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PREPARATION OF A  
MODEL LAW ON LEASING  
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### **PRELIMINARY DRAFT MODEL LAW ON LEASING**

*(prepared by the Reporter on the basis of the guidelines provided by the Advisory Board  
at its first session (Rome, 17 October 2005)):*

#### **COMMENTS**

by Mr Bey, Dr Castillo-Triana, Leaseurope, Ms Normantovitch, Professor Shi and Mr Sultanov,  
members of the Advisory Board

#### **COMMENTS OF MR BEY**

##### *Brief comments*<sup>1</sup>

Generally, I would suggest, as to form, that the text be presented in a more concentrated and logical manner. For example, Article 27, entitled “Rejection of non-conforming delivery”, deals in the first place with those situations where the equipment is not delivered, which concerns non-performance of the duty in question and in no way imperfect performance of the same. Moreover, there is a latent contradiction in the text, in that it provides (a) that “[w]hen the equipment is not delivered . . . the lessee has the right to accept the equipment, to reject the equipment . . .”. How can one, at the same time, ascertain non-delivery of equipment and accept or reject it? In truth, the text is concerned with late or non-conforming delivery. Its translation could be improved. It would even be a good idea to split it up so as only to keep in this part (Chapter V) the grounds for termination, the subject-matter of this part, and move the rest to Article 17, which deals specifically with rejecting equipment in the circumstances provided for in Article 27. . . .

As to substance, I would suggest deleting all that needlessly invokes the common law, the rules of interpretation, . . . so as only to keep what is specific to the subject being dealt with. It would therefore seem useful to me to delete Articles 4, 5, 6 and 7 and thus the entirety of Chapter II. Besides, I fail to see how the interpretation of a contract (Article 5) can concern the formation thereof (Chapter II, Formation).

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<sup>1</sup> *Note by the Secretariat:* In his accompanying letter Mr Bey suggested that it was possible that some of his comments might have their root in a free translation of the original English-language version of the preliminary draft model law.

The “documentation” required in Article 6 of Chapter II (Formation) should be limited to the requirement of a written record. This provision, moreover, may be linked to Article 3 (Freedom of contract). It is furthermore to be noted that Article 6(3) is ambiguous. Who, indeed, is to “determin[e] what provision to supply” and who is to consider the intention of the parties . . . ? Is this the judge dealing with the contract? If so, he would be a party to the contract, which is not possible!

Is there also any point in keeping Article 8 (Enforceability), which is a question of general principles of contract law and specific areas of the law (bankruptcy law . . . )?

I would suggest reworking our text, starting from the Ottawa Convention, which represents the synthesis of the Institute’s work in this area, some major European laws relating to this area and practice (which is faced with the specific problems of bailment and financial leasing . . . ).

It seems likewise necessary to me that we do not lose sight of the fact that bailment is a commonplace institution and that therefore only those matters specific to the bailment of equipment should be dealt with in the model law by distinguishing mandatory provisions, thus not capable of being derogated from, from provisions subject to the will of the parties. Moreover, this principle should be extended to the model law in general. It has certainly been done regarding liquidated damages (Article 25). But is one to conclude that all provisions of the model law which are not expressly or impliedly mandatory are subject to the will of the parties? It would seem to me useful that the model law enumerate those provisions that are not intended to be subject to derogation!

A detailed reading of the preliminary draft leads me to note, concerning sphere of application (**Article 1**), that a “transaction” may not legally “create . . . a lease”. A transaction is made up of a collection of interdependent contracts for the realisation of the objective pursued. To my knowledge, the term transaction is not legally defined, even if certain laws, as in France for the banking law, the law on financial leasing . . . , use it without giving it, in law, any definition. Bailment is accordingly one of the contracts making up the leasing transaction, which is not, however, limited to just this one contract. In this regard, it is to be noted that the preliminary draft only deals with the sale contract (supply agreement) incidentally, whereas this is an important contract in the overall financial leasing transaction. The explanation for this difference in treatment lies, to my opinion, in the methodology initially chosen, consisting in treating together the bailment of equipment, which is finally a commonplace institution, and financial leasing, whereas they could have been dealt with separately in the interest of greater clarity.

The term “within [the State]” covers national territory. To make the applicability of the law dependent on “the transaction”, by a provision of the leasing agreement, comes up against the rule of privity of contract, in that the sale contract is *ipso jure* subject to that rule. Now, this is of some interest to the supplier, as a third party to the leasing agreement. Of course, the law may do anything it wants to, but is it necessary to envisage a situation the useful effect of which concerns international leasing contracts subject to the private international law of States? Generally, the drafting of this Article, the importance of which is incontestable, could be improved.

Regarding **Article 2** (Definitions), is not the “individual” (a propos of the “[c]entre of main interests”) none other than the natural business person as opposed to the legal person revealed by its registered (company) office?

I would suggest deleting “[d]efault . . . Article 22” or else all the important words should be defined.

Personal property is defined by its tangible or intangible character but not by its purpose, which here is essential, as it is determinative of the sphere of application of the law. Equipment is indeed personal property . . . , but for a commercial, professional, or service-oriented use . . . , which would exclude goods for domestic use. In my opinion, a definition must be complete.

In this regard, are we envisaging “the unborn young of animals” being leased or made the subject of financial leasing arrangements??!! I would note that the question of the financial leasing of “productive” animals, such as horses and milk-yielding cows, has arisen in some countries. Company managers have envisaged financing football players or having them financed by financial leasing! It seems to me very important to take another look at the definition of the term “equipment”, bearing in mind that in professional terminology it is used as a synonym of professional equipment.

I would note that in the definition of financial leasing (b) “the lessor acquires the equipment”, which would imply that the sale contract (supply agreement) is a constitutive element of the “transaction” (see above) in the same way as the leasing agreement.

The “right to possess and use the equipment” means, to my mind and logically, the right to “hold” and exploit (?) this equipment, the term “to possess” not being taken in the sense that it has under certain legal systems, that is the *de facto* exercise of a right *in rem* over a tangible object as opposed to holding, which recognises the right of someone else. In this intellection, which legal transaction is envisaged by the words “the lessor acquires . . . the right to possess and use the equipment in connection with the lease or a previous lease, and the supplier is so notified”? This provision is very important insofar as it is definitional of financial leasing.

Moreover, the lessee’s option to purchase the equipment is ignored as a definitional ingredient of financial leasing by the preliminary draft, even though Article 21(2) provides expressly that “[w]hen the leasing agreement comes to an end the lessee, unless exercising a right to buy the equipment or to hold the equipment on lease for a further period, shall return the equipment to the lessor . . . .” It is to be noted that certain legal systems treat the purchase option as a definitional ingredient of financial leasing and that, in practice, many international contracts give the lessee this option so long as the law governing freedom of contract does not prohibit it.

Sub-paragraph (d) seems to me, at the very least, excessive once financial leasing is reserved to professional parties and thus consumers are excluded from its sphere of application and once it is the lessee that freely chooses his supplier.

A lease is not a “transaction” but a contract. It may not consist in the “control” of equipment “granted” by the lessor to the lessee “for use . . . .”. In many legal systems what is involved is the lessor’s undertaking to procure for his co-contractant, the lessee, the enjoyment of the defined asset for a period of time and against the payment of an agreed price, called the rental. Furthermore, the counterpart for the enjoyment of the leased asset being the payment of a rental, the alternative provided for in the preliminary draft “or other funds payable” seems to me unsuitable and to raise questions as to its meaning.

Besides, in law, so as to avoid any unfortunate confusion, “the term (lease) includes (in reality, it cannot include) a sub-lease”, in that here we are talking about two distinct, albeit, in certain respects, related contracts.

The same thought arises in respect of “lessee” and “lessor”. In “supplier” does the term “... or leases equipment to be leased under a financial lease” cover the case of *crédit-bail adossé*?<sup>2</sup>

As regards “freedom of contract” in **Article 3**, it is appropriate to be mindful of the fact that the model law is designed to be for domestic use. As a result, the words “and the law of [this State]” are inappropriate. “Freedom of contract” only has any sense in relation to the mandatory provisions that it is advisable to enumerate. In the international field, it may be chosen as the law governing freedom of contract.

Given that any contract is binding on the parties thereto and its enforceability only makes sense with regard to third parties, the provision in **Article 8** whereby “a leasing agreement is effective and enforceable according to its terms between the parties” is a pleonasm. Likewise, it appears to me superfluous to add that it is enforceable “against purchasers of the equipment” except to specify that the lessor in a financial lease and the lessor for the purposes of the present law have the option to assign the equipment leased, during the contract, without prejudicing the rights of the lessee. The leasing agreement is also enforceable against creditors and the “insolvency administrator” (court-appointed administrator, bankruptcy trustee, liquidator . . . ) except where there is fraud. Article 8, insofar as it is not specific to the subject being dealt with and involves a rule of common law, is a pleonasm.

**Article 9** on the transfer of the “leasing” agreement fails to take account, as indicated by the heading to this Article, of the transfer of the equipment during the term of the lease (see above).

Neither does the preliminary draft deal with the purchase option, which it fails to take account of as a definitional ingredient of financial leasing (above) but which is implicitly referred to in Article 22(2).

In Article 9(1), it seems to me that it is necessary for the lessor to inform the lessee of the transfer envisaged with the information necessary for him to be able to preserve his rights. Failing that, it would be necessary to strike down a transfer that contravened his rights as unenforceable (against him).

In **Article 10(1)(a)**, the term “promises” is extremely imprecise. Articles 10(1)(a) and 10(1)(b), on the one hand, and 10(1)(c), on the other, conceal an important contradiction in that the former extend the benefit “of the promises and . . . warranties” under the supply agreement to the lessee by the effect of the law, whereas the latter subjects the parties to the duty of creating a “contract[ual link] between the lessee and supplier”, the “absence” of which triggers the liability of the lessor in accordance with this text! In my opinion, the law should leave it to the supplier and the purchaser/lessor to organise the implementation of the right thus created by it in favour of the lessee. It cannot at one and the same time create this right by its will (the law) and leave it to the parties to create by their will (the contract) the same right!

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<sup>2</sup> *Note by the Secretariat:* In his and Professor Christian Gavalda's “*Le crédit-bail mobilier*” (published in 1981 in the *que sais-je* series by the Presses universitaires de France), Mr Bey described *crédit-bail adossé* in the following terms:

“In *crédit-bail adossé* the supplier sells equipment produced by it to a financial institution with the obligation for the latter to lease it back to it under a financial lease with the option to sub-lease.”

Moreover, given that the lessee under a finance lease derives his right from the law and, in line with practice, has freely chosen the equipment and his supplier without any intervention by the lessor or following a non-“primar[y]” (Article 2) reliance on the skill and judgment of the latter, there is no basis for the said lessor to be liable. It therefore seems to me that Article 10(1)(a), (b) and (c) would gain from being looked at afresh.

Article 10(3), to my mind, goes beyond the provisions of Article 10(1)(a) and (b), which limit the right of the lessee to the benefit of promises and warranties under the supply agreement. It does not make him a co-contractant of the supplier. He remains a third party in relation to this supply agreement as regards the other provisions thereof. In this intellection he cannot dispose of prerogatives attached to the capacity of a co-contractant, such as “the right to modify, terminate or rescind the supply agreement”. This is where the common law should take over again.

The law may, doubtless, provide otherwise. But in this case it would pay to envisage the situation in detail and to determine the legal consequences, including those underlying the financial consequences, thereof with regard to the three protagonists, the supplier, the lessor under a finance lease and the lessee under a finance lease.

**Article 11** would gain from being redrafted. It envisages complex situations the treatment of which is not uniform in all countries. Perhaps it would be more prudent to refer the question to the common law, subject to some rearranging to take account of the legitimate rights of the interested parties.

**Article 12** bears a heading “[o]ther laws” which is not particularly felicitous. Without saying as much, it deals with the giving of public notice of “the lease”. Does it exclude financial leasing? Does it limit these formal requirements simply to “registration” of the lease? Does it, *a contrario*, exclude other modes of giving public notice?

**Article 14**(2) and (3) raise several questions.

It would not appear opportune to refer to the insurance of the equipment and the extent of the coverage, which are usually matters left to freedom of contract and given that the preliminary draft has disregarded this situation hitherto. Moreover, how is it possible that the lessor can be made to bear the risk of loss in respect of equipment which is in the custody of the lessee? The same is true of the supplier under a financial lease, where the point is more relevant since this risk remains with the supplier “from the beginning”, whereas the equipment is delivered to the lessee under a financial lease (performance of the duty of delivery). More specifically, are we covering loss of the equipment in the sense of the adages *res perit creditori*, *res perit debitori* and *res perit domino*?

Given that under a classic lease the rental is the counterpart of quiet enjoyment of the asset leased, it would seem to me more logical to tie the reduction in rentals envisaged in **Article 15**(b) not to the depreciation of the equipment consequential upon the “partial” loss considered but to the degree to which the lessee’s enjoyment is impaired as a result thereof, which corresponds to the loss sustained.

Moreover, the use of the term “with due allowance from the rentals payable . . .” at a time when the equipment is not yet delivered would necessarily imply that the lessee has paid some rentals in advance – prepaid rentals. Are they concerned by this reduction even though the text does not say so?

What is to be understood by “independent” duties in **Article 16**? Is this meant to refer to those duties indivisible by the will of the parties which is without effect at that time?

In **Article 17(2)** it seems to me more legal to replace “non-conformity” by the “unfitness of the equipment”, which is linked to the type of user. This is, moreover, what principally interests the lessee, especially if he does not have a purchase option. Furthermore, the defects constituting the unfitness often only appear with such user. Finally, equipment may conform to the order and, consequently be accepted by the lessee, while concealing, notwithstanding what is therefore such apparent conformity, latent or hidden defects rendering it unfit for the user for which it is intended. The situation is, of course, quite clear and simple where the defects are apparent, that is, immediately or easily discernible. To my mind, it is in this last case that the “non-conformity” of the preliminary draft is useful.

In the state of the text, we need to bear in mind that acceptance of the equipment by the lessee may also be the result of fraudulent or unfair action by the supplier.

In its current state, **Article 17(2)** needs to be brought closer to Article 19(2) and (3) dealing with the “warranty of merchantability” of the equipment.

**Article 20(1) and (2)** (“[w]arranty of fitness for a particular purpose”) would gain from being redrafted so as to avoid the legal uncertainties of subjective situations.

In **Article 21**, does the reference, regarding use of the equipment, to it being used “reasonably in the light of the manner in which such equipment is ordinarily used . . .” displace the relevant technical instructions of the manufacturer and the supplier? Now, these are legally essential. It seems to me that it is necessary to make it a duty incumbent on the lessee to use the equipment in conformity with the technical instructions of the manufacturer and/or supplier, whom he declares to have knowledge of through having received the relevant documentation. Failing such user, . . . he shall use it “reasonably. . .”

I would suggest treating in this same Article, but with a broadened heading, the preservation of the lessor’s rights of ownership over the equipment: prohibition on exchange, loan, . . . but with authorisation of sub-leasing, . . .

Article 21(2) deals with the acquisition of equipment by the lessee without one knowing whether it is pursuant to the raising of a purchase option at the end of, or during the lease or if it is negotiated at the end of the lease. We would observe that the purchase option is a substantial feature of leasing in many laws.

The French heading of Chapter V “*inexécution*”<sup>3</sup> is too restrictive to the extent that it treats both of non-performance and “default” by the lessee (**Article 23 et seq.**). In practice, the lessee breaches his contract and is contractually “in default” when he fails to perform his contract or performs it imperfectly, thus prejudicing the rights of the lessor. I would therefore propose to define “default” as imperfect performance of the contract. For both non-performance and imperfect performance put the lessee contractually in default (*code Napoléon* . . .). The simplest solution would be to refer the qualification in question to the common law of the contract of the State enacting the law.

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<sup>3</sup>

*Note by the Secretariat:* It would seem that this comment is peculiar to the French text.

I would suggest inverting the proposal contained in Article 23 and providing for notice to the lessee that he is in default and may cure such default within the time agreed or fixed by the law. This is the principal virtue of giving formal notice.

In **Article 24** default should have the same meaning as that which may be adopted if my previous comments are accepted (Article 22). I would suggest replacing the word "*percevoir*" in the French text <sup>4</sup> by "*bénéficiaire*" and adding the word "judicial" (as opposed to "liquidated" damages in the following Article) to the word "damages" both in the heading to, and the body of the text.

The drafting of **Article 25** would not seem to me to be very felicitous. The validity of the leasing agreement cannot, in fact, depend on the validity of a liquidated damages clause. Furthermore, the problem dealt with does not relate to the manner in which damages are calculated but to the amount of these. The clause considered being a penalty clause, prohibited under the law of some countries, maintaining Article 25 in its present drafting would result in the invalidity of the leasing agreement through the mere fact that it contains such a clause. The same sanction would, besides, be visited on the same lease for the same reason even if the penalty clause was enshrined in the law of the country in question, in the current state of the text at issue.

In **Article 26(1)** I would propose making termination of the contract for "default" by one of the parties subject to the giving of prior notice (above). The reason for Article 26(3) disappears if the idea of the giving of notice is accepted, bearing in mind that the "notice" that would be covered by such notice need not necessarily have the meaning that it has in the judicial procedure of some countries (court official serving process . . . ).

In **Article 27(1)(a)** to write "[w]hen the equipment is not delivered . . . , the lessee has the right to accept the equipment, to reject the equipment . . . " is to introduce an evident contradiction into the text. I would suggest that the termination provided for should only occur after notice is given to deliver unless it is impossible to do so. In Article 27(2)(b) it would seem to me more legal to replace the words "reasonable sum for" by "reasonable sum corresponding to". In Article 27(2)(c) the lessee should guarantee that he will keep the equipment concerned until such time as it is returned by the same lessee or is removed by the lessor or the supplier, and this at the expense of the lessor or the supplier, according to the case (to be defined). The costs would be those incidental to such custody and returning of the equipment (insurance, transport, . . . ).

In **Article 28(1)** the removal of the equipment may not take place "upon termination of the leasing agreement" but after such termination (subsequently thereto).

In Article 28(2) the lessor can only dispose of his equipment subject to those contractual provisions safeguarding the interests of the lessee such as those granting him the right to introduce a new lessee or a purchaser to the lessor. . .

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<sup>4</sup>

*Note by the Secretariat:* Again, it would seem that this comment is peculiar to the French text.

## COMMENTS OF DR CASTILLO-TRIANA

I took the liberty to insert some suggested changes to the Preliminary Draft (Attached hereto with changes highlighted in red). It is my intention that these insertions will open a constructive discussion regarding the main issues that in my humble opinion, we will need to discuss in depth in the Second Session. Here is a summary of the main issues:

1. Expand the **definition of Equipment** to include plant, property (including infrastructure works) and software. My rationale for including such concepts is the following:
  - a. Developing countries (and this does not hurt developed countries at all) need allocation of resources to develop a valuable infrastructure. Since the general tendency in public finances demonstrate the increasing inability of the public budget to fully finance such projects, the markets have demonstrated an ability to pool resources for infrastructure. However, the legal structure of infrastructure financing is far from perfect: There is no asset based financing mechanism, and the creation of Special Purpose Vehicles turns to be very expensive, complicated and risky. A Model Law of Leasing should overcome such limitations bringing a legal definition of a legal vehicle whereby capital investment can be funneled and the rights and remedies of the parties involved in such ventures, should have a predictable and reliable legal framework;
  - b. The world is progressing around the deployment of software (The growth of global interdependence has been fueled by the PC becoming an essential household and business device, enhanced by the Windows, internet, open systems and further technological advances). Intellectual Property protection which is key to achieving such development, can only be made compatible to open access to an increasing number of people, if software financing is permitted through an asset based financing mechanism. Again, leasing demonstrates to be the best fitted legal structure, such as the Argentine Law of 2000 expressly acknowledged.
2. Since Equipment is a capitalized (defined term), I suggest to capitalize it throughout the whole text;
3. I suggest including a **definition of Operating Leasing**, which is missing in the Model Law. Without such explicit definition, the concept may turn out to be a residual concept (Everything except such transactions defined as Finance Leases), leading to confusion and impairing the development of a sophisticated and professional leasing industry within each country. Bringing a definition of Operating Leases contributes to lead to the application of best practices of leasing in the countries adopting the Model Law;
4. For the purposes of **enforceability** (Art.8), I suggest to include a provision in line with the Cape Town Convention aim and principles if, at a local level, the concept of registration is extended and really implemented (Again the Argentine leasing law created a registration system that proves to be very effective). I recognize that the issue is highly debatable as the World Bank can witness for the failed efforts to implement such Cape Town types of registration on mobile or personal property, but I believe that it is worthwhile to persist with this purpose;



5. **Article 13** needs to be further expanded at least to differentiate lessor liability (i) towards lessee from lessor liability towards (ii) third parties. In the first scenario, it is clear that the current formulation of article 13 makes sense. But regarding third parties, the Model Law will need to deal with issues of “vicarious liability”, or *responsabilité objective* included in the applicable Statute Law, and the principle I suggest is that such risk must be borne by the person who operates the equipment rather than by its legal owner. It may happen in some instances (for example in point of car fleet leasing products) that lessor could be operating the equipment, while in the vast majority of cases, the operator of the equipment is the lessee. Equity imposes that the risk of third party liability must be borne by whoever operates the equipment;
6. In **article 16**, I am suggesting assigning to the “Delivery and Acceptance” certificate or D&A the value that it has in the prevailing contract practice, namely, the supplier is not out of the loop and the deal is not funded, until the lessee is satisfied with the Equipment. Keeping the formulations of rejections that derive from the 1980 Vienna Convention on International Sales Agreements are not offensive, but I must say that rather obsolete in the real world.
7. In **article 19**, I suggest defining the term “merchant” as it concerns to lessor. The context of the article leads to think that such “merchant” shall be someone having close links with the equipment manufacturer (such as a captive company) and has the ability to handle equipment inventory in a timely and reliable form. Merchant has different meanings in different English speaking countries, not to mention the wide meaning it may have in the translated versions in French and Spanish, among other.

[...] As you can see, I agree in some very key and fundamental formulations you included (such as the definition of rentals, which leads to the “hell or high-water” concept, the definition of damages, assignability, which facilitates syndication and securitizations, etc.).

*[Note by the Secretariat: In addition to capitalising all references to “Equipment”, Dr Castillo-Triana offered the following comments and proposed revisions directly to the text. Dr Castillo-Triana’s proposed additions are marked with underscores; his proposed deletions are marked with strikes.]*

## CHAPTER I: GENERAL PROVISIONS

### Article 1 Sphere of application

This Law applies to any transaction that creates a lease of equipment, plant or property (collectively “Equipment”) if ~~the~~ such equipment, plant or capital goods are ~~is~~ within [the State], or the lessee’s centre of main interests is within [the State], or the leasing agreement provides that [the State’s] law governs the transaction.

*Source: Uniform Commercial Code of the United States of America (hereinafter referred to as “U.C.C.”) § 2A-102 (2003), supplemented to specify the Law’s geographic sphere of application; UNIDROIT Convention on International Financial Leasing, Art. 1(1)(a)*

## Article 2 Definitions

In this Law:

...

**Equipment** means all personal property that is movable or that is a fixture, including future equipment, specially manufactured equipment, and the unborn young of animals, plant, capital goods, including infrastructure projects, software and other tangible and intangible capital goods. The term does not include information, money, investment securities, ~~or software except to the extent that the software is so embedded in equipment as to become part of the equipment, but n.~~ No Equipment shall cease to be equipment for the sole reason that it becomes attached or fixed to real estate.

*Source: U.C.C. § 2A-103(1)(n) (2003), ~~modified to exclude software;~~ Article 11 GATT Agreement on Trade Related Aspects of Intellectual Property Rights (the "TRIPS" Agreement)*

...

**Operating Lease** means a Lease whereby Lessor retains all economic risks and rewards of the secondary market, Fair Market Value of the Equipment, and does not transfer such risks or rewards to Lessee.

...

## CHAPTER II: EFFECT OF LEASING AGREEMENT

### Article 8 Enforceability

Except as otherwise provided in this Law, a leasing agreement is effective and enforceable according to its terms between the parties, against purchasers of the Equipment and against creditors of the parties, including an insolvency administrator.

For the purposes of this article, a public recording of a lease shall produce the effect of full evidence and shall enable Lessor to repossess the Equipment wherever such Equipment is located, and without need of any further evidence. Lessee shall be entitled to recover such repossessed Equipment provided that it proves to be current in all its obligations under the Lease.

*Source: U.C.C. § 2A-301 (2003), modified to include reference to insolvency administrator. UCC-9 and Cape Town Convention.*

...

### Article 13 Liability for death, personal injury, or property damage caused to third parties

1. In a financial lease, the lessor shall not, in its capacity of lessor, be liable to the lessee or third parties for death, personal injury, or damage to property caused by the Equipment or the use of the Equipment. ~~unless~~

2. However, liability of the lessor towards lessee shall be assessed to the extent such lessor was involved in selecting the supplier or the Equipment, in which case the lessor shall be liable to the extent of that involvement.

3. In connection with liability of lessor towards third parties, such liability shall be only assessed to the extent that lessor is directly involved in the operation of the Equipment.

#### **Article 14 Risk of loss**

1. Except in a financial lease, or as the parties freely agree, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a financial lease, risk of loss passes to the lessee.

...

#### **Article 16 Irrevocability**

1. In a financial lease, the lessee's duties to the lessor become irrevocable and independent when the leasing agreement and supply agreement have been created and the lessee has acknowledged delivery and acceptance of the Equipment.

...

#### **Article 19 Warranty of merchantability**

1. Except in a financial lease, a warranty that the Equipment will be merchantable is implied in a leasing agreement if the lessor is a merchant with respect to equipment of that kind.

2. In a financial lease, a warranty that the Equipment will be merchantable is implied in a supply agreement if the supplier is a merchant with respect to equipment of that kind.

*Comment of Dr Castillo-Triana: The term "merchant" must be defined. It can be understood as a permanent dedication to the business of buying and selling the same kind of equipment on an on-going basis.*

...

## COMMENTS OF LEASEUROPE

**Note by the Secretariat:** *Leaseurope's comments were prepared on the basis of the model law's preliminary draft, UNIDROIT 2005 Study LIXA-Doc. 3, as well as on the summary report of the Advisory Board's first session (UNIDROIT 2005, Study LIXA-Doc. 2).*

### General consideration

- It seems that this model law regulates “lease” more than “Financial lease”. **“Financial lease”** is considered more as an exception (i.e. *Art. 14 – Risk of loss 1. Except in a financial lease, risk of loss... Art. 15 – Damage to equipment Except in a financial lease, when equipment...Art.19 Warranty of merchantability – 1.Except in a financial lease, a warranty...Art. 20 – Warranty of fitness for a particular purpose 1. Except in a financial lease, if the lessor...*), but in many EU countries “Financial lease” is the form of leasing most widely used. Furthermore “lease” as such should already be regulated by its own rules in every country and it seems to be missing what this law should add.
- Resolution of the contract should be regulated more in deep.

### Definitions

- In many EU countries “Financial lease” is an activity “reserved” to leasing companies subject to supervision by National Authorities. No mention of the “lessor” as a financial company/bank regulated by the Authorities is included in the preliminary draft; on the contrary, the draft (Article 2 – Definitions) just refers to the **lessor** as a “person”. A similar issue could be raised for the lessee definition: as far as the lessee is concerned, it's not clear if in this term it has to be included also an enterprise – the natural party of the leasing contract – and we believe that the word “person” could lead to a misunderstanding about the consumer credit regulations, which should be peculiar and different.
- The definition of **“financial leases”** doesn't include an end-of-term purchase option (included in the UNIDROIT Convention on International Financial Leasing instead) that is essential to distinguish “Financial leases” from “operational leases” for contracts within continental law countries.
- In both civil and common law countries in a financial lease all the risks pass to the lessee, but in the definitions nothing is said about that.
- We doubt as to the appropriateness of excluding real estate and software leases.
- Since counter-productive experience was reported in some EU countries, we wonder about the reasons behind the need for a “model law”.

### Art. 16 – irrevocability

- We found the interpretation of this article quite difficult: we don't understand what the lessee's duties become independent from.

**Uniform Commercial Code of the United States**

- In an European environment Leaseurope does not support the reference made to a US standard (in Study LIXA-Doc.2 p.4) of the Uniform Commercial Code of the United States.

**Accountancy Practices**

- Leaseurope believes that such an initiative will hardly avoid some form of impact on the accountancy practices.

## COMMENTS OF MS NORMANTOVITCH

*[Note by the Secretariat: Ms Normantovitch's comments on the underscored portions of the text are indicated below.]*

...

### Article 2 Definitions

...

**Lease** means a transaction in which a person grants a right to possession or control of equipment to another person for use in trade or business for a term in return for rentals or other funds payable. Unless the context indicates otherwise, the term includes a sub-lease.

*Comment of Ms Normantovitch: It will be advisable to avoid the reference to the right of "control" in the definition of "lease". There is not any reference to the right of "control" anywhere in this document, except this paragraph. In our opinion, such a reference can only make it uncertain what scope of rights is granted under a lease. It should be clarified that making a lease transaction unambiguously means granting the right to possession and use of equipment.*

...

### Article 9 Transfer

1. The lessor's rights and duties under the leasing agreement may be transferred except when a transfer would impair the lessee's rights in the equipment.

*Comment of Ms Normantovitch: In our opinion, there should be no limits on the lessor's ability to transfer its rights and duties under the leasing agreement. The criteria of non-impairing of the lessee's rights seem to be vague. What exactly should prevent the lessor from transferring of its rights and duties? In case the lessor decides to transfer, who is supposed to decide whether the transfer would impair the lessee's rights in the equipment or not? At the same time, the lessee should be provided with remedies to be applied if the lessee's rights in the equipment have been impaired due to the transferring of the lessor's rights and duties under the leasing agreement.*

2. The lessee's rights and duties under the leasing agreement may be transferred only (a) with the consent of the lessor, which may not be unreasonably withheld, and (b) subject to the rights of third parties. The lessor and third parties may give their consent in advance.

*Comment of Ms Normantovitch: Does the reference to the rule that the lessor can't unreasonably withhold its consent mean that the lessor should somehow fix the reasons to withhold so they could be examined later? We suppose that each case of withholding the consent to transferring the lessee's rights and duties is subject to a separate detailed examination, so, such a reference can hardly prevent any abuse of the right to give a consent.*

3. A transfer that is prohibited is otherwise effective if made to one who did not know and reasonably should not have known that the transfer was prohibited.

*Comment of Ms Normantovitch: In our opinion, this clause may provide the field to abuse. Making a transfer of the lessee's rights and duties prohibited indicates the lessor's intent to keep the relations under the leasing agreement with the determined lessee only. Buying the equipment that is supposed to be used by another person may be connected with checking the financial results of the activity of that person in order to be sure that the person will afford paying rentals. In case the lessee's rights and duties are to be transferred, the lessor may withhold its consent having no intent to deal with a new lessee. But if the new lessee insists on having no idea that a transfer was prohibited, the lessor will be faced with the problem that such a transfer is nevertheless effective and so, the lessor has to deal with the new lessee.*

#### **Article 10 Lessee under financial lease as beneficiary of supply agreement**

...

1. (c) Where the absence of privity of contract between the lessee and supplier creates a deficiency in the lessee's efforts to enforce the supplier's promises or warranties against the supplier, the lessor shall be bound to take commercially reasonable steps to assist the lessee. If the lessor does not take such steps, the lessor is deemed to have assumed such promises and warranties.

*Comment of Ms Normantovitch: No doubt, what seems to be commercially unreasonable to the lessor, may be taken as a reasonable step by the lessee. It doesn't give rise to enthusiasm, taking into account the consequences of non-observing the rule to take those steps to assist the lessee.*

2. The lessee's rights under this Article shall not be affected by a variation of any term of the supply agreement unless the lessee consented to that variation. If the lessee did not consent to such variation, then the lessor is deemed to have assumed the promises and warranties of the supplier to the lessor that were so varied to the extent of the variation.

*Comment of Ms Normantovitch: In case the lessee has previously consented the terms of the supply agreement, no doubt that the lessee's consent to a variation of those terms is required. If the consent hasn't appeared, the terms of the supply agreement can be changed without the lessee's consent.*

...

#### **Article 13 Liability for death, personal injury, or property damage**

##### **caused to third parties**

In a financial lease, the lessor shall not, in its capacity of lessor, be liable to the lessee or third parties for death, personal injury, or damage to property caused by the equipment or the use of the equipment, unless the lessor was involved in selecting the supplier or the equipment, in which case the lessor shall be liable to the extent of that involvement.

*Comment of Ms Normantovitch: In our opinion, when the lessor is involved in selecting the supplier or the equipment, the cases of causing death, personal injury or damage to property to the lessee or third parties should be treated differently. There is no doubt, that the lessor is liable*

to the extent of that involvement. But in case the lessee is the suffering party, the liability is imposed right on the lessor. In all other cases, when injures or damages are suffered by third parties, the lessee becomes liable to them as the one who uses the equipment. But then the lessee should be provided with the right to regress to the lessor.

...

### **Article 17 Acceptance**

...

2. Once a lessee has accepted equipment, the lessee may still be entitled to damages for any non-conformity, but the lessee may reject the equipment under Article 27 only if the non-conformity substantially impairs the value of the equipment and either (a) the lessee accepted the equipment without knowledge of the non-conformity, owing to the difficulty of discovering it, or (b) the lessee's acceptance was induced by the lessor's or supplier's assurances.

*Comment of Ms Normantovitch: We find it necessary to mention that in case the lessee selects the supplier and/or the equipment, the lessee should have no right to reject the equipment once it has been accepted by the lessee. Those are negative consequences which the lessee has to suffer due to the selection the lessee made. No doubt that the lessee may enforce the supplier's promises or warranties against the supplier, including the right to ask for a compensation for the lessee's losses arisen as a result of the equipment's non-conformity.*

...

### **Article 27 Rejection of non-conforming delivery**

1. (a) When the equipment is not delivered or is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the equipment, to reject the equipment in whole or in part, or, in a lease other than a financial lease, and subject to paragraph 1 of this Article, Article 22 and Article 26(1), to terminate the leasing agreement.

*Comment of Ms Normantovitch: There is one interesting problem that derives from the rejection of the equipment in part. Some countries know the principle of indivisibility of the subject to lease under a one leasing agreement. It means that the equipment can be leased only in a unity of its parts mentioned in a specification that is attached to the lease agreement. So, when the equipment can be accepted only in part due to its non-conformity or if some parts of the equipment are failed to be delivered, or are delivered late, and the lessee rejects to accept such a part, should it be allowed to lease the accepted part of the equipment? It's especially important to know in case the time for performance has expired or the non-conforming part of the equipment can't be replaced by a new one due to some other reasons.*

...



## **COMMENTS OF PROFESSOR SHI**

### **1. How are we going to set the objective of our draft law?**

The objective of the draft law could be considered in the narrow sense or the broad one, based on the development of the leasing industry.

If it takes the narrow sense, it should only concentrate on the rights and obligations of the parties in a domestic financial leasing transaction.

If it takes the broad sense, it should concentrate on the legal framework of the leasing industry, which contains not only the law on rights and obligations, but also the regulations and laws on the accounting treatment, taxation, and supervision relating to a leasing transaction. On the other hand, the legal framework can be classified into private laws and public laws. Of course, each type of laws has its own legislative objective.<sup>1</sup>

According to such philosophy, the first draft itself falls mainly into the narrow sense, the scope of private law; but it contains one or two clauses on supervision, a kind of public law. Such arrangement is not logical enough, given the legal frameworks for leasing industry.

So here a question arises. How are we going to set the objective of our drafting law?

Recalling the leasing practice worldwide, the successful development of a leasing industry not only needs each of the four aspects of the legal framework in leasing industry to be well designed, but it also needs the four aspects' harmony. As a contrary example, the unsuccessful development of China's leasing industry is mainly attributed to the lack of well-designed tax treatment for leasing transaction and the proper regulation for the lessors, as well as the aspects' lack of harmony. That has kept China's leasing industry at the bottom, even after China legislated an independent chapter for Financial Leasing in its Contract Law.

Therefore, I suggest that we just focus on the rights and obligations of the leasing transaction for our drafting law. Meanwhile, we can also recommend a report, as an attachment to our MODEL LAW ON LEASING. The only disadvantage in such arrangement is that the report on legal framework for leasing industry will go beyond the research area of UNIDROIT.

### **2. Comments on the terms "Financial lease" and "lease"**

(1) **The purpose of definition.** Making a definition on the transaction at the very beginning of the proposed draft serves the purpose of setting up a foundation for all the components of this law. All the rights and obligations we should formulate will arise from its relationship to the civil and commercial law aspects. Understanding the purpose of the definition will let us know its importance and provide for us the philosophy for formulating the particular rules.

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<sup>1</sup> *Note by the Secretariat:* On this point, Professor Shi has provided the slides from a presentation she gave on Preparing the Small and Medium Enterprise Development Program. These slides will be provided to Advisory Board members before the second session.

(2) **Term Selection.** There are several pairs of expressions on lease terms in the lease market, like financial leasing vs rental, finance lease vs operating lease, and so on. Each expression has its definite meaning in practice. Only the term of “financial leasing” is a proper selection for our purpose since this expression covers all kinds of leasing transactions except rental (or traditional lease, or short term lease, or hire). In practice, the term “lease” is generally an abbreviated expression of “financial leasing”. It is a serious mistake to define the two terms, the term of “financial lease” and the one of “lease”, at the same time. It is extremely wrong that we treat the financial lease and the lease as two different types of transaction from the perspective of legislation. Thereafter, the articles about the financial lease and lease are not proper.

(3) **The method of definition.** Listing the characteristics to define the “financial lease” is a good method.

(4) **Characteristics to be included.** In addition to the characteristics in the paragraphs (a) and (b) of the definition of “financial lease” in Article 2, the following should be added:

(i) the lessee leases the equipment from the lessor, and in return pays the rental;

(ii) the lease term should be more than one year. (The purpose of adding this item is to distinguish financial leasing from traditional rental.)

The above characteristics, the (a) (b) and (i) (ii), give us a whole picture about the transaction our law is going to govern. That means that no matter how the parties call it, a transaction would be governed by this law if it meets simultaneously the above four characteristics.

We will find that a lot of articles formulated in the first draft are not proper if we accept the above philosophy of defining the financial leasing transaction.

(5) **Characteristics not to be included.** The paragraphs (c) and (d) of the definition of “financial lease” in of Article 2, should not be included. For Paragraph (c), it is an accounting issue rather than a legal one. For Paragraph (d), almost all the situations described here will not exist in a domestic financial leasing transaction. Simply speaking, the leasing agreement becomes effective only at the time when the lessee signs the Acceptance Certificate. On the other hand, there is no any argument on the equipment between lessee and supplier if the AC has been signed. Or the AC will not be signed if the lessee is not satisfied with the equipment that is supplied. Then the financial leasing agreement will not become effective.

### **3. The understanding of a domestic leasing process and the re-examining of relevant clauses in the draft law**

Simply speaking, a leasing business goes through 3 stages: inception phase, duration phase and termination phase.

For the phase of inception, it follows the following steps:

1. The lessee selects the equipment and the supplier.
2. The lessee presents to the lessor its credit information as well as the information of the equipment and supplier.

3. The lessor investigates the information that the lessee presented. The lessor accepts or refuses it.
4. The purchase agreement is signed by supplier with lessee (general) or lessor. If a deposit is needed, the deposit is, in general, paid by lessee.
5. The supplier delivers the equipment.
6. The lessee checks and adjusts the equipment.
7. The lessee will sign the Acceptance Certificate to the lessor if it accepts the equipment.
8. The lessor will not pay the supplier until it receives the AC, and at that point, the lease agreement will become effective.

Contrasting the above steps, we can find several situations we assumed in the preliminary draft would not exist.

*[Note by the Secretariat: Professor Shi's comments on the underscored portions of the text are indicated below.]*

## Article 2 Definitions

In this Law:

...

**Supplier** means a person from whom a lessor buys or leases equipment to be leased under a financial lease.

*Comment of Professor Shi: It is better to use the word "acquire" to replace "buys" since the word "acquire" covers "buy" but that is not all. It is not adequate to add the word "lease" here. The parties' titles would be lessor and lessee if their relationship were leasing.*

...

## Article 22 Definition of default

...

2. In the absence of agreement, default for the purpose of this Chapter occurs when one party substantially deprives the other party of what it is entitled to expect under the leasing agreement and this Law.

*Comment of Professor Shi: There is a big argument about the phrase "substantial default" when we talk about the Convention on International Leasing worldwide since the word "substantially" relies on the judge's subjectivity too much.*

## COMMENTS OF MR SULTANOV

### I. COMMENTS TO THE DRAFTED ARTICLES

*[Note by the Secretariat: Mr Sultanov's comments on the underscored portions of the text are indicated below.]*

...

#### Article 2 Definitions

In this Law:

...

**Equipment** means all personal property that is movable or that is a fixture, including future equipment, specially manufactured equipment, and the unborn young of animals. The term does not include information, money, investment securities, or software except to the extent that the software is so embedded in equipment as to become part of the equipment, but no equipment shall cease to be equipment for the sole reason that it becomes attached or fixed to real estate.

*Comments of Mr Sultanov:*

1. *The suggestion is to use the term "leased asset" instead of the term "equipment". Albeit the Draft Law defines "equipment" in broad terms, the word itself nevertheless can be interpreted narrowly during translations into local languages.*
2. *Not all movables and fixtures can be leased assets; there shall be limitation that only non – consumable assets can be leased. Definition of non – consumables does exist in many jurisdictions, however in commentaries, explanation can be provided that "non–consumable goods" means the goods which are not destroyed or transferred into another form/condition once used and which retain their original form during the use and depreciate gradually.*

**Financial lease** means a lease that includes the following characteristics:

...

(c) the rentals or other funds payable under the leasing agreement are calculated so as to take into account the amortisation of the whole or a substantial part of the cost of the equipment;

...

*Comment of Mr Sultanov: In clause (c) of the proposed definition of a financial lease it is recommended to apply term "compensation" instead of "amortization". In several former USSR countries chapters which regulate leasing in the Civil Code were primarily based on the Convention which applies term "amortization" as well. "Amortization" was translated as "depreciation" and in the definition of a lease payment<sup>1</sup>, the latter was tied to the norms of depreciation of a leased asset which is incorrect for the following reasons:*

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<sup>1</sup> Lease payments which lessee pays under the lease agreement include the cost of the appropriate part of the depreciation of the leased asset, other expenses incurred by the lessor and lessor's profit. (Belarus legislation)

- 1) *The periodicity and amount of lease payment shall be agreed between the parties and shall not depend on the norms of depreciation;*
- 2) *Depreciation amount is changing depending in revaluation of the fixed assets and the amount of lease payment shall not necessarily be equal to the depreciation amount of the leased asset.*

**Lease** means a transaction in which a person grants a right to possession or control of equipment to another person for use in trade or business for a term in return for rentals or other funds payable. Unless the context indicates otherwise, the term includes a sub-lease.

*Comment of Mr Sultanov: The proposed definition of a lease specifies that the leased asset shall be used only by the lessee to conduct trade and business operations whereas definition of a financial lease does not contain such restriction. In the light of the discussions that for the purposes of the Model Law the leased asset shall be used for conducting commercial activity only, such restriction shall be imposed on both financial lease and lease.*

...

### **CHAPTER III: FORMATION AND DOCUMENTATION OF LEASING AGREEMENT**

*Comment of Mr Sultanov: Whereas the Chapter II provides for a consistent framework with regards to formation and documentation of leasing agreement, such framework may not necessarily be accepted by most of jurisdiction which will be applying the Model Law. In the absence of a written agreement (in many countries in the absence of a written agreement that also includes several essential terms) it will be excessively difficult to enforce such agreement or the agreement will not have legal effect in the first place (general rules of property hire in Civil Codes of several countries require that any agreement in which right of use is transferred to another party (the so called "usufructuary contracts") shall be made in written form). Notions such as "intent of the parties" and "reasonableness" can be hardly incorporated or applied by relatively incoherent and imperfect legal systems (especially judiciary) in developing countries.*

...

#### **Article 12 Other laws**

A leasing agreement subject to this Law is also subject to any law of [this State] requiring registration of a leasing agreement. Failure to comply with such law has only the effect specified therein.

*Comment of Mr Sultanov: Failure to include the provision of this article will not affect country's legislation in force which may prescribe that leasing agreements are subject to registration (vehicles registration, for instance, etc.). However this provision may be interpreted as if all lease agreements may be subject to registration – the outcome least desirable. Alternative solution is to keep the article but in the commentaries provide that not all lease agreements shall be subject to registration.*

...

## Article 26 Termination

1. Notwithstanding Article 16, a leasing agreement may be terminated by operation of this Law, by agreement of the parties, or by an aggrieved party upon the lessee's or lessor's default.

*Comment of Mr Sultanov: This article effectively entitles a party to unilaterally terminate the agreement without intervention of the court. This right undoubtedly shall be made available to the parties however only in those circumstances when the party expressly provided in the agreement the events of default. Paragraph 2 of the Article 22 provides that "in the absence of agreement, default for the purpose of this Chapter occurs when one party substantially deprives the other party of what it is entitled to expect under the leasing agreement and this Law." In the event of default such as that described in the paragraph 2 of the Article 22, one party shall be entitled to demand termination of the agreement but that shall be done through an appropriate judicial intervention as long as it shall be ultimately for the court to judge the extent to which deprivation was substantial or not.*

...

## Article 27 Rejection of non-conforming delivery

1. (a) When the equipment is not delivered or is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the equipment, to reject the equipment in whole or in part, or, in a lease other than a financial lease, and subject to paragraph 1 of this Article, Article 22 and Article 26(1), to terminate the leasing agreement.

(b) Rejection of equipment or termination of the leasing agreement under the preceding sub-paragraph must be within a reasonable time after the non-conforming delivery.

2. (a) When a lessee rejects equipment in accordance with this Law or the leasing agreement while the lessee's duties are revocable, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied.

(b) When a lessee terminates a leasing agreement in accordance with the preceding paragraph or the leasing agreement while the lessee's duties are revocable, the lessee is entitled to recover any rentals and other funds paid in advance, less a reasonable sum for any benefit the lessee has derived from the equipment.

(c) When a lessee, in accordance with this Law or the leasing agreement, rejects equipment in its possession, the lessee has a duty to hold the equipment with reasonable care for a time sufficient to permit the lessor or supplier to remove it.

*Comment of Mr Sultanov: Paragraph 2 (a) of Article 27 can unlikely be applied to a financial lease as long as Article 16 provides that "in a financial lease, the lessee's duties to the lessor become irrevocable and independent when the leasing agreement and supply agreement have been created". Thus, lessee in a financial lease can reject the equipment based on the paragraph 1 A of the Article 27, but will not be entitled to withhold rentals until the non-conforming delivery has been remedied because lessee's duties in any case will be already irrevocable before lessee exercises his right of rejection – both supply and lease agreements must have been created by that time.*

Having said that, the following situation can occur:

*The lessee in a financial lease may reject equipment but will be obliged to perform under a lease agreement without the right to demand the reduction of payments, nor will he be able to terminate the agreement<sup>2</sup> should the supplier fail to remedy its failure or if lessee needed the equipment in that specific time and cannot accept replaced asset because of this time constrains.*

*If the lessee chosen the supplier then the law shall operate in such a way. However, if the selection of supplier was conducted by the lessor, the lessee shall have the right to demand reduction in payments and termination of the lease agreement. Also in this case the Law shall provide that the lessor and the supplier will be jointly and severally liable to the lessee.*

...

### **Article 28 Lessor's right to the equipment**

1. Subject to the rights of a transferee under Article 9(3), upon termination of the leasing agreement by the lessor, the lessor has the right to take possession of the equipment. The lessor may proceed without judicial process if it can be done without breach of the peace.
2. Upon termination of the leasing agreement by the lessor, the lessor has the right to dispose of the equipment in its possession.

*Comment of Mr Sultanov: Once the leasing agreement is terminated prematurely either according to the agreement between the parties, or owing to default of the party (article 26), or the agreement is performed and lessee did not exercise the purchase option or the agreement did not provided for transfer of the title to the lessee at the end of the lease (paragraph 2 Article 21), the Law shall state that the lessee is obliged to return the leased asset in all these cases. If the lessee does not return the asset, the lessor shall have the right to repossess the asset.*

*In most of the developing countries the concept of self help repossession will not be upheld. In fact attempts by the leasing companies to exercise repossession without turning to the courts resulted in lessee's suing leasing companies for embezzlement. Defining the notion of the breach of the peace may also be difficult in countries with continental law tradition and will be difficult to apply by relatively inexperienced judiciary. The law shall provide that the lessor shall be entitled to turn to any procedure available/applicable in the State to repossess the leased asset in specified cases but shall not discuss the manner in which repossession can be conducted. Such procedural issues can be addressed in the comments section by outlining different methods of repossession that may be applicable: judicial repossession, non judicial repossession (through court order, or through the ruling of the judge in the expeditious matters, notary writ etc.) and self help repossession.*

## **II. OTHER AREAS FOR THE LAW TO ADDRESS**

### **1. Transfer of ownership over the leased asset to a third party**

The Law shall recognize that transfer of title to a leased asset (as the case may be when lessor sells an asset, third party exercises foreclosure of the leased asset or leased asset is sold in an

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<sup>2</sup> The right to terminate will be available for the lessee in this case only if supplier's failures were agreed between the parties as an event of default under lease agreement.

auction as a part of the bankruptcy proceedings etc.) to a third party will not result in modification or termination of the lease agreement. Thereupon, the lessor's rights and obligations, specified in the lease agreement, are transferred to the new owner. The party that acquires the lessor's assets as a result of the latter's default is only able to enforce the rights of the original lessor under the lease i.e. the receipt of lease payments. The new owners are not able to take possession of the asset for all cases in which the lessee is still meeting its obligations under the lease. The obligations and rights are simply assigned from the original lessor to a new party.

## 2. Accelerated repayment

The right of accelerated repayment should be recognized by the Law and made available to the lessee when lessor agrees to such right.

## 3. Default

It is necessary to address in the Law what remedies are available for lessor in cases of termination of the lease agreement as a result of lessee's breaching his obligation by making additions to the Article 24. The lessor shall have in this case an option either to demand from the lessee all outstanding lease payments and transfer the title to the lessee or to recover possession of the leased asset and demand compensation.

The framework used in the article 13 of the Convention can be applied:

In the event of default by the lessee, the lessor may recover accrued unpaid rentals, together with interest and damages.

Where the lessee's default is substantial, then 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.

## 4. Bankruptcy of the parties to a lease

It is recommended that the Law addresses issues of bankruptcy of the parties to a lease.

*Lessor's bankruptcy:* The Leased Asset in case of lessor's bankruptcy shall become the part of the insolvent pool of assets. The right of the lessee to continue with the lease contract shall be available notwithstanding the fact of the bankruptcy proceedings against the lessor. The creditor of the lessor that receives the leased asset in his ownership as a part of his remedy shall become the new lessor and shall have no right to impose new conditions in the agreement or demand the termination of the contract as long as the lessee is not in default himself.

*Lessee's bankruptcy:* If a decision to liquidate the lessee or declare his bankruptcy is issued the leased asset shall not be included in the general security of the creditors and shall not be considered part of the liquidation or bankruptcy assets.