



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

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**UNIDROIT COMMITTEE OF GOVERNMENTAL  
EXPERTS FOR THE PREPARATION OF A DRAFT  
MODEL LAW ON LEASING  
Second session  
Muscat, 6/9 April 2008**

UNIDROIT 2007  
Study LIXA - Doc. 13  
Original: English  
June 2008

## **SUMMARY REPORT**

(prepared by the UNIDROIT Secretariat)

### **I. INTRODUCTION**

The second session of the UNIDROIT Committee of governmental experts for the preparation of a draft model law on leasing (hereinafter referred to as the *Committee*) met, at the kind invitation of the Government of the Sultanate of Oman, in Muscat from 6 to 9 April 2008 further to review the preliminary draft model law on commercial leasing (the text of which is reproduced in Appendix I to this summary report and which is hereinafter referred to as the *preliminary draft model law*) as reviewed by the Committee during its first session, held in Sandton, Johannesburg from 7 to 10 May 2007.

As at the first session of the Committee, the proposed model law's special purpose of assisting developing countries and countries with economies in transition to a market economy warranted the invitation of non-member States which were either developing countries or countries with economies in transition. 23 States, two international Organisations and two professional associations (see List of participants reproduced in Appendix II to this summary report) were represented at the session in Muscat (hereinafter referred to as the *session*). In the enforced absence of Mr I.S. Thindisa (South Africa), following a serious accident, the session was chaired, in his place, by Mr N.J. Makhubele (South Africa).

The session was opened at 8.30 a.m. on 6 April 2008 by H.E. Maqbool Ali Sultan, Minister of Commerce and Industry of Oman, who inaugurated a half-day seminar entitled *The preliminary draft model law on commercial leasing as reviewed by the Committee of governmental experts during its first session: an introduction to its objectives and basic features*, designed both to explain the preliminary draft model law's purpose and features and the urgent need for it as expressed by the States for which it was designed and by Organisations seeking to encourage and facilitate leasing in such States, as well as to permit those attending to raise questions. The text of the opening address given by the Minister and that of the response given, on behalf of UNIDROIT, by Mr M.J. Stanford (Deputy Secretary-General of UNIDROIT) are reproduced in Appendices III and IV to this summary report respectively.

The seminar (the programme for which is reproduced in Appendix V) was chaired by H.E. Yahya Al Jabri, Executive President, Capital Market Authority of Oman. The text of the address

given by Mr Stanford on the need for the proposed model law and the work accomplished to date, that of the address given by Mr R.M. DeKoven (Associate Member, 3/4 South Square, London, Of Counsel to Jenner & Block LLP and a UNIDROIT correspondent) on the overall conceptual approach followed in the drafting of the proposed model law, that of the address given by Mr B. Hauck (Associate, Jenner & Block LLP, Washington, D.C.) on the sphere of application of the proposed model law, that of the paper prepared by Mr E.M. Bey (former Chairman of the Legal Affairs Committee of the European Federation of Leasing Company Associations (Leaseurope) and a UNIDROIT correspondent) on the rights and duties of the parties under the proposed model law, that of the address given by Mr M. Sultanov (Legal Adviser to the PrivateEnterprisePartnership for the Middle East and North Africa of the International Finance Corporation) on the practical need for and potential uses of the proposed model law, in particular for Middle East economies, that of the address given by Chief Mrs T. Oyekunle (Legal Practitioner, Lagos, Honorary Vice-President of the International Council for Commercial Arbitration and a UNIDROIT correspondent) on the viewpoint of Africa in that regard, that of the address given by Ms A. Donchenko (Ministry of Economic Development and Trade of the Russian Federation) on the viewpoint of transition economies in the same regard, that of the address given by Mr Stanford on the process for finalisation and adoption of the proposed model law and that of the closing remarks made by the Chairman of the seminar are reproduced in Appendices VI to XIV respectively.

## **II. BUSINESS OF THE COMMITTEE**

The Committee was seised of the following papers:

- Draft agenda (C.G.E. Leasing/2/W.P. 1);
- Preliminary draft model law on commercial leasing (as reviewed by the Committee of governmental experts during its first session (Johannesburg, 7-10 May 2007)) (C.G.E. Leasing/2/W.P. 2);
- Preliminary draft model law on commercial leasing: comments submitted by Governments, Organisations and members of the Advisory Board (C.G.E. Leasing/2/W.P. 3 and Addenda 1-5).

The Committee adopted the agenda, the text of which is reproduced in Appendix XV to this summary report.

The organisation of the Committee's work was introduced by Mr Stanford. It was decided that during the session the Committee should carry out a second reading of the preliminary draft model law on an Article-by-Article basis, in such a way as to permit the Drafting Committee to implement any amendments decided upon by the Committee during this review and then to enable the Committee itself to review the work thus accomplished by the Drafting Committee.

One member of the Drafting Committee established at the first session of the Committee (Rwanda) not being represented at the session, Burundi was co-opted onto the Drafting Committee, alongside Oman, Tanzania and the United States of America, as a substitute for Rwanda.

Mr DeKoven, Reporter to the Committee, was invited by the Chairman to lead the Committee through the preliminary draft model law, Article by Article.

### III. REVIEW OF THE PROVISIONS OF THE PRELIMINARY DRAFT MODEL LAW BY THE COMMITTEE ON SECOND READING

#### *Re: Title and preamble*

The Committee decided, first, that a paragraph should be added recognising the important contributions that non-member States with developing economies and economies in transition had made to the creation of the proposed model law. The Committee also decided to emphasise that the proposed model law might be useful even for States that already had leasing legislation.

The Committee further asked the Drafting Committee to consider modifying the reference to the ability of a legal framework to facilitate “swift” growth of a leasing industry, when experience had shown that some patience might be required and to clarify certain other terms that some thought had the potential to confuse.

#### *Re: Article 1 - Sphere of application*

After it had been clarified that the preliminary draft model law would defer to any national law governing leases of real property and that ordinary choice of law rules would apply to any decision of the parties to apply the law of a particular State, the Committee adopted Article 1 as drafted.

#### *Re: Article 2 - Definitions*

##### (a) “Asset”

Two States requested clarification as to whether the preliminary draft model law was intended to exclude leases of software and other intellectual property. It was agreed that, whilst it was unnecessary to identify software and other intellectual property in the definition expressly, their omission was not meant to imply that such property could not qualify as an “asset” capable of being leased under the preliminary draft model law. Given the importance of such transactions, it was agreed that the future Commentary should make this clear.

It was also pointed out that the reference in the English-language version of the definition to “plant” and “land” could be inconsistent with the reference in Article 3(2) to “real property”; this question was referred to the Drafting Committee for review.

##### (b) “Centre of main interests”

One State questioned whether it would be preferable to replace the term “centre of main interests” by “place of business”. Given what was described as the increasing and successful use of the term “centre of main interests” in international instruments, it was agreed that the preliminary draft model law should continue to use this term.

The Committee, accordingly, adopted this definition as drafted.

##### (c) “Financial lease”

Several States noted that, while the existing definition of “financial lease” extended the protections of, and cheaper cost of capital associated with the financial lease only to those leases in which the rentals or other funds payable under the leasing agreement took into account the amortisation of the whole or a substantial part of the investment of the lessor, there had been a

significant growth in residual-based leasing. In order to encourage such leases, these States proposed modifying clause (c) of the definition of "financial lease" in such a way as to ensure that it did not restrict the definition of "financial lease" to the full payout lease.

These States did not, however, favour the deletion of clause (c), as such a modification might create a lack of clarity in certain States regarding the relationship between the financial lease and the concept of the irrevocability of the lessee's duties.

It was, therefore, agreed that the Drafting Committee should not remove clause (c) entirely but should revise the clause so as to reflect the Committee's decision that leases that did not take into account the amortisation of the whole or a substantial part of the investment of the lessor could also qualify as financial leases.

(d) "Lease"

One State noted that, in the light of the Committee's decision regarding clause (c) of the definition of "financial lease", some of the written comments regarding other types of lease were also thereby resolved. The Committee made no changes to the definition of "lease".

The Committee, accordingly, adopted this definition as drafted.

(e) "Lessee"

The Committee adopted the definition of "lessee" as drafted.

(f) "Lessor"

One State suggested that the preliminary draft model law should specifically address the issue of captive lessors and make it clear that a lessor did not lose its status as a lessor because it was also affiliated with a supplier. It was agreed that the future Commentary should make this clear.

The Committee, accordingly, adopted this definition as drafted.

(g) "Person"

The Committee adopted the definition of "person" as drafted.

(h) "Supplier"

One State suggested that, when a lessor was also a vendor of a particular asset, supplying the asset from stock, the lessor might be entitled to certain protections offered by the financial lease but not other such protections. It was agreed that such issues should be dealt with not in the definition of supplier but rather in those Articles that afforded such protections.

The Committee, accordingly, adopted this definition as drafted.

(i) "Supply agreement"

The Committee asked the Drafting Committee to consider whether it would be beneficial to make this definition consistent with the definition of "supplier", which included the phrase "under a financial lease".

*Re: Article 3 - Other laws*

The UNIDROIT Secretariat's report on the history of Article 3(1) and the relationship between the preliminary draft model law and the Legislative Guide on Secured Transactions prepared by the United Nations Commission on International Trade Law (UNCITRAL) was followed by the recommendation, made jointly by the UNIDROIT and UNCITRAL Secretariats, that the reference in Article 3(1) to "acquisition financing right" be replaced by "acquisition security right", so as to correspond to the language contained in the UNCITRAL Legislative Guide. The Committee asked the Drafting Committee to implement this recommendation.

The UNIDROIT Secretariat also conveyed a further recommendation from the UNCITRAL Secretariat that the future model law indicate, for instance in a footnote to Article 3(1), that, when States adopted both the future model law and legislation based on the recommendations of the UNCITRAL Legislative Guide adopting a non-unitary approach to acquisition financing, the reference in Article 3(1) to an acquisition security should be replaced by one to the terms "acquisition security right, retention-of-title right and financial lease right". The Committee endorsed this recommendation and decided that the most appropriate place to make this point clear was in the future Commentary; it was agreed that the language to be employed for this purpose should be as follows:

"If a State that enacts the Model Law on Commercial Leasing also enacts the recommendations of the UNCITRAL Legislative Guide on Secured Transactions adopting a non-unitary approach to acquisition financing, the reference to an acquisition security in Article 3(1) should be replaced by a reference to the terms 'acquisition security right, retention-of-title right and financial lease right'."

Finally, the Drafting Committee was asked by the Committee to consider one State's suggestion that a paragraph be added to Article 3 for the purpose of excluding leases of mobile equipment that were covered by other laws uniquely tailored to those types of asset.

*Re: Article 4 – Interpretation of this Law*

The Committee agreed with one State's suggestion that the words "of this Law" in this Article's heading were unnecessary. After discussion of the reference in Article 4(2) to the "general principles on which this Law is based", it was agreed that such a reference would facilitate interpretation of the future model law and that the reference should, therefore, be retained.

*Re: Article 5 – Freedom of contract*

The Committee reviewed Article 5, and in particular the question as to which Articles should be made mandatory, after it had completed its second reading of the entire preliminary draft model law. In that review, the Committee declared itself content with the Articles designated as mandatory in the preliminary draft model law as reviewed at its first session.

The Committee adopted Article 5 as drafted.

*Re: Article 6 – Enforceability*

After being reminded that the Committee had previously considered the implications of the introduction of a public registration requirement too expensive for the purposes of the future model

law and upon assurance that nothing in the preliminary draft model law would interfere with other laws governing the rights of a *bona fide* purchaser, the Committee adopted Article 6 as drafted.

*Re: Article 7 – Lessee under financial lease as beneficiary of supply agreement*

The question raised by one State as to whether the last sentence of Article 7(1)(a) needed clarification was referred to the Drafting Committee for review.

The Committee agreed with another State's suggestion that the English-language version of Article 7(2) be clarified with a view to making it clear whether it was the "variation" or the "term" that was to have been previously approved by the lessee.

The Committee also noted that the second reference to the "lessor" in Article 7(2) should rather be one to the "lessee".

*Re: Article 8 – Priority of liens*

The Committee adopted Article 8 as drafted.

*Re: Article 9 – Limitation of liability of the lessor*

The Committee agreed that the future Commentary should make it clear that, whilst Article 9 limited the lessor's liability in its capacity as lessor, it did not affect the lessor's liability in other capacities, such as its capacity as vendor or owner.

The Committee, accordingly, adopted Article 9 as drafted.

*Re: Article 10 – Irrevocability*

The Drafting Committee was asked by the Committee to consider whether the parties' duties should become effective upon signature, rather than at the time when the agreement was entered into.

*Re: Article 11 – Risk of loss*

After considering whether to change the time at which the risk of loss passed to the lessee, the Committee decided to leave the passing of such risk at the time when the leasing agreement was entered into, so as to enable the lessee to obtain insurance at the earliest moment. It was noted that providing for the passing of the risk of loss at the time when the agreement was entered into would also encourage leasing companies to enter new markets.

The Committee, accordingly, adopted Article 11 as drafted.

*Re: Article 12 – Damage to the asset*

The Committee took two decisions with respect to Article 12(1).

First, it decided to delete the phrase "but without further right against the supplier" in Article 12(1) and to leave the lessee's remedies in that respect subject to the parties' freedom of contract.

Secondly, it asked the Drafting Committee to consider whether Article 12(1) (and, in the same manner, Article 13(2)) adequately ensured that the lessor's residual interest in the asset was not diminished if the lessee received a remedy from the supplier for a damaged asset.

*Re: Article 13 – Acceptance*

The Committee asked the Drafting Committee to review Article 13(2) in the same sense as Article 12(1), namely regarding the lessor's residual interest in a damaged asset.

*Re: Article 14 – Remedies*

Apart from one State's suggestion that the future Commentary make clear the lessee's rights when dealing with a vendor-lessor, the Committee adopted Article 14 as drafted.

*Re: Article 15 – Transfer of rights and duties*

A number of States agreed with the suggestion that the future model law, like other international instruments, should explicitly permit parties to agree that the lessee would not assert certain defences or rights of set-off against a transferee of the lessor, the Drafting Committee being invited by the Committee to review Article 15(1) in this connection.

*Re: Article 16 – Warranty of quiet possession*

In response to the concern expressed by one State that Article 16(1) and (2) would prevent one who acted under the authority of a court from obtaining rightful possession of an asset, another State noted that, under the Article as drafted, one who acted under the authority of a court would still be able to obtain the interest that the court dictated but that requiring the lessor to warrant against such a disturbance ensured that the lessor would have to pay such other remedies as might be required.

Article 16 was thus adopted as drafted.

*Re: Article 17 – Warranty of acceptability and fitness for purpose*

At the suggestion of one State, it was agreed that the Drafting Committee should consider whether Article 17(1) was consistent with Article 7(1)(c).

*Re: Article 18 – Duties of the lessee to maintain and return the asset*

The Committee adopted Article 18 as drafted.

*Re: Article 19 – Definition of default*

The Committee adopted Article 19 as drafted.

*Re: Article 20 – Notices*

The Committee adopted Article 20 as drafted.

*Re: Article 21 – Damages*

It was agreed that damages under Article 21 might include arrears in rental payments but that no change in the text was necessary.

The Committee, accordingly, adopted Article 21 as drafted.

*Re: Article 22 – Liquidated damages*

The Committee adopted Article 22 as drafted.

*Re: Article 23 – Termination*

The Committee reconsidered the decision it had taken at its first session to prohibit the lessor in a financial lease from terminating a leasing agreement even upon fundamental default by the lessee. Several States advocated that the lessor be permitted the remedy of termination in such cases and the Committee, accordingly, decided to return to the wording of Article 23(1)(b) employed in the text of the preliminary draft model law submitted to its previous session.

*Re: Article 24 – Possession and disposition*

One State suggested that, because lessors in some circumstances – say, when a piece of hospital equipment was employed for medical needs - might not seek physically to repossess an asset, it would be desirable to make it clear that Article 24 did not prevent lessors from recapturing the value of the asset by other means – by capturing, for example, the value that the asset generated when in use. It was agreed that no change to the text was, however, necessary.

The Committee, accordingly, adopted Article 24 as drafted.

**IV. REVIEW BY THE COMMITTEE OF THE AMENDMENTS TO THE PRELIMINARY DRAFT MODEL LAW EFFECTED BY THE DRAFTING COMMITTEE FOLLOWING ITS SECOND READING**

Following completion of the Committee's second reading of the preliminary draft model law, the Drafting Committee met to implement the amendments agreed upon during that reading. The preliminary draft model law as thus amended (the text of which, in marked-up form, is reproduced in Appendix XVI to this summary report) was reviewed by the Committee on the last day of the session, with the Reporter introducing the amendments made.

The Committee endorsed the text of the preliminary draft model law as reviewed by the Drafting Committee, with the following exceptions:

*Re: preamble*

It was noted that the square brackets around the preamble had been omitted, in error, from the text of the preamble after its review by the Drafting Committee; the need for these square brackets was dictated by the fact that the drafting of the preamble was, traditionally, a matter reserved for the diplomatic plenipotentiaries at the time of finalisation of draft UNIDROIT instruments, on the basis of a draft prepared by the Secretariat, and the text of the preamble to the preliminary draft model law was, thus, simply to be seen as reflecting the Secretariat's thoughts in this regard.



It was also noted that the word "their" in the second line of the eighth clause of the English-language version of the preamble should read "its".

*Re: Article 2 - Definitions*

(a) "Asset"

The Committee was pleased with the Drafting Committee's adjustments to the English-language version of this definition designed to bring the references to "plant" and "land" into line with the reference in Article 3(2) to "real property".

(c) "Financial lease"

On reviewing the Drafting Committee's work, which proposed broadening the definition of "financial lease" to cover financial leases that "take into account or fail to take into account" the amortisation of the whole or a substantial part of the lessor's investment, the Committee considered the words "fail to take into account" unhelpful for this purpose. It was, therefore, decided to replace them by the words "do not take into account".

(i) "Supply agreement"

The Committee approved the manner in which the Drafting Committee had made this definition consistent with the definition of "supplier", by including the phrase "under a financial lease".

*Re: Article 3 – Other laws*

The Committee approved the manner in which the Drafting Committee had brought Article 3(1) further into line with the UNCITRAL Legislative Guide on Secured Transactions.

With a view to implementing the suggestion made by one State that a paragraph be added to Article 3 designed to exclude leases of mobile equipment covered by other laws uniquely tailored to those types of asset, the Drafting Committee had proposed revising Article 3(2) in such a way as to ensure that, in the event of conflicts with laws governing real property, public notice or certain specified categories of mobile equipment, the future model law would defer to the treatment contained in such other laws.

In the course of the Committee's review of the Drafting Committee's proposal, it was argued by some States that the preliminary draft model law should instead exclude coverage of either such mobile equipment altogether or, specifically, aircraft, aircraft engines, helicopters, railway rolling stock, ships and space assets. Others, however, noted that excluding leases of aircraft and other mobile equipment from the sphere of application of the future model law would defeat one of its fundamental objectives, namely facilitation of investment in such critical infrastructure for developing countries and economies in transition.

It was, therefore, agreed that the proposal that the sphere of application of the future model law should not include aircraft, aircraft engines, helicopters, railway rolling stock, ships and space assets be included inside square brackets as a new Article 3(3), so as to signal that this was a matter requiring further consideration at the following session of the Committee.

*Re: Article 4 – Interpretation*

The Committee endorsed the Drafting Committee's modification of the heading of this Article.

*Re: Article 7 – Lessee under financial lease as beneficiary of supply agreement*

After considering the alternative formulation proposed by the Drafting Committee, designed to clarify the last sentence of Article 7(1)(a), the Committee decided that it would be better to reinstate the language used in the previous version of this provision.

The Committee, on the other hand, approved both the manner in which the Drafting Committee had made it clear, in Article 7(2), that it was the supply agreement's terms that had to have been approved by the lessee and its deletion of the word "previously".

*Re: Article 10 – Irrevocability*

The Committee endorsed the conclusion of the Drafting Committee, namely that the term "entered into" was more inclusive than "signed" and that it would, accordingly, be better to maintain the more inclusive term.

*Re: Article 12 – Damage to the asset*

With a view to responding to the Committee's request that Article 12(1) be reviewed so as to ensure that the lessor's residual interest in the asset was not diminished where the lessee received a remedy from the supplier for a damaged asset, the Drafting Committee had proposed adding a sentence to Article 12(1) designed to clarify the lessor's interest in that respect.

It was agreed that this proposal should be amended in such a way as to make it clear that it was open to the parties to agree on the manner in which compensation for any diminished interest was to be handled.

*Re: Article 13 – Acceptance*

The language proposed by the Drafting Committee to respond to the Committee's request that it review Article 13(2) being the same as that it had proposed in respect of Article 12(1), it was agreed that this language should be amended in the same way as had been decided upon in respect of Article 12(1).

In response to an enquiry from a State as to the reasons for including the concept of "acceptance" in the preliminary draft model law, it was explained that identifying the point at which acceptance occurred in a lease was important in those legal systems in which the law of sale, which interacted in many ways with the law of leases, placed the transfer of certain risks and duties at the time at which acceptance occurred. It was, however, agreed that this issue could be considered further at the following session of the Committee, as necessary.

*Re: Article 15 – Transfer of rights and duties*

In the course of the Committee's review of the proposal of the Drafting Committee, which was based on language taken from the 2001 United Nations Convention on the Assignment of Receivables in International Trade, it was agreed that the phrase "other than those arising from the

incapacity of the lessee" should be placed inside square brackets, as some States raised questions regarding the meaning of the term "incapacity" in this context.

It was further agreed that, in the interests of clarity, those provisions of Article 15(1)(a) dealing with transfer of the rights of the lessor under a leasing agreement, on the one hand, and those dealing with transfer of the duties of the lessor under such an agreement, on the other, should be separated into two clauses.

*Re: Article 17 – Warranty of acceptability and fitness for purpose*

The Committee endorsed both the Drafting Committee's conclusion that there was, indeed, a potential for conflict between Article 17(1) and Article 7(1)(c) and its proposal for harmonising the two provisions.

*Re: Article 23 – Termination*

The Committee endorsed the Drafting Committee's implementation of the decision it had taken on second reading with respect to Article 23(1)(b). It also endorsed the Drafting Committee's suggestion for use of the term "fundamental default", given that this term was consistent with the UNIDROIT Principles of International Commercial Contracts and that it could, therefore, be interpreted by reference to those Principles and to local law.

The text of the preliminary draft model law with the title thereof and the preamble thereto as reviewed by the Committee during the session is reproduced in Appendix XVII to this summary report, in marked-up form, and in Appendix XVIII, in clean form.

## **VI. FUTURE WORK**

Mr Stanford indicated that a summary report on the session, incorporating the amended text of the preliminary draft model law as reviewed by the Committee during the session, would be sent out in due course. In the meantime, the preliminary draft model law as reviewed by the Committee during the session would be laid before the UNIDROIT Governing Council at its 87<sup>th</sup> session, to be held in Rome from 21 to 23 April 2008, for advice and consent as to the most appropriate follow-up action to be taken; the Secretariat would, in this connection, be proposing that the Council authorise the transmission of this text to Governments and Organisations for finalisation and adoption, in Rome in Autumn 2008, at a joint session of the General Assembly of UNIDROIT member States – sitting in extraordinary session – and the Committee – in particular, so as to guarantee the continuing participation of those non-member States which had played such an important part in the negotiations to date. A brief commentary on the preliminary draft model law and its provisions would be prepared by the Reporter with a view, in particular, to assisting those Governments coming to the text for the first time at the anticipated joint session.

**PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING**

*(as reviewed by the Committee of governmental experts during its first session  
(Johannesburg, 7-10 May 2007))*

**[PREAMBLE**

*THE GENERAL ASSEMBLY OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF  
PRIVATE LAW (UNIDROIT),*

*Recognising* that leasing provides developing countries and countries in transition in particular with an important source of capital for the development of infrastructure and small- and medium-sized enterprises;

*Aware* that, while many States already possess leasing legislation and a well-developed leasing industry, many other States, and in particular those States with developing economies and economies in transition, require a legal framework that will foster the swift growth of a nascent or non-existent leasing industry;

*Convinced* accordingly as to the usefulness of proposing a model law on commercial leasing for consideration by national legislators, which may adapt it to meet their specific needs;

*Committed* to the purpose of harmonising legal regulations of leasing on a global basis in order to facilitate trade in capital goods;

*Finding* that the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) has not only removed certain legal impediments to the international financial leasing of equipment while maintaining a fair balance of interests between the different parties to the transaction for States Parties thereto, but has also frequently served as a model for States drafting their first leasing laws;

*Considering* the legal regimen enshrined in the aforementioned Convention as a useful starting point for the development of a comprehensive model law governing such transactions;

*Being of the view* that in the preparation of such a model law priority must be given to the establishment of rules governing the civil and commercial law aspects of commercial leasing,

*Mindful* of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law as opposed to the specific area of that law reserved to leasing,

*HAS APPROVED THE FOLLOWING TEXT OF THE UNIDROIT MODEL LAW ON COMMERCIAL  
LEASING:]*

## CHAPTER I: GENERAL PROVISIONS

### Article 1 Sphere of application

This Law applies to any lease of an asset, if the asset is within [the State], the centre of main interests of the lessee is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

### Article 2 Definitions

In this Law:

**Asset** means all property used in the trade or business of the lessee, including plant, land, capital goods, equipment, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. No asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in land.

**Centre of main interests** means the place where a person conducts the administration of its interests on a regular basis. In the absence of proof to the contrary, the registered office of the person, or habitual residence in the case of an individual, is presumed to be the centre of main interests of the person.

**Financial lease** means a lease, with or without an option to purchase, that includes the following characteristics:

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) the rentals or other funds payable under the leasing agreement take into account the amortisation of the whole or a substantial part of the investment of the lessor.

**Lease** means a transaction in which a person grants a right to possession and use of the asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

**Lessee** means a person who acquires the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessee.

**Lessor** means a person who grants the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessor.

**Person** means any legal, private or public entity or an individual.

**Supplier** means a person from whom a lessor acquires the asset or the right to possession and use of the asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires the asset or the right to possession and use of the asset for lease.

### **Article 3 Other laws**

1. This law does not apply to a leasing agreement that creates a security right or an acquisition financing right, as defined in the UNCITRAL Legislative Guide on Secured Transactions.
2. A leasing agreement subject to this Law is also subject to any law of [this State] applicable to real property or public notice with respect to a leasing agreement or an asset subject to a leasing agreement.

### **Article 4 Interpretation of this Law**

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.
2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

### **Article 5 Freedom of contract**

Except as provided in Articles 7(3), 16(1)(a), 16(2) and 22(3) and the law of [this State], the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a leasing agreement.

## **CHAPTER II: EFFECTS OF LEASING AGREEMENT**

### **Article 6 Enforceability**

Except as otherwise provided in this Law:

- (a) a leasing agreement is effective and enforceable according to its terms between the parties; and
- (b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

### **Article 7 Lessee under financial lease as beneficiary of supply agreement**

1. (a) In a financial lease, the duties of the supplier under the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

(b) The extension of the duties of the supplier to the lessee under the preceding subparagraph does not modify the rights and duties of the parties to the supply agreement, whether arising therefrom or otherwise, or impose any duty or liability under the supply agreement on the lessee.

(c) Where the absence of a contract between the lessee and supplier prevents the lessee from enforcing the duties of the supplier under the supply agreement, 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 the duties of the supplier.

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

3. The parties may not derogate from or vary the effect of the provisions of paragraphs 1 and 2.

4. Nothing in this Article shall entitle the lessee to modify, terminate or rescind the supply agreement without the consent of the lessor.

#### **Article 8 Priority of liens**

1. A creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the rights and remedies of the parties to the leasing agreement and cannot attach any interest arising under the leasing agreement.

2. Except as otherwise provided by the law of [this State], a creditor of the lessor takes subject to the rights and remedies of the parties to the leasing agreement.

#### **Article 9 Limitation of liability of the lessor**

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 asset or the use of the asset.

### **CHAPTER III: PERFORMANCE**

#### **Article 10 Irrevocability**

1. (a) In a financial lease, the duties of the parties become irrevocable and independent when the leasing agreement has been entered into.

(b) In a lease other than a financial lease, the parties may agree to make any of their duties irrevocable and independent by specifically identifying each duty that is irrevocable and independent.

2. A duty that is irrevocable and independent must be performed, regardless of the performance or non-performance of any other party, unless the party to whom the duty is owed terminates the leasing agreement or otherwise explicitly agrees.

#### **Article 11 Risk of loss**

1. (a) In a financial lease, risk of loss passes to the lessee. If the time of passage is not stated, the risk of loss passes to the lessee when the leasing agreement has been entered into.

(b) In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, the lessee, subject to paragraph 1 of Article 18, may treat the risk of loss as having remained with the supplier from the beginning.

2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

#### **Article 12 Damage to the asset**

1. In a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and at the option of the lessee either accept the asset with due compensation from the supplier for the loss in value but without further right against the supplier or, subject to Article 10, seek such other remedies as are provided by law.

2. In a lease other than a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,

(a) if the loss is total, the leasing agreement is terminated; and

(b) if the loss is partial, the lessee may demand inspection and at the option of the lessee either treat the leasing agreement as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

#### **Article 13 Acceptance**

1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.

2. (a) Once a lessee in a financial lease has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement.

(b) Once a lessee in a lease other than a financial lease has accepted an asset, the lessee is entitled to damages from the lessor if the asset does not conform to the leasing agreement.



## **Article 14 Remedies**

1. In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

2. (a) In a lease other than a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the leasing agreement. Rejection or termination must be within a reasonable time after the non-conforming delivery.

(b) In a lease other than a financial lease, once a lessee has accepted the asset, the lessee may reject the asset under the preceding sub-paragraph only if the non-conformity substantially impairs the value of the asset and either

(i) the lessee accepted the asset without knowledge of the non-conformity, owing to the difficulty of discovering it, or

(ii) the acceptance by the lessee was induced by the assurances of the lessor.

(c) In a lease other than a financial lease, when the lessee rejects an asset in accordance with this Law or the leasing agreement, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied and to recover any rentals and other funds paid in advance, less a reasonable sum corresponding to any benefit the lessee has derived from the asset.

3. If the lessee rejects an asset in accordance with this Article and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

## **Article 15 Transfer of rights and duties**

1. The rights of the lessor under the leasing agreement may be transferred without the consent of the lessee. The duties of the lessor under the leasing agreement may be transferred only with the consent of the lessee, which may not be unreasonably withheld.

2. The rights and duties of the lessee under the leasing agreement may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

3. The lessee, lessor and third parties may consent to such transfers in advance.

## **Article 16 Warranty of quiet possession**

1. (a) In a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right or who claims a superior title or right and acts under the authority of a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor. The parties may not derogate from or vary the effect of the provisions of this sub-paragraph.

(b) In a financial lease, a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications.

2. In a lease other than a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right, who claims a superior title or right and acts under the authority of a court or who makes a claim by way of infringement. The parties may not derogate from or vary the effect of the provisions of this paragraph.

3. The sole remedy for a disturbance of the quiet possession of the lessee under sub-paragraph (a) of paragraph 1 and under paragraph 2 is an action for damages against the lessor.

#### **Article 17 Warranty of acceptability and fitness for purpose**

1. In a financial lease, the supplier warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used and the warranty is enforceable only against the supplier.

2. In a lease other than a financial lease, the lessor warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used if the lessor regularly deals in assets of that kind.

#### **Article 18 Duties of the lessee to maintain and return the asset**

1. (a) The lessee shall take proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.

(b) When a leasing agreement sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the use of the asset, the compliance by the lessee with such agreement or instructions shall satisfy the requirements of the preceding sub-paragraph.

2. When the leasing agreement comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the asset to the lessor in the condition specified in the preceding paragraph.

### **CHAPTER IV: DEFAULT**

#### **Article 19 Definition of default**

1. The parties may at any time agree as to the events that constitute a default or otherwise give rise to the rights and remedies specified in this Chapter.

2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the leasing agreement or this Law.

### **Article 20 Notices**

An aggrieved party shall give a defaulting party notice of default, notice of enforcement, notice of termination and a reasonable opportunity to cure.

### **Article 21 Damages**

Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the leasing agreement, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

### **Article 22 Liquidated damages**

1. When the leasing agreement provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.
2. Such sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.
3. The parties may not derogate from or vary the effect of the provisions of this Article.

### **Article 23 Termination**

1. (a) Subject to sub-paragraph (b), a leasing agreement may be terminated by operation of law, by operation of Article 12, by agreement of the parties or by an aggrieved party upon [substantial] default by the lessee or lessor.  
  
(b) [Neither party to a financial lease may terminate the leasing agreement upon [substantial] default by another party but either party is entitled to such other remedies as are provided by the agreement of the parties and by law.]
2. Subject to Article 10, on termination all duties under the leasing agreement that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

### **Article 24 Possession and disposition**

After the leasing agreement comes to an end or is terminated, the lessor has the right to take possession of the asset and the right to dispose of the asset.

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Ms Marina SCHNEIDER, Senior Officer

Mr Ronald DeKOVEN, Reporter to the Committee

Mr Brian HAUCK, Secretary to the Committee

Chief Mrs Tinuade OYEKUNLE, Chairman of the Advisory Board

Mr Fritz PETER, Member of the Advisory Board

**UNIDROIT**

**INTERNATIONAL INSTITUTE FOR THE  
UNIFICATION OF PRIVATE LAW**

**IN CO-OPERATION WITH THE GOVERNMENT OF THE SULTANATE OF OMAN**

***THE PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING AS REVIEWED BY THE  
COMMITTEE OF GOVERNMENTAL EXPERTS AT ITS FIRST SESSION: AN INTRODUCTION TO  
ITS OBJECTIVES AND BASIC FEATURES***

**A half-day seminar addressed to the Governments and international Organisations  
invited to participate in the second session of the Committee of governmental experts**

**(Muscat, 6 April 2008)**

*Opening address*

*by H.E. Maqbool Bin Ali Sultan  
Minister of Commerce and Industry of Oman*

Your Excellencies,  
Mr Martin Stanford, Deputy Secretary General, UNIDROIT and dear delegates.

It is indeed my pleasure to inaugurate this session of the UNIDROIT Committee of Governmental experts, the very first meeting to be held by UNIDROIT, not only in Oman, but in the entire Middle East. It is gratifying to observe that delegates from different parts of the world have taken the trouble to travel all the way to Oman to participate in the proceedings. This is a reflection of the importance that you and your colleagues place on developing a suitable 'leasing law'. In Oman, we too place considerable importance on the development of a suitable leasing law and I believe your deliberations will play an invaluable role in the developing of leasing across the world, particularly in developing economies and I wish you every success in your deliberations.

I am informed that the first references to leasing emerged in the Sumerian cuneiforms some four thousand years ago and this is indeed understandable, given the importance of leasing in the development of commerce and industry. We are accustomed to looking to banking as a primary source of finance, however, this is not without its limitations. Banking, by its very nature, depends on collateral security, comprehensive documentation, financial analysis and covenants, and all of this will, I believe, increase manifold with the increasing emphasis on risk imposed by Basle II. On the other hand, at my ministry, we have observed that these are the kind of conditions that small and medium enterprises find difficult to fulfill. Yet, these are the industries that need the most financial support, and are the very industries that we seek to encourage, given their critical importance in employment creation and wealth distribution. It is here, that leasing plays a key role. I have observed that the leasing industry adopts a much more S.M.B. friendly approach and looks to the security of the asset financed and their own ability to get close to and understand the needs of their clients, for their recoveries.

Consequently, leasing plays a key role in economic development and, in Oman, the Central Bank, has actively encouraged the development of leasing. While our industry is not as old as that of the Sumerians, Oman has had leasing for the past 20 years, and the industry is today quite vibrant and mature, with six successful and well capitalised players comprising a combined net worth of US \$ 226 million and assets of well over one million. The industry has also achieved a degree of sophistication, offering not only leasing products, but also other forms of asset financing like hire purchase, debt factoring and project financing.

The preliminary draft model law that you will be deliberating on in the next few days will play a key role in shaping the development of leasing not only in your own countries but also, globally, on two dimensions.

Firstly, the preliminary draft model law once approved will form the basis for the development of local laws furthering the development of the domestic leasing industry. Secondly, and even more importantly, I see the implementation of reasonably uniform leasing laws encouraging the development of cross-border leasing which will provide capital to the nations and regions that need it most. Uniform leasing laws will also facilitate the transfer of leasing know-how that is so badly needed in a globalising economy.

In conclusion, while encouraging you, with your onerous deliberations, I would be remiss if I did not encourage you to also enjoy 'OMAN', while you are here. Oman offers some of the finest beaches and unparalleled opportunities for enjoyment both of our ancient culture and our unique topography.

Thank you.

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*Response to opening address*

*by Martin Stanford  
Deputy Secretary-General  
UNIDROIT*

Minister, Your Excellencies, Ladies and Gentlemen,

Thank you for all taking the time to come from near and far to be here to-day. Thank you especially to our Omani hosts, and in particular Saleem Al-Zawawi and Raphael Parambi and their indefatigable team, for all their hard work in making the necessary arrangements for the holding of this session in Muscat and for placing at our disposal such magnificent premises.

UNIDROIT, the Organisation that I have the honour to represent here to-day, is an intergovernmental Organisation based in Rome, the statutory objectives of which are the examination of ways of harmonising and co-ordinating the private law of States and groups of States and the preparation gradually for the adoption by the various States of uniform rules of private law. Increasingly, though, the leading characteristic of the international instruments that it prepares is their role in modernising law.

The importance of this session, in particular the fact that it is being held so far from Rome, the seat of UNIDROIT, is to be seen in a number of facts.

First, the basic market for UNIDROIT products, international uniform law, is neither Italy nor the industrialised world but rather the developing world and the economies in transition to a market economy. It is these countries that stand to gain the most from modern legal rules, especially when it comes to tapping the international capital markets.

Secondly, the membership of UNIDROIT, which is restricted to States – 61 States, drawn from the four corners of the world, are currently members - is largely made up of industrialised countries, which is a reflection in many ways of the manpower difficulties affecting the Governments of developing countries and economies in transition when it comes to finding the resources necessary to follow UNIDROIT projects.

Thirdly, the practical result of this in terms of the parties that traditionally negotiate the international uniform laws promoted by UNIDROIT is that they are essentially negotiated by representatives of the industrialised countries, with little or no input from developing countries and economies in transition, obliged in general to be represented by junior staff from their local diplomatic mission, acting only on the basis of instructions, where any, and, as a result, with virtually no mandate to participate in the normal cut-and-thrust of the negotiations.

Yet, fourthly, it is just these countries whose vital interests are most at issue in the work being accomplished by UNIDROIT and its sister Organisations. Talks with some of our developing country members, accordingly, convinced us of the timeliness and, indeed, the necessity of taking our projects and their negotiations to those parts of the world for which they are primarily intended, as also of the need to leaven our Work Programme with projects of serious interest and usefulness for developing countries and transition economies.

Fifthly, through our pioneering work in the field - whether in sponsoring the Unidroit Convention on International Financial Leasing, opened to signature in Ottawa in 1988, or in jointly sponsoring with the International Civil Aviation Organization the Convention on International Interests in Mobile Equipment, opened to signature in Cape Town in 2001, leasing is definitely an area in which we have special technical expertise. Aware as we were of the projects in this area underway in various parts of the developing world and amongst economies in transition – not least that underway within the International Finance Corporation for the development of the private sector – persuaded us as to the suitability of launching such a new approach with a model law on leasing specifically designed for use in developing countries and transition economies.

Moreover, sixthly, a key element of this new approach being a more active involvement of the prospective beneficiary countries in the negotiating process, logic demanded that we take the negotiating process in respect of this model law to the developing countries and transition economies.

Africa being the primary focus of this project, we, therefore, held the first session of the UNIDROIT Committee of governmental experts in South Africa. Thanks in large measure to the munificent and wise hospitality of our hosts on that occasion, the Ministry of Justice and Constitutional Development, we made excellent progress with an unprecedentedly active participation in the negotiations by the representatives of developing and transition economies.

Now, for the second session of the Committee, we have the great pleasure and honour of being the guests of the Government of the Sultanate of Oman, and in particular of the Ministry of Commerce and Industry. We do not doubt that the munificence displayed by the Government of the Sultanate of Oman in preparing this session offers the most solid guarantee for the successful continuation of the efforts commenced in Johannesburg.

Minister, you have our undying gratitude and admiration for the invaluable support that you and your Government are giving us in this new approach to the negotiating of international uniform law. Thank you in particular for kindly taking the time to honour the opening of this session with your presence.

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Conscious of the particular aptitude of leasing to provide much-needed finance for the needs, in terms of equipment and infrastructure, of developing countries, in particular in Africa, and countries engaged in the transition to a market economy, the International Institute for the Unification of Private Law (UNIDROIT) has under preparation a model law on commercial leasing designed to facilitate greater access to lease finance by such countries. The preliminary draft model law on leasing established by a UNIDROIT Advisory Board (which brought together legal and business expertise from North Africa and Arabic-speaking countries, sub-Saharan Africa, the Asia-Pacific region, the countries of the Former Soviet Union, Europe, Latin America and North America) has been transmitted by the UNIDROIT Governing Council to Governments, for finalisation. In the belief that those Governments and international Organisations attending the second session of the UNIDROIT Committee of governmental experts called to continue the process of finalisation begun in Johannesburg, from 7 to 10 May 2007, at the first session of said Committee will find it helpful to have an introduction to both the objectives and the basic features of the preliminary draft model law, UNIDROIT has judged it opportune to organise a half-day seminar at the very beginning of this second session designed, on the one hand, to permit members of the Advisory Board to introduce the preliminary draft model law, in particular to those representatives of Governments and Organisations participating in the work of the Committee for the first time, and, on the other, to permit the representatives of Governments and Organisations attending the session to raise any questions that they may have. The Governments and Organisations intending to participate in the session are, accordingly, urged to seize this invaluable opportunity to familiarise themselves with the preliminary draft.

*PROGRAMME*

- 8.30 a.m. Opening address - *H.E. Maqbool Ali Sultan, Minister of Commerce and Industry of Oman*
- Response to opening address - *Martin Stanford, Deputy Secretary-General, UNIDROIT*

*BACKGROUND TO PREPARATION OF MODEL LAW AND PROGRESS TO DATE*

- 8.45 a.m. Need for model law and work accomplished to date - *Martin Stanford*

*BASIC FEATURES OF MODEL LAW*

- 9 a.m. Overall conceptual approach followed in drafting of model law - *Ronald DeKoven, Associate Member, 3/4 South Square, London; Of Counsel, Jenner & Block LLP; UNIDROIT Correspondent; Reporter to Committee of governmental experts*
- 9.20 a.m. Sphere of application of model law - *Brian Hauck, Associate, Jenner & Block LLP, Chicago; Secretary to Committee of governmental experts*
- 9.40 a.m. Rights and duties of parties under model law - *El Mokhtar Bey, former Chairman, Legal Affairs Committee, European Federation of Leasing Company Associations (Leaseurope); UNIDROIT Correspondent; Member of Advisory Board (to be summarised, in his absence, by Martin Stanford)*
- 10 a.m. *Morning refreshments*

*ASSESSMENT OF RELEVANCE OF MODEL LAW FOR DEVELOPING AND TRANSITION ECONOMIES*

- 10.30 a.m. Practical need for, and potential uses of model law, in particular for Middle East economies - *Murat Sultanov, Legal Adviser, PrivateEnterprise Partnership Middle East and North Africa, International Finance Corporation; Member of Advisory Board*
- 10.50 a.m. The viewpoint of Africa - *Tinuade Oyekunle, Legal Practitioner, Lagos; Honorary Vice-President, International Council for Commercial Arbitration; UNIDROIT Correspondent; Chairman of Advisory Board*
- 11.05 a.m. The viewpoint of transition economies – *Anna Donchenko, Ministry of Economic Development and Trade of the Russian Federation*

*OPEN FORUM DISCUSSION*

- 11.20 a.m. Question-and-answer session  
*Moderator: Ronald DeKoven*

*PROCESS AND SUBSTANCE MOVING FORWARD*

- 11.40 a.m. The process for finalisation and adoption of the model law - *Martin Stanford*
- 11.50 a.m. Closing remarks by Seminar Chairman – *H.E. Yahya Al Jabri, Executive President, Capital Market Authority of Oman*

**UNIDROIT**

**INTERNATIONAL INSTITUTE FOR THE  
UNIFICATION OF PRIVATE LAW**

**IN CO-OPERATION WITH THE GOVERNMENT OF THE SULTANATE OF OMAN**

***THE PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING AS REVIEWED BY THE  
COMMITTEE OF GOVERNMENTAL EXPERTS AT ITS FIRST SESSION: AN INTRODUCTION TO  
ITS OBJECTIVES AND BASIC FEATURES***

**A half-day seminar addressed to the Governments and international Organisations  
invited to participate in the second session of the Committee of governmental experts**

**(Muscat, 6 April 2008)**

*Need for model law and work accomplished to date on preparation thereof*

*by Martin Stanford  
Deputy Secretary-General, UNIDROIT*

**NEED FOR MODEL LAW**

Mr Sultanov will be introducing you to the especial usefulness of the future model law in the context of the I.F.C.'s programmes in developing countries and transition economies designed, through the development of leasing industries, to assist the development of the private sector in these countries.

Generally, leasing has shown itself to be a particularly creative and flexible vehicle for economic growth all over the world. This was particularly noticeable in the industrialised world in the aftermath of World War II, when its 100% financing was crucial to the effort to get the world economy moving again. But it showed its particular credentials as an engine of national and individual economic growth for transition economies in the post-Soviet world.

The 100% financing it provides, for instance, permitted one country to develop a whole plastics industry without any upfront financing from the Government. The factory obtained the necessary technical know-how from a Western company that recouped its investment through the exclusive right to sell a portion of the products of the factory over a given period of time. The financier who provided the funding recovered its investment through the sale of these products. After a certain time the country in question found that it had acquired a new industry capable of generating new wealth, all this without any money being advanced upfront by the Government of that country.

Our enquiries showed that there are still whole parts of the world where the message of leasing and its potential as an engine of growth have still not got through. There are whole areas of the economy that are crying out for lease investment; for example, we heard from the World Bank that there is a very serious shortfall in infrastructure financing in Africa that leasing would be particularly well suited to help with.



A legislative framework alone is clearly not going to create a leasing industry in one of these countries. But the establishment of a modern legal framework for leasing is going to be absolutely necessary if foreign investors are going to feel sufficiently protected in order to invest in such countries.

By providing a uniform framework like the proposed model law we are aiming not only to provide the necessary legal certainty for foreign investors to invest in a new country via leasing but also to avoid having to reinvent the wheel anew each time a country sets out to develop its leasing industry.

There are, moreover, countries, like the People's Republic of China which are currently in the process of developing their leasing law and the proposed model law provides a perfect model for such countries to take in developing their own municipal legislation.

### **PRELIMINARY ENQUIRIES MADE BY UNIDROIT**

The UNIDROIT Secretariat started out by verifying the need for, and feasibility of a model law on leasing for developing and transition economies among some of the key economic stakeholders, in particular the World Bank, the International Finance Corporation (I.F.C.), the Equipment Leasing Association of America (E.L.A.) and the European Federation of Leasing Company Associations (Leaseurope). These preliminary enquiries confirmed both the need for, and the feasibility of such a model law, in particular with a view to meeting the serious infrastructure financing shortages experienced in African countries.

### **DECISION BY UNIDROIT TO PREPARE MODEL LAW**

In the light of the preliminary enquiries made by the UNIDROIT Secretariat, the UNIDROIT Governing Council (at its 84<sup>th</sup> session, held in Rome from 18 to 20 April 2005) recommended, and the UNIDROIT General Assembly (at its 59<sup>th</sup> session, held in Rome on 1 December 2005) decided upon the inclusion of the preparation of a model law on leasing in the Work Programme of UNIDROIT, albeit on the understanding that it should not impact on UNIDROIT's Budget.

A project, once included in the UNIDROIT Work Programme, typically follows a three-stage process. The first stage consists in the preparation of a first draft by an independent body of experts, the second, depending on the reaction of the UNIDROIT Governing Council to this first draft, in its transmission to Governments for finalisation by a Committee of governmental experts and the third in the adoption of the draft instrument emerging from this intergovernmental consultation process by a diplomatic Conference, in the case of an international Convention, or by the General Assembly of UNIDROIT member States, in the case of a model law.

In this case, the first stage has been completed. A preliminary draft model law has been prepared by an Advisory Board made up of representatives of the world's major economic and legal systems, including key economic stakeholders such as the I.F.C. and the E.L.A. The Board included amongst its members representatives of North Africa and the Middle East, sub-Saharan Africa, Asia and the Pacific region, the Former Soviet Union countries, Europe, North America and Latin America. All those serving on the Board, including the Chairman, Chief Mrs Tinuade Oyekunle (Nigeria) and the Reporter, Mr Ronald DeKoven (United Kingdom), were acknowledged experts in the field of leasing. Three sessions of the Board were held in Rome, in October 2005, February 2006 and April 2006 respectively. A preliminary draft model law on leasing was established at the conclusion of the third session, in equally authentic English- and French-language versions.

The second stage of this project commenced with the consideration by the UNIDROIT Governing Council, in May 2006, of the preliminary draft established by the Advisory Board and, subject to a number of amendments, its authorisation of the preliminary draft's transmission to

Governments for finalisation. The preliminary draft was duly transmitted for comment, in July 2006, to all member Governments and the interested international Organisations and professional associations, as well as non-member Governments with developing and transition economies. A considerable body of comments came in from the Governments of Austria, Bolivia, Bulgaria, Cameroon, the People's Republic of China, Germany, Japan, Latvia, Mongolia, Morocco, the Russian Federation, Tunisia, the United Kingdom and the United States of America as well as from the International Civil Aviation Organization, the E.L.A., Leaseurope, the International Chamber of Commerce and the Latin American Leasing Federation (Felalease). In January 2007 the Government of South Africa informed the UNIDROIT Secretariat that it would be happy to see the session of the UNIDROIT Committee of governmental experts for the preparation of a draft model law on leasing held on its territory and, accordingly, with its co-operation.

The first session of the Committee was, accordingly, held in Johannesburg from 7 to 10 May 2007. It is the text of the preliminary draft model law on commercial leasing as reviewed by the Committee at that session which is on the table at this second session of the Committee.

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*Basic features of model law:*

*Overall conceptual approach followed in drafting of model law*

*Ronald DeKoven, Associate Member, 3/4 South Square, London;  
Of Counsel, Jenner & Block LLP; UNIDROIT Correspondent;  
Reporter to Committee of governmental experts*

Excellencies,

The focus of my talk will be on the conceptual approach of the proposed model law. I think the best way to introduce the subject is to essentially ask the question why a law is needed, because, certainly, if a lessor has property that it wishes to allow another to use, that person could, under the basic principles of contract law, write an agreement and say I allow you to use this property for a month, for a year or a decade and you agree to pay me a certain amount of money for that. So why do we need a law? The answer is that that agreement is only binding on the lessor and the lessee. There are other people involved that may have a different view of what the lessor has done and then, if they do, they may end up with a superior claim to the property. So it is important to involve the State in creating a legal framework that is conducive to the lessor and the lessee entering into this transaction.

Beyond the impact on third parties there is also the question of the benefit of the bargain: certainly when the lease is entered into the lessee freely acknowledges that she does not own the equipment; the equipment belongs to the lessor. However, over time, circumstances change: the lessee becomes dependent on the equipment and, even though the lessee may not be able to continue to pay the lessor, the lessee starts to feel she has a proprietary interest in the equipment and, even though she has not paid the lease payments to the lessor, she may want to retain it. How does the lessor get her property back in such circumstances? Having a simple agreement with the lessee may not be enough.

The question is how will the judicial system treat the lessor. Is there any need to access the judicial system or is there a way to make it more efficient for the lessor to get her property back if she is not being paid in a timely fashion? That is where the State steps in; that is why you need a legal framework that sets forth some fundamental rules for the parties to follow. Now, we

focussed on the relationship between a lessor and a lessee, which seems in certain respects to be somewhat mundane, given that there are only two parties involved.

Why is it important enough for the State to be asked to get involved, for the State to be asked to create a law that encourages this type of transaction. For the answer to that question I should like to go back to my own experience. When I started practising law in the United States, in 1968, one of my first clients was a leasing company and they would call up and tell me that they were going to lease a particular type of property to a company, let us say, in New York and we would like you to document that transaction. What I had to do, upon receiving that telephone call, was first to see if there was a form of lease agreement that was generally accepted by lawyers in New York and then, because at the time I did not live in and was not admitted to practice in New York until 1980, I had to do some research: I had to find out whether New York had some unique laws that affected the leasing of property. Only after all that was done could I sit down with the client and ask her to tell me what the terms and conditions of the lease were. Then I would go away and draft and revise the lease agreement. Then I would send it off to my client and she would look at it and I would change it again. Then I would send it to the lessee's lawyer. Even though the transaction may not have involved much money, it involved a lot of my time. So, looking back, I would argue to you that what I did was very inefficient but I had no choice and this is what I had to do.

Years later, I was asked to be the person responsible for drafting the portion of the Uniform Commercial Code that focusses on leases, that is now Article 2A. It took a few years and I certainly did not do it alone: there was a committee that was heavily involved and hundreds and hundreds of lawyers from all over the country but, fortunately, it did finish and was successful and that law is now in force in every State of the United States. So to-day a young lawyer receiving a telephone call from a leasing company knows what the law is in New York, even though she may be in Texas or Kentucky or Illinois, because the United States has essentially a uniform system of laws. That is not to say that the law of each State is identical because it is not but a service is available that shows how each State may have changed what I drafted. And they have changed what I drafted but not in important ways. The changes are modest and easily understood. As a result, that young lawyer to-day can be very efficient when putting together the documentation for the transaction.

You do not need to believe me when I say this. The proof is in what has happened to the market for leasing in the United States between 1968, when I started practicing law, and to-day: In 1968 there was, effectively, virtually no market for leasing: the market was very small. In fact, if you were to ask a lawyer in the United States at the end of the 1960's to describe a lease and tell you what the fundamental principles of the Common law were based on, the likelihood is that that lawyer could not answer the question, because the law upon which leasing is based in the Common law is called bailment and the law schools stopped teaching that decades before I began my practice: it was thought not to be sufficiently important to be taught. So lawyers did not understand the basis for leasing and you can imagine what that did to the quality of their work when they were asked to write a lease or to enforce a lease.

What has happened in the forty years since I started practicing is that the leasing market in the United States to-day is enormous: it is not just because there is a model law and there are obviously other reasons. But without that model law I submit to you that it would not have happened: the growth is a function of the stability that a clearly drafted legal framework provides. You must create certainty for a provider of capital. I would even go so far as to say – and I know that some of you will argue with me about this – that it almost does not matter what the rule is but what matters is that there is a rule. If they understand what they can and cannot do, then they can function. It is uncertainty that creates the problem for an industry. So, we are doing our best in drafting this model law to create a system of rules, hopefully a system of rules that are balanced (and I shall come back to that in a moment).

If there is any question as to the need for a model law, I think there are a few developments that can convince you that there is a need.

In 1988 UNIDROIT completed its Convention on International Financial Leasing. That was designed for what lawyers call cross-border leasing transactions: it was not designed as the basis of internal law. But because so many States lacked a leasing law, several of them essentially used the Convention as their model and created an internal law based on the Convention. That is flattering to UNIDROIT but, in fact, there are better ways to solve the problem. But the fact that people did that shows you how great the need is.

Secondly, if you question the need for a model law, we have our colleagues from the International Finance Corporation here. Not everyone knows what an incredible job they have done over time in creating leasing industries in dozens of countries. As they do that, they focus on the law in the State where they are thinking about creating an industry. They do not open the business, transfer the capital and hope for the best: they work with the State to create the legal foundation. And I think you will hear later that, if we are successful in completing this project, this model law will assist them in expediting the growth of the leasing industry throughout the world.

Now, those were our points of reference in drafting this law. As I told you a few moments ago, I was the chief reporter for Article 2A of the Uniform Commercial Code. If you were ever to read it, you would find it very long and complex. Why is it that way? As an American citizen, I would suggest that the legal structure in the United States is always more complicated than it should be. The reason for this is that one of the great products of the United States is young lawyers: every year thousands and thousands of them are produced by American law schools and they tend, in my opinion, to over-lawyer what they do, looking to create too much certainty. As a result, when laws in the United States are created, they have a list of the things that they think should be included in the law to create greater certainty. At some point that is not helpful, because no-one is smart enough to know what the future will bring.

So, in drafting a law, it is important to introduce flexibility, because, whatever we think is the issue of the moment, our children will not be dealing with that and will think it is laughable. If we create a legal framework that is clear, understandable and flexible, that legal framework will live. But, as you add things to it, it weighs it down. I must say that, even though I did write Article 2A, if it had just been my own product it would have been a lot shorter. But it was not: I did what I was asked to do by my clients and I think they were happy with the product. When I started that drafting job, as I said, there were essentially very few leasing laws in the United States and what I tried to do was to come up with an example that I would use as I worked over the years to create this law.

I felt I had to have a typical example to refer to a test on theories. And the same is true with the proposed model law. But this model law is different: as Mr Stanford said, we are writing this for countries that are hoping to create a leasing market and for countries that are hoping to enhance an existing leasing market that could be greater. So, the example that I came up with was the lease of a donkey, because my hope was that in a subsistence economy the introduction of this law would attract capital and enable subsistence-level farmers to obtain livestock and other goods that they might need to run their farms. Interestingly, my example was too grand, although at the time I did not think so. About a year and a half ago I was the guest of the African Leasing Association (Afrolease) and I was sitting in the audience listening to the President telling us about leasing in Africa: he told us the story about leasing a bee-hive in Rwanda. If you think about it, how much capital is required for the lessor to create a bee-hive: you need a few pieces of wood and a queen bee and that is pretty much it. It is pretty modest and the reason why it is so compelling, I think, is that it shows you that, with just the smallest amount of capital in certain situations, wonderful things can develop. Hopefully, in the proposed model law we shall be enabling

States like Rwanda to have a bee-hive leasing industry and, from starting with a bee-hive, the hope is that they may be able one day to lease a Mercedes truck.

Beyond the question of our focus, there is also the question of the relevance of our product. In this room there are numerous types of legal system represented. The proposed model law is not a Common law product. It is not a Civil law product. And it is not a Shari'a law product. The hope is that it has been drafted in such a way that in each State, regardless of the origins of that State's existing law, the future model law will be able to be taken, adapted and used by that State. It is important to understand that, as I think, it is unlikely that the future model law will be enacted without change anywhere; in fact, if it is, it probably will not work very well. The enactment process will require local lawyers, professors and judges to think through the implications for them of enacting the proposed model law as it is finally promulgated. The way I think about it is that there is an 80:20 rule: if 80% of what we achieve is uniform in the States that enact the law then we shall have been successful. There is no way that the degree of uniformity achieved will be 100% but, hopefully, it will be 80%.

The last two things that I should like to talk about are the scope of the law and freedom of contract.

It is probably difficult, if not impossible, to satisfy everyone on the scope of the law. The first area that people focus on is what do we think is included in the notion of lease. On the one hand, you have some people who have read the preliminary draft and come away thinking that the only type of lease that this future instrument governs is a financial lease: this is not so. And I know that because I felt very strongly from the beginning that the scope of the proposed model law should be much broader than that .... and I believe that it is.

The next area of question is what is the scope of that which can be leased? What types of property are we going to include? Some people say that we should include real estate and that it would be a grand thing if we had a law for the leasing of real estate, whereas others say that that would be a terrible mistake.

The third issue under this rubric is software: does the proposed model law include software, should it do so and what are the implications of that? You will hear more about that today as we go through the specific provisions of the preliminary draft.

Last but not least, there is the issue of freedom of contract. What should we allow the lessor and the lessee to agree to on their own? Are there issues where the State says no, you cannot agree on this; it must be a certain way? Certainly, if we were writing a law for large companies, I would submit there is no issue and that they can take care of themselves. But when you are writing a law that affects farmers – and I am not talking about the farmer with the Mercedes tractor or truck but rather about the farmer that has just leased a bee-hive – there may be questions where the State intervenes and says no, you simply cannot do that.

In concluding, I should like to remind those of you who were with us in Johannesburg and those who were not of the remarks made there by the Deputy Minister of Justice and Constitutional Development, because at the time I thought they were compelling. I think that, in addition to all the things that we are going to be looking at in the proposed model law, probably the most important thing is balance and fairness: have we put together something that will work for all the parties. That, I think, is the fundamental question and you are all here to answer that.

Thank you.

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*Sphere of application of model law*

*by Brian Hauck  
Associate, Jenner & Block LLP, Chicago;  
Secretary to the Committee of governmental experts*

**I. Introduction**

As Mr Stanford described in the opening of the session, the preliminary draft before the Committee today has come a long way from the first version of it that appeared several years ago. But through many revisions, the text has remained remarkably consistent with the principles that Mr DeKoven has just described. The model law continues to take a flexible, clear, wide-open approach that will encourage investment in emerging and transitioning economies, and in particular, will assist the small- and medium-sized enterprises that are especially important in driving that growth. It should permit the industry to grow in many different directions, depending on where the opportunities emerge, across the world's various legal systems. I think we can say while we have work to do at this session, a consensus has emerged on important points regarding the scope of the model law.

**II. Civil rights and duties**

First, a consensus has emerged that the model law should focus on the rights and duties of the parties. This is consistent with UNIDROIT's focus on private law issues, and has been reflected through the many rounds of revisions through which the law has come. Accordingly, the preliminary draft model law does not deal with issues of taxation, accounting or supervision in this document. This is not to say those issues are not important. To the contrary, they are critical to the growth of the industry. But a consensus has emerged that those issues should come after the rights and duties are defined, and always involve public policy questions that differ from State to State.

### III. Commercial leases

Secondly, a consensus has emerged that the model law should only cover commercial leases, and not consumer leases. This restriction is contained in Article 2's definition of the "assets" that the model law covers. The model law covers only leases of assets that are "used in trade or business." This Committee confirmed the limitation when it amended the preliminary draft's title, making clear that the law focuses on "Commercial Leasing." This limitation is important. It means, first, that the model law focuses on the transactions that are most critical to economic development. And, secondly, it means the law need not have the kinds of consumer protections that one might expect in a law governing consumer leases. The parties to the commercial lease will be business entities, for whom consumer protections would be inappropriate and would discourage transactions that the parties would willingly enter.

### IV. Types of asset

A consensus has also emerged regarding the scope of the kinds of asset that may be leased under the model law. At our last session, the Committee decided to make clear that agricultural products could be leased, but chose otherwise to maintain Article 2's definition of "assets" as written. The question of intellectual property came up specifically. It was decided that because intellectual property is more commonly licensed than leased, and because such leases involve very unique issues, the law should not mention intellectual property specifically. I will note that in this decision the Committee has kept the model law in line with the Vienna Convention's treatment of software. Under the Vienna Convention, States have concluded that sometimes software and intellectual property should be treated like "goods" or an asset, as when you pick a Microsoft product off the shelf, but sometimes software and intellectual property should be treated like a "service," as when you hire a developer to create and maintain custom software for your particular needs. By not mentioning them specifically in this draft, the Committee is preserving the interpretation that is developing in these legal systems. Some kinds of software and intellectual property will be treated as assets under this law, and some will not be treated as assets. Thus, the consensus that has emerged in our discussions is consistent with a larger consensus that has emerged in applying the Vienna Convention.

I should note that we also appear to have reached a consensus on how the law should handle leases of real property. Once again, Article 2's definition of "asset" makes no mention of real property. Under the definition, *all property used in the lessee's trade or business* can be leased. This broad language includes real property, and thus the law will facilitate leases of real property in States that may not have laws governing such leases. However, the Committee has recognised that leases of real property involve unique domestic concern, and that no model law can handle such issues in the localised manner they require. Accordingly, Article 3 makes clear that the model law defers to any existing law that governs real property.

### V. Geographic scope

Thus the scope of the model law with respect to assets. The model law also has a geographic scope on which we appear to have reached agreement. Under Article 1, the model law applies when a transaction meets any one of three criteria: leases in which "the asset is within [the State], the lessee's centre of main interests is within [the State] or the leasing agreement provides that [the State's] law governs the transaction." The reach of the law is thus broader than the reach of the 1988 Ottawa Convention, which covers only cross-border leases. This law applies both to purely domestic leases *and* to cross-border leases. This reach will thus both encourage foreign investment, like the Ottawa Convention, *and* encourage the growth of a domestic leasing industry. We appear to have reached agreement on these terms.



## VI. Lease

This brings us to the definitions of “lease” and “financial lease” themselves. Comments submitted prior to this session indicate that there are still discussions that need to be had, but some important points of consensus have emerged that may be useful in framing those discussions.

First, there appears to be no controversy over the proper definition of “lease.” Article 2’s definition sets the universe of transactions that this model law governs:

**Lease** means a transaction in which a person grants a right to possession and use of the asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

It appears that this definition has been accepted.

Then, as you will recall, the current version of the model law breaks down the universe of leases into two categories: leases that qualify as “financial leases” and all leases other than financial leases. Under this structure, anything that qualifies as a “lease” falls within the model law’s scope – and the question then becomes whether the lease is treated as a “financial lease” or as a lease other than a financial lease. Financial leases then give certain protections to the lessor and reduce the cost of capital. Article 2 defines the “financial lease” as a lease in which

1. the lessee specifies the asset and selects the supplier;
2. the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
3. the rentals or other funds payable under the leasing agreement take into account the amortisation of the whole or a substantial part of the investment of the lessor

If a lease meets these criteria, it will be treated as a financial lease under the model law. If it does not, it will be treated as a lease other than a financial lease.

Some States and Organisations have suggested that the universe of “leases” in the model law be divided differently. These suggestions include creating additional categories of lease that are particularly important, or expanding the definition of the financial lease so that shorter-term leases can receive the preferred treatment that financial leases receive. These are important suggestions, and there may be differing views on how the model law should divide up the universe of leases.

However, there appears to be no disagreement that the model law should cover these various types of lease, and that parties should be able to create the benefits of a financial lease regardless of where the model law’s definition draws the line. The model law’s Article 5 gives the parties the freedom to create whatever kind of transaction they want: They can create any kind of lease they desire, and they can agree to give it all the benefits of a financial lease or not. So the question before the Committee is not necessarily whether certain kinds of lease are valuable and ought to be encouraged; on that point we have reached consensus: The model law should encourage all kinds of lease, so long as there is a proper balance between the rights and duties of the lessee and lessor. The question is how should the law best encourage these various types of lease, consistent with the needs of the world’s various legal systems. And on that point the Committee’s many perspectives will be quite useful.

## **VII. UNCITRAL**

Finally, I would note the very important decision that this body took at its last session regarding the scope of the model law with respect to the legislative guide on secured transactions prepared by the United Nations Commission on International Trade Law (UNCITRAL). As we discussed, it is hoped that States may choose to adopt both the present model law and legislation based on the UNCITRAL guide on secured transactions. Because the line between financing an acquisition using a lease and financing the transaction by means of a security interest is thin, it was important to clarify the scope of this law with respect to transactions that might appear to function as security interests. At its last session, the Committee agreed to adopt Article 3(1), which had been carefully prepared through a series of discussions between the UNIDROIT and UNCITRAL Secretariats. In essence, Article 3(1) makes clear that if a transaction is governed by legislation based on the UNCITRAL guide, then the transaction falls outside the scope of this model law on leases, and falls within the scope of the law governing security interests. This decision created important clarity for States that have laws based on both instruments.

## **VIII. Conclusion**

As you can see, then, this Committee has reached several important agreements regarding the scope of this model law. It will govern financial leases and non-financial leases of all kinds of asset of a commercial nature, whether the transaction is entirely domestic or has a cross-border element. The law should thus be of significant value in ensuring investors that a wide variety of transactions will be given effect. Although we have work to do, it appears that most of that work is in further clarifying the distinctions within the model law's scope and not in setting the scope of the law itself. I believe that Mr Bey's paper will shed some light on those questions.

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*Rights and duties of parties under model law*

*by El Mokhtar Bey*

*former Chairman, Legal Affairs Committee, European Federation of Leasing Company Associations  
(Leaseurope); UNIDROIT Correspondent; Member of UNIDROIT Advisory Board*

**I.**

The preliminary draft model law submitted for your assessment deals with two types of leasing, those leases responding to certain relative criteria, such as the asset leased, and financial leasing, called, for example, in France and in certain African countries "crédit-bail".

A leasing agreement and financial leasing are considered, as expressly specified, as regards leasing, by the definition given in Article 2, and as regards financial leasing, by that in Article 2, as "a transaction" and accordingly involve multiple contracting parties and contracts that are, however, all united by the final purpose, i.e. its performance – performance of the transaction in question – to the satisfaction of all parties and hence, to that of all those involved.

**II.**

Which, then, in this preliminary draft model law, are the rights and duties of the parties to, first, a leasing agreement – which is the term we shall use in this report (II-1) – and, second, to a financial lease (II-2)? Which are these rights and duties (1A) and which are the sanctions for breach thereof (1B)?

## II-1 THE RIGHTS AND DUTIES OF THE PARTIES TO A LEASING AGREEMENT

### 1A. Which are these rights and duties?

Pursuant to Article 2, a lease is a “transaction in which a person grants a right to possession and use of an asset to another person for a specific term in return for rentals”. It is, therefore, a bilateral contract, concluded between the *lessor* “who grants the [aforementioned] right to possession and use”, and the *lessee*, “who acquires the right to possession and use” in return for payment.

It flows from this definition that both lessor and lessee have a duty and a right, each of which is reciprocal: the duty, for the lessor, to grant to the lessee the right to possession and use of the leased asset in return for the right to the regular payment of the agreed rentals, which is the duty of the lessee.

#### A-a. Duties of the lessor and, therefore, rights of the lessee

In order for the lessee to enjoy the right thus granted (the right to use the leased asset in return for the payment of fixed rentals), the lessor must perform its duty to deliver the asset in question to the lessee. This duty is implicit in the text. It flows from Article 11(2) and (3) on the “risk of loss”, Article 12(2) on “damage to the asset”, and above all from Articles 13, on acceptance of the asset, and 14, on rejection of the asset for the reasons set forth in that Article.

Accordingly, as provided for in Article 11, the “risk of loss is retained by the lessor and does not pass to the lessee.”

It follows from a combined reading of Articles 11(3) and 14 that, if the asset is delivered late, is delivered only in part or fails to conform – non-conformity – to the parties’ agreement, the risk of loss is retained by the lessor if the lessee:

- does not accept the asset as it is, the tender of which is then to be considered as not being a conforming tender (Article 14(2)(a)),
- or accepts the asset as it is, initiates proceedings to terminate the leasing agreement and – if required to do so under the contract – complies with its duty to maintain the asset (Article 18(1)(a) and (b)).

All this means that the asset delivered must conform to the specifications of the lease if the lessee is to be able to use it normally and, as a consequence, to make regular, full payment of the rentals.

However, the leased asset may, upon its delivery to the lessee, be found to have sustained damage without fault of the lessor. In that case, the lessee, under Article 12(2), has the option of:

- either “treat[ing] the leasing agreement as terminated” – by reason of the mere fact of the damage – if the loss is total; although the preliminary draft does not specify what is meant by total loss (Article 12(2)(a)), this will generally mean damage such as to render the asset wholly unfit for the purpose for which it was intended;
- or, if the loss is partial, “treat[ing] the leasing agreement as terminated” upon inspection; although the preliminary draft does not specify the degree of loss, it would be logical to assume, in line with the theory of abuse of right – as known in civil law systems, for

example – that substantial loss is required (Article 12(2)(b)) and not total loss as contemplated by Article 12(2)(a).

This assessment also follows from Article 12(1), which gives the lessee the option of accepting the asset as it is but with a reduction in the rentals payable for the balance of the lease term to reflect the loss in value of the asset rather than the extent to which the lessee's enjoyment of the asset has thereby been reduced.

As a rule, pursuant to Article 13(2)(b), the lessee, even where it has accepted the asset as it is, is entitled to claim damages from the lessor if the asset does not conform to the leasing agreement; given that, under Article 13(1), acceptance occurs when the lessee signals to the lessor or supplier – and, therefore, expressly – that the asset conforms to the agreement, fails to reject it or uses it – and, therefore, tacitly accepts it – after a reasonable opportunity to inspect it.

In order to ensure the lessee's full and quiet possession of the leased asset, Article 17(2) provides that a warranty that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is normally intended to be used is implied in the leasing agreement if the lessor regularly deals in assets of that kind. This is the warranty of acceptability and fitness of the leased asset.

The lessor also warrants, under Article 16 (Warranty of quiet possession), that the lessee's quiet possession will not be disturbed by a person who has a superior title or right or who claims a superior title or right and acts under the authority of a court, or who makes a claim by way of infringement.

This is a mandatory provision and the parties may not derogate from it or vary its effects.

- The lessee is entitled to transfer its rights and duties, but only - in accordance with Article 15(2) - with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

A-b. Duties of the lessee and, therefore, rights of the lessor

- The lessee has several duties. It must pay – as laid down in Article 2 (Definition), – rentals for a specific term, in accordance, of course, with the deadlines and other terms of the contract, although the preliminary draft does not specifically state this.
- The lessee must, pursuant to Article 18(1)(a), take proper care of the asset, which is the property of the lessor, and use it reasonably in the light of the manner in which such assets are ordinarily used and keep it in the condition in which it was delivered, subject to fair wear and tear.
- When the manufacturer or supplier of the asset issues technical instructions for the asset's use and maintenance, under Article 18(1)(b), the lessee's compliance with such instructions satisfies its duty of proper care and maintenance, if such is the intent of the parties.
- Finally, the lessee has the duty to return the asset to the lessor when the leasing agreement comes to an end or is terminated (Article 24), in the condition in which it was delivered. Since the lessee is not entitled to buy the asset, an option that may only be exercised in the case of a financial lease, it cannot acquire it by exercising such an option. The lessee may nevertheless buy the asset, in accordance with municipal law, once the

leasing agreement expires or it may hold it on lease for a further period, in accordance with Article 18(2).

One or other of the contracting parties may breach the terms of the leasing agreement. The preliminary draft model law contemplates this situation, which it refers to as "default".

*1B. What then is the sanction for "default" by one of the parties to the leasing agreement under the preliminary draft model law?*

B-a. Termination of the leasing agreement

- Pursuant to Article 19(1), the parties may, at any time, agree as to the events that shall constitute default. In the absence of such agreement, Article 19(2) provides that default "occurs when one of the parties fails to perform a duty arising under the leasing agreement or this Law." However, the sanction of termination only applies to such default as is termed "fundamental" in Article 23(1)(a), which does not however provide a definition for that term.
- In that case, the leasing agreement is terminated by operation of law, by agreement of the parties or by an aggrieved party upon fundamental default by the other, in accordance with Article 23(1)(a).

In this last case, in accordance with Article 20, except as otherwise provided in the leasing agreement, the aggrieved party must give the defaulting party notice of the reason for such termination as well as a reasonable opportunity to cure its default.

B-b. Damages

- Once the agreement is terminated, the defaulting contracting party must compensate the aggrieved party for the damage it has caused. The aggrieved party is, accordingly, entitled to such damages as will, in accordance with Article 21, place it "in the position in which it would have been had the agreement been performed in accordance with its terms.

However, the parties may also make provision in their contract for compensation – liquidated damages – but the amount stipulated must not be not just excessive but not "grossly excessive", in relation to the harm resulting from the default. Article 22(2) does not, however, provide any specific guidance as to when such a sum is to be adjudged not merely excessive but grossly excessive.

In this case, the sum agreed may be reduced to a reasonable amount, which may, however, still be excessive for the purpose of attaining the coercive and dissuasive objective of the relevant clause. In order to prevent abuse, the parties may not derogate from the provisions of Article 22 (Article 22(3)).

Such are the rights and duties of the parties to a leasing agreement and the sanctions for breach of the same.

## **II-2. THE RIGHTS AND DUTIES OF THE PARTIES TO A FINANCIAL LEASING TRANSACTION**

What are the rights and duties of the parties to a financial leasing transaction, in which the lease serves a financial purpose, an idea eloquently rendered by the French "crédit-bail" or "crédit par le bail"?

First of all, however, what is financial leasing?

## 2A. *The definition of financial leasing and a description of its structure*

### A-a. Constitutive ingredients:

- Article 2 describes a financial lease as a lease, with or without an option to purchase, that presents the following cumulative characteristics:
  - (a) the lessee specifies the asset to be leased and selects the supplier;
  - (b) the lessor acquires the asset, in principle on terms freely agreed with the supplier, although this is not specified in the text; and
  - (c) “the rentals and other funds payable under the leasing agreement” – not specified in the text – “take into account the amortisation of the whole or a substantial part of the lessor’s investment”, i.e. the capital it has invested in the transaction, which includes the purchase price of the asset and related costs such as the cost of transport and insurance, customs duties, ..., the cost of alterations, which, taken together, form the rental base on the basis of which the rentals are calculated but which do not affect the rentals’ legal nature.

Accordingly, the rental is not merely the counterpart of the right to possession and use of the asset leased under a financial lease, determining their *legal character*, but also, indeed chiefly, part of the amortisation corresponding to the lessor’s investment and profit margin, determining their *financial character*.

The combination of these two elements explains the special nature and originality of this type of leasing which find a logical and balanced expression in the preliminary draft, which reflects, *inter alia*, the multiplicity of the parties and contractual relationships involved, which we shall now look at, from the perspective of the rights and duties of the parties to such transactions.

### A-b. Structure(s)

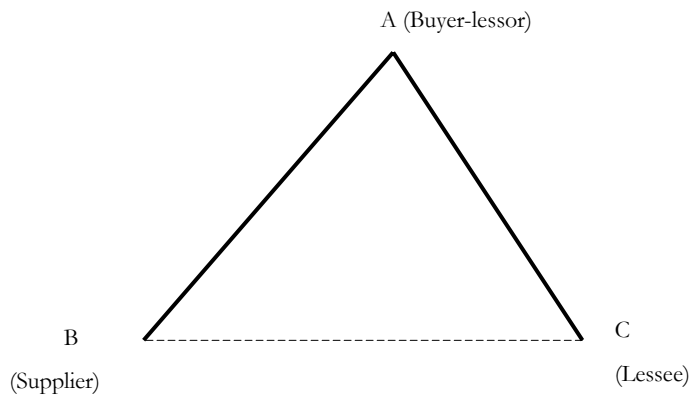
- Pursuant to Article 2 of the preliminary draft, the lessor acquires the asset, selected by the lessee, from a supplier designated by it, or the right to possession and use of the asset in question under a lease; in both cases, in order to lease the asset to the lessee, the financial leasing transaction consists *either* in a contract of sale – called the supply agreement – and a leasing agreement for the same asset, then bought and leased to the lessee – a simple leasing agreement with an option to purchase the leased asset which turns into an actual sale once the lessee expresses its intention to buy on the agreed terms – *or* a simple leasing agreement and a sub-lease for the same asset or a leasing agreement with an option to purchase the asset and a sub-lease for the same asset with the purchase option from the leasing agreement transferred to the sub-lessee.

Since such a transfer amounts to the transfer of a possible future right which is not allowed in some legal systems or a purely discretionary condition which is invalid under some legal systems, this transaction comes down to either a simple lease and a simple sub-lease or a lease with a purchase option and a simple sub-lease, except if we consider that Article 15 authorises the transfer in question (in that it refers to the rights and duties of the parties “under the leasing agreement”, which specifically grants this option).

There are six possible scenarios in respect of financial leasing.

In the first scenario, the transaction involves, on the one hand, the supplier and the buyer-lessor, bound by a contract of sale for the asset to be leased, and on the other hand, the lessor and the lessee, bound by a leasing agreement for the asset in question (see Diagram No. 1).

Diagram No. 1



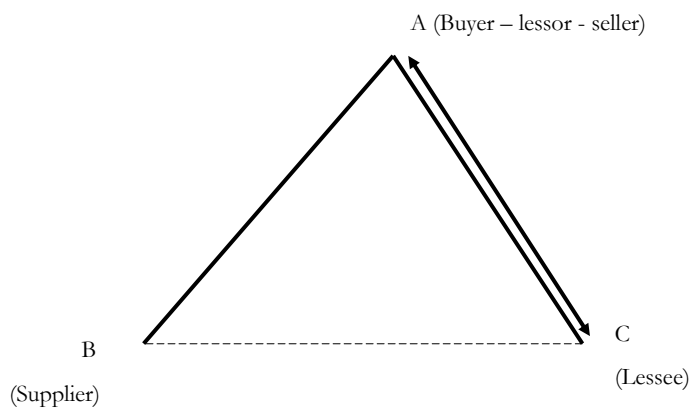
AB= supply agreement (the initial sale)

AC= simple leasing agreement

BC= legal relationship created by the intent of parties A and B in view of the financial nature of the transaction (Art. 7(1)(a) and (c)).

In the second scenario, the lease relationship AC is supplemented by the lessee enjoying an option to purchase the asset. Where the lessee exercises the option, a sale of the asset originally purchased and leased takes place on the terms, in particular the financial terms, agreed (see Diagram No. 2).

Diagram No. 2



AB= supply agreement (the initial sale))

AC= - leasing agreement with a purchase option

- contract of sale following the lessees exercising of the purchase option

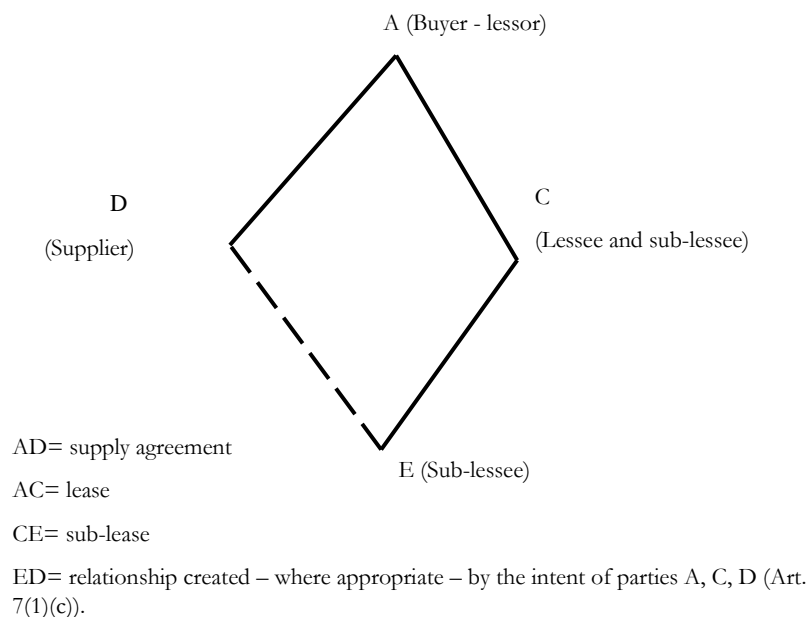
BC= legal relationship created by the intent of parties A and B in view of the financial nature of the transaction (Art.. 7(1)(a) and (c)).



Since the lessor's fundamental purpose is to amortise, either in full or in part, the capital invested in buying the asset and to make a profit by collecting rentals for the term of the lease, on the one hand, and since the user of the purchased asset – the person who requested the financing by way of leasing – who is the beneficiary of an option to purchase the asset in question, is the lessee who selected the asset and the supplier of that asset in accordance with its own technical, economic, commercial and financial specifications, and approved the supply agreement as provided in Article 7(2), the lessee must, where necessary, be entitled to rely on the supply agreement against the supplier as if it were a party to that agreement.

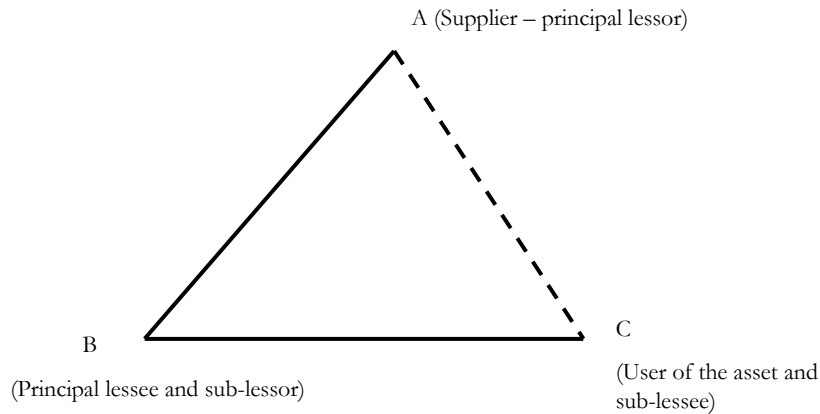
The combination of Article 2, whose definition of financial lease includes sub-lease in the lease, and Article 7(1)(c) which provides that "[w]here the absence of privity of contract between the lessee and supplier prevents the lessee from enforcing the supplier's duties under the supply agreement, the lessor shall be bound ...", suggests a third scenario in which the relationships in Diagram No. 1 are supplemented by a sub-leasing relationship – binding the sub-lessee to the lessee – which is typical of what in the technical jargon of some countries is known as *leasing adossé*, in which the lessee – the principal lessee – is, economically speaking, a guarantor, whereas the sub-lessee is the real user, who will not normally have been approved by the lessor, usually on grounds of financial risk. Here, it is clearly the sub-lessee's right to rely on the supply agreement against the supplier as though it were a party to that agreement (see Diagram No. 3).

Diagram No. 3



In a fourth scenario, the supplier – perhaps the manufacturer of the asset – is the lessor of the asset granted under a simple lease to the lessee, which might be a subsidiary – a captive – and in effect the sub-lessor (see Diagram No. 4). The difference from Diagram No. 1 resides in the position of the lessor and the sub-lessor.

Diagram No. 4



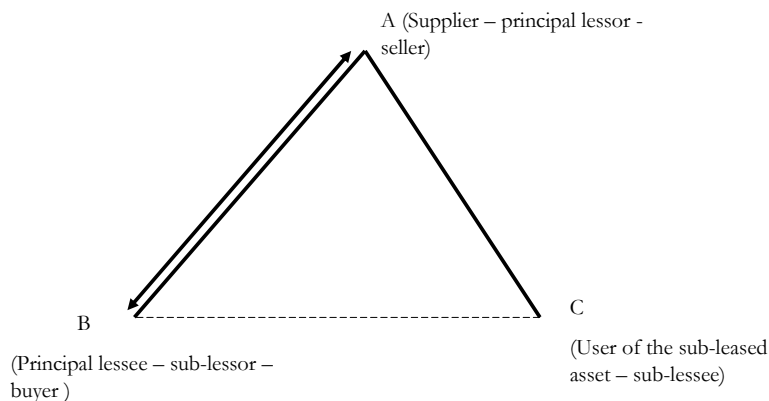
AB= principal lease

BC= sub-lease

AC= choice of asset and establishment of the terms of the transaction; legal relationship created by the intent of parties A and B in favour of C

In this same transaction, the principal lessee may have a purchase option, which does not apply to the sub-lessee (see Diagram No. 5).

Diagram No. 5



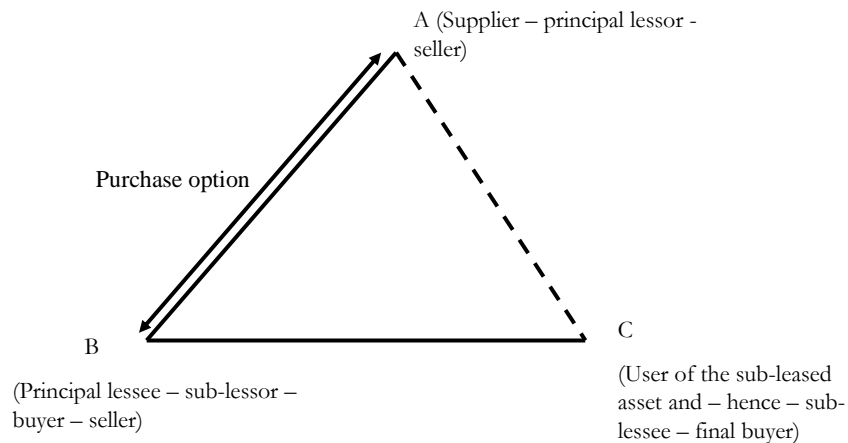
- In these two cases, the sub-lessee being the user of the asset, it is the sub-lessee that chooses the asset and the supplier. The leasing company does not buy the asset but leases it. It, therefore, has the capacity of lessee in relation to the supplier, which is then its lessor, and lessor or, rather, sub-lessor in relation to its own lessee or sub-lessee.

By the same token, the sub-rentals are made up of the principal rentals, increased in such a way as to provide remuneration for the sub-lessor. In addition, since the sub-lessor is not the owner of the asset, it cannot grant the sub-lessee an option to purchase the asset. This

means that the term of the lease and that of the sub-lease must be identical and cover the economic life of the asset, the usefulness of which diminishes with time. Article 2 of the preliminary draft does not deal with these consequences.

However, the sub-lessor, who is the lessee in the principal leasing relationship, may have a purchase option which it would then transfer to its own lessee – the sub-lessee (see Diagram No. 6).

Diagram No. 6



AB= principal lease with purchase option and subsequent contract of sale

BC= sub-lease with the same purchase option and subsequent contract of sale

AC= choice of asset and establishment of the terms of the transaction

In some legal systems, it would nevertheless be impossible to transfer the purchase option – considered as a possible future right or a purely discretionary clause – although Article 15 authorises the parties to transfer their rights and duties in compliance with the terms of that Article, “under the leasing agreement”, which precisely stipulates such a purchase option.

Which, then, are the rights and duties arising from such a financial leasing transaction in which the relationships between the parties are structured as described above?

## 2B. *Rights and duties of the parties*

The rights and duties of the parties are subject, on the one hand, to the normal municipal law of a State, as expressly provided for in Articles 3, 5, 8(2), 12(1) and 23(1)(a) and (b), applicable to real property and public notice (as provided by Article 3), rules which are, however, compatible with the mandatory provisions of the preliminary draft model law, and, on the other hand, to the text that forms the subject of this analysis.

The rights and duties in question concern:

- the creation of a direct right of action between the lessee or the sub-lessee and the supplier (Ba);
- the lessor’s relief from liability (Bb);
- the transfer of risks to the lessee (Bc);
- the lessee’s right of action for breaches the lessor’s duty to deliver (Bd);

- warranties (Be);
- other duties (by reference) (Bf).

#### B-a Direct right of action between lessee and supplier

The preliminary draft model law regulates the relationship between the parties in the light of the financial nature of the transaction, which is the predominant factor in the determination of its legal nature and which explains the derogations, not to the principle of the relativity of contracts but to the ordinary municipal law governing leasing, which it makes. These derogations are justified by the prerogatives and initiatives of the principal actor, the lessee, for whose benefit the transaction is made, the fundamental purpose of the supplier being to sell the asset and that of the lessor being to amortise and make a profit on its investment over the term of the lease, through the rentals – amortisation and profit margin – agreed, subject, however, to the substantive features of the agreement.

- As a result, Article 7(1)(a) creates a direct right of action between the lessee and the supplier which enables the former to rely on the duties arising out of the supply agreement – notwithstanding the fact that, legally speaking, it is a third party to that agreement – “as if the lessee were a party to that agreement”, on the understanding that the supplier cannot be held liable vis-à-vis both the lessee and the buyer-lessor for the same damage and that, pursuant to Article 7(1)(b), this extension of the supplier’s duties to the lessee does not modify the rights and duties of the parties to the supply agreement, or impose any duty or liability under the supply agreement on the lessee.
- This direct right of action is not, however, mandatory, since, pursuant to Article 7(1)(c), “[w]here the absence of privity” – described as contractual and hence as expressing the intent of the parties and complying with the relativity of contracts – between the lessee and 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 duties.”

These provisions of Article 7(1)(a), (b) and (c) may not be derogated from (Article 7(1)(d)).

- Where the supply agreement grants rights to the lessee and once the latter has approved that agreement, the agreement may not be modified in any way without the lessee’s consent. If the agreement is modified, the lessor is deemed to have assumed the duties of the supplier as so varied and to the extent of such variation (Article 7(2)).
- Ever observant of the principle of the relativity of contracts, Article 7(3) does not authorise the lessee to modify, terminate or rescind the supply agreement without the lessor’s consent.

#### B-b. Lessor’s relief from liability

- Since the lessor neither chooses the asset nor selects the supplier and since it clearly does not use the asset, Article 9 relieves the lessor, in its capacity of lessor, from liability vis-à-vis the lessee for death, personal injury or damage to property caused by the asset or the use of the asset. This relief from liability of the lessor extends to any liability that the lessor might incur to third parties in its capacity of lessor/owner – which covers the case of strict liability – or in any other capacity.

#### B-c Transfer of risks to the lessee

Since the financial role in the transaction is reserved to the lessor and responsibility for the technical aspects – relating to the asset – is reserved to the lessee, together with the initiatives and prerogatives that are, as a result, the lessee's, the risk of loss of the asset passes to its user, the lessee, on the date agreed or, if no time for the passing of risk is stated, when the leasing agreement has been entered into (Article 11(1)). However, the lessee may, if the asset is not delivered, is partially delivered, is delivered late or fails to conform to the terms of leasing agreement, claim that the risk of loss has remained with the supplier from the beginning, provided that it has taken proper care of the asset and used it reasonably in compliance with such instructions from the manufacturer or supplier as may exist and with the terms of the leasing agreement (Article 18(1)(a) and (b)).

#### B-d Lessee's direct right of action for breach of the lessor's duty to deliver

In the event of damage to the asset before it is delivered, without fault on the part of any of the contracting parties, the lessee may demand inspection and accept the asset with due compensation from the supplier, not for its diminished usefulness but for its loss in value, but without any further right against the supplier, or seek such other remedies as are provided by municipal law, in compliance with its duties to the lessor, which Article 10(1)(a) declares to be irrevocable and independent when once the leasing agreement has been entered into (Article 14(1)).

If the asset is not delivered, delivered only in part, delivered late or fails to conform to the financial leasing agreement, the lessee has the right, pursuant to Article 14(1), to demand a conforming tender from the supplier or seek such other remedies as are provided by law, on the understanding that, pursuant to Article 14(3), if the lessee rejects the asset, the lessor or supplier has the right to cure its non-performance within the time stipulated for delivery.

#### B-e. Warranties

- Once the lessee has chosen the asset to be leased and selected the supplier, the lessor, pursuant to Article 16(1)(a), which is mandatory, warrants that the lessee's quiet possession will not be disturbed by a person who has a superior title or right or who claims a superior title or right and acts under the authority of a court, however only where such title, right or claim derives from a negligent or intentional act or omission of the lessor.
- By the same token, a lessee who provides specifications to the lessor or the supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications (Article 16(1)(b)).
- Moreover, Article 17(1) provides that a warranty that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used is implied in the supply agreement and is enforceable only against the supplier.

#### B-f. Other duties (by reference)

With respect to the duty to maintain and return the asset (Article 18), the definition of default (Article 19), notice (Article 20), damages and liquidated damages (Articles 21 and 22), termination (Article 23), the lessor's recovery of possession and its right to dispose of the asset (Article 24), we would refer you to our comments on the leasing agreement.

It should however be borne in mind that:

- the lessee does not return the asset if it exercises an option to purchase the asset or if it leases it for a further term (Article 2);
- damages and liquidated damages designed to compensate the lessor for the loss that it sustains through the lessee's default must basically be limited to the financial loss sustained, on the understanding that the leased asset is returned upon termination of the lease;
- the lessee may not terminate the leasing agreement upon the lessor's or supplier's default but is entitled to such other remedies as are provided by the agreement of the parties and by law (Article 23(1)(b));

Finally, it should be pointed out that Article 5, which enshrines the principle of freedom of contract subject to the substantive rules that it enumerates, authorises the parties to adapt the model law to the specific features and objectives of a given transaction.

### III.

Such are the rights and duties of the parties and leading players in the complex area of leasing as proposed under the preliminary draft model law, which the parties are free to supplement and adapt in accordance with municipal law and subject to the mandatory rules that it lays down.

**UNIDROIT**

**INTERNATIONAL INSTITUTE FOR THE  
UNIFICATION OF PRIVATE LAW**

**IN CO-OPERATION WITH THE GOVERNMENT OF THE SULTANATE OF OMAN**

***THE PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING AS REVIEWED BY THE  
COMMITTEE OF GOVERNMENTAL EXPERTS AT ITS FIRST SESSION: AN INTRODUCTION  
TO ITS OBJECTIVES AND BASIC FEATURES***

**A half-day seminar addressed to the Governments and international Organisations  
invited to participate in the second session of the Committee of governmental experts**

**(Muscat, 6 April 2008)**

*Assessment of relevance of model law for developing and transition economies:*

*Practical need for, and potential uses of model law, in particular for Middle East economies*

*by Murat Sultanov*

*Legal Adviser*

*PrivateEnterprisePartnership Middle East and North Africa*

*International Finance Corporation;*

*Member of Advisory Board*

## **UNIDROIT Draft Model Law on Leasing: Middle East and Northern Africa perspective**

**Muscat  
April 6, 2008**

### **IFC: 30 Years experience promoting leasing worldwide**

#### **IFC Investments**

- Financed 190 leasing projects in 57 countries for \$1.3 billion
- Helped establish first leasing company in 26 countries

#### **Advisory & Technical Assistance**

- Assisted governments in 35 countries to improve legislative regimes for leasing
- Currently implements 28 leasing worldwide (\$14+ million)



## IFC is a leader in MENA as well

- **ALGERIA:** Investment and capacity building for the first private Leasing Company (Arab Leasing Corporation)
- **EGYPT, PAKISTAN, SAUDI ARABIA and OMAN:** Investment in private Leasing Co. ORIX Leasing
- **JORDAN, YEMEN, AFGAHNISTAN, AND WEST BANK & GAZA:** Long term Technical Assistance Program to develop leasing market in place since late 2005
- **AFGHANISTAN:** Capacity building for Afghanistan Finance Company – first leasing company in the country



## IFC Leasing Project's activities

- Partnership with local governments to create and improve legislation for leasing, including the enactment and/or amendment of the Laws and Regulations governing leasing.
- Capacity building for lessors, lessees, suppliers, investors and other stakeholders on leasing to increase the use of leasing.
- Increasing public awareness of leasing through a targeted public awareness campaign;
- Expansion of financial resources available for leasing in the country of operation.



## IFC MENA Leasing Program – working on improving legal framework

### Yemen:

- The Law on Leasing was adopted by the Parliament and signed by the President in April 2007.

### West Bank and Gaza:

- The Draft Law on Leasing has been presented to the Palestinian Authority and is currently under discussion.

### Jordan:

- The new Law on Leasing is currently under discussion in the Cabinet of Ministers;

### Afghanistan:

- The Draft Law on leasing has been agreed with the Central Bank and will soon be presented to the Ministry of Justice.



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*Assessment of relevance of the model law for developing and transition economies:*

*The viewpoint of Africa*

*by Chief Mrs Tinuade Oyekunle*

*Legal Practitioner, Lagos;*

*Honorary Vice-President, International Council for Commercial Arbitration;*

*UNIDROIT Correspondent; Chairman of the Advisory Board*

We are all assembled here in this beautiful city of Muscat, Oman for the second session of the Committee of governmental experts to consider the preliminary draft model law on commercial leasing which incorporated the views, opinions and suggestions thoroughly thought out by participants in the first session last year in Johannesburg, South Africa.

The objectives of such an important draft remained vital to the development of the economies of developing countries and countries in transition to a market economy.

When the intention of builders is to build a house and in order to achieve that purpose they have put on site all necessary materials, the house is not completed until all masons and workers commissioned to build the house have completed their assignments and the house becomes visible as a completed project. The task of participants here is to follow through the purpose for which this draft is designed in a very logical way that will enhance various economies by producing a workable draft for the benefit of the parties to the leasing agreement. What is required is a draft which can be adapted in the legislation of appropriate national laws on leasing. This procedure will guarantee an understanding of leasing laws which take into consideration the suitability to the State of promulgation.

Let me repeat the concern in developing economies like mine which I brought to the attention of participants at the Johannesburg session: we cannot afford to delay taking the most appropriate decisions to assist our countries before the industrial structures have completely broken down or destroyed.

This seminar was arranged to inform participants about the purpose of the draft and to enable them ask questions on clarification of issues where they are in doubt. It was my viewpoint, and it still is, that something urgent has to be done to adopt this document.

Looking inwards in the local areas there is a worrisome aspect of lending between banks and industrialists and other medium-income users, who want to acquire equipment from overseas suppliers, who sell by outright purchase because there are no attractive laws within the national hemisphere to protect them as lessors.

Lending rates instead of being favourable are also going up to the disadvantage of industrialists and other borrowers. The consequence of these factors is high production prices and the encouragement of the illicit importation of cheaper goods from outside the country in spite of custom regulations put in place. Other disturbing consequences are the inability of local professionals (e.g the indigenous engineers, contractors etc) to perform their occupations. The inability of these indigenous professionals to arrange favourable loans to purchase equipment from abroad or the lack of laws that enable lessors to come into their country and enter into leasing agreements which will enable them to obtain the needed equipment put them at great disadvantage vis-à-vis foreign contractors in developing countries. The adverse effects of such a situation are far reaching and lead to the retardation of national development and the creation of local unemployment.

Improved leasing activities will surely revitalize industrialization, which will in turn increase the employment of labour in these countries. Increased employment will in turn enhance the living conditions of the people and the social and economic position of the country.

As noted by the United Nations Commission on Human Rights, "the equality of opportunity for development is as much a prerogative of nations as of individuals within a nation". Accordingly, the modern expectations and perspectives of individuals and entities require a corresponding shift in the attitudes of Governments toward the present rapidly evolving momentum of globalisation.

Without doubt an adequate national leasing law following the preliminary draft model law promulgated within nations will also attract investors, which will in effect increase employment, enhance the economy and comply with the international obligations of reaching the United Nations Economic Decade in the year 2010 and the Millennium Development Goal in the year 2015.

**UNIDROIT**

**INTERNATIONAL INSTITUTE FOR THE  
UNIFICATION OF PRIVATE LAW**

IN CO-OPERATION WITH THE GOVERNMENT OF THE SULTANATE OF OMAN

***THE PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING AS REVIEWED BY THE  
COMMITTEE OF GOVERNMENTAL EXPERTS AT ITS FIRST SESSION: AN INTRODUCTION TO  
ITS OBJECTIVES AND BASIC FEATURES***

**A half-day seminar addressed to the Governments and international Organisations  
invited to participate in the second session of the Committee of governmental experts**

**(Muscat, 6 April 2008)**

*Assessment of relevance of the model law for developing and transition economies:*

*The viewpoint of transition economies*

*by Anna Donchenko*

*Ministry of Economic Development and Trade of the Russian Federation*

***Introduction***

"Theory of the transition period" is still considered to be rather new and bad-reviewed from the point of view of its evaluation. But you can already follow the logic of forming the market economy in modern "post-Soviet countries" basing on the political and economical works, especially on the questions of political business cycle and development economics.

The evolution in the technologies' sphere is followed by carrying out a policy of social liberalisation as to provoke the concurrence fight that is the first principle of any liberal economics on its financial market. The concurrence growth in the sector of financial services in the countries engaged in the transition to a market economy became the reason of the primary risks. The risks are partially connected with the uncertainty of the future situation. They occur where the real facts are different from those expected. Since the risks took place in the conditions of market globalisation, international supervision banking authorities along the lines International Monetary Fund, European Bank of Reconstruction and Development became the principal institutions of innovation in the transition economy countries.

History knowledge permits plain ding necessary steps that should be undertaken as to avoid any mistakes in the future. Social-economical system is the plot of regulations and provisions functioning and developing in the particular scope of business. The most important phenomenon in any society is economics, because it designates the "spine" of life and co-existence. The last decade was the transition period from the planned economy into the theory of the transition economy. The first one runs the gamut of all parts of any man's life. Obviously, the planned economy was not able to satisfy all society demands. The transition for Russia began in the 90's like in other post-Soviet countries. The previous structure once destroyed, a new one arises from its basic.

Any civilised change of the common system and public reforms is accompanied by revolutions. In order to have stability such countries as Spain, Italy, Japan or Korea took 15-30 years to overcome the crisis. As for industries and companies, they need to follow the step-by-step line to be adapted to the situation and to be provided with the knowledge collecting period.

### ***International leasing***

The process of international leasing development requires standardisation in all leasing operations. According to the aim mentioned above the UNIDROIT Convention on International Financial Leasing was adopted. The Convention foresees unified co-ordinated terms on leasing in different countries, on the basis of the sole legal definitions and generally accepted conditions. The tendency of global leasing market expansion is connected with different world-wide as well as national causes. The first ground is fascinated with the general character of the world globalisation and internationalisation movements in all economy-related spheres. The second reason concerns the specific nature of leasing relations that give access to the import equipment to the countries. Developed countries have already transferred into 'the most-favoured-nation policy', as for the countries under development – they have just taken their way to market relations; however their structures are still much weaker and they are mostly interested in national space defense.

The goal of foreign leasing companies in Russia is to go up with so-called special schemes where the subject to any leasing deal is the foreign suppliers' equipment for Russian companies as well as for foreign ones that have their business in Russia. Here there are three categories of international leasing scheme working in Russia with the participation of foreign lessors.

1. Those that had had no business in Russia before
2. Those having a non-commercial representation in Russia
3. Those having a permanent representation in Russia

Nowadays a lot of foreign leasing companies have created joint enterprises and branches in Russia aiming to realise the schemes.

There are several prerequisites to the further use of international leasing in Russia. The accession to the World Trade Organization makes the improvement and development of all kinds collaboration of Russia with foreign countries more actual from the point of view of the adoption to some new conditions and integration into economic activities. However such process requires the growth of competition of national companies both in the internal and international markets.

### ***Leasing "of today"***

Leasing is one of the most efficient instruments for renewing the basic assets of Russian enterprises. It is conditioned by a range of factors. In the first place, the Government provides tax privileges. Still, leasing companies will likely be flexible when operating either with a client or with a deal. Finally, a leasing company may submit a range of different supplementary services: registration in several special administrative structures using their name; making insurance; supply organising; custom equipment services and a lot of others.

### ***Operating lease***

In addition to the scoring programme of leasing, a lessee addresses to the operating automobile lease. Its peculiarity is the fact that among all lease payments there are insurance charges, registration payment, traffic taxes, service handlings and others. There can be included several unexpected charges connected with the use of the automobile. Such a product is of much interest now.

### ***Operating leasing***

Operating leasing is a new kind of leasing in Russia (no transfer of right of ownership for the lessee upon termination of the contract). The concept of leasing has been known just as a financial instrument, being a good alternative to any credit operation. In this context, leasing contracts stipulated a compulsory transfer of the right of ownership to the lessee upon termination of the contract because leasing companies feared to get back subject to leasing in a period according to a number of reasons. These reasons are as follows: they did not understand the individuality of business in different fields; they did not know the potential buyers' equipment coming back from leasing; there were no professionals among leasing companies staff; leasing companies had no opportunity to evaluate the price of purchased equipment in a couple or more years; absence of good service and low culture of clients' equipment handling. A lot of problems were solved due to leasing companies' experience, understanding the specificity of different branches, appreciation of development perspectives, realising close collaboration with suppliers and learning the main players' base. Operating leasing is also attractive from the point of view of low monthly leasing payments. But the main problem of operating leasing is the lack of this notion in Russian legislation, making multiple leases of the same piece of equipment impossible.

### ***"Affiliated financing"***

This programme can also be called classic financing leasing. It presumes the involvement of affiliated financing for new foreign equipment purchases from the producer. The features of the product are low rates and long-term duration in comparison with Russian financing.

It is important to keep in mind that in the context of a more compound structure and a big number of participants, such deals require more time to reach a decision by all parties on the financing of the project and the carrying out of the deal itself. However, the instrument is one of the most perspective ways of financing and purchasing basic assets in Russia now.

### ***Real estate leasing***

This notion is characterised by a complex and long-term procedure for the deal, but also special features of the subject to leasing that does not have any tendency towards writing down. It helps leasing companies when having 20%-30% of advance interest "to close eyes" on the financing condition of the lessee. This market is badly developed in Russia. There are two reasons for that. First of all, lacunae in legislation makes risks higher both for lessors and lessees. And, on the other hand, the realisation and financing of such projects require long-duration money. (minimum seven-year duration.) Unfortunately, resources of this kind are accessible only to a small number of leasing companies in Russia. Notwithstanding, this market is very challenging and its stormy growth is likely expected in the nearest future.

### ***Leasing outlook***

Statistics proves the growth of leasing deals in Russia. It is mostly called by small entrepot. Half the deals are carried out with the participation of small enterprises and keepers. And it is not surprising. Property use under leasing contracts involves a substantial lightening of the tax burden, that is expressed in:

- expense costing of leasing payments on the cost value;
- economy in property tax payment;
- income tax reduction at the expense of accelerated property amortisation passed on leasing.

Finally, making a leasing contract requires the rise of effectiveness when using circulating assets by means of primary expenses minimisation for acquiring property.

The range of leasing operations use is broadening every day. Leasing purchased equipment is exercised in the following:

- movement of cargo and passengers;
- construction;
- logistical warehouse;
- commercial property services;
- equipment purchase for producing authorities, for private clinics, trade, etc.

Still, it might be noted that there are discussions on the Federal law of leasing in Russia. In particular, it is suggested that there should be changes regarding civil aviation, leases of aircraft and their equipment.

### ***Conclusion***

The elaboration of legal principles, conditions and mechanism for transnational leasing in States Parties of the Commonwealth of Independent States was done at two levels: national and transnational. In order to work out a legal basis for transnational leasing, the participants analysed the national legislation of each State. The results of this research showed a range of peculiarities in the legislation, including the notion of leasing as a sort of activity, its role and place in the economic process as well as in the degree of elaboration of special legal acts, and regulations. Tax, monetary, customs and audit questions in the leasing-related sphere stipulated in national legal acts had a rather inconsonant character. The comparison led participants to consider the need for forming a common legal basis for the free trade zone of the Commonwealth of Independent States in the field of leasing.

### ***Branch concept***

Branch principles of leasing development (for example, in agricultural business) were stated in the mutually agreed, affirmed concept of leasing in respect of agricultural machinery and mechanisms by the Commonwealth of Independent States. Among the main provisions that are regulated in this document are:

- special-purpose programme of intergovernmental leasing;
- learning and implementation of national legislation of the Commonwealth of Independent States in the sphere of leasing operations;
- mobilisation of commercial structure research and other means of the Commonwealth of Independent States for financing leasing operations and creating banking commercial syndicates for concrete projects and programmes;
- appropriation of leasing payments for lessee's expenses, including taxation;
- certification of assets subject to leasing;
- forming an efficient infrastructure for leasing equipment services;
- right for operational and redemption leasing, etc.

In order to receive any practical approval of the programme, the participants worked out a project for a "pilot programme" of intergovernmental leasing in the Commonwealth of Independent States for agricultural machinery and mechanisms for the period from 2006 until 2010.



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*The process for finalisation and adoption of the model law*

*by Martin Stanford  
Deputy Secretary-General  
UNIDROIT*

The text of the preliminary draft model law as it comes out of this second session of governmental experts will be laid before the UNIDROIT Governing Council at its 87<sup>th</sup> session, to be held in Rome from 21 to 23 April 2008, for advice and consent as to the most appropriate follow-up action. On the assumption that the Committee of governmental experts will be able to achieve consensus on the text at this session, it is the intention of the Secretariat to propose to the Governing Council that it authorise the transmission of the text, as a draft model law, to Governments and Organisations for finalisation and adoption, at a joint session of the UNIDROIT General Assembly and the Committee of governmental experts to be held in Rome in the Autumn.

Assuming that the Governing Council endorses the Secretariat's proposal, then the Secretariat will communicate the text of the resulting draft model law, incorporating any amendments that the Governing Council may have considered it appropriate to introduce, to the Governments and Organisations represented at this session as soon as possible thereafter, together with details of the dates and venue of the joint session of the General Assembly and the Committee of governmental experts.

Invitations to participate in the joint session will subsequently be sent out to all member Governments of UNIDROIT and those non-member Governments having participated in the work of the Committee of governmental experts, as well as to Organisations. On the same occasion these Governments and Organisations will be invited to formulate such comments on the draft model law as reviewed by the Governing Council as they may consider appropriate.

The model law, once adopted at the joint session, would be offered to States for consideration for implementation as national law.

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*Closing remarks*

*by H.E. Yahya Abdullah Al Jabri  
Executive President  
Capital Market Authority of Oman*

Your Excellencies,

Mr Martin Stanford, Deputy Secretary-General, UNIDROIT, Respected Speakers and Delegates from various countries,

At the conclusion of the morning session, we have indeed covered substantial ground. On behalf of H.E. the Minister, who unfortunately was called away due to some pressing commitments, I would like to thank each and every one of you for taking the trouble to visit the Sultanate and for your active participation.

As H.E. the Minister has pointed out, while inaugurating the Seminar, leasing plays a key role in economic development especially in the development of small and medium enterprises which are indeed the back-bone of any economy. We expect the leasing industry to continue to flourish in the coming years and I trust the law that you will discuss over the next four days will indeed encourage the industry to do so. In a very interesting presentation Mr Stanford underlined the importance of the law and the hard work put in by yourself and your predecessors in bringing things to this stage. It is interesting to hear from Ron, Brian and El Mokhtar Bey of the details of the law, the intended application and the perspective regarding the respective rights and duties of the various parties thereto.

In Oman we have observed that the leasing industry, if encouraged by local provisions and supported regulatory framework, contributes substantially to economic progress. The six leasing companies which are all listed on the stock exchange and, to that extent, report to the Capital Market Authority have served approximately a quarter of a million customers, which is a very interesting figure, considering that our population is under three million. From the presentation in the second session of this morning seminar it is clear that it is a wish of Africa and of the Russian Federation that leasing, in those jurisdictions, plays a similar

constructive role that I have seen has been active in promoting leasing within the Middle East region and also in facilitating the development of suitable laws. Indeed, I.F.C. is a foundation shareholder in one of the leasing companies in the Sultanate and we are grateful to it for the active involvement in regional development. Once again I welcome you and thank you for the trouble you have taken to visit the Sultanate. While wishing you a very successful round of deliberations, I would join H.E. the Minister and also inviting you to join what is possibly one of the most beautiful, hospitable and safe countries in the world.

Thank you.

**AGENDA**

1. Opening of the session
2. The preliminary draft model law on commercial leasing as reviewed by the Committee of governmental experts during its first session: an introduction to its objectives and basic features (a half-day seminar addressed to the Governments and international Organisations invited to participate in the second session) (Muscat, 6 April 2008)
3. Adoption of the agenda
4. Organisation of work
5. Consideration of the preliminary draft model law on commercial leasing as reviewed by the Committee of governmental experts during its first session, in particular in the light of the summary report on that session (Study LIXA - Doc. 12) and the comments thereon to be submitted by Governments and Organisations
6. Future work
7. Any other business.

**PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING**

*(as reviewed by the Drafting Committee in the light of the second reading carried out by the Committee of governmental experts)*

**⌈PREAMBLE**

*THE GENERAL ASSEMBLY OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW (UNIDROIT), IN JOINT SESSION WITH THE UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT MODEL LAW ON LEASING, IN ROME ON...*

*Recognising* that leasing provides developing countries and countries in transition in particular with an important source of capital for the development of infrastructure and small- and medium-sized enterprises;

*Aware* that, ~~while many States already possess leasing legislation and a well-developed leasing industry,~~ many ~~other~~ States, and in particular those ~~States~~ with developing economies and economies in transition, require a legal framework that will foster the ~~swift~~ growth of a nascent or non-existent leasing industry and that other States, whilst already having a well-developed leasing industry, may nevertheless be interested in adopting this Law;

*Convinced* accordingly as to the usefulness of proposing a model law on commercial leasing for consideration by national legislators, which may adapt it to meet their specific needs;

*Committed* to the purpose of harmonising legal regulations of leasing on a global basis in order to facilitate trade in capital goods;

*Finding* that the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) has not only removed certain legal impediments to the international financial leasing of equipment while maintaining a fair balance of interests between the different parties to the transaction for States Parties thereto, but has also frequently served as an important reference model for States drafting their first leasing laws;

*Considering* the legal regimen enshrined in the aforementioned Convention as a useful starting point for the development of a comprehensive model law governing such transactions;

*Being of the view* that in the preparation of such a model law priority must be given to the establishment of rules governing ~~the civil and commercial law~~ aspects of commercial leasing other than their fiscal and accounting aspects;

*Mindful of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law as opposed to the specific area of that law reserved to leasing;*

*Taking account of the important contribution made by developing countries and countries in transition which, though not members of UNIDROIT, served on the Committee of governmental experts in the preparation of this Law;*

*HAS APPROVED THE FOLLOWING TEXT OF THE UNIDROIT MODEL LAW ON COMMERCIAL LEASING:}*

## CHAPTER I: GENERAL PROVISIONS

### Article 1 – Sphere of application

This Law applies to any lease of an asset, if the asset is within [the State], the centre of main interests of the lessee is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

### Article 2 – Definitions

In this Law:

**Asset** means all property used in the trade or business of the lessee, including real property~~plant, land~~, capital goods, equipment, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. No asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in real property~~land~~.

**Centre of main interests** means the place where a person conducts the administration of its interests on a regular basis. In the absence of proof to the contrary, the registered office of the person, or habitual residence in the case of an individual, is presumed to be the centre of main interests of the person.

**Financial lease** means a lease, with or without an option to purchase, that includes the following characteristics:

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) the rentals or other funds payable under the leasing agreement ~~take into account the amortisation~~amortise or fail to amortise of the whole or a substantial part of the investment of the lessor.

**Lease** means a transaction in which a person grants a right to possession and use of the asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

**Lessee** means a person who acquires the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessee.

**Lessor** means a person who grants the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessor.

**Person** means any legal, private or public entity or an individual.

**Supplier** means a person from whom a lessor acquires the asset or the right to possession and use of the asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires the asset or the right to possession and use of the asset for lease under a financial lease.

### Article 3 – Other laws

1. This ~~l~~aw does not apply to a leasing agreement that creates a security right or an acquisition ~~financing~~security right, as defined in the UNCITRAL Legislative Guide on Secured Transactions.

2. In the event of a conflict between A leasing agreement subject to this Law and is also subject to any another law of [this State] [or an international agreement to which [the State] is a party] applicable to:

(a) real property;

(b) ~~or~~ public notice with respect to a leasing agreement or an asset subject to a leasing agreement; or

(c) aircraft, aircraft engines, helicopters, railway rolling stock or any other asset that constitutes mobile equipment.

the other law [or international agreement] shall prevail.

### Article 4 – Interpretation ~~of this Law~~

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

### Article 5 – Freedom of contract

Except as provided in Articles 7(3), 16(1)(a), 16(2) and 22(3) and the law of [this State], the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a leasing agreement.

## CHAPTER II: EFFECTS OF LEASING AGREEMENT

### Article 6 – Enforceability

Except as otherwise provided in this Law:

- (a) a leasing agreement is effective and enforceable according to its terms between the parties; and
- (b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

### Article 7 – Lessee under financial lease as beneficiary of supply agreement

1. (a) In a financial lease, the duties of the supplier under the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall ~~not~~ be liable to ~~either both~~ the lessor ~~and~~ the lessee in respect of the same damage.

(b) The extension of the duties of the supplier to the lessee under the preceding subparagraph does not modify the rights and duties of the parties to the supply agreement, whether arising therefrom or otherwise, or impose any duty or liability under the supply agreement on the lessee.

(c) Where the absence of a contract between the lessee and supplier prevents the lessee from enforcing the duties of the supplier under the supply agreement, 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 the duties of the supplier.

2. The rights of the lessee under this Article with respect to a supply agreement that was approved by the lessee shall not be affected by a variation of any term of ~~such the supply agreement that was previously approved by the lessee,~~ unless ~~the lessee~~ consented to by the lessee that variation. If the lessee did not consent to such variation, the lessor is deemed to have assumed the duties of the supplier to the lessee ~~or~~ that were so varied to the extent of the variation.

3. The parties may not derogate from or vary the effect of the provisions of paragraphs 1 and 2.

4. Nothing in this Article shall entitle the lessee to modify, terminate or rescind the supply agreement without the consent of the lessor.

### Article 8 – Priority of liens

1. A creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the rights and remedies of the parties to the leasing agreement and cannot attach any interest arising under the leasing agreement.

2. Except as otherwise provided by the law of [this State], a creditor of the lessor takes subject to the rights and remedies of the parties to the leasing agreement.



### **Article 9 – Limitation of liability of the lessor**

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 asset or the use of the asset.

## **CHAPTER III: PERFORMANCE**

### **Article 10 – Irrevocability**

1. (a) In a financial lease, the duties of the parties become irrevocable and independent when the leasing agreement has been entered into.

(b) In a lease other than a financial lease, the parties may agree to make any of their duties irrevocable and independent by specifically identifying each duty that is irrevocable and independent.

2. A duty that is irrevocable and independent must be performed, regardless of the performance or non-performance of any other party, unless the party to whom the duty is owed terminates the leasing agreement or otherwise explicitly agrees.

### **Article 11 – Risk of loss**

1. (a) In a financial lease, risk of loss passes to the lessee. If the time of passage is not stated, the risk of loss passes to the lessee when the leasing agreement has been entered into.

(b) In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, the lessee, subject to paragraph 1 of Article 18, may treat the risk of loss as having remained with the supplier from the beginning.

2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

### **Article 12 – Damage to the asset**

1. In a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and at the option of the lessee either accept the asset with due compensation from the supplier for the loss in value ~~but without further right against the supplier~~ or, subject to Article 10, seek such other remedies as are provided by law. [Such compensation shall be remitted to the lessor and applied on account of the duties of the lessee under the leasing agreement.]

2. In a lease other than a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,

(a) if the loss is total, the leasing agreement is terminated; and

(b) if the loss is partial, the lessee may demand inspection and at the option of the lessee either treat the leasing agreement as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

### Article 13 – Acceptance

1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.

2. (a) Once a lessee in a financial lease has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement. [\[Such compensation shall be remitted to the lessor and applied on account of the duties of the lessee under the leasing agreement.\]](#)

(b) Once a lessee in a lease other than a financial lease has accepted an asset, the lessee is entitled to damages from the lessor if the asset does not conform to the leasing agreement.

### Article 14 – Remedies

1. In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

2. (a) In a lease other than a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the leasing agreement. Rejection or termination must be within a reasonable time after the non-conforming delivery.

(b) In a lease other than a financial lease, once a lessee has accepted the asset, the lessee may reject the asset under the preceding sub-paragraph only if the non-conformity substantially impairs the value of the asset and either

(i) the lessee accepted the asset without knowledge of the non-conformity, owing to the difficulty of discovering it, or

(ii) the acceptance by the lessee was induced by the assurances of the lessor.

(c) In a lease other than a financial lease, when the lessee rejects an asset in accordance with this Law or the leasing agreement, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied and to recover any rentals and other funds paid in advance, less a reasonable sum corresponding to any benefit the lessee has derived from the asset.

3. If the lessee rejects an asset in accordance with this Article and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

### **Article 15 – Transfer of rights and duties**

1. (a) The rights of the lessor under the leasing agreement may be transferred without the consent of the lessee. The leasing agreement may provide that the lessee shall not raise against a transferee any of its defences or rights of set-off against the lessor other than those arising from the incapacity of the lessee.

(b) The duties of the lessor under the leasing agreement may be transferred only with the consent of the lessee, which may not be unreasonably withheld.

2. The rights and duties of the lessee under the leasing agreement may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

3. The lessee, lessor and third parties may consent to such transfers in advance.

### **Article 16 – Warranty of quiet possession**

1. (a) In a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right or who claims a superior title or right and acts under the authority of a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor. The parties may not derogate from or vary the effect of the provisions of this sub-paragraph.

(b) In a financial lease, a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications.

2. In a lease other than a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right, who claims a superior title or right and acts under the authority of a court or who makes a claim by way of infringement. The parties may not derogate from or vary the effect of the provisions of this paragraph.

3. The sole remedy for a disturbance of the quiet possession of the lessee under sub-paragraph (a) of paragraph 1 and under paragraph 2 is an action for damages against the lessor.

### **Article 17 – Warranty of acceptability and fitness for purpose**

1. In a financial lease, the supplier warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used. and Subject to sub-paragraph (c) of paragraph 1 of Article 7, the warranty is enforceable only against the supplier.

2. In a lease other than a financial lease, the lessor warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used if the lessor regularly deals in assets of that kind.

### **Article 18 – Duties of the lessee to maintain and return the asset**

1. (a) The lessee shall take proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.

(b) When a leasing agreement sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the use of the asset, the compliance by the lessee with such agreement or instructions shall satisfy the requirements of the preceding sub-paragraph.

2. When the leasing agreement comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the asset to the lessor in the condition specified in the preceding paragraph.

## **CHAPTER IV: DEFAULT**

### **Article 19 – Definition of default**

1. The parties may at any time agree as to the events that constitute a default or otherwise give rise to the rights and remedies specified in this Chapter.

2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the leasing agreement or this Law.

### **Article 20 – Notices**

An aggrieved party shall give a defaulting party notice of default, notice of enforcement, notice of termination and a reasonable opportunity to cure.

### **Article 21 – Damages**

Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the leasing agreement, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

### **Article 22 – Liquidated damages**

1. When the leasing agreement provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.

2. Such sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.

3. The parties may not derogate from or vary the effect of the provisions of this Article.

### Article 23 – Termination

1. (a) Subject to sub-paragraph (b), a leasing agreement may be terminated by operation of law, by operation of Article 12, by agreement of the parties or by an aggrieved party upon ~~substantial~~ fundamental default by the lessee or lessor.

(b) ~~Neither party to~~The lessee in a financial lease may not terminate the leasing agreement upon ~~substantial~~fundamental default by the lessor or the supplier ~~another party~~ but ~~either party~~ is entitled to such other remedies as are provided by the agreement of the parties and by law.†

2. Subject to Article 10, on termination all duties under the leasing agreement that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

### Article 24 – Possession and disposition

After the leasing agreement comes to an end or is terminated, the lessor has the right to take possession of the asset and the right to dispose of the asset.

**PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING**

*(as established by the Committee of governmental experts at its second session, held in Muscat from 6 to 9 April 2008)*

**[PREAMBLE**

*THE GENERAL ASSEMBLY OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW (UNIDROIT), IN JOINT SESSION WITH THE UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT MODEL LAW ON LEASING, IN ROME ON...*

*Recognising* that leasing provides developing countries and countries in transition in particular with an important source of capital for the development of infrastructure and small- and medium-sized enterprises;

*Aware* that many –States, and in particular those with developing economies and economies in transition, require a legal framework that will foster the –growth of a nascent or non-existent leasing industry and that other States, whilst already having a well-developed leasing industry, may nevertheless be interested in adopting this Law;

*Convinced* accordingly as to the usefulness of proposing a model law on commercial leasing for consideration by national legislators, which may adapt it to meet their specific needs;

*Committed* to the purpose of harmonising legal regulations of leasing on a global basis in order to facilitate trade in capital goods;

*Finding* that the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) has not only removed certain legal impediments to the international financial leasing of equipment while maintaining a fair balance of interests between the different parties to the transaction for States Parties thereto, but has also frequently served as an important reference for States drafting their first leasing laws;

*Considering* the legal regimen enshrined in the aforementioned Convention as a useful starting point for the development of a comprehensive model law governing such transactions;

*Being of the view* that in the preparation of such a model law priority must be given to the establishment of rules governing –aspects of commercial leasing other than ~~its~~<sup>its</sup> fiscal and accounting aspects;

*Mindful* of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law as opposed to the specific area of that law reserved to leasing;

*Taking account* of the important contribution made by developing countries and countries in transition which, though not members of UNIDROIT, served on the Committee of governmental experts in the preparation of this Law;

HAS APPROVED THE FOLLOWING TEXT OF THE UNIDROIT MODEL LAW ON COMMERCIAL LEASING: ]

## CHAPTER I: -GENERAL PROVISIONS

### Article 1 ~~—~~ Sphere of application

This Law applies to any lease of an asset, if the asset is within [the State], the centre of main interests of the lessee is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

### Article 2 ~~—~~ Definitions

In this Law:

**Asset** means all property used in the trade or business of the lessee, including real property, capital goods, equipment, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. No asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in real property.

**Centre of main interests** means the place where a person conducts the administration of its interests on a regular basis. In the absence of proof to the contrary, the registered office of the person, or habitual residence in the case of an individual, is presumed to be the centre of main interests of the person.

**Financial lease** means a lease, with or without an option to purchase, that includes the following characteristics:

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) the rentals or other funds payable under the leasing agreement take into account amortise or do not take into account the amortisation of the whole or a substantial part of fail to amortise the investment of the lessor.

**Lease** means a transaction in which a person grants a right to possession and use of the asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

**Lessee** means a person who acquires the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessee.

**Lessor** means a person who grants the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessor.

**Person** means any legal, private or public entity or an individual.

**Supplier** means a person from whom a lessor acquires the asset or the right to possession and use of the asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires the asset or the right to possession and use of the asset for lease under a financial lease.

### Article 3 ~~—~~ Other laws

1. This Law does not apply to a leasing agreement that creates a security right or an acquisition security right, as defined in the UNCITRAL Legislative Guide on Secured Transactions.

2. ~~A leasing agreement subject to~~ ~~in the event of a conflict between~~ this Law ~~is also subject to any and another~~ law of [this State] ~~for an international agreement to which [the State] is a party~~ applicable to ~~—~~

~~(a) — real property~~ ~~or~~ ~~—~~

~~(b) — public notice with respect to a leasing agreement or an asset subject to a leasing agreement~~ ~~—~~ ~~or~~

~~[3. This Law does not apply to a lease of (e) — aircraft, aircraft engines, helicopters, railway rolling stock, ships or space assets if the lease is governed by another law of [the State] or any other asset that constitutes mobile equipment, the other law [or international agreement to which [the State] is a party.] shall prevail.~~

### Article 4 ~~—~~ Interpretation

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

### Article 5 ~~—~~ Freedom of contract

Except as provided in Articles 7(3), 16(1)(a), 16(2) and 22(3) and the law of [this State], the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a leasing agreement.



## CHAPTER II: EFFECTS OF LEASING AGREEMENT

### Article 6 — Enforceability

Except as otherwise provided in this Law:

- (a) a leasing agreement is effective and enforceable according to its terms between the parties; and
- (b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

### Article 7 — Lessee under financial lease as beneficiary of supply agreement

1. (a) In a financial lease, the duties of the supplier under the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall not be liable to ~~both~~ the lessor ~~and~~ the lessee in respect of the same damage.

(b) The extension of the duties of the supplier to the lessee under the preceding subparagraph does not modify the rights and duties of the parties to the supply agreement, whether arising therefrom or otherwise, or impose any duty or liability under the supply agreement on the lessee.

(c) Where the absence of a contract between the lessee and supplier prevents the lessee from enforcing the duties of the supplier under the supply agreement, 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 the duties of the supplier.

2. The rights of the lessee under this Article with respect to a supply agreement that was approved by the lessee shall not be affected by a variation of any term of such agreement unless consented to by the lessee. If the lessee did not consent to such variation, the lessor is deemed to have assumed the duties of the supplier to the lessee that were so varied to the extent of the variation.

3. The parties may not derogate from or vary the effect of the provisions of paragraphs 1 and 2.

4. Nothing in this Article shall entitle the lessee to modify, terminate or rescind the supply agreement without the consent of the lessor.

### Article 8 — Priority of liens

1. A creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the rights and remedies of the parties to the leasing agreement and cannot attach any interest arising under the leasing agreement.

2. Except as otherwise provided by the law of [this State], a creditor of the lessor takes subject to the rights and remedies of the parties to the leasing agreement.

### **Article 9 — Limitation of liability of the lessor**

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 asset or the use of the asset.

## **CHAPTER III: -PERFORMANCE**

### **Article 10 – -Irrevocability**

1. (a) In a financial lease, the duties of the parties become irrevocable and independent when the leasing agreement has been entered into.

(b) In a lease other than a financial lease, the parties may agree to make any of their duties irrevocable and independent by specifically identifying each duty that is irrevocable and independent.

2. A duty that is irrevocable and independent must be performed, regardless of the performance or non-performance of any other party, unless the party to whom the duty is owed terminates the leasing agreement or otherwise explicitly agrees.

### **Article 11 — Risk of loss**

1. (a) In a financial lease, risk of loss passes to the lessee. If the time of passage is not stated, the risk of loss passes to the lessee when the leasing agreement has been entered into.

(b) In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, the lessee, subject to paragraph 1 of Article 18, may treat the risk of loss as having remained with the supplier from the beginning.

2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

### **Article 12 — Damage to the asset**

1. In a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and at the option of the lessee either accept the asset with due compensation from the supplier for the loss in value or, subject to Article 10, seek such other remedies as are provided by law. ~~The parties may agree that such~~ Such compensation shall be remitted to the lessor and applied ~~to reduce on account of the rentals owed by~~ ~~the lessee, under the leasing agreement.]~~ duties of the lessee, under the leasing agreement.]

2. In a lease other than a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,

(a) if the loss is total, the leasing agreement is terminated; and

(b) if the loss is partial, the lessee may demand inspection and at the option of the lessee either treat the leasing agreement as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

### Article 13 ~~—~~ Acceptance

1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.

2. (a) Once a lessee in a financial lease has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement. ~~The parties may agree that such~~ Such compensation shall be remitted to the lessor and applied ~~to reduce on account of the rentals owed by~~ duties of the lessee. ~~under the leasing agreement.]~~

(b) Once a lessee in a lease other than a financial lease has accepted an asset, the lessee is entitled to damages from the lessor if the asset does not conform to the leasing agreement.

### Article 14 ~~—~~ Remedies

1. In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

2. (a) In a lease other than a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the leasing agreement. Rejection or termination must be within a reasonable time after the non-conforming delivery.

(b) In a lease other than a financial lease, once a lessee has accepted the asset, the lessee may reject the asset under the preceding sub-paragraph only if the non-conformity substantially impairs the value of the asset and either

(i) the lessee accepted the asset without knowledge of the non-conformity, owing to the difficulty of discovering it, or

(ii) the acceptance by the lessee was induced by the ~~assurances~~ assurances of the lessor.

(c) In a lease other than a financial lease, when the lessee rejects an asset in accordance with this Law or the leasing agreement, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied and to recover any rentals and other funds paid in advance, less a reasonable sum corresponding to any benefit the lessee has derived from the asset.

3. If the lessee rejects an asset in accordance with this Article and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

**Article 15 — Transfer of rights and duties**

1. (a) (i) The rights of the lessor under the leasing agreement may be transferred without the consent of the lessee.

(ii) The leasing agreement may provide that the lessee shall not raise against a transferee any of its defences or rights of set-off against the lessor [other than those arising from the incapacity of the lessee].

(b) The duties of the lessor under the leasing agreement may be transferred only with the consent of the lessee, which may not be unreasonably withheld.

2. The rights and duties of the lessee under the leasing agreement may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

3. The lessee, lessor and third parties may consent to such transfers in advance.

**Article 16 — Warranty of quiet possession**

1. (a) In a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right or who claims a superior title or right and acts under the authority of a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor. The parties may not derogate from or vary the effect of the provisions of this sub-paragraph.

(b) In a financial lease, a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications.

2. In a lease other than a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right, who claims a superior title or right and acts under the authority of a court or who makes a claim by way of infringement. The parties may not derogate from or vary the effect of the provisions of this paragraph.

3. The sole remedy for a disturbance of the quiet possession of the lessee under sub-paragraph (a) of paragraph 1 and under paragraph 2 is an action for damages against the lessor.

**Article 17 — Warranty of acceptability and fitness for purpose**

1. In a financial lease, the supplier warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used. —Subject to sub-paragraph (c) of paragraph 1 of Article 7, the warranty is enforceable only against the supplier.

2. In a lease other than a financial lease, the lessor warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used if the lessor regularly deals in assets of that kind.

**Article 18 — Duties of the lessee to maintain and return the asset**

1. (a) The lessee shall take proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.

(b) When a leasing agreement sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the use of the asset, the compliance by the lessee with such agreement or instructions shall satisfy the requirements of the preceding sub-paragraph.

2. When the leasing agreement comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the asset to the lessor in the condition specified in the preceding paragraph.

**CHAPTER IV: –DEFAULT****Article 19 — Definition of default**

1. The parties may at any time agree as to the events that constitute a default or otherwise give rise to the rights and remedies specified in this Chapter.

2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the leasing agreement or this Law.

**Article 20 — Notices**

An aggrieved party shall give a defaulting party notice of default, notice of enforcement, notice of termination and a reasonable opportunity to cure.

**Article 21 — Damages**

Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the leasing agreement, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

**Article 22 — Liquidated damages**

1. When the leasing agreement provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.

2. Such sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.

3. The parties may not derogate from or vary the effect of the provisions of this Article.

**Article 23 ~~—~~ Termination**

1. (a) Subject to sub-paragraph (b), a leasing agreement may be terminated by operation of law, by operation of Article 12, by agreement of the parties or by an aggrieved party upon ~~fundamental default~~ by the lessee or lessor.

(b) The lessee in a financial lease may not terminate the leasing agreement upon fundamental default by the lessor or the supplier ~~but~~ is entitled to such other remedies as are provided by the agreement of the parties and by law.

2. Subject to Article 10, on termination all duties under the leasing agreement that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

**Article 24 ~~—~~ Possession and disposition**

After the leasing agreement comes to an end or is terminated, the lessor has the right to take possession of the asset and the right to dispose of the asset.

**PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING**

*(as established by the Committee of governmental experts at its second session, held in Muscat from 6 to 9 April 2008)*

**[PREAMBLE**

*THE GENERAL ASSEMBLY OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW (UNIDROIT), IN JOINT SESSION WITH THE UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT MODEL LAW ON LEASING, IN ROME ON....*

*Recognising* that leasing provides developing countries and countries in transition in particular with an important source of capital for the development of infrastructure and small- and medium-sized enterprises;

*Aware* that many States, and in particular those with developing economies and economies in transition, require a legal framework that will foster the growth of a nascent or non-existent leasing industry and that other States, whilst already having a well-developed leasing industry, may nevertheless be interested in adopting this Law;

*Convinced* accordingly as to the usefulness of proposing a model law on commercial leasing for consideration by national legislators, which may adapt it to meet their specific needs;

*Committed* to the purpose of harmonising legal regulations of leasing on a global basis in order to facilitate trade in capital goods;

*Finding* that the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) has not only removed certain legal impediments to the international financial leasing of equipment while maintaining a fair balance of interests between the different parties to the transaction for States Parties thereto, but has also frequently served as an important reference for States drafting their first leasing laws;

*Considering* the legal regimen enshrined in the aforementioned Convention as a useful starting point for the development of a comprehensive model law governing such transactions;

*Being of the view* that in the preparation of such a model law priority must be given to the establishment of rules governing aspects of commercial leasing other than its fiscal and accounting aspects;

*Mindful* of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law as opposed to the specific area of that law reserved to leasing;

*Taking account* of the important contribution made by developing countries and countries in transition which, though not members of UNIDROIT, served on the Committee of governmental experts in the preparation of this Law;

HAS APPROVED THE FOLLOWING TEXT OF THE UNIDROIT MODEL LAW ON COMMERCIAL LEASING:]

## CHAPTER I: GENERAL PROVISIONS

### Article 1 – Sphere of application

This Law applies to any lease of an asset, if the asset is within [the State], the centre of main interests of the lessee is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

### Article 2 – Definitions

In this Law:

**Asset** means all property used in the trade or business of the lessee, including real property, capital goods, equipment, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. No asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in real property.

**Centre of main interests** means the place where a person conducts the administration of its interests on a regular basis. In the absence of proof to the contrary, the registered office of the person, or habitual residence in the case of an individual, is presumed to be the centre of main interests of the person.

**Financial lease** means a lease, with or without an option to purchase, that includes the following characteristics:

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) the rentals or other funds payable under the leasing agreement take into account or do not take into account the amortisation of the whole or a substantial part of the investment of the lessor.

**Lease** means a transaction in which a person grants a right to possession and use of the asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

**Lessee** means a person who acquires the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessee.



**Lessor** means a person who grants the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessor.

**Person** means any legal, private or public entity or an individual.

**Supplier** means a person from whom a lessor acquires the asset or the right to possession and use of the asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires the asset or the right to possession and use of the asset for lease under a financial lease.

### **Article 3 – Other laws**

1. This Law does not apply to a leasing agreement that creates a security right or an acquisition security right, as defined in the UNCITRAL Legislative Guide on Secured Transactions.

2. A leasing agreement subject to this Law is also subject to any law of [this State] applicable to real property or public notice with respect to a leasing agreement or an asset subject to a leasing agreement.

[3. This Law does not apply to a lease of aircraft, aircraft engines, helicopters, railway rolling stock, ships or space assets if the lease is governed by another law of [the State] or an international agreement to which [the State] is a party.]

### **Article 4 – Interpretation**

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

### **Article 5 – Freedom of contract**

Except as provided in Articles 7(3), 16(1)(a), 16(2) and 22(3) and the law of [this State], the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a leasing agreement.

## **CHAPTER II: EFFECTS OF LEASING AGREEMENT**

### **Article 6 – Enforceability**

Except as otherwise provided in this Law:

(a) a leasing agreement is effective and enforceable according to its terms between the parties; and

(b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

#### **Article 7 – Lessee under financial lease as beneficiary of supply agreement**

1. (a) In a financial lease, the duties of the supplier under the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

(b) The extension of the duties of the supplier to the lessee under the preceding subparagraph does not modify the rights and duties of the parties to the supply agreement, whether arising therefrom or otherwise, or impose any duty or liability under the supply agreement on the lessee.

(c) Where the absence of a contract between the lessee and supplier prevents the lessee from enforcing the duties of the supplier under the supply agreement, 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 the duties of the supplier.

2. The rights of the lessee under this Article with respect to a supply agreement that was approved by the lessee shall not be affected by a variation of any term of such agreement unless consented to by the lessee. If the lessee did not consent to such variation, the lessor is deemed to have assumed the duties of the supplier to the lessee that were so varied to the extent of the variation.

3. The parties may not derogate from or vary the effect of the provisions of paragraphs 1 and 2.

4. Nothing in this Article shall entitle the lessee to modify, terminate or rescind the supply agreement without the consent of the lessor.

#### **Article 8 – Priority of liens**

1. A creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the rights and remedies of the parties to the leasing agreement and cannot attach any interest arising under the leasing agreement.

2. Except as otherwise provided by the law of [this State], a creditor of the lessor takes subject to the rights and remedies of the parties to the leasing agreement.

#### **Article 9 – Limitation of liability of the lessor**

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 asset or the use of the asset.

## **CHAPTER III: PERFORMANCE**

### **Article 10 – Irrevocability**

1. (a) In a financial lease, the duties of the parties become irrevocable and independent when the leasing agreement has been entered into.

(b) In a lease other than a financial lease, the parties may agree to make any of their duties irrevocable and independent by specifically identifying each duty that is irrevocable and independent.

2. A duty that is irrevocable and independent must be performed, regardless of the performance or non-performance of any other party, unless the party to whom the duty is owed terminates the leasing agreement or otherwise explicitly agrees.

### **Article 11 – Risk of loss**

1. (a) In a financial lease, risk of loss passes to the lessee. If the time of passage is not stated, the risk of loss passes to the lessee when the leasing agreement has been entered into.

(b) In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, the lessee, subject to paragraph 1 of Article 18, may treat the risk of loss as having remained with the supplier from the beginning.

2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

### **Article 12 – Damage to the asset**

1. In a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and at the option of the lessee either accept the asset with due compensation from the supplier for the loss in value or, subject to Article 10, seek such other remedies as are provided by law. The parties may agree that such compensation shall be remitted to the lessor and applied to reduce the rentals owed by the lessee.

2. In a lease other than a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,

(a) if the loss is total, the leasing agreement is terminated; and

(b) if the loss is partial, the lessee may demand inspection and at the option of the lessee either treat the leasing agreement as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

### **Article 13 – Acceptance**

1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.

2. (a) Once a lessee in a financial lease has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement. The parties may agree that such compensation shall be remitted to the lessor and applied to reduce the rentals owed by the lessee.

(b) Once a lessee in a lease other than a financial lease has accepted an asset, the lessee is entitled to damages from the lessor if the asset does not conform to the leasing agreement.

### **Article 14 – Remedies**

1. In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

2. (a) In a lease other than a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the leasing agreement. Rejection or termination must be within a reasonable time after the non-conforming delivery.

(b) In a lease other than a financial lease, once a lessee has accepted the asset, the lessee may reject the asset under the preceding sub-paragraph only if the non-conformity substantially impairs the value of the asset and either

(i) the lessee accepted the asset without knowledge of the non-conformity, owing to the difficulty of discovering it, or

(ii) the acceptance by the lessee was induced by the assurances of the lessor.

(c) In a lease other than a financial lease, when the lessee rejects an asset in accordance with this Law or the leasing agreement, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied and to recover any rentals and other funds paid in advance, less a reasonable sum corresponding to any benefit the lessee has derived from the asset.

3. If the lessee rejects an asset in accordance with this Article and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

### **Article 15 – Transfer of rights and duties**

1. (a) (i) The rights of the lessor under the leasing agreement may be transferred without the consent of the lessee.

(ii) The leasing agreement may provide that the lessee shall not raise against a transferee any of its defences or rights of set-off against the lessor [other than those arising from the incapacity of the lessee].

(b) The duties of the lessor under the leasing agreement may be transferred only with the consent of the lessee, which may not be unreasonably withheld.

2. The rights and duties of the lessee under the leasing agreement may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

3. The lessee, lessor and third parties may consent to such transfers in advance.

### **Article 16 – Warranty of quiet possession**

1. (a) In a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right or who claims a superior title or right and acts under the authority of a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor. The parties may not derogate from or vary the effect of the provisions of this sub-paragraph.

(b) In a financial lease, a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications.

2. In a lease other than a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right, who claims a superior title or right and acts under the authority of a court or who makes a claim by way of infringement. The parties may not derogate from or vary the effect of the provisions of this paragraph.

3. The sole remedy for a disturbance of the quiet possession of the lessee under sub-paragraph (a) of paragraph 1 and under paragraph 2 is an action for damages against the lessor.

### **Article 17 – Warranty of acceptability and fitness for purpose**

1. In a financial lease, the supplier warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used. Subject to sub-paragraph (c) of paragraph 1 of Article 7, the warranty is enforceable only against the supplier.

2. In a lease other than a financial lease, the lessor warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used if the lessor regularly deals in assets of that kind.

### **Article 18 – Duties of the lessee to maintain and return the asset**

1. (a) The lessee shall take proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.

(b) When a leasing agreement sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the use of the asset, the compliance by the lessee with such agreement or instructions shall satisfy the requirements of the preceding sub-paragraph.

2. When the leasing agreement comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the asset to the lessor in the condition specified in the preceding paragraph.

## **CHAPTER IV: DEFAULT**

### **Article 19 – Definition of default**

1. The parties may at any time agree as to the events that constitute a default or otherwise give rise to the rights and remedies specified in this Chapter.

2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the leasing agreement or this Law.

### **Article 20 – Notices**

An aggrieved party shall give a defaulting party notice of default, notice of enforcement, notice of termination and a reasonable opportunity to cure.

### **Article 21 – Damages**

Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the leasing agreement, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

### **Article 22 – Liquidated damages**

1. When the leasing agreement provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.

2. Such sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.

3. The parties may not derogate from or vary the effect of the provisions of this Article.

### **Article 23 – Termination**

1. (a) Subject to sub-paragraph (b), a leasing agreement may be terminated by operation of law, by operation of Article 12, by agreement of the parties or by an aggrieved party upon fundamental default by the lessee or lessor.

(b) The lessee in a financial lease may not terminate the leasing agreement upon fundamental default by the lessor or the supplier but is entitled to such other remedies as are provided by the agreement of the parties and by law.

2. Subject to Article 10, on termination all duties under the leasing agreement that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

### **Article 24 – Possession and disposition**

After the leasing agreement comes to an end or is terminated, the lessor has the right to take possession of the asset and the right to dispose of the asset.