



**UNIDROIT COMMITTEE OF GOVERNMENTAL
EXPERTS FOR THE PREPARATION OF A DRAFT
MODEL LAW ON LEASING
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**PRELIMINARY DRAFT MODEL LAW ON LEASING ESTABLISHED BY A UNIDROIT
ADVISORY BOARD AS AUTHORISED FOR TRANSMISSION TO GOVERNMENTS,
FOR FINALISATION, BY THE UNIDROIT GOVERNING COUNCIL:**

INTRODUCTORY NOTE

(prepared by the Secretariat)

I. Background

1. *Reasons for UNIDROIT'S undertaking of preparation of model law*

Recent developments, whether it be in relation to the UNIDROIT Convention on International Financial Leasing, opened to signature in Ottawa on 28 May 1988 (hereinafter referred to as the *UNIDROIT Convention*), or the Convention on International Interests in Mobile Equipment, opened to signature in Cape Town on 16 November 2001 (hereinafter referred to as the *Cape Town Convention*), have highlighted the special need that developing countries and countries engaged in the transition to a market economy have for the introduction of modern legal rules governing the financing of equipment, of every level of value, in order to develop their economic infrastructure. In particular, those engaged in running the projects of the International Finance Corporation (I.F.C.) for the development of leasing industries in such countries have invariably taken the rules contained in the UNIDROIT Convention as the model for the leasing laws to underpin such new leasing markets. On occasions, the UNIDROIT Secretariat has been approached by Governments seeking UNIDROIT'S assistance in the development of leasing legislation. The States Parties to the UNIDROIT Convention are, moreover, almost all either developing countries or countries in transition.

A similar pattern has emerged with the Cape Town Convention. In particular, not only was the diplomatic Conference that saw the adoption of this Convention attended by an unusually high proportion of States with developing economies but the majority of the States that have to date become Parties to that Convention and the Protocol thereto on Matters specific to Aircraft Equipment are also developing countries.

These considerations led the UNIDROIT Governing Council to decide that it would be appropriate for UNIDROIT to draw up a model law on leasing, in particular targeted at just such developing countries and countries in transition. It was considered that this would be a more efficient way of developing basic leasing laws in developing countries and countries in transition than to reinvent the wheel each time a new leasing industry was being established, in particular

since it would be primarily on the basis of the aforementioned UNIDROIT Convention, as, in effect, the latest expression of the international legislators' will in this area, and through making use of UNIDROIT'S unique expertise in this area.

Before, however, embarking on the preparation of such a model law, the UNIDROIT 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. and the Equipment Leasing Association of the United States of America (E.L.A.). 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.

2. *Work of UNIDROIT Advisory Board for the preparation of a preliminary draft model law on leasing*

From the beginning the parameters of the project were clearly delimited by reference to the needs of developing countries and countries in transition, the end-product of the Institute's work in this area being perceived as a particularly apposite and efficient method of ameliorating the inadequate investment capacities of such countries. In establishing the composition of the Advisory Board to which the preparation of a preliminary draft model law was entrusted, the UNIDROIT Secretariat, therefore, had especial regard to the need to reflect adequately those legal and economic systems that were intended to be the essential beneficiaries of the project amongst its membership: in addition to experts from Europe and North America, the Advisory Board thus included experts from North Africa and the Arabic-speaking world, sub-Saharan Africa, the People's Republic of China, Latin America and the countries of the Former Soviet Union.¹ In addition, Chief Mrs T. Oyekunle (Nigeria) was elected Chairman of the Advisory Board.

In the light of the unique expertise that he had acquired as the Reporter on Article 2A (Leases) of the Uniform Commercial Code of the United States of America, in addition to serving on the UNIDROIT Study Group that prepared the preliminary draft version of what was to become the aforementioned UNIDROIT Convention, Mr R.M. DeKoven was elected Reporter to the Advisory Board.

The Advisory Board met in Rome, at the seat of UNIDROIT, on three occasions, on 17 October 2005, on 6 and 7 February 2006 and from 3 to 5 April 2006. Its first session was devoted to a consideration of the issues to be encompassed by the preliminary draft model law. On the basis of these indications, the Reporter prepared a first draft which, after being submitted to members of the

¹ The members of the Advisory Board were: Mr A. Albeni (European Federation of Equipment Leasing Company Associations), Mr E.M. Bey, UNIDROIT correspondent (France/Tunisia), Mr R. Castillo-Triana (Colombia), Mr R. Clarizia (European Federation of Equipment Leasing Company Associations), Mr C. Dageförde (Germany), Mr R.M. DeKoven, UNIDROIT correspondent (United Kingdom), Mr. R. Downey (E.L.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.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.

Advisory Board for comment, was considered by the latter at its second session. In the light of this first reading and the proposals for the amendment of the preliminary draft agreed at the second session, the Reporter prepared a second version of the preliminary draft model law, which was again submitted to members of the Advisory Board for comment prior to its third and final session. This last session permitted a final reading of the preliminary draft as well as its revision and refinement by a drafting committee, composed of the Reporter, Mr E.M. Bey and Mr M. Sultanov.

The text of the preliminary draft model law as established by the Advisory Board on the last day of its third session was submitted to the UNIDROIT Governing Council, at its 85th session, held in Rome from 8 to 10 May 2006, for advice as to the most appropriate follow-up action. Subject to a number of amendments proposed by members of the Council, which were duly implemented by the UNIDROIT Secretariat, the preliminary draft model law was authorised for transmission to Governments for finalisation. It was agreed that, given the urgency attached by key economic stakeholders, in particular the I.F.C. and the E.L.A., to having the future model law available for implementation at the earliest possible opportunity, every effort should be made to complete the intergovernmental consultation process in respect of the preliminary draft as quickly as possible. It was, therefore, decided to structure the process over two three- or four-day sessions, with the first half-day of the first session being given over to a presentation of the preliminary draft by members of the Advisory Board and the text of a draft model law to come out of these sessions then being laid for adoption before an extraordinary session of the UNIDROIT General Assembly.

The question of the relationship between the preliminary draft model law, on the one hand, and the draft Legislative Guide on Secured Transactions under preparation by UNCITRAL, on the other, was raised by the UNCITRAL Secretariat during the preparation of the preliminary draft. Sensitive to the need to ensure maximum co-ordination between the products of the two Organisations, representatives of the UNIDROIT and UNCITRAL Secretariats have subsequently been engaged in working out an appropriate solution, to be laid, as a joint proposal of the two Secretariats, before Governments and Organisations in time for the first session of the UNIDROIT Committee of governmental experts for the preparation of a draft model law on leasing.

II. Overview of the preliminary draft model law

1. General purpose of the preliminary draft

In preparing the preliminary draft model law and authorising its transmission to Governments for finalisation, the Advisory Board and the Governing Council respectively were particularly mindful of its especial importance for countries with emerging economies and economies making the transition to a market economy. Leasing is an especially important means of providing capital in such countries: more flexible than traditional secured loans and less dependent on sophisticated legal structures and registries, leasing can fuel the growth of the small- and medium-sized enterprises on which these economies rely. However, until lessors are confident that a State's legal framework will recognise and respect leasing transactions, leasing will not be in a position to fulfil its potential as an engine of growth.

Since 1988 the UNIDROIT Convention has provided the certainty necessary for cross-border leases involving States that are parties to that Convention. However, the domestic legislation of many States - particularly States with emerging and transition economies - is still inadequate. States have sought to address these inadequacies in a number of ways: some have sought to adapt the UNIDROIT Convention's framework or particular provisions for domestic use, whilst others, as indicated above

often working with the I.F.C., have begun drafting new legislation. The results have varied and, even when successful, have duplicated efforts.

The Advisory Board and the Governing Council kept these factors and the special needs of developing and transition economies very much in mind as they respectively prepared and approved for transmission to Governments the preliminary draft. The latter is designed for use in emerging and transition economies and their nascent leasing industries. This decision was considered appropriate for several reasons. First and foremost, leasing's potential to alleviate poverty and build a middle class, in countries and regions where poverty is rampant and the middle class is small, was deemed too important to ignore. Secondly, it was not likely that States with successful leasing industries and well-developed legal regimes would abandon the legal framework that had made them successful; because it was unlikely that an eventual model law would take the place of laws that were working successfully, the goal was not to mimic legislation that reflected the current needs and status of any one State's industry but rather to draft legislation that would create room for growth where the industries were emerging.

This decision to focus on the needs of emerging leasing markets had several consequences for the preliminary draft's structure and text.

First, the preliminary draft provides for freedom of contract. Because the parties to a leasing arrangement will be in the best position to create the economic relationship they desire, they should be free to contract as they choose. Since the preliminary draft is limited to transactions involving assets for use "in trade or business" or non-consumer leases, the special protections appropriate in the consumer context were deemed not appropriate. Rather, except for a few provisions in Articles 7(2), 16 and 22, the parties to a commercial lease are free to contract as they see fit.

Secondly, the preliminary draft allows for emerging leasing industries to grow organically, without being channelled or forced in any particular direction: since it is difficult to predict how any one leasing industry will evolve, flexibility is critical. Thus, the preliminary draft covers both financial and non-financial leases and assets of all kinds, from animals to real property. The types of financing, and the products to be financed, will vary from State to State. Rather than providing for certain products to be outside the law's reach, and thus probably eliminating them as potential sources of growth, the preliminary draft takes a broad and inclusive approach.

Thirdly, the preliminary draft must fit well in a variety of legal systems. The future model law's terms must be capable of working, for example, in Civil law, Common law and Shari'a law systems. Indeed, regions in which multiple States adopt the future law uniformly may reap greater gains, as uniform legislation will reduce transaction costs in cross-border transactions. At the same time, the future model law must recognise that certain leasing practices considered routine in one tradition, such as a lessor's right to self-help, may be considered inappropriate in another. Sensitivity to these factors is important when the implementing States may have legal systems at different levels of reliability and expertise.

Finally, the future model law must respect the implementing States' sovereignty. The States that may adopt this model legislation will approach issues of taxation, accounting and regulation of financial institutions in different ways. Efforts to impose uniform public law rules through leasing legislation may render the legislation unacceptable. Although subsequent commentary may describe possible approaches to these issues, the preliminary draft, accordingly, focusses solely on the parties' rights and duties.

2. *Key features of the preliminary draft*

The preliminary draft model law consists of 24 articles contained in four chapters. The first chapter, entitled "General provisions", contains certain rules and definitions that are necessary for the operation of the future model law as a whole, including the law's sphere of application, its relationship to other laws, its interpretation and the philosophy of freedom of contract that underpins the preliminary draft. The latter's broad scope is particularly apparent in this chapter, which defines the term "lease", provides the distinction between financial leases and all other leases and provides for leases of all kinds of property used in trade or business.

Chapters II and III, entitled "Effect of leasing agreement" and "Performance" respectively, deal with the meaning and operation of a leasing transaction respectively. Chapter II defines the nature of the relationships that are created among the lessee, lessor, supplier and third parties. Chapter III provides for the manner in which the parties may carry out their agreement, with provisions governing, *inter alia*, the lessee's duty to pay rentals, the parties' powers to transfer their rights under a lease and the warranties owed by the lessor and lessee.

Finally, Chapter IV, entitled "Default", deals with the many issues that arise as a transaction comes to an end. The consequences of a party's default, the parties' ability to terminate a lease, the calculation of damages and the disposition of the leased asset at the end of the lease are all covered in this chapter.