3, 1.4 of the Civil Code of Azerbaijan Republic at <www.azerbaijanleasing.com> - last visited on 29 March 2009.

¹²⁶ Cited from UCC Article § 2A-103.1 (h) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

The Civil Code of Azerbaijan Republic states that:

“Object of leasing is movable or immovable property related to fixed assets in accordance with classification set up by appropriate legislation with exception of goods without free civil turnover or goods with limited civil turnover”¹²⁷.

From the first point of view it seem like in US interpretation only movable property can be the subject of the leasing agreement, while in Azerbaijan law both are possible. But when you go to Section 2A-309, you see that the real estate is also mentioned there. The real difference here is that under UCC the list of the subjects which cannot be subject of leasing contract is presented. In the Civil Code of Azerbaijan Republic it is only said that “with exception of goods without free civil turnover or goods with limited civil turnover”, what is not clear and is showed in a general aspect.

Now it will be good to move to the topic of the form and content of the leasing contract. According to UCC the leasing contract is not enforceable unless:

“there is a writing, signed by the party against whom enforcement is sought or by that party's authorized agent, sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term”¹²⁸.

In Azerbaijan law it is said that leasing contract shall be concluded in a written form and shall state the information about the object and period of leasing contract¹²⁹. Both systems mention the general terms with regards to the form and content of the leasing agreement: that the contract should be concluded in the written form and that the information about subject and term of the contract should be mentioned. There is not additional information given to the contract term question in Azerbaijan law. The only thing expressed is that the term should be presented in the contract and that it is defined by the parties' mutual agreement. As it was

¹²⁷ Cited from Article 747-2 of the Civil Code of Azerbaijan Republic at <www.azerbaijanleasing.com> - last visited on 29 March 2009.

¹²⁸ Cited from UCC Article § 2A-201.1 (b) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹²⁹ Article 748 of the Civil Code of Azerbaijan Republic.

mentioned before in this work, the period of leasing contract in Azerbaijan is usually set equal to the period of full amortization of the leased property. In UCC Articles related to the term of the leasing contract it is stated that the term of the leasing contract is defined

“if there is a writing signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified”, “if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted” and “a reasonable lease term”¹³⁰.

It can be stated that according to US legislation the term of the leasing is defined by the parties or is equal to the reasonable time of the lease. If to compare two interpretations it can be stated that they both are similar.

There are also several provisions of UCC aimed to the subleasing which state that “Sublease means a lease of goods the right to possession and use of which was acquired by the lessor as a lessee under an existing lease”¹³¹. It is also needed to mention that in provisions of UCC related to the leasing there is an additional sentence which states that “Unless the context clearly indicates otherwise, the term includes a sublease contract”¹³². In other words, all terms related to the leasing contract should be applied also to the subleasing contract. Articles of the Civil Code of Azerbaijan Republic state that in subleasing the actions of the parties are the same to those in the leasing and it is formed by subleasing contract¹³³. It seems like subleasing is regulated similarly in Azerbaijan and United States.

The allocation of risks and insurance in the leasing contract is also takes an important place in US legislation. UCC Article 2A-218 says that “The parties by agreement may determine that one or more parties have an obligation to obtain and pay for insurance covering

¹³⁰ Cited from UCC Article § 2A-101.4 (a,b,c) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹³¹ Cited from UCC Article § 2A-103.1 (w) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹³² Cited from and presented in UCC Articles § 2A-103.1 (k,l,n,p,x) at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹³³ Article 747-4 of the Civil Code of Azerbaijan Republic

the goods and by agreement may determine the beneficiary of the proceeds of the insurance”¹³⁴. As it can be explained from the provision insurance of the subject of the leasing contract in US is not mandatory and can be executed by parties’ wish. The situation in Azerbaijan is vice versa where according to Article 748.6 of the Civil Code of Azerbaijan Republic “Object of leasing shall be insured against loss (destruction), deterioration or damage risks, starting from the date of provision of the property through the end of leasing agreement, unless otherwise prescribed in the leasing agreements”¹³⁵. Even though the insurance is a mandatory condition, “Leasing agreement shall specify party which shall pay insurance fees, the beneficiary of the insurance, as well as duration of insurance”¹³⁶, so this provision is similar to US one. Article 2A-219 of UCC dedicated to the risk of loss states that “Except in the case of a finance lease, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a finance lease, risk of loss passes to the lessee”¹³⁷. The similar rule is presented in the Civil Code of Azerbaijan Republic where “Lessee is responsible for insurance of the object of lease against all kinds of damage to property, destruction, loss, deterioration, malfunctioning before the end of useful life, mistakes during installation and operation, unless otherwise is specified in the leasing agreement”¹³⁸. As financial lease is widely used in Azerbaijan it can be assumed that this provision is aimed to the financial lease. So it comes out then that both legislation have similar regulations regarding the allocation of risks in the leasing contract.

¹³⁴ Cited from UCC Article § 2A-218.5 at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹³⁵ Cited from Article 748-6.1 of the Civil Code of Azerbaijan Republic at <www.azerbaijanleasing.com> - last visited on 29 March 2009.

¹³⁶ Cited from Article 748-6.3 of the Civil Code of Azerbaijan Republic at <www.azerbaijanleasing.com> - last visited on 29 March 2009.

¹³⁷ Cited from UCC Article § 2A-219.1 at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹³⁸ Cited from Article 748-7.1 of the Civil Code of Azerbaijan Republic at <www.azerbaijanleasing.com> - last visited on 29 March 2009.

The last point of this subchapter dedicated to the legal regulation of leasing in US is the alteration and rescission of the leasing contract. According to Article 2A-508 of UCC,

“If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract or a lessee rightfully rejects the goods or justifiably revokes acceptance of the goods then with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired the lessor is in default under the lease contract and the lessee may: cancel the lease contract; recover so much of the rent and security as has been paid and is just under the circumstances; cover and recover damages as to all goods affected whether or not they have been identified to the lease contract or recover damages for nondelivery; exercise any other rights or pursue any other remedies provided in the lease contract”¹³⁹. “If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, the lessee may also: if the goods have been identified, recover them; in a proper case, obtain specific performance or replevy the goods; If a lessor is otherwise in default under a lease contract, the lessee may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease; If a lessor has breached a warranty, whether express or implied, the lessee may recover damages”¹⁴⁰.

As it can be observed from this rule, US legislation gives adequate protection to the lessee in case of the lessor’s default, because in case of lessor’s violation or non-performance lessee has many ways for back-up such as: terminate the contract, require the performance and even claim for damages. In Azerbaijan law, such case is regulated by the relevant provisions of the Civil Code dedicated to the rent, because there are no separate provisions on this issue for the leasing¹⁴¹. There the lessee can terminate the contract and claim damages in cases when lessor is not executing his obligations, creates obstacles for use of the subject of leasing or provides lessee with the damaged property.

In case of lessees default,

“If a lessee wrongfully rejects or revokes acceptance of goods or fails to make a payment when due or repudiates with respect to a part or the whole, then, with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired, the lessee is in default under the lease contract and the lessor may: cancel the lease contract; proceed respecting goods not identified

¹³⁹ Cited from UCC Article § 2A-508.1 at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹⁴⁰ Cited from UCC Article § 2A-508.2 at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009.

¹⁴¹ Please see Chapter 2, Subchapter 6 of this research.

to the lease contract; withhold delivery of the goods and take possession of goods previously delivered; stop delivery of the goods by any bailee; dispose of the goods and recover damages or retain the goods and recover damages, or in a proper case recover rent; exercise any other rights or pursue any other remedies provided in the lease contract”¹⁴². “If a lessor does not fully exercise a right or obtain a remedy to which the lessor is entitled under subsection (1), the lessor may recover the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner, together with incidental damages, less expenses saved in consequence of the lessee's default”¹⁴³.

In Azerbaijan law, such case is regulated by Article 748-1.12 of the Civil Code of Azerbaijan Republic which states that

“In following cases lessor has a right to indisputably take back money and object of leasing and by so doing terminate the leasing agreement before expiration date of the agreement: conditions of use of object of lease are not compliant with conditions of leasing agreements or purpose of object of leasing; If lessee subleased the object of leasing without consent of lessor; If lessee has not been maintaining the object of lease in operation, which worsens its productive qualities; If lessee has failed more than two consecutive times to make payment of on leasing agreement in timely manner”¹⁴⁴.

If to compare tthis case both from lessor’s and lessee’s point of views I can state that both systems highly protect the interests of the parties in the cases of the violations or non-performance in the leasing contract.

This is the whole information related ot the legal regulation of the leasing contract which I thought is relevant to discuss.

¹⁴² Cited from UCC Article § 2A-523.1 at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009

¹⁴³ Cited from UCC Article § 2A-523.2 at <<http://www.law.cornell.edu/ucc/2A/article2A.htm#s2A-101>> - last visited on 29 March 2009

¹⁴⁴ Cited from Article 748-1.12 of the Civil Code of Azerbaijan Republic at <www.azerbajjanleasing.com> - last visited on 29 March 2009.

CONCLUSION

Leasing is multilateral complex of legal, economic and financial relationships. Having an aim to study the legal relationships coming out from leasing contract, this research tried to reveal the main features of leasing contract in Azerbaijan and then compare it to the situation in United States.

By making conclusion to my research on leasing contract in Azerbaijan, I would like to point out that leasing contract, which by its nature is referred to the rent contract, is not a traditional rent, but is proportion of financial and rent relationships. The main process in leasing is lessor's financing provided to lessee by transferring him the property which was purchased from the seller selected by lessee.

Opinions of different authors regarding the legal nature of leasing contract were presented in this work. There is no single opinion on this question. Some of them consider leasing as independent contract; others say that it is the variety or rent contract. The most appropriate opinion in Azerbaijan which should be valued as right one is that leasing contract is an independent type contract, which should be differentiated from the usual rent contract by special features proper to it. As in the traditional rent contract, leasing contract implies the transfer of the property to use and possession, but lessor's obligations are complicated with the fact that at the beginning he has to purchase the equipment by sale-purchase contract.

Leasing contract is considered to be entrepreneurial (based on financing to lessee by lessor), mutual (based on intentions of both parties) and onerous (each party gets something in result). These characteristics become apparent through the discovery of rights and obligations of the parties of the leasing contract: lessor, lessee and seller. Lessor first of all chases the financial aim in the leasing contract. Lessor as owner of the leasing subject does not need this property; he buys it to transfer it to the lessee. During the period of leasing contract, lessor

does not carry liability on risks of damage or destruction of the leasing subject. Lessee on the contrary, carries higher responsibility and he is obliged to insure the leasing subject. The sale-purchase contract concluded between seller and lessor has its own specific character, according to which seller is performing in front of the lessee. The possibility of subleasing is also described in this work.

The second part of this work was dedicated to the development of leasing and its legal regulation in United States. As it can be seen from the historical part of leasing development, leasing in United States is really developing very dynamically despite the fact that the state regulations there are on very strict level.

The main part of comparison analysis was dedicated to the comparison of legal regulation of leasing in two systems. As it was mentioned before in this work, leasing is regulated in two countries by two legal instruments: Civil Code of Azerbaijan and Uniform Commercial Code of United States of America. The comparison of systems showed that most important general terms which are mentioned in UCC is also represented in the Civil Code of Azerbaijan Republic. Among these I can mark up the legal definitions of leasing contract, parties and their rights and obligations, form and content of the leasing contract, grounds and results in case of alteration or rescission of the leasing contract and types of leasing. Sure US legal system is more improved as leasing in US has appeared much earlier than in Azerbaijan. Besides this, UCC is more detailed and its scope is much wider than the Civil Code of Azerbaijan Republic.

One of the facts that holds the development of leasing in Azerbaijan is its novelty and as a result, imperfection of the legislation regulating leasing transactions. Leasing in Azerbaijan is regulated by Civil Code and other legal acts of Azerbaijan Republic. The existence of the separate law regulating leasing relationships is a needed necessity. Despite

the fact that provisions of the Civil Code describe the main parts of the leasing contract, it still needs to be developed and detailed. Though some of the provisions of legislation should be interpreted in more précised way. For example, I think that definition of subleasing contract is not formulated very well as it does not match the used experience of conclusion of such types of contracts. Despite the fact that there is an appropriate provision (Chapter 34 of the Civil Code of Azerbaijan Republic) in the Civil Code related to subleasing, it seems like it matches the interpretation of sub rental contract. Such provision should not be considered as right taking into consideration the possible benefits which are provided to the parties of the leasing contract. Another provision which I think should be widened or at least set open is the list of subject parties in the leasing agreement. I think this makes sense as in reality there can be more subject parties involved in the leasing legal relationships.

In the final part of my research I would like to lay stress again on big importance of leasing in economy of Azerbaijan. Despite the fact that in comparison to the developed countries the “weight” of the leasing in the whole amount of financing made to the economy of Azerbaijan is yet small enough, its potential is enormous. Leasing has many advantages in comparison with other civil-law economic institutions which are:

1. Leasing gives an opportunity to obtain the equipment for use and possession without its full payment;
2. Leasing gives an opportunity to establish new production without mobilization of required large financial assets;
3. Leasing gives an opportunity to upgrade the production without attraction of debt capital;
4. Leasing gives an opportunity to test the equipment till its full payment or use it only for the period when it is needed.

That leasing makes it possible to conform in the best way the interests of banks and leasing companies, producers and consumers. Leasing is more profitable way of purchasing the equipment rather than buying or taking it via traditional rent. It can be stated for sure that the leasing contracts concluded by Azerbaijani business people will rise each year and finally the unit weight of leasing in the total capacity of investments, will reach the level of the successfully developing countries. What at a final stage will bring to the renewal of the main assets and material technical base of the enterprises and as a result, to the economic growth of the country.

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