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### **UNIDROIT MODEL LAW ON LEASING**

(adopted in Rome, on 13 November 2008, by a Joint Session of the UNIDROIT General Assembly and the UNIDROIT Committee of governmental experts for the finalisation and adoption of a draft model law on leasing):

#### **OFFICIAL COMMENTARY**

(as prepared by the UNIDROIT Secretariat, in close co-operation with Mr R.M. DeKoven, Reporter to the Joint Session, Mr N.J. Makhubele (South Africa), Chairman of the UNIDROIT Committee of governmental experts, and Ms M. Allouch and Ms C. Walsh (Canada), Mr E.M. Bey (France) and Messrs M.J. Dennis, H.D. Gabriel, W. Henning and S. Weise (United States of America), as members of the Drafting Committee of the Joint Session)

#### **Historical background**

At its 84<sup>th</sup> session, held in Rome from 18 to 20 April 2005, the UNIDROIT Governing Council was seized of a proposal from the UNIDROIT Secretariat that it work on the development of a model law on leasing, designed, in particular, to make leasing more widely available to developing countries and transition economies. A number of suggestions had been received by the UNIDROIT Secretariat for the idea of it either assisting individual Governments with the development of national laws on leasing or drafting a model law on leasing, based on the prescriptions to be found in the UNIDROIT Convention on International Financial Leasing, opened to signature in Ottawa on 28 May 1988.

At the time of its adoption, this Convention was seen as being every bit as valid as a blueprint for national legislation in general as a regulation of international financial leasing in particular. Indeed, the Convention was much used by developing countries and transition economies in developing their national leasing legislation. Equally, through its pioneering work in developing the Convention, UNIDROIT was seen as the repository of a unique fund of technical expertise in this field.

Moreover, leasing was recognised as being particularly well suited as a means of developing the private sector in the developing world and amongst economies in transition, as exemplified by the successful work in this field carried out over the last three decades by the International Finance Corporation (I.F.C.), work which bore witness to the fact that there were still whole parts of the world where the message of leasing and its potential as an engine of growth had not yet got through; the development of a basic legislative framework had proven crucial in the I.F.C.'s work in this field.

Whilst it was clear that a legislative framework alone would not create a leasing industry in a given country, it was equally clear that the establishment of a modern legal framework for leasing was absolutely necessary if foreign investors were to feel sufficiently protected to invest lease finance in such a country. By providing a modern legislative model, UNIDROIT would be not only providing such legal certainty for foreign investors but also avoiding the wheel having to be reinvented each time a country set out on the path toward the development of a national leasing industry.

The Governing Council, accordingly, authorised the Secretariat's development of the proposed model law. The Secretariat was instructed to do this with minimum impact on the UNIDROIT budget.

Before, however, embarking on the preparation of such a model law, the Secretariat considered it expedient to consult some of the potential key economic stakeholders in such a project, in particular the World Bank, the I.F.C., the American Equipment Leasing and Finance Association (E.L.F.A.) and the European Federation of Leasing and Long and Short Term Automotive Rental Company Associations (Leaseurope). The idea behind this consultation was to ascertain both the economic and legal expediency of the project, as exemplified by such Organisations' willingness to contribute thereto. The favourable outcome of this consultation, significantly, reflected the undoubted enthusiasm of such potential stakeholders to be able to avail themselves, at the earliest possible opportunity, of the use of such a model law. In particular, it was pointed out that the countries of Africa stood to benefit enormously from the fillip that leasing might be expected to give to the overcoming of their serious infrastructure financing shortcomings. In addition, the model law was considered to a particularly helpful tool for those countries currently engaged in the drafting of leasing legislation.

UNIDROIT, accordingly, organised an Advisory Board, made up, virtually entirely, of UNIDROIT correspondents, all of whom kindly agreed to participate at their own expense. Serving on the Advisory Board were representatives from North Africa and the Middle East, sub-Saharan Africa, Asia and the Pacific region, Europe, the former Soviet Union countries, Latin America and North America.<sup>1</sup> The Advisory Board was chaired by Chief Mrs T. Oyekunle, a former senior Government official from Nigeria who was at the time a legal practitioner in Lagos and Honorary Vice-President of the International Council for Commercial Arbitration. Mr R.M. DeKoven, Barrister, 3-4 South Square, London and Reporter on Article 2A (Leases) of the Uniform Commercial Code, acted as Reporter. Mr B. Hauck, at the time Associate, Jenner & Block LL.P., Chicago (on secondment to UNIDROIT) and, having been made Partner with the same firm, currently Counsel to the Associate Attorney-General of the United States of America, acted as Secretary.

After three sessions, held in Rome on 17 October 2005, on 6 and 7 February 2006 and from 3 to 5 April 2006, the UNIDROIT Advisory Board was already able to transmit a preliminary draft model law to the UNIDROIT Governing Council at its 85<sup>th</sup> session, held in Rome from 8 to 10 May 2006, for advice as to the most appropriate follow-up action. The Governing Council authorised transmission of the preliminary draft model law to Governments, for finalisation. First, though, a consultation exercise was conducted with Governments and Organisations, comments

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<sup>1</sup> The members of the Advisory Board were: Mr A. Albensi (Leaseurope), Mr E.M. Bey, UNIDROIT correspondent (France), Mr R. Castillo-Triana, UNIDROIT correspondent (Colombia), Mr R. Clarizia (Leaseurope), Mr C. Dageförde (Germany), Mr R.M. DeKoven, UNIDROIT correspondent (United Kingdom), Mr. R. Downey (E.L.F.A.), Ms R. Freeman (I.F.C.), Ms A. Normantovich (Russian Federation), Chief Mrs T. Oyekunle, UNIDROIT correspondent (Nigeria), Mr F. Peter, UNIDROIT correspondent (Switzerland), Ms Y. Shi (People's Republic of China) and Mr M. Sultanov (I.F.C.). Ms Freeman being unable to attend the second session of the Advisory Board, she was represented by Ms M. Ndonde. Mr Downey being unable to attend the third and final session of the Advisory Board, the E.L.F.A. was represented at that session by Ms I. Cassidy and Mr R. Petta. The Secretariat of the United Nations Commission on International Trade Law (UNCITRAL) was represented as an observer on the Advisory Board by Mr R. Sorieul and Mr S. Bazinas.

coming in from all over the world.<sup>2</sup> Once the decision to launch the intergovernmental consultation process had been taken, it was recognised that it would be desirable for this process to be structured in such a way as to permit a more active involvement of the prospective beneficiary countries in this process than could be guaranteed by the traditional format of negotiations held in Rome: it was felt that logic demanded that the intergovernmental stage in the process for the development of a model law designed principally for the use of developing countries and transition economies be taken to those countries.

It was thus that, at the kind invitation of the Department of Justice and Constitutional Development of South Africa, the first session of the UNIDROIT Committee of governmental experts for the finalisation and adoption of a draft model law on leasing was held in Johannesburg from 7 to 10 May 2007 and that, at the kind invitation of the Ministry of Commerce and Industry of Oman, the second session of the Committee was held in Muscat from 6 to 9 April 2008. Experts from 30 Governments,<sup>3</sup> assisted by observers from three intergovernmental Organisations,<sup>4</sup> one international non-governmental Organisation<sup>5</sup> and two professional associations<sup>6</sup> came together at these sessions. The Committee appointed its chairman in the person of Mr I.S. Thindisa (Senior State Law Adviser, Chief Directorate: International Legal Relations, Department of Justice and Constitutional Development of South Africa), with Mr DeKoven again being appointed Reporter and Mr Hauck again acting as Secretary. In the absence of Mr Thindisa, the second session was chaired by Mr N.J. Makhubele (Deputy Chief State Law Adviser, Chief Directorate: International Legal Relations, Department of Justice and Constitutional Development of South Africa).

Particularly mindful of the words pronounced by Mr J.H. de Lange, Deputy Minister of Justice and Constitutional Development of South Africa, in opening the first session of the Committee, the latter sought at all times to ensure the establishment of a balanced instrument that would be responsive in particular to the needs of developing countries and transition economies for “model legal rules governing the financing of various goods but also equipment at every level of value in order to develop their economic infrastructure”.<sup>7</sup> The fact that excellent progress was able to be made right across the board in the achievement of this all-important objective during the Johannesburg and Muscat sessions owed not a little to the unprecedentedly leading participation in the negotiations of the representatives of developing and transition economies, especially when it was a question of those points that were crucial for countries at their level of development.

The preliminary draft model law as reviewed by the Committee of governmental experts at the Johannesburg and Muscat sessions was laid before the UNIDROIT Governing Council at its 87<sup>th</sup> session, held in Rome from 21 to 23 April 2008, for advice as to the most appropriate follow-up action. Subject to the making of a number of amendments, principally to the French-language version, the Governing Council authorised the transmission of what thus became a draft model law on leasing to Governments for finalisation and adoption, at a joint session of the General Assembly of UNIDROIT member States and the Committee of governmental experts. In recommending such a novel procedure for adoption of the draft model law, the Governing Council showed its desire, on

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<sup>2</sup> In particular 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 and from the International Civil Aviation Organization, the International Chamber of Commerce (I.C.C.), E.L.F.A., the Latin American Leasing Federation (Felalease) and Leaseurope, (cf. UNIDROIT 2007 C.G.E. Leasing/1/W.P.4).

<sup>3</sup> Angola, Australia, Brazil, Bulgaria, Burkina Faso, Burundi, Cameroon, Chile, the People’s Republic of China, Colombia, Gambia, Germany, India, Indonesia, the Islamic Republic of Iran, Ireland, Japan, Kuwait, Latvia, Oman, the Islamic Republic of Pakistan, Poland, Portugal, Qatar, the Russian Federation, Rwanda, South Africa, Sudan, Tanzania and the United States of America.

<sup>4</sup> The Commonwealth Secretariat, the I.F.C. and UNCITRAL.

<sup>5</sup> The I.C.C.

<sup>6</sup> E.L.F.A. and Felalease.

<sup>7</sup> Cf. UNIDROIT 2007 - Study LIXA - Doc. 12 - Appendix IV, p. ii.

the one hand, to ensure maximum transparency vis-à-vis the entirety of UNIDROIT's membership and, on the other, to reflect the key role played in the development of the draft model law by a significant number of non-member States, from those parts of the world for which it was principally intended.

The Joint Session was held in Rome from 10 to 13 November 2008. Representatives of 33 States,<sup>8</sup> two intergovernmental Organisations,<sup>9</sup> two international non-governmental Organisations<sup>10</sup> and three professional associations<sup>11</sup> participated in the finalisation of the draft model law and witnessed adoption of the *UNIDROIT Model Law on Leasing* on 13 November 2008. Ms A. Vanstone, Ambassador of Australia in Italy, as the sitting President of the UNIDROIT General Assembly, chaired the opening meeting of the Joint Session as well as its final meeting, at which the Model Law was adopted. Mr Makhubele, as Chairman of the Committee of governmental experts, chaired the other meetings, during which the Joint Session reviewed the draft model law prepared by the Committee of governmental experts, as amended by the UNIDROIT Governing Council. Mr DeKoven and Mr Hauck again acted as Reporter and Secretary to the Joint Session respectively.

In line with the frequent reference made during the intergovernmental negotiations to the need to clarify certain provisions of the Model Law in a future Official Commentary, the Joint Session passed a Resolution calling upon the Secretariat to draw up such an official commentary, in close co-operation with the Reporter to the Joint Session, the Secretary to the Joint Session, the Chairman of the Committee of governmental experts and members of the Drafting Committee. A first draft of the planned Commentary was prepared by the Reporter and circulated among those invited to assist the Secretariat in the preparation of the Commentary with a view to the garnering of comments, for discussion at a meeting held in Rome on 23 and 24 June 2009, under the chairmanship of Mr M.J. Stanford, Deputy Secretary-General of UNIDROIT.<sup>12</sup> It was agreed by all involved that the Official Commentary should not be in the nature of an exhaustive explanatory report but rather serve precisely to clarify those provisions of the Model Law which were found during the negotiations to merit clarification.

The text of the Official Commentary set out hereunder represents the agreed conclusions of the Secretariat, the Reporter to the Joint Session, the Chairman of the Committee of governmental experts and those members of the Drafting Committee who participated in its preparation.

Echoing the decision by the UNIDROIT Governing Council, at its 88<sup>th</sup> session, held from 20 to 22 April 2009, to pass a Resolution, in particular expressing its deep gratitude to Mr DeKoven for the way in which he had given so generously of his time and expertise to the development of the Model Law, the Secretariat takes this opportunity to place on record its own debt of gratitude to Mr DeKoven for his exemplary fulfilment of the duties of a UNIDROIT correspondent, as indeed to all those other correspondents who contributed so unstintingly and generously to the realisation of the felicitous outcome represented by adoption of the Model Law.

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<sup>8</sup> Argentina, Australia, Burkina Faso, Burundi, Cameroon, Canada, Chile, the People's Republic of China, Colombia, Croatia, Egypt, France, Germany, Greece, Hungary, India, Indonesia, Ireland, Italy, Japan, Latvia, Lithuania, Mexico, Nicaragua, Oman, Poland, the Republic of Korea, the Russian Federation, South Africa, Sudan, Turkey, the United States of America and Uruguay.

<sup>9</sup> The I.F.C. and UNCITRAL.

<sup>10</sup> The Aviation Working Group and the International Bar Association.

<sup>11</sup> E.L.F.A., Leaseurope and Felalease.

<sup>12</sup> The meeting was attended by Mr DeKoven, as Reporter to the Joint Session, Mr Makhubele (South Africa), as Chairman of the Committee of governmental experts, and Ms M. Allouch and Ms C. Walsh (Canada), Mr E.M. Bey (France) and Messrs M.J. Dennis, H.D. Gabriel, W. Henning and S. Weise (United States of America), as members of the Drafting Committee of the Joint Session. The Secretary to the Joint Session notified his withdrawal from the project following the Joint Session.

## Title

### UNIDROIT Model Law on Leasing

#### *Commentary*

1. *It is important to note that, whereas the single word “leasing” is used in the title of the English-language version of this Model Law (hereinafter referred to as the Law), the French-language version employs the two terms “location” and “location-financement”. The term “leasing” was considered fully adequate to cover the two genera of leasing principally contemplated by the Law, namely the lease and its derivation, the financial lease, in the English text but not sufficient to embrace the two in the French text, notably in view of the separate legislative treatment that has been reserved for financial leases in France and many of the legal systems essentially based on the French legal system.*

#### **Preamble**

*THE JOINT SESSION OF THE UNIDROIT GENERAL ASSEMBLY AND THE UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE FINALISATION AND ADOPTION OF A DRAFT MODEL LAW ON LEASING, MEETING IN ROME ON 13 NOVEMBER 2008,*

*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 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 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, signed in Ottawa on 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 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 LEASING:

#### *Commentary*

2. *Particular significance is to be attributed to a number of the clauses of the preamble to the Law.*

3. *The first clause spells out the particular aptitude of leasing to provide developing countries and transition economies with capital for the development of their infrastructure and their small- and medium-sized enterprises.*

4. *The second clause of the preamble highlights the especial importance that a legal framework may be expected to play in fostering the growth of leasing in developing countries and transition economies, as also the interest that such a legal framework may have for countries with a more developed leasing industry.*

5. *The third clause specifies the essential nature of the Law, namely as a model that enacting States are free to adapt, according to their specific needs.*

6. *The fourth clause of the preamble underscores the importance that harmonised legal regulations for leasing, when adopted on a global basis, may be expected to have in facilitating trade in capital goods.*

7. *The fifth clause stresses the importance of the UNIDROIT Convention on International Financial Leasing, opened to signature in Ottawa on 28 May 1988, and in particular the role it has frequently played as an important reference for States when drafting their first leasing laws. The sixth clause, therefore, goes on to acknowledge the useful starting point that the UNIDROIT Convention provided in the development of the Law.*

8. *The seventh clause of the preamble underlines the differing philosophies inevitably underlying leasing's treatment for fiscal and accounting purposes and other purposes, making it clear that the Law's business is essentially with the private law aspects of leasing.*

9. *The eighth clause reflects the decision taken, early on, by the drafters of the Law that rules governing the formation and documentation of a lease would be quite superfluous, given that such rules would be those applicable for the generality of contracts and, in particular, in view of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law.*

10. *The ninth clause of the preamble pays special tribute to the important contribution made to development of the Law by developing countries and transition economies, even though not members of UNIDROIT, this importance having to do not only with the specific contribution that such countries brought to the task of rendering the Law suitably responsive to the needs of their own economies but also the unique nature of the exercise undertaken in this area by UNIDROIT, the membership of which among developing countries and transition economies is not particularly strong and which had been invited by developing country members to pay greater attention in the formulation of its work programme to projects having a specific relevance for such countries.*

## 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 lease provides that [the State's] law governs the transaction.

#### *Commentary*

11. *This Article provides that the Law applies to “any lease of an asset” (see the Official Commentary on the definitions of “lease” and “asset” in Article 2 of the Law).*

12. *The Law applies if the asset is within the enacting State, the centre of main interests of the lessee is within the enacting State or the parties agree that the law of the enacting State governs the transaction. The reference to “centre of main interests” implicitly incorporates the definition of that term in the UNCITRAL Model Law on Cross-Border Insolvency, adopted in Vienna on 30 May 1997 (see Article 2(b) of that Law).*

13. *A transaction may, prima facie, fall within the sphere of application of the leasing laws of as many as three different enacting States (as where the asset is in State A, the centre of main interests of the lessee is in State B and the parties agree that the law of State C governs the lease). Pursuant to this Article, in such cases the general conflict of laws rules of the forum State determine which State's leasing law applies. In other words, this Article is not intended to override the conflict of laws rules of the enacting State.*

### Article 2 – Definitions

In this Law:

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

#### *Commentary*

14. *The definition of “asset” is significant, since it determines which assets may be the subject of a lease within the sphere of application of the Law.*

15. *The restriction to assets used in the craft, trade or business of the lessee means that a lease of assets acquired by the lessee for personal, family or household purposes does not come within the sphere of application of the Law. There may be cases where the lessee acquires the asset for mixed business and personal uses. If the business use is the primary use, the definition of asset is still satisfied.*

16. *The definition of asset is sufficiently broad to include intellectual property, notably software. The software may be embodied in a tangible asset so as to form a single functional item, for example a motor-car. Here, the subject matter of the lease would be the motor-car, not the software, so that the question of whether the asset includes the software does not arise.*

17. *However, there may be cases where the software is not embodied in a tangible asset, for example, a software programme designed to be installed in a computer. Here, one must take into account the definition of "lease", which requires that the transaction be one in which the lessor "grants a right to possession and use of the asset". The Law does not define possession, thereby leaving the definition of that concept to the general law of each State. In States in which the term "possession" refers to actual physical possession of a tangible asset, "possession" cannot refer to intangible assets such as intellectual property. In that case, the Law would not apply to a transaction in which a "lessee" acquires the right to use intellectual property.*

18. *In States in which "possession" is given an extended meaning to include functional control or constructive possession, the Law might, subject to paragraph (b) of the definition of financial lease, apply to a transaction involving the lease of an intangible asset. Of course, the lessee's right of use would be constrained by the terms and conditions established by the lessor in the lease agreement.*

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

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires 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 lease take into account or do not take into account the amortisation of the whole or a substantial part of the investment of the lessor.

#### *Commentary*

19. *The definition of a financial lease should be read in conjunction with the definition of a lease as "a transaction in which one person provides another person with the right to possess and use an asset for a specific term in return for rentals." The distinctive feature of a financial lease is the presence of a third party supplier selected by the lessee from whom the lessor acquires the asset under a separate supply agreement.*

20. *Paragraph (c) of the definition of financial lease confirms that the lessee's payments over the term of the lease need not amortise the entire investment of the lessor. Likewise, the chapeau of the definition confirms that the lease need not involve an option to purchase. In other words, a financial lease may include an operating lease. This reflects the evolving industry practice whereby lessees are often interested only in acquiring the benefit of possession and use of the asset for a limited period of time.*



21. *If the lessor re-leases the asset at the end of the term of a financial lease, the re-lease may qualify as a “financial lease” if it satisfies the requirements of paragraphs (a) and (b) of the definition. The lessor’s ability to re-lease the asset in a transaction that qualifies as a financial lease permits the lessor to lower both lessees’ rental payments and gives the subsequent lessee the benefit of the duties owed to the original lessee under Article 7 of the Law.*

22. *The requirement in paragraph (b) of the definition of financial lease that the supplier have knowledge that the lessor is acquiring the asset in connection with “a lease” is satisfied in the case of a re-lease, since knowledge of the identity of the lessee is unnecessary. The requirement in paragraph (a) that the lessee select the supplier is satisfied in the case of a re-lease if the circumstances clearly indicate to the lessee that the lease involves an asset acquired by the lessor from a supplier for financial leasing purposes, for example by a term in the lease to this effect.*

**Large aircraft equipment** means all “aircraft objects” as defined in the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment, signed in Cape Town on 16 November 2001.

*Commentary*

23. *This definition should be read in conjunction with that part of the Official Commentary relating to Article 3(2).*

**Lease** means a transaction in which one person provides another person with the right to possess and use an asset for a specific term in return for rentals. The term includes a sub-lease.

*Commentary*

24. *This definition should be read in conjunction with that part of the Official Commentary relating to the definitions of “asset” and “financial lease.”*

**Lessee** means a person who acquires the right to possess and use an asset under a lease. The term includes a sub-lessee.

*Commentary*

25. *In reading this definition, account should be taken of the definition of “asset”, which requires that the lessee acquire the asset primarily for business purposes in order for the lease to come within the sphere of application of the Law.*

**Lessor** means a person who provides another person with the right to possess and use an asset under a lease. The term includes a sub-lessor.

*Commentary*

26. *Lessor is defined to mean any person who enters into a lease. Accordingly, the lessor need not be engaged exclusively or primarily in the business of leasing. For example, the lessor may be a dealer who also sells assets of the type subject to the lease.*

27. *“Person” is defined elsewhere in this Article to mean any legal entity or individual and “supplier” is defined to mean “a person” from whom a lessor acquires the asset for lease under a financial lease. Accordingly, the fact that the lessor is a subsidiary of, or has a long-term relationship with, or is otherwise closely affiliated with the supplier, including under a financial lease, does not affect the status of the lessor as long as it is a distinct legal entity or individual.*

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

*Commentary*

28. *The definition of “person” does not deal with the question of what constitutes a “legal” entity. This is left to be determined by the general law of persons for each enacting State.*

29. *The term person is used in the definitions of lessee, lessor and supplier and reference should be made to those parts of the Official Commentary relating to those definitions.*

**Supplier** means a person from whom a lessor acquires the asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires the asset for lease under a financial lease.

*Commentary*

30. *These definitions should be read in conjunction with that part of the Official Commentary relating to Article 7 and the definition of financial lease elsewhere in this Article.*

### **Article 3 – Other laws**

1. This Law does not apply to a lease that functions as a security right.

*Commentary*

31. *This paragraph is designed to ensure that when the lessor’s ownership of the leased asset functions as a security right the Law does not apply to any aspect of the lease. It does not matter how the parties have designated the lease. If a State does not have a law relating to security rights, reference may be made to the UNCITRAL Legislative Guide on Secured Transactions, adopted in Vienna on 14 December 2007, which defines “security right” to mean a property right in a movable asset that is created by agreement and secures payment or other performance of an obligation. Because the lessor’s ownership right under many leases, including financial leases, does not function as a security right, the Law will still apply to a broad range of leases.*

2. This Law shall not apply to a lease or a supply agreement for large aircraft equipment unless the lessor, the lessee and the supplier have otherwise agreed in writing.

*Commentary*

32. *This paragraph provides that large aircraft equipment of the type covered by the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment, opened to signature in Cape Town on 16 November 2001 (that is airframes, aircraft engines and helicopters of a certain size), is excluded from the sphere of application of the Law, unless the lessor, the lessee and the supplier otherwise agree in writing. The words "unless the lessor, the lessee and the supplier otherwise agree in writing" allow the parties to agree to partial application of the Law. This exclusion removes a potential source of conflict between the Law and the aforementioned Protocol.*

**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.

*Commentary*

33. *A provision similar to the one contained in this Article appears in a number of private law treaties (see, for example, Article 7 of the United Nations Convention on Contracts for the International Sale of Goods, opened to signature in Vienna on 11 April 1980). More recently, it has been recognised that such a provision would also be useful in a non-treaty instrument, such as a model law, in that a State enacting a model law also has an interest in its harmonised interpretation (see, for example, Article 3 of the UNCITRAL Model Law on Electronic Commerce, adopted in New York on 12 June 1996, as modified in 1998, and Article 8 of the UNCITRAL Model Law on Cross-Border Insolvency).*

34. *This Article is intended to provide guidance for interpretation of the Law by courts and other national or local authorities, so that they will take into account the international nature and purposes of the Law. This will promote uniformity of interpretation of the uniform text, once incorporated in local legislation, and discourage interpretation only by reference to the concepts of local law.*

35. *The purpose of Article 4(1) is to draw the attention of courts and other national or local authorities to the fact that the provisions of the Law (or the provisions of the instrument implementing the Law), while enacted as part of domestic legislation and, therefore, domestic in character, should be interpreted with reference to its international origin in order to ensure uniformity in the interpretation of the Law in various countries.*

36. *The purpose of Article 4(2) is to ensure that minor gaps and ambiguities in this text do not become a conduit for the introduction of broader local law variations. Accordingly, when a question concerning a matter governed by the Law is not expressly settled in it, such a question is to be settled in conformity with the general principles on which it is based.*

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

Except as provided in Articles 7(4) 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 lease.

#### *Commentary*

37. *This Article recognises the principle of freedom of contract. Accordingly, the provisions of the Law are subject to, and may be varied by agreement between the lessor and the lessee. This enables the parties to organise relations between themselves in accordance with their particular concerns while still being in conformity with the Law*

38. *This Article recognises two specific exceptions to the parties' freedom of contract: Article 7 (concerning the supply agreement between the lessor and the supplier) and Article 22 (concerning agreements on liquidated damages).*

39. *This Article also makes the parties' freedom of contract subject to other mandatory rules of law of the enacting State.*

## **CHAPTER II: EFFECTS OF A LEASE**

### **Article 6 – Effectiveness between the parties and as against third parties**

Except as otherwise provided in this Law:

(a) a lease 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.

#### *Commentary*

40. *Paragraph (a) of this Article confirms that the lease is effective and enforceable according to its terms between the lessor and lessee. Paragraph (b) provides that the rights and remedies of the parties under the lease are enforceable against purchasers and creditors, including an insolvency administrator.*

41. *This Article applies except "as otherwise provided elsewhere in this Law". Other provisions of the Law incorporate exceptions arising under other laws of the enacting State, thereby indirectly incorporating exceptions in addition to those set out explicitly in the Law. For example, the enforceability of the rights and remedies of the parties to the lease against third party creditors is subject, under Article 8, to the priority rights of creditors under other laws of the enacting State (see that part of the Official Commentary relating to Article 8). Such other laws might, for example, include the enacting State's insolvency law.*

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

1. 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.
2. At the request of the lessee, the lessor shall assign its rights to enforce the supply agreement to the lessee. If the lessor does not, the lessor is deemed to have assumed the duties of the supplier.
3. 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.
4. The parties may not derogate from or vary the effect of the provisions of paragraphs 1, 2 and 3.
5. Nothing in this Article shall entitle the lessee to negotiate a modification, termination or rescission of the supply agreement without the consent of the lessor.

#### *Commentary*

42. *In some financial leases, the lessor, lessee and supplier are involved in a tripartite contractual relationship. This permits the lessee to assert a direct claim against the supplier in respect of, in particular, non-conforming delivery of the leased asset and defects in the asset under general contract law. However, in other transactions, the lease and the supply agreement are independent contracts and the doctrine of privity of contract might prevent the lessee from claiming directly against the supplier. Accordingly, paragraph 1 of this Article entitles the lessee to claim directly against the supplier, as an exception to the privity doctrine.*

43. *Paragraph 1 of this Article extends the duties owed to the lessor by the supplier under the supply agreement to the lessee to the same extent as if the lessee had been a party to that agreement. This gives the lessee a direct right of action against the supplier without the need for co-operation by the lessor. The granting of this right to the lessee benefits the lessor, since it no longer bears primary responsibility for pursuing action in respect of the lessee's loss.*

44. *Paragraph 2 of this Article enables the lessee to assert the rights which the lessor has under the supply agreement. The lessee may only do so, however, if the lessor has assigned such rights to the lessee, at the latter's request. A lessor not acceding to such a request is deemed to have assumed the duties owed by the supplier to the lessee. It is both logical and in the interest of the lessor to meet this requirement so as to avoid finding itself so bound toward the lessee, when any litigation that may arise will be a consequence of the specifications given for the asset and the selection of the supplier, both matters which are not within the lessor's province.*

45. *Paragraph 3 of this Article protects the lessee against a modification of its direct rights against the supplier, under paragraphs 1 and 2 of this Article, through an agreement between the supplier and the lessor to vary the original supply agreement. If the lessee does not consent to the*

*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.*

46. *Under paragraph 4 of this Article, paragraphs 1, 2 and 3 are mandatory and cannot be varied or derogated from by the parties.*

47. *Article 7 does not effect a legal novation. In other words, it does not operate to substitute the lessee for the lessor as the party to the supply agreement. Accordingly, paragraph 5 of this Article confirms that a variation of the supply agreement effected by the lessee and the supplier does not affect the rights of the lessor if the lessor has not consented to it.*

### **Article 8 – Priority of liens**

Except as otherwise provided by the law of [this State]:

(a) 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 lease and cannot impair any interest arising under the lease; and

(b) a creditor of the lessor takes subject to the rights and remedies of the parties to the lease.

#### *Commentary*

48. *This Article provides rules for determining the continued effectiveness of the rights of the lessor or the lessee where a creditor of either one or the other obtains a lien or similar right against the leased asset under other laws of the enacting State, for example its law governing judgment enforcement or insolvency.*

49. *Under paragraph (a), a creditor of the lessee takes subject to the rights and remedies of the parties to the lease and cannot impair either party's interest under the lease. For example, the creditor cannot impair the lessor's rights in the leased asset. Similarly, under paragraph (b), a creditor of the lessor takes subject to the rights of use and possession of the lessee.*

50. *However, as noted in the Official Commentary relating to Article 6 of the Law, the operation of these rules is subject, pursuant to the chapeau, to any provision to the contrary in other laws of the enacting State, for example its insolvency law.*

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

In a financial lease, the lessor when acting in its capacity of lessor and as owner within the limits of the transaction, as documented under the supply agreement and the lease, shall not 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.

#### *Commentary*

51. *This Article exempts the lessor in a financial lease from liability for action taken in the course of performing its duties as lessor and as owner where the lessee or a third party suffers personal injury or property damage as the result of a defect in, or through use of the leased asset.*

52. *This Article, while limiting liability based on the lessor's capacity as lessor or owner, does not exclude liability based on other grounds, such as fraudulent acts of the lessor, acts outside the documented scope of the transaction, liability to the enacting State or liability arising under that State's international obligations.*

53. *The rule provided in this Article differs from the rule provided in Article 8(1) of the UNIDROIT Convention on International Financial Leasing. That provision excludes liability of the lessor in its capacity of lessor but is silent as to liability based on the lessor's capacity as owner (see Article 8(1)(c) of the UNIDROIT Convention). The rule in this Article recognises that, while the lessor in a financial lease is formally the owner of the asset, the lessor is essentially a conduit between the supplier and the lessee and is protected because its function is limited to financing the lessee's right to possess and use the leased asset pursuant to the lease.*

### **CHAPTER III: PERFORMANCE**

#### **Article 10 – Irrevocability and independence**

1. (a) In a financial lease, the duties of the lessor and lessee become irrevocable and independent when the asset subject to the lease has been delivered to and accepted by the lessee.

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

2. Except as otherwise provided in Article 23(1)(c), 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 lease.

#### *Commentary*

54. *Reflecting the lessor's limited role as a financier, sub-paragraph 1(a) of this Article makes the parties' duties in a financial lease irrevocable and independent once the asset subject to the lease has been delivered to, and accepted by the lessee. In the case of a lease other than a financial lease, sub-paragraph 1(b) confirms that the parties' duties are irrevocable and independent only if and to the extent specified in their agreement.*

55. *Paragraph 2 of this Article confirms that a duty that is irrevocable and independent must be performed, regardless of performance or non-performance by any other party of its duties, "unless the party to whom the duty is owed terminates the lease."*

56. *Notwithstanding termination of the lease by the lessor in accordance with Article 23 of the Law, the lessee may still owe the lessor duties, including the duties of maintenance and return of the leased asset as set forth in Article 18(2) and duties derived from the lessee's default or performance prior to termination under Article 23(2). Generally, after the delivery and acceptance of an asset subject to a financial lease, the lessor has no continuing duties under the Law. However, this is subject to Article 23(1)(c), which entitles the lessee to terminate the lease for fundamental breach of the warranty of quiet possession referred to in Article 16 of the Law.*

### Article 11 – Risk of loss

1. In a financial lease:
  - (a) risk of loss passes to the lessee when the lease is entered into; and
  - (b) when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the lease and the lessee enforces its remedies under Article 14, the lessee, subject to Article 18(1), may treat the risk of loss as having remained with the supplier.
2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

#### *Commentary*

57. *Again reflecting the lessor's limited role as a financier, sub-paragraph 1(a) of this Article provides that the risk of loss with respect to an asset subject to a financial lease passes to the lessee when the lease is entered into.*

58. *Sub-paragraph 1(b) of this Article provides an exception to this rule where, after the financial lease has been entered into, the leased asset is not delivered, is partially delivered, is delivered late or fails to conform to the lease and the lessee, accordingly, enforces its remedies under Article 14 of the Law. In these circumstances, the lessee may treat the risk of loss as having remained with the supplier, subject to the lessee's duty under Article 18(1) to preserve and maintain the asset.*

59. *In a lease that is not a financial lease, the lessor, under paragraph 2 of this Article, retains the risk of loss.*

### Article 12 – Damage to the asset

1. In a financial lease, when an asset subject to a lease is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and either accept the asset with due compensation from the supplier for the loss in value or seek such other remedies as are provided by law.
2. In a lease other than a financial lease, when an asset subject to a lease is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,
  - (a) if the loss is total, the lease is terminated; and
  - (b) if the loss is partial, the lessee may demand inspection and either treat the lease 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.

#### *Commentary*

60. *This Article provides guidance on the lessee's rights when an asset subject to a lease is damaged without the fault of the lessee or the lessor before it is delivered to the lessee.*



61. *If the lease is a financial lease, paragraph 1 of this Article provides that the lessee may demand inspection and either accept the asset with due compensation from the supplier for the loss in value or not accept the asset (see Article 14(1) of the Law) and seek such other remedies as are provided by other laws of the enacting State. The operation of this rule is subject to the principle of freedom of contract enunciated in Article 5 of the Law. Accordingly, when a lessee accepts a damaged asset with due compensation from the supplier for the loss in value, the lessee and the lessor are free to agree that this compensation is to be remitted to the lessor and applied to reduce the rentals owed.*

62. *In a financial lease, the lessee cannot terminate the lease once the asset has been delivered and accepted, even if the damage renders the equipment inoperable (see that part of the Official Commentary relating to Articles 10(1)(a), 14 and 23(1)(b)): in such a case the lessee's remedy is limited to damages (see that part of the Official Commentary relating to Article 13).*

63. *If the lease is not a financial lease, paragraph 2 of this Article provides that the lessee may terminate the lease if the loss is total and, in the case of partial loss, elect either to terminate the lease or accept the lease with due compensation for the loss in value from 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. After a lessee has accepted an asset,

(a) in a financial lease, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement; and

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

#### *Commentary*

64. *Paragraph 1 of this Article identifies the circumstances in which acceptance of an asset by the lessee occurs.*

65. *Pursuant to paragraph 1, a lessee will be treated as having accepted the asset, even if it does not conform to the relevant agreement, if the lessee either uses the asset or fails to reject it after a reasonable opportunity for inspection. Accordingly, paragraph 2 provides guidance on the lessee's post-acceptance right to damages in respect of a non-conforming asset. The lessee is entitled to damages from the supplier in the case of a financial lease (see also Article 7(2) and (3) of the Law) and from the lessor in the case of a lease other than a financial lease. This Article is subject to the principle of freedom of contract enunciated in Article 5 of the Law: accordingly, when a lessee is entitled to damages for a non-conforming asset, the lessee and the lessor are free to agree that the compensation is to be remitted to the lessor and applied to reduce the rentals owed.*

## 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 lease, 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 lease, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the lease. Notice of rejection or termination must be given by the lessee 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 lease, 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.

(d) If the lessee rejects an asset in accordance with paragraph 2 and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

### *Commentary*

66. *This Article provides rules on the lessee's remedies where an asset is not delivered, is partially delivered, is delivered late or fails to conform to the lease.*

67. *In a financial lease, the lessee is entitled, under paragraph 1 of this Article, to demand a conforming asset from the supplier and to seek such other remedies as are provided by the law of the enacting State. Paragraph 1 should be read in conjunction with Article 7 of the Law, which gives the lessee the right to pursue the supplier directly for breach of the duties owed by the supplier to the lessor in respect of the delivery of the asset and its conformity to the supply agreement.*

68. *In a lease that is not a financial lease, the equivalent duties to deliver a conforming asset are owed by the lessor to the lessee. Paragraph 2 of this Article sets out the range of remedies available to the lessee against the lessor for breach and the conditions governing the availability of these remedies.*

## Article 15 – Transfer of rights and duties

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

(ii) The lessor and lessee may agree 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.

(iii) Nothing in this sub-paragraph shall affect the lessee's ability to assert its rights against the lessor.

(b) The duties of the lessor under the lease 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 lease 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.

#### *Commentary*

69. *Paragraph 1 of this Article entitles the lessor to transfer its rights against the lessee without the consent of the lessee. This enables the lessor to use the stream of rental payments owed by the lessee to finance its own capital needs, including, for example, by granting a security right in its payment rights against the lessee.*

70. *Sub-sub-paragraph 1(a)(i) of this Article does not affect the right of the lessee to raise against the transferee any defences and rights of set-off it may have against the lessor under other laws of the enacting State. However, sub-sub-paragraph 1(a)(ii) of this Article explicitly permits the lessor and lessee to agree that the lessee will not assert against a transferee of the lessor's rights defences or rights of set-off that the lessee holds against the lessor, other than those arising from the lessee's incapacity. The reference in this sub-sub-paragraph to the lessee's ability to assert defences or rights of set-off arising from the incapacity of the lessee is to a lease transfer that is invalid owing to the lessee's lack of legal capacity to contract.*

71. *The approach in paragraphs 1 and 2 of this Article is in line with other international instruments, such as the United Nations Convention on the Assignment of Receivables in International Trade, opened to signature in New York on 12 December 2001.*

72. *This Article also provides for the transfer of the lessee's rights and the transfer of both parties' duties, but only with the consent of the other party, which consent may be given in advance and may not be withheld unreasonably.*

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

1. In a financial lease:

(a) 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; and

(b) a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement 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.

3. Except as otherwise provided by Article 23(1)(c), 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.

#### *Commentary*

73. *Under this Article, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has or claims a superior title or right to the asset or acts under the authority of a court.*

74. *In a financial lease, the lessor's warranty is limited to a disturbance of quiet possession by a third party whose superior title, right or claim derives from a negligent or intentional act or omission of the lessor (cf. Articles 16(1)(a) and 16(2)). This limitation recognises that in a financial lease the lessee is responsible for the selection of the supplier and, therefore, bears responsibility for ascertaining the quality of the supplier's rights in the leased asset.*

75. *Sub-paragraph 1(b) of this Article provides that a lessee in a financial lease who furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement that arises out of its compliance with such specifications. Paragraph 2 of this Article provides that in a lease other than a financial lease the lessor warrants to the lessee that its quiet possession will not be disturbed by any claim of infringement.*

76. *The lessor's warranty of quiet possession does not interfere with any right of an owner or any other holder of a superior interest to take possession of the asset subject to the lease. Paragraph 3 of this Article in general limits a lessee whose quiet possession has been disturbed to a claim for damages from the lessor. However, in the event of "a fundamental default" by the lessor in respect of the warranty of quiet possession under a financial lease, the lessee may also terminate the lease, as provided in Article 23(1)(c) of the Law.*

### **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 lease and is fit for the ordinary purposes for which an asset of that description is used. Subject to Article 7(2), 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 lease 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.

#### *Commentary*

77. *In a financial lease, paragraph 1 of this Article provides that the supplier warrants that the asset being leased conforms to what is accepted in the trade under the description in the lease and is fit for its ordinary purposes. This warranty is enforceable by the lessee only as against the supplier, unless the lessor is deemed to have assumed the supplier's duties as a result of not*

*acceding to the lessee's request to assign its rights under the supply agreement to the lessee under Article 7(2) of the Law. Of course, the same result is obtained under Article 7(3) of the Law when the lessor, after approval of a supply agreement by the lessee, varies the agreement without obtaining the lessee's consent.*

78. *In a lease other than a financial lease, paragraph 2 of this Article provides that the lessor has the same warranty obligation as a supplier, provided that the lessor deals regularly in assets of the kind described in the lease and can, therefore, be expected to have specialised knowledge of the expectations of the trade. Specialised knowledge on the part of a lessor cannot be presumed in the case of a non-financial lease, which may sometimes involve a particular leasing arrangement concerning a specific asset.*

### **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 lease 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 lease 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.

#### *Commentary*

79. *Sub-paragraph 1(a) of this Article specifies the standard of care required of the lessee in relation to its use and maintenance of the leased asset. Under sub-paragraph (1)(b), the lessee is deemed to have satisfied this standard of care if it complies with a duty of maintenance in respect of the asset set out in the lease or with technical instructions for the use of the asset issued by the manufacturer or supplier.*

80. *Sub-paragraph 1(b) of this Article applies only where the lease or technical instructions specifically deal with the issue of maintenance or use: if they do not, the lessee is liable for failure to satisfy the standard of care laid down in sub-paragraph 1(a).*

81. *On termination of the lease, the lessee, under paragraph 3 of this Article, is placed under the duty of returning the asset in a condition consistent with the lessee's exercise of the standard of care required by paragraph 1.*

## CHAPTER IV: DEFAULT AND TERMINATION

### Article 19 – Definition of default

1. The parties may agree 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 lease or this Law.

#### *Commentary*

82. *Under paragraph 1 of this Article, the parties may agree on the events that constitute a default; paragraph 2 provides a definition of default where the parties do not so agree.*

83. *This Article does not define “fundamental default”. Pursuant to the principle of freedom of contract enunciated in Article 5 of the Law, the parties may agree on what constitutes a “fundamental default”. The consequences of “fundamental default” are dealt with in Article 23.*

### 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.

#### *Commentary*

84. *This Article is protective of the “debtor”, whether this be the lessor or the lessee, in that the sanction for default by either party may only be enforced once the “aggrieved party” has, on the one hand, given the debtor notice of its default, of the action that it stands to have enforced against it and of the termination of its agreement and, on the other hand, provided the debtor with a “reasonable” opportunity to cure its default.*

85. *Whether notice is adequate is governed by other laws of the enacting State (see, for example, Article 1.10(1) of the UNIDROIT Principles of International Commercial Contracts).*

86. *Whether the opportunity to cure is reasonable is determined by other laws of the enacting State (see, for example, Article 7.1.4 of the UNIDROIT Principles of International Commercial Contracts).*

### 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 lease, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

#### *Commentary*

87. *This Article entitles an aggrieved party to recover damages in an amount sufficient to place it in the position in which it would have been in the absence of default.*

88. *The measure of damages provided for in this Article can be modified by agreement to the contrary (see that part of the Official Commentary relating to Article 5) or by a liquidated damages clause in a lease (see that part of the Official Commentary relating to Article 22). It follows that this Article must be read in conjunction with Article 22 of the Law.*

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

1. When the lease 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.

#### *Commentary*

89. *Paragraph 1 of this Article permits the lessor and the lessee to agree on an amount of liquidated damages to be paid in the event of default. Paragraph 2, however, sets a limit on the enforceability of such a clause: where the amount agreed is found to be “grossly excessive” in relation to the harm resulting from the default, it may be reduced to a reasonable amount.*

90. *The sum agreed to by the parties is not subject to reduction merely because it exceeds the loss actually suffered. In order to be reduced, the sum must be grossly excessive. Such a sum may only be deemed to be grossly excessive where account is taken of, on the one hand, the actual harm resulting from the default and, on the other, the dual purpose served by the liquidated damages clause, namely at one and the same time compensating the aggrieved party in accordance with Article 21 of the Law and acting as a deterrent against default by that party’s co-contractant. This ensures greater certainty and predictability in the enforceability of such clauses while still protecting the defaulting party from severe adverse consequences where the amount agreed to is grossly in excess of the aggrieved party’s actual loss.*

91. *Pursuant to paragraph 3 of this Article, paragraph 2 is not subject to the principle of freedom of contract enunciated in Article 5 of the Law.*

### **Article 23 – Termination**

1. (a) Subject to sub-paragraph (b), a lease 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) Except as otherwise provided in sub-paragraph (c), after the asset subject to the lease has been delivered to and accepted by the lessee, the lessee in a financial lease may not terminate the lease 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.
  - (c) In the event of a fundamental default by the lessor in respect of the warranty of quiet possession referred to in Article 16, the lessee in a financial lease may terminate the lease.

2. Subject to Article 10, on termination all duties under the lease 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.

*Commentary*

92. *Sub-paragraph 1(a) of this Article deals with the events which may bring about termination of a lease. These include termination by operation of law, including by operation of paragraph 2 of this Article, or by the agreement of the parties. In addition, a lessor or a lessee may terminate a lease unilaterally upon fundamental default by the other party. Under paragraph 2 of this Article, termination discharges all the parties' future duties but does not discharge any right based on prior default or performance.*

93. *Sub-paragraph 1(b) of this Article precludes the lessee in a financial lease from terminating the lease for a fundamental default by the lessor or the supplier occurring after the asset has been delivered to, and accepted by the lessee. The lessee is, however, entitled to such other remedies as are provided by the agreement of the parties and by the law of the enacting State.*

94. *Sub-paragraph 1(b), moreover, is subject to sub-paragraph 1(c), which preserves the lessee's right of termination under a financial lease, even after delivery and acceptance, for a fundamental default by the lessor in respect of the warranty of quiet possession referred to in Article 16(1)(a) of the Law.*

95. *In the absence of a definition of fundamental default in the Law (see paragraph 83 of the Official Commentary), the question as to whether a default is fundamental is determined by other laws of the enacting State. Under Article 7.3.1 of the UNIDROIT Principles of International Commercial Contracts, whether a default amounts to a fundamental default shall be determined with regard to whether (a) the default substantially deprives the aggrieved party of what it was entitled to expect under the agreement unless the other party did not foresee and could not reasonably have foreseen such result; (b) strict compliance with the duty that has not been performed is of essence under the agreement; (c) the default is intentional or reckless; (d) the default gives the aggrieved party reason to believe that it cannot rely on the other party's future performance; and (e) the defaulting party will suffer disproportionate loss as a result of the preparation or performance if the agreement is terminated.*

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

After the lease 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.

*Commentary*

96. *This Article provides that the lessor has the right to take possession of the leased asset at the end of the lease. It should be read in conjunction with Article 18(2) of the Law.*

97. *The legal means by which an owner-lessor may take possession of an asset that has previously been leased are left to be determined by other laws of the enacting State.*