The New Law of Georgia on Leasing – A Critical Analysis

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1. Urgency of the New Law on Leasing

Through the adoption of the new Law of Georgia on the Promotion of Leasing Activities (Law on Leasing) the legislative body of Georgia intended to comprehensively regulate the leasing contractual relations and create the legal basis for it.

This on a *prima facie* basis seems progressive. The history of leasing as a legal institute is only thirty years old. Thus, it is far younger than the western civil laws and consequently is not regulated as a separate type of contract, apart from some exemptions. The leasing contract is considered either as a (not typical) rent contract or as an outcome of a freedom of contract - as a special type of contract (*sui generis*) that derives from the rent law. In some countries, parts of sales, loan and service laws are used to regulate leasing. The legal construction of leasing is rather complex. Therefore, it is expedient to regulate explicitly at least the basic principles of its concept.

Leasing relations were regulated in Georgia even before the adoption of the law on Leasing. Namely, during the elaboration of the Civil Code the legislative body of Georgia decided to provide for leasing in Chapter 4 of Book 3 as a separate type of contract (Articles 576-580). Chapter 4 provides the definition of the concept of leasing (Article 576) and the minimum requirements for the format and content of a leasing agreement (Article 577). Together with special provisions, regulating liability that derives from the specific nature of leasing, reference is made to the provisions of the Civil Code regulating rent contract. This reference secures the regulation of leasing activities without any deficiencies. The definition given in Article 576 serves the purposes of legal clarity and is a model according to international practice. Civil Code provisions are compatible with the established practice of western countries, where leasing derives from the rent law or is regulated directly by the rent law.

Pursuant to its preamble the purpose of the new law on leasing is to develop leasing relations envisaged by the civil code. In fact, however, these grounds do not require the need to adopt a special law, as the Civil Code provisions are sufficient. Given the complex nature of leasing, it would be better to apply already known and well-developed provisions of the civil code and the rent law. Any leasing law must be very detailed and complex

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in order to meet various interests related to it. Consequently, most European Union Member States do not have such a law.

While the adoption of a separate law on leasing is considered neither necessary nor prudent, we shall analyse it in detail to assess the reasonability of its provisions and interrelations between them.

2. Individual Provisions of the Law on Leasing

a) Chapter 1 - General Provisions

Firstly, the Law lacks a reference to Articles 576-580 of the Civil Code and the rent law, which by virtue of Article 580 of Civil Code should be applicable with regard to leasing agreements. The hierarchical position of the new Law in relation to the leasing law and rent law provided in the Civil Code is imprecise.

Article 1 provides definitions. Its title the “Interpretation of Terms” is misleading as it gives definitions and not interpretations of the terms. Article 2 – “Types of Leasing” lists the special types of leasing contract.

These two articles are not separated from each other systemically. The so-called definitions given in Article 1 somewhat exceed the definition of terms and list certain types of leasing contract (which from a systemic point of view should be included in Article 2) or sets forth some legal obligations (which from a systemic point of view should be regulated by Chapter 3).

Paragraph (a) of Article 1 is more than the definition of a term. It does not define “leasing” but sets forth the basic obligations of the lessor and the lessee. As regards basic obligations, the Law repeats the content of Article 576 of the Civil Code. Inasmuch as the hierarchical interrelation between the Civil Code and the Law on Leasing is not clear a question may arise. What is the purpose of this repetition? The result is the existence of two competitive provisions containing the legal definition of a leasing contract.

The second part of Article 1(a) contradicts the first sentence of Section 3 of Article 576 of the Civil Code. This provision reads: “The leasing agreement *may* obligate or entitle the lessee to either purchase or rent the subject of leasing upon the expiration of the term of the agreement, unless the agreement ends with the complete depreciation of the thing (…)”. The second part of Article 1(a) makes it mandatory for the lessee to be obligated or entitled to purchase the subject of leasing upon the expiration of the term of the agreement without inclusion of any specific stipulation in the agreement. Such a wording not only contradicts the Civil Code, but is pointless as well. Leasing agreements without the mandatory option of purchase after the expiration of the term of the agreement are universally acknowledged internationally. The reason of inclusion of the obligation of purchase option into the definition of the term “leasing” is not clear.

Paragraph (h) of Article 1 also exceeds the scope of definition of a term and creates a legal construction of the so-called “sub-leasing”. However, this type of leasing agreement is not mentioned among the types of leasing. As far as the list given in Article 2 is exhaustive, there arises an apparent contradiction between Article 1(h) and Article 2.

The definition of sub-leasing is given only in Article 4. According to the structural arrangement of the law, it is not correct to define this legal institute in Article 1, not to mention it in the list, given in Article 2 and later to re-define it in a special provision.

The provisions of Articles 1 and 4 are mutually contradictory not only from the point of view of structural arrangement, but also in terms of content. Article 1(h) states that: “the transfer of the right on the usage of the subject of leasing by the lessee to a third person shall be affected on the grounds of a leasing agreement”. Paragraph 1 of Article 4, however, is concerned with the “type of leasing... on the grounds of which the lessee shall transfer the subject of leasing to a third person”. The issue whether the transfer of the subject of leasing to a third person should be envisaged by an initial leasing agreement remains unclear. It is also not clear whether the transfer of the subject of leasing provided for by Article 1(h) (“transfer of the right on the usage of the subject of leasing by the lessee to a third person”) and Article 4 (1) (transfer of the subject of leasing to a third person) means, a long-term or temporary transfer of the subject of leasing to a third person and what the legal framework should the transfer be based on.

Article 2 gives the definition of four types of leasing:
Leasing agreement when the lessor is himself the owner or the producer of the subject of leasing (in German law this corresponds to “producer’s leasing”) is denominated as a “direct leasing” by Article 2(a). The purpose of this definition is unclear because the Law and the Civil Code do not distinguish a leasing contract according to various types;

Paragraph (b) of the same Article gives the definition of the so-called “compensational leasing” (when the lessee makes leasing payments through the supply of goods or services). Agreement whether the payment of the contract value should be effected in some other manner than the pecuniary payment is generally the subject of contractual agreement and of course is allowed for the parties under the Civil Code. The development of a special type of leasing contract for such a contractual agreement is pointless;

Paragraph (c) provides for the definition of the so-called “service leasing”, the wording of which is rather ambiguous. It is probably supposed to develop a special type of leasing under which the lessor shall have such additional responsibilities, as there are the maintenance and insurance of the subject of leasing. However, this raises the question of why does the introduction of an additional obligation create a special type of leasing, when the parties may make a respective stipulation in the contract;

Finally Paragraph (d) defines all the other cases, not falling within the scope of the contracts regulated by Paragraphs (b) and (c) as “net leasing”.

As the law only gives the definition of "types of leasing" but does not provide for the rights and obligations of the parties with respect to the specific type of leasing contract, the meaning and implication of these definitions remains unclear. It should be mentioned that "various types of leasing" provides an opportunity for a number of their combinations with each other. For example, if a lessor leases a thing produced by him, or insures it and the lessee pays the compensation in kind, this will be the case of a "direct leasing", "compensational leasing" and "service leasing" all at once. This, of course is not destructive, but no legal consequences arise from such a classification.

The legal definition of different types of leasing would be reasonable if it provides for different legal constructions. It would have been expedient, for example, if a difference were made between ordinary "financial leasing" (when the subject of leasing is transferred for a long period) and "operating leasing" (when the subject of leasing is transferred for a short period, according to the demand). Financial leasing has the elements of sales law, while operating leasing is generally regulated by the rent law. This results in the respective difference with regard to such issues, as financing, responsibility and the right to dissolve a contract. Some peculiarities are also characteristic for the so-called "sale-and-lease-back" agreements, when the seller of a thing and the lessee is the same person. The development of special types of leasing agreements for this type of contractual construction would be reasonable if there were special provisions concerning responsibility and security.

As a result, the Law fails to develop various types of contract concurrent with the interests of the parties through the essential differentiation between various types of leasing. Thus, the existence of Article 2 in its current form is superfluous and misleading.

b) Chapter 2 – Leasing Contract

Article 3.1 of the Law on Leasing lists the minimum requirements for the content of a leasing contract. There is no reference to the parallel provision of Article 577 of the Civil Code. The latter's minimum requirements set forth the mandatory written form and written agreement regarding the total value, amount of leasing payments, time periods of payments and terms and conditions of final settlement. Article 3.1 of the Law establishes a variety of requirements related to the content that rather limit the freedom of contract.

Subparagraph (a) of Article 3.1 is a repetition of the second half of Article 1(a), by virtue of which the lessee becomes the owner of the subject of leasing after the expiration of the term of the contract. This, at the same time, means that leasing contracts, which do not contain a purchase option, are not leasing contracts under this law, while they are considered as such under the Civil Code. Such a restriction is not compatible with the essence of leasing and is not justified from the point of view of contemporary economic relations.

Subparagraph (b) states that the duration of the agreement should be essentially equal to the economic life of the subject of leasing. This excludes the ordinary operating leasing largely

applied in every western country. This is when a leasing contract is made for an indefinite or a short period and when one subject of leasing is transferred to several lessees in turn.

Further provisions provide for additional requirements that should be met in the leasing contract with regard to the transfer of the title to the property and in appropriate cases the sum payable to the lessor. A common feature of these deficiently worded provisions is that they press the leasing contract within a specific framework that is mainly oriented on the type of financial leasing. As a result, any other contract made with regard to any other type of leasing, or where the individual interests of parties to the contract are respectively modified, is not considered as a leasing contract. Therefore, one type of leasing contract becomes the only admissible one, though the reason for this is not clear. The main consequence of Article 3 is that the legal options of leasing contracts are minimised and the parties to the contract fall within the framework opposing the reality. Such a provision clearly demonstrates that the drafters of the Law are not aware of legal reality of the contemporary economic relations, what may cause considerable damage instead of promotion.

Furthermore, these provisions are not good for customers. They impose wider obligations on the lessee than one would find in Western Europe. For instance, the lessee is not entitled to dissolve a contract unless he paid “at least” the full amount of the leasing payment (Subparagraph (c)).

Article 3.2 of the Law requires the leasing contract to contain a stipulation of the cases when the subject of leasing could be considered as received and time periods for its receipt. The content of this provision is rather ambiguous. It is not clear which party is to fulfil what necessary preconditions in order for a contract to become valid. Development of the above said into “desired” (dispositional) rule will make the provision dependent on the will of the parties, thus its existence is unjustified.

To summarise, Article 3 is not necessary and is useless. It limits the whole leasing law to several standard contracts and creates legal ambiguity rather than legal clarity with regard to any other possible types of leasing contract. In those contracts that fall within the scope of Article 3, and in terms of international practice, the rights of the lessee are excessively limited. It is not clear why this was done as there is a clear and market economy oriented Article 577 of the Civil Code.

Article 5 states that a leasing agreement may be registered in the public register. However, non-registration is not a basis for its voidance. The possibility of registration may be regulated by provisions governing the maintenance of a public register and there is no need to regulate them in a special law. If the registration is mandatory for a certain type of leasing contract, than the necessity of a respective provision arises. As far as this is not the case Article 5 is pointless.

c) Chapter 3 – Rights and Obligations of the Parties to the Leasing Contract

Article 6 establishes the right of a lessor to retain the title to property by virtue of which he will not lose this title, even in the case of merging of the subject of leasing with the other movable or immovable things. This provision is not detrimental, as the protection of property right of a lessor is the essential part of a leasing law. However, it should be mentioned that in western countries this is generally done through a respective stipulation of the contract. The prerogative of such individual clauses is that the terms and conditions for maintenance of property rights could be stipulated in a more detailed manner. A contractual stipulation may better provide for the peculiarities and the purposes of usage.

Article 7 regulates rights and obligations of the lessor, but it does not mention the main obligations of the lessor. The Law makes no mention of the most essential obligation of the lessor – to timely transfer the property (subject of leasing) to the lessee and the property shall be in a state stipulated by contract or defectless. The main obligations of the parties to a contract are of course crucial provisions of every civil code. The Law on leasing violates this basic rule and defines the obligations of the lessee rather unilaterally.

The extensive right of the lessor to dissolve a contract, provided for Article 7 deserves criticism. Against certain preconditions, the lessor is entitled to dissolve a contract without prior notice, especially when the lessee encounters problems with payment (Article 7.4 of the Law). The right to dissolve a contract is rather strange from the point of view of international practise and explicitly violates the lessee's interests. In the case of violation of any other obligation by the lessee, provided for by the contract, when the preconditions set forth by Paragraph 4 are not met, the lessor is entitled to dissolve a contract only upon the prior notice (Paragraph 3). The period for the termination set by the law is 15 days.

In case the lessee violates his obligations, the lessor is entitled to demand the whole amount of leasing payment and full reimbursement of expanses caused by the transfer of the thing (Article 7.4) exclusive of the market value and the sum already paid. This means that the lessor is entitled to fully demand the interest deriving from the performance (profit he would have received in the case of performance of contract). This contradicts the principle that performance depends on counter-performance and it could be refused unless counter-performance occurs. This gives an unjustified preference to the lessor that is incompatible with the provisions of the law of obligations of the Civil Code. In the Civil Code, the lessee does not enjoy the right to dissolve the contract. Consequently only the provisions of the rent law should apply on the grounds of general reference made in Article 580 of the Civil Code.

According to Article 8.2 in the case of damage or loss of the subject of leasing, the responsibility lies with the lessee. This rule is not compatible with the laws of the majority of West European countries under which the renter or the lessor is obliged to take care of the thing and to bear the risk of incidental lost or damage. Generally, in a leasing contract this risk may be transferred to the lessee on the grounds of a contractual stipulation. It is generally admissible to make such a stipulation in contract, provided it does not deterio-

rate the lessee's status disproportionately. Thus, the legal consequences are the same as provided for by the Georgia's leasing law.

In principle it is not wrong to put the responsibility over the thing upon the lessee. However, from the systemic and legal-political points of view such a rule is not desirable. This kind of change in the risk distribution requires supplementary agreements, e.g. transfer of the right to demand against a third person from a lessor to the lessee, the obligation to notify the lessor, agreement on the repair and reimbursement. The generalised provisions in this law do not regulate the complexity of the issues related to the distribution of obligations and risks in an agreeable manner. Article 8.2 has the danger of making a contract with crushing terms that given the violation of the principle of equivalency, results in such a distribution of risk that it becomes a burden for the lessee. Consequently, under the Law on Leasing the lessee should pay the whole amount of leasing payment in the case of the loss of the subject of leasing (as well as in the case of dissolution of the contract by the lessor on the grounds of non-performance of the above-mentioned obligations by lessee). Such an obligation would be inadmissible in most European countries. The latter once again demonstrates that the law is benevolent to the lessor and ignores such fundamental values of the civil code, as the principles of performance and counter-performance, risk distribution and consumer protection.

The Law on Leasing does not regulate the right of a lessee to contest or dissolve a contract, as well as the cases of non-performance of obligations by a lessor and the obligation to secure that thing is defectless.

Article 10 empowers the lessor to be admitted to the subject of a lease any time and to exercise control over it. Irrespective of the provisions of a specific contract, the law obliges the lessee to secure the lessor with access to the thing without any restriction and to allow him to get familiar with the documents related to it. This obligation of the lessee does not depend on any mandatory conditions and is not subject to any restrictions. It is universally acknowledged that the lessee bears the obligation to maintain the subject of leasing. This is conditioned by the neighbourhood of the lessee and the subject of leasing and thus it is justified. As a result, he is responsible for any damage of the thing and is obliged to pay repair expanses (see above). The purpose is to relieve the lessor of the burden of maintenance of the subject of leasing, exercising permanent control over it and taking care of it. Hence, as general rule, there is no need to reinforce in the law controlling functions that the lessor tries to get rid of in international practice. Apart from this, the provision unreasonably limits the rights of the lessee. In western countries, the rent law (which as a rule is applied with regard to leasing contracts) stipulates that an owner is obliged to transfer a thing into possession and not to groundlessly prevent the renter from its usage. There are no grounds for the restriction of this basic principle through granting the lessor with the possibility of exercising control and supervision as provided by the Law.

d) Chapter 4 – Settlement Procedure, Chapter 5 – Bankruptcy and Chapter 6 – Final Provisions

Chapter 4 regulates the settlement procedure, while Chapter 5 – bankruptcy of one of the parties. Chapter 6 includes provisions related with coming the Law into force. These provisions do not regulate anything what does not derive from the general principles of the law and what is generally not covered by the contract terns. Consequently, they are not necessary for the regulation of a leasing contract.

3. Conclusion

With regard to the new Law on Leasing the following requires our particular attention:
The Law on Leasing fails to regulate comprehensively the legal relations inherent to a leasing contract and covers only several general principles. Thus, one should assume that the principles of Article 576 and subsequent articles of the Civil Code and the rent law are to be maintained on the grounds of the reference in Article 580 of the Civil Code. However, the hierarchy of the provisions is unclear: According to the preamble, the law on Leasing aims to develop Article 576 and subsequent articles of the Civil Code. On the one hand, we can presume, that this Law is *lex specialis* (a special law) with regard to the Civil Code provisions and the Civil Code should be applied only for filling gaps and whenever the interpretation is required. However, on the other hand, this law could be understood as an additional source for interpretation and specification, though the provisions of the Civil Code shall be still applied in the case of collision of rules. The Law lacks the reference to the applicability of the Civil Code provisions;

The general provisions of Chapter 1 and Chapter 2 of the Law are pointless. They partially repeat the text of the Civil Code and list unnecessary definitions and types of contract that do not contribute to the legal regulation of the issues. Due to their non-systemic nature and contradictory wordings, they cause ambiguity. Certain items contradict the Civil Code and make the legal basis unclear, which was comprehensible until now;

Chapter 3 is supposed to set forth the rights and obligations of the parties to the contract. Actually, they are not regulated. These provisions are only for giving legal status to the universally acknowledged contractual clauses, but at the same time, they unreasonably restrict the contractual freedom and limit the lessee's rights. This law was not harmonised with the general values and principles of the Civil Code. Furthermore, no account was taken of the practice of regulation of leasing relations in the laws of West-European countries. The Law on Leasing strongly upsets the balance in favour of the lessor, while the rent and sales law of Georgia provides for equal rights for both parties. Hence, the apparent violation of consumer rights in the Law on Leasing contradicts the civil law. Due to this reason the Law is incompatible with other provisions of the Civil Code from the systemic point of view. It ignores the basic principles of contract law, and thus is contradictory to the Civil Code;

Chapter 4 and Chapter 5 contain several principles that derive already from general provisions.

It is unclear what good the Law on Leasing can do. In nearly all western countries, the internationally accepted general principles of leasing derive from Civil Code rules. In Georgia, they are already in force by virtue of Article 576 of the Civil Code and subsequent articles. Thus the legal framework is comprehensive and meets the modern requirements of the economic relations.

The new codification, more advanced than the already regulated provisions would be useful only in case of detailed regulation of the leasing law with due consideration of economic interests and filling up the general rules, which are not comprehensively regulated by rent law from the point of view of leasing relations. This did not happen. Non-systemic Law on Leasing complicates the already existing legal framework. The Law limits legal opportunities. Internationally acknowledged types of leasing become even inadmissible by virtue of this legal Act. Georgia thus disassociates itself from internationally acknowledged principles. This piece of legislation is a drawback within the context of Georgian law and international commercial practice.

And finally, it is not clear why the rights of the lessee should be limited to such extent that would be inadmissible according to EU standards. The Law unilaterally serves the interests of large, mainly foreign lessors at the expense of Georgian consumers.

Against the background of already existing provisions in the Civil Code, this new law is pointless. It is detrimental for legal clarity and impedes functional leasing economic relations. One hopes the law will be reviewed as soon as possible, or simply nullified.