UNIDROIT

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW.

STUDY GROUP
ON THE
LEASING CONTRACT

REPORT

by the Secretariat of UNIDROIT
on the first session of the Group
held in Rome from 17 to 19 November 1977

Rome, November 1978
1. In accordance with the decision taken by the Governing Council of UNIDROIT at its 56th session (Rome, 19-20 May 1977), the President of UNIDROIT convened the first session of a Study Group responsible for the preparation of uniform rules on the leasing contract, which met in Rome at the seat of UNIDROIT from 17 to 19 November 1977. Its composition was as follows:

Members of the Study Group:

Mr. László Reczéi
Professor of Law at the University of Budapest, Ambassador, Member of the Governing Council of UNIDROIT, Chairman of the Study Group
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Mr. El Mokhtar Bey
Directeur Juridique et du Contentieux Judiciaire du Groupe LOCARANCE
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Mr. Peter F. Coogan
Member of the Massachusetts bar, Professor of Law at the University of Georgia, Member of the Permanent Editorial Board for the Uniform Commercial Code, Representative of the Department of State of the United States of America
225 Franklin St. - BOSTON - Massachusetts 02110

Mr. Christian Gavalda
Professeur de droit commercial et bancaire et Directeur du Centre de Recherches du droit des affaires à l’Université de Paris I, Panthéon - Sorbonne - 12 place du Panthéon - 75005 PARIS

Mr. Royston M. Goode
Crowther Professor of Credit and Commercial Law, Queen Mary College, University of London - Mile End Road - LONDON E1 4NS

Mr. Fritz Peter
Honorary Chairman of the European Federation of Equipment Leasing Company Associations (Leaseurope), Expert consultant to the Study Group - Industrie Leasing AG, Albisriederplatz, Hardstrasse 1 - CH 8040 ZURICH
2. The Study Group was seized of the following papers:

(i) Draft Agenda of the session (Leasing Study Group - 1st session /AG);

(ii) Preliminary Analysis of the replies to the Questionnaire on the leasing contract (with special reference to international leasing) prepared by the Secretariat (Study LIX - Doc. 3, UNIDROIT 1976);

(iii) Minutes of the 55th session of the Governing Council (C.D. 55th session, UNIDROIT 1976);

(iv) Note for the attention of the restricted exploratory working group of the Governing Council on the leasing contract (Study LIX - Doc. 4, UNIDROIT 1977);

(v) "Le statut légal du leasing par M. Paul Bibot, Directeur de la S.A. Locabel" (French only) (Leasing C.D. Sous-Comité 2ème session - D.T.2);
(vi) Restricted exploratory working group of the Governing Council on
the leasing contract - Report of the session held in Rome 16-18 March 1977
incorporating the recommendations adopted by the Group at its final meeting
(Study LIX - Doc. 5, UNIDROIT 1977);

(vii) Minutes of the 56th session of the Governing Council (C.D. 56th
session - UNIDROIT 1977);

(viii) Note for the attention of the Study Group for the preparation of
uniform rules on the leasing contract (first session: 17-19 November 1977)
(Study LIX - Doc. 6, UNIDROIT 1977);

(ix) Definition of Equipment Leasing prepared by Leaseurope (European
Federation of Equipment Leasing Company Associations) (in English, French
and German).

3.- Opening the session, the President of UNIDROIT reminded the
Group of the terms of reference it had received from the Governing Council.
These involved it in proceeding to a preliminary exchange of views on the
legal problems raised by this novel form of contractual mechanism with a view
to identifying the areas where it might prove possible to prepare basic
uniform rules. In this context he stressed the fact that the work of the
Group was in no way conditioned by the type of end product to be envisaged,
whether a draft convention for submission to a diplomatic Conference of
adoption or a model law or some entirely different instrument. He voiced
the opinion nevertheless that, whatever form this end product might even-
tually take at such time as it came to be presented to Governments, its
value could only be enhanced by the neutral character of the forum in
which it would have been worked out. He drew particular attention to the
merit in this context of the Governing Council's choice of Mr. Rézei as
Chairman of the Study Group, whose coming from a State with such a totally
different economic system from that of those States in which leasing had found
its initial impetus could only reinforce his impartiality in the chair.

4.- The Chairman, after ascertaining the Group's approval of the
draft agenda prepared by the Secretariat, drew the Group's attention in
particular to the Note prepared for its attention by the Secretariat
(Study LIX - Doc. 6, UNIDROIT 1977) and the trilingual definition of
equipment leasing recently established by the member associations of the
European Federation of Equipment Leasing Company Associations (Leaseurope).
He proposed that the Group's discussions should be engaged around the list
of questions set out in the aforementioned Note, of which:

(i) Should one concentrate on a particular form of leasing and, if so,
which, e.g. the sui generis leasing mentioned in the recommendations of the
restricted Working Group of the Council, or should one rather endeavour to
provide a legal framework for leasing contracts in general?
5. - The Group was unanimously of the opinion that attention should be focused primarily on general leasing contracts of an international character as identified in the recommendations of the working group of the Governing Council (Study LIX - Doc. 5, UNIDROIT 1977, Annex 1, § 6 et seq.).

(ii) Should one aim immediately to create a complete legal framework for the form of leasing contract indicated in the Group's answer to (i) or would the chances of success perhaps be enhanced were one to restrict one's initial endeavours to a limited number of fundamental points?

6. - After Mr. Cavallo had indicated his feeling that the interests of making progress with the subject required that attention should be concentrated for the time being on the fundamental points involved, as he believed that it would be very difficult indeed to achieve a systematic unification of the whole subject, the Chairman ventured the further question as to what exactly were to be regarded as the fundamental points involved in leasing contracts.

7. - Mr. Coogan felt that one of the fundamental issues to be settled at the outset was whether, in view of the considerable divergence between what would be classified as a leasing contract under the Common law and Civil law systems, it would be feasible to arrive at a common set of rules for both systems or whether it might not be necessary to prepare separate sets of rules for each. He considered this to be a question of especial relevance as the experience of his own legal system had taught him the vanity for the purposes of American law of describing as a leasing contract something bearing certain of the features that would characterise the same name of contract under Civil law systems: while his own legal system would still regard such a contract as a perfectly valid contractual obligation, he pointed out that it would nevertheless not be possible for it to be classified as a lease under such a system.

8. - He explained that leasing in the United States had emerged as a means of circumventing what were regarded as the drawbacks associated with the acquisition of goods by what was formerly called a conditional sale but what was now better known as a purchase money security interest. He recalled a case of the 1870's in which the Supreme Court held that a lease under which the cost of rolling stock would be spread over various rental instalments, on the entire payment of which the lessor would transfer title to the lessee for a nominal consideration, was a conditional sale and accordingly required filing for the lessor's title to be protected against third parties. Thus already in 1909 when Professor Williston came to write his treatise on the Law of Sale, he was able to state that where there was an obligation on the lessee to pay an amount substantially equal to the purchase price as a result of which he had the right to obtain ownership of the property, this was to be regarded as a conditional sale and not as a lease.
9.- Mr. Goode agreed with the previous speaker as to the fundamental nature of the problem he had raised, explaining that English law too would not agree to classify as a lease something bearing such a feature of the French "crédit-bail" system, for example, as the option to purchase. He felt that a fundamental problem in defining a lease for the purpose of uniform rules could well stem from the understandable desire of the business communities in different countries to use the form of transaction best suited to their requirements. He accordingly wondered whether the better technique would not lie in avoiding the problems inherent in attempting to devise an all-embracing definition of a lease by seeking other means of dealing with the problem. One such possibility in his opinion might lie in the adoption of a formula stating that what is treated as a lease under the law of the relevant jurisdiction should be accepted as a lease in other jurisdictions where a dispute arises concerning a particular transaction.

10.- He felt that in this connexion it would be useful for the Group to set about identifying the particular practical problems to be solved by uniform legislation, rather than operating in the abstract. Such an exercise could well show that the problems encountered in one country differed from those encountered in another just as it could reveal the existence of common problems; in the former connexion he cited the prominence given in French legal literature to the question of whether the lessor can be regarded as the mandatory of the lessee and vice-versa for particular purposes, a question which had raised absolutely no problems in the United Kingdom for example.

11.- Mr. Coogan explained that the United States had undergone several stages with regard to the use of the lease, with the result that some of the reasons which had at one time appeared to militate particularly forcefully in favour of leasing had now completely disappeared. Leasing in the United States had received a particular impetus in the wake of World War II as businesses set about filling the great need for new industrial equipment. The conventional means of responding to this need was the conditional sale but this almost invariably required a traditional down payment of 15% - 20%, a sum which many companies simply did not then have. There were also questions as to whether the kind of debt that would show in the balance sheet as a result of the creation of a security interest in the equipment and the obligation to pay for it would make the balance sheet unattractive to other creditors. At that time it was thought that such an obligation did not have to be shown on the balance sheet simply if the transaction were termed a lease, apparently in complete disregard of the aforementioned Supreme Court decision of the 1870's which had held a transaction that was termed a lease by the parties to be in reality nothing more than a conditional sale. Another problem was that the amount which could be taken as a deduction against tax for depreciation was rather severely limited by the laws in force in the United States-
prior to 1954. Thus, prior to 1954, a lessee acquiring the use of equipment through, for instance, a three-year lease, would have been able to charge off the rent equal to the purchase price in three years, whereas he could not have taken that same deduction by way of depreciation. The United States Treasury Department did not take long in catching up with this particular idea, so that towards 1947 accountants began to become concerned as to whether a company's books accurately reflected its actual financial position where very considerable payment obligations were not shown as permanent debts. The period between 1947 and 1970 accordingly witnessed the promulgation of a long series of accounting regulations designed to cover leasing, culminating in October 1970 in the Financial Accounting Standards Board No. 13: this had placed very severe limitations indeed on the ability of an enterprise to acquire the use of goods by means of a transaction which, while having all the earmarks of a purchase and sale, was termed a lease by the parties. Thus the accounting advantages and the original fiscal advantages could now be regarded as having largely disappeared.

12.- As a result of the fact that use of a lease under terms which were acceptable at the present time to both the accounting and revenue authorities entailed turning over the residual to the lessor at the term of the lease at a time when it still had a not insignificant value, an enterprise in need of equipment nowadays examining the comparative merits of a lease as against a conditional sale would only tend to resort to the former where it would itself be unable to take advantage of the investment tax credit available, at rates often as high as 10% of the purchase price, as a deduction against tax over the first year after purchase and where it could not generate sufficient income to take full advantage of the depreciation available over the life of the equipment. Only in such a case therefore, he stressed, would it now be standard practice for such an enterprise to turn to a leasing company able to take advantage of the said advantages through what to it would therefore be the decreased cost of money. He admitted that the current popularity of leasing could not moreover be totally divorced from such non-logical reasons as the possibility offered under leasing of forgoing the need to seek official sanction in respect of the acquisition of vital but expensive items of equipment which a plant manager had overlooked to include in his capital budget.

13.- After noting, however, that there was no actual definition of leasing in the United States, the Chairman wondered whether the wiser course for the Group would not be to refrain entirely from seeking to establish a definition of a leasing contract and rather leave the problem of definition to be resolved under the applicable national law.
16. Mr. Peter felt that in the exercise proposed by UNIDROIT it was vital to distinguish between the legal and the fiscal and accounting aspects of leasing. He considered that the rules published by the F.A.S.B. in October 1976 should not be regarded as dealing with specifically legal aspects of leasing. He viewed Mr. Coogan's exposition of the present situation regarding leasing in the United States as simply further evidence of the great divide separating leasing as practised there from leasing as known in Europe, where he maintained that the tax impact was that much less important. He felt the Group should not lose sight of the fact that not only the leasing business but also the whole philosophy underlying that business differed radically in Europe from the United States.

15. He recalled that the question as to whether a lease should be regarded as a contract of hire or as a conditional sale was one that had been debated now for many years, and that it was now generally accepted in Europe that it could be classified under neither one nor the other of these proposed schemas but that it should rather be treated, as was the feeling of the restricted Working group of the Governing Council at its March 1977 meeting, as a sui generis contract.

16. As regards defining this contract, he drew the Group's attention to the definition of equipment leasing agreed after many years of hard struggle by the member associations of Leasemeurope, an exercise which had shown the need in formulating such a definition to leave a certain amount of room for specific national legal systems, as, for instance, in the case of the option to purchase. He reminded the Group that in certain countries for a leasing contract to be recognised as such it had to include such an option, whereas in other countries the inclusion of such an option had exactly the opposite effect, in destroying the transaction's possibility of being upheld as a lease. He felt that details of this nature, which, while of importance if the practical life of leasing companies, were of less significance for legal purposes, had to be steered clear of by the Group in favour of the many more fundamental issues on which widespread agreement was attainable, such details being best left to the individual national legal systems.

17. The Chairman accordingly proposed that the Group should for the time being take the Leasemeurope definition as an appropriate working basis, at the same time leaving itself free to enter into discussion of the merits of the substance of the said definition at a later stage. This proposal was supported by Mr. Goode who declared himself to be in agreement with Mr. Peter's basic point in that there were a number of ingredients to a lease and, in particular, to a finance lease on which they could all agree as being common to all legal systems.
18.- Supporting the case for the Group's concentrating its attention on the fundamental issues of the leasing contract, with secondary questions being left to the individual national legal systems, Mr. Gavaldà nevertheless felt that, as one of the objectives expected of unification in this field was precisely that of diminishing the number of unpleasant legal surprises awaiting a businessman intent on extending his activities across national frontiers, the Group had accordingly to beware of so playing down the importance of certain aspects of the leasing contract that the end product of its work through vital omissions might still leave an intolerable element of surprise at the level of international transactions. Thus, whereas he attached absolutely no importance to whether or not the Group's endeavours bore, for example, on such an aspect of leasing as the requirement under French law that the lessor should have the status of a bank or of a financial institution, precisely because this was one aspect of leasing which could hardly be regarded as constituting an intolerable element of surprise at the international level, he nevertheless felt quite differently regarding both the question of whether the leased equipment should or should not appear in the balance sheet as being subject to a leasing contract and that of the inclusion in leasing contracts of an option to purchase, a factor which in France was at the root of a whole series of important fiscal consequences. He considered that the issue of whether or not the leased item should appear in the balance sheet raised a question of "publicity" which was of vital interest to everyone, just as the option to purchase, notwithstanding the considerable divergencies in its regard as between Common law and Civil law systems, was a matter the importance of which in the context of the Group's task he would hesitate to play down precisely because of its surprise potential in cross-border transactions. While therefore agreeing with the view that there were a number of fundamental points on which agreement could and should be attained just as there were a number of matters which could be regarded as being of secondary importance and best left to national jurisdictions, he drew attention to the existence of a third and most significant category, namely those issues of a fundamental practical importance on which agreement would be most difficult but on which agreement there would have to be if the Group's work were to be meaningful in diminishing the intolerable element of surprise at present dogging cross-border leasing transactions.

19.- Mr. Bey, addressing himself to the remarks of Mr. Goode, specified that the French legislation on "crédit-bail" had not defined the contract itself but had rather sought to provide a legal framework for the operation within which the parties were then entirely free to make their individual arrangements. The French Legislation had thus nowhere spoken of "mandat": this was something which arose from and reflected the contractual terms agreed by the parties. The "mandat" question was definitely, in his view, not to be regarded as a fundamental aspect of the leasing operation for the purpose of the Group's work.
20. He pointed out that the fiscal and accounting implications of leasing in France were the direct expression and consequence of the legal definition of that operation, which viewing the leasing contract as essentially a contract of hire situated the contractual and statutory relations of the parties within the framework of hire contracts. Thus, for example, he found it quite natural that the ownership of the equipment should be vested in the lessor and that the latter should be entitled to depreciate it just as the lessee should be entitled to deduct his rentals but not be entitled to depreciate the equipment.

21. Mr. Coogan drew attention to what was fast becoming a major problem in the United States, namely the increasing number of lessees who were defaulting on rental payments at a quite advanced stage of their leases. This, he explained, had come about as a result of the expansion of the leasing business, lessors perhaps having been induced into being less selective in their choice of customers from the point of view of their credit rating. The problem of defaulting lessees had raised the question as to whether the lessor should be able to require payment by the lessee of the full amount of future rentals in addition to taking back the equipment or as to whether there should be some rule of mitigation of damage. Hitherto the only answer available to such questions in the United States was to be found in the general principles of contract law. He accordingly felt that the question of setting out the rights and obligations of the parties inter se could legitimately be seen as a fundamental point for coverage in uniform international legislation, and one on which he imagined that a general consensus could be reached amongst all countries.

22. As regards France, Mr. Gavaldà explained that the question of the lessor's insolvency was one that hardly ever arise as lessees were obliged under French law to have the status of either a bank or a financial institution and cases of insolvency affecting such bodies were most rare. In the case of the lessee's insolvency, on the other hand, he explained that leasing offered a considerable advantage over other forms of real security available in France in that lessors could in such cases recover their equipment, as compared with the very limited protection available to the holder of other forms of real security. As regards the situation concerning the payment of future rentals by a defaulting lessee, he stressed that in France this was essentially a matter left to the parties when making their contract, although an element of uncertainty had been introduced into this calculation for the parties by the passing in 1975 of a law whereby the judge was given a fairly wide discretionary power to revise such minimum payment clauses.
23.- Mr. Boy added that it would be difficult for a lessor in France to find himself insolvent simply in view of his ownership of all the equipment leased out by his company. Furthermore where a lessor was in financial difficulty, this would be because of his having failed adequately to equate his borrowings to the rate of his potential incomings from rentals. As regards the lessee's insolvency, he pointed out that this was essentially a matter of penalty clauses, which, he added, were included in virtually all leasing and "crédit-bail" contracts as a dissuasive to the lessee against defaulting on his obligations under the contract. Since the 1975 law, the French judge would allow the lessor to recover a sum representing the financial damage suffered by him, on the principle that so long as the lessee was solvent there was no reason why his co-contractant should suffer financial damage through his act. He felt that this was a matter on which most countries could agree, on the basis of the generally recognised principle of contract law that a person who committed a breach of contract had to compensate his co-contractant for the damage the latter had sustained thereby.

24.- Mr. Fantozzi expressed his agreement with the idea that the Group should seek to frame a general definition for the leasing contract without going into over much detail and pointed out that, in his view, the fiscal and accounting problems associated with leasing were matters substantially dependent on its legal definition. Whilst approving both the proposal for taking the Leaseurope definition as a suitable working basis for the Group's further deliberations and its endorsement of the sui generis nature of leasing, he nevertheless felt that it would be desirable for the Group to reach a decision on whether the sui generis type of leasing which it had in mind was to be regarded essentially as a financing operation - as was he indicated the case in Italy and many other countries, with leasing companies in general belonging to banks or banking groups through which they financed their activities - or rather more as a simple hire contract. He pointed out that the answer to this question would indicate whether the Group's definition of leasing would necessarily entail the intervention of a third party financier or whether it would embrace the wider situation of a manufacturer leasing his equipment directly to the user without recourse to a financier.

25.- The Chairman, in the light of the foregoing, concluded that there was general agreement that the Leaseurope definition should be taken as a useful working basis and that the endeavours of the Group should be channelled rather in the direction of a number of fundamental points than toward the preparation of a complete legal framework for the leasing contract. Nevertheless time should not at this stage be wasted on deciding on the fundamental or non-fundamental nature of individual points. Rather, he felt,
that if it should subsequently be deemed that a point was capable of attracting a wide measure of acceptance, then this could be seen as a strong argument for its inclusion in an international convention, whereas, if a point did not seem capable of attracting wide acceptance, than that would probably argue in favour of its featuring in a model law.

(iii) Should attention be concentrated on international leasing operations or rather on leasing operations in general?

**25 bis.** After the Chairman had indicated his feeling that attention should rather be focussed on international operations, the President of UNIDROIT pointed out that this question raised the very difficult problem as to what precisely was to be understood by international leasing and in particular which criteria should be employed in determining the international or non-international character of the operation, given the tripartite nature of the *sui generis* operation on which the Group had decided to concentrate. In answering this question the Group should perhaps look at whether it preferred the use of objective or subjective criteria. He recalled the difficulties encountered on this point during the drafting of the 1964 Uniform Law on the International Sale of Goods, namely whether the international character of the transaction should be decided according to the residence of the parties or else according to whether or not the goods had moved from one country to another.

**25 ter.** Mr. Peter for his part felt that it was impossible to talk about international leasing without first considering leasing at the purely national level. It was his view that the problems at present bedevilling international leasing operations could not be solved until there was a solution to the problems raised by leasing at the national level. This was brought home, he felt, by the fact that operations of an internal character — whereby he intended those operations in which, even if the manufacturer were sometimes situated in a different country, at least two of the three parties, lessor and lessee, were situated in the same country as one another — at present accounted for about 90% of all leasing operations, a figure which in the United States, he suggested, might even rise to 99%. He accordingly concluded that the Group should aim to provide rules for leasing operations in general, given the rather limited incidence of specifically international operations as he understood that term.

**25 quart.** The Chairman noted that there was general agreement with Mr. Peter's conclusion.
(iv) How can a lease be defined for the purpose of uniform rules, in particular so as to distinguish it from a security interest?

26.- The Chairman recalled the definition put forward by Mr. Bibot of Belgium in his paper "Le statut légal du leasing" laid before the restricted exploratory working group of the Governing Council on the leasing contract which had met in March 1977 (refere: Leasing C.D. Sous-Comité, 2ème session -- D.T. 2, at pages 3 -- 5) in which he characterized the leasing contract as one concluded for the hire of goods at a time when the latter have not yet been acquired by the lessor and may not even exist.

27.- Mr. Googan indicated that the answer to this question in the United States would be that a true lease was one in which payment was made for the use for less than its useful life of a certain item of equipment, which was to be returned to the lessor at the end of the lease unless the parties agreed to an extension thereof at the reasonable market value of the equipment or that the lessee should purchase it, on condition that the latter was in such a shape that it still had a not insignificant residual value. Any departure from any of these standards, for example where the duration of the lease corresponded to the economic life of the equipment, would tend to characterize the transaction as a lease for security, on the ground that all the real incidents of ownership had been transferred to the lessee.

28.- Mr. Goode indicated that English law would broadly follow United States law in treating a lease under which the lessee was committed to paying what in effect was the full price of the item leased as a conditional sale. He added, however, that English law as also the law of most other countries differed from United States law in that retention of title under a sale contract was not treated as a security interest. English law, he pointed out, distinguished between, on the one hand, security by a mortgage or pledge and, on the other hand, retention of title under a sale contract which was not treated as a security and therefore not subject to registration.

29.- He disagreed with the underlying philosophy of Question (iv) as he did not feel that the Group should necessarily aim in respect of all aspects of the proposed uniform law to define a lease in such a way as to distinguish it from security interests. He pointed out that there were many problems affecting leasing which the Group could well aim to deal with whether the lease were intended as security or not. The one matter where it would be important to determine whether the lease was or was not intended for security was for the purposes of registration giving third parties notice of the lessor's title. However, there were many other problems such as penalty clauses and the damages which the lessor was entitled to recover for which it might well not matter whether the lease was one intended for security or not.
30.- He was accordingly of the view that this question was not necessarily fundamental to the whole area which the Group intended to cover and raised the further question of whether the security aspect of a finance lease should in fact be treated in the proposed uniform law or whether it should rather be left out as part of the wider problem of security over movables.

31.- Mr. Coogan pointed out that in the United States the main difference in treatment that would result from the policy implicit in this question would lie in the field of remedies, in that, in the relative absence of case-law on this aspect of true leases, it would at present be impossible to enumerate accurately the entire range of remedies available, that is apart from the lessor's obvious right to recapture the goods. The question which remained as yet unanswered in his country concerned the extent to which a lessor under a true lease could collect rentals which had not yet accrued. A court would probably, he thought, in such a case hold that the lessor was entitled to be made whole but no more than whole. Thus if the value of the goods were such that he had recaptured his investment through their residual value, he anticipated that, in accordance with the principle that one must mitigate one's loss, an American court would be reluctant to grant him any further remedy regardless of what might have been stipulated in the contract. On the other hand, a lease for security would not only be subject to the usual equity of redemption on the part of the lessee but also to the secured party's right to collect a deficiency in the event of his being unable to obtain enough for the collateral to pay off the debt owed him.

32.- Explaining how the distinction made in Common law jurisdictions on this matter did not exist in continental Civil law jurisdictions, Mr. Gavalda pointed out that the Civil law did not classify leasing as a security, notwithstanding its recognition of the security incorporated within a leasing transaction and the fact that such a security was now considered to be one of the best forms of security available in France, particularly in the context of the systematic questioning of almost all securities, especially those granted to banks.

33.- He explained that the security offered by a leasing transaction in France consisted primarily in the lessor's priority entitlement, in the event of the lessee's insolvency, to recapture the equipment as his own property, whilst at the same time recognising that the real value of such a security could well prove to be limited by the realisable market value of the recaptured goods. On the other hand, the security offered in France by the lessor's right to compensation was that much less valuable to the lessor to the extent that his right thereto was subject to the
concurrent claims of other creditors. The problem was, he stressed, one that only had practical significance in the event of the lessee's insolvency, as he considered that the lessor would in other circumstances not experience difficulty in obtaining compensation from his lessee.

34. - **Mr. Boy** saw the security aspect of leasing as a consequence of the nature of the transaction. Thus, viewing the leasing contract as a hire contract, he felt that it was natural that the equipment, on breach, should have to be returned to the lessor. This meant that, in the event of the lessee's insolvency, the lessor could by recapturing the equipment then rely on the minimum payments clause contained in the contract, or where the lessee was in bonis proceed against the latter to recover his total loss. The security aspect of leasing in France, he felt, emerged most clearly in connexion with the importance attached to the residual market value of leased equipment by courts assessing the fairness of minimum payments clauses. Thus, whereas no problem would arise in a case where the residual market value exceeded the actual loss sustained and the lessor would simply be allowed to recover such part of the amount fixed in the minimum payments clause as represented his actual loss, where the residual market value instead did not suffice to cover the actual loss sustained by the lessor through the lessee's breach, the court would rectify the situation by allowing the lessor to recover an additional sum by way of penalty. In this way, he argued, the goods constituted in the mind of the French judge a genuine economic security.

35. - **Mr. Goode**, while noting that English, American and French law all recognised retention of title as a real right or right in rem, added however that English and American law drew a distinction between absolute ownership and security rights. Thus if a seller or a lessor retained title, English law would regard such a person as remaining absolute owner, his interest not being restricted to a mere security interest. One consequence of that was that where, under English law, goods supplied under a lease or a conditional sale which had as a result of default been repossessed by the lessor or seller and sold and the proceeds of their sale exceeded the total balance outstanding from the debtor under the contract, the lessor or seller was allowed to retain this surplus because such a surplus resulted from the sale of his own property. On the other hand, were the transaction characterised as a mortgage, 'gage' or 'nantisissement', and therefore under United States law a security interest, then the seller would be accountable to the buyer, as the lessor would be accountable to the lessee, for such a surplus.

36. - **Mr. Cooper** wondered how effective the French lessor's right to repossess in the event of the lessee's bankruptcy would prove to be in the future, in the light of what was now happening in the United States. He referred to a case decided by the United States Court of Appeals for the
Second Circuit holding that a lessor, although entitled to compensation, could not repossess trucks he had leased out because this would prevent the lessee, a truck company, from reorganizing. He pointed out that the draft American bankruptcy law currently before Congress, notwithstanding such protective provisions as one that required that the lessor should not be permanently harmed, also contained a provision that would empower the court to order retention of the equipment by the lessee in bankruptcy reorganisation notwithstanding the fact that the lease agreement specifically gave the lessor the right to terminate.

37.- Mr. Bey noted that this same system already to a certain extent existed under French bankruptcy law, in the form of the power given to trustees in bankruptcy to continue the life of contracts already in the course of performance, above all in the interest of avoiding the termination of contracts causing unnecessary harm to business activities. Thus whereas before 1967 the opening of bankruptcy proceedings automatically entailed the termination of contractual relationships, since the passing of the law of that year, specifically Article 38 thereof, the trustee in bankruptcy was empowered to go on with the performance of contracts even where the contract itself had expressly provided for automatic termination in the event of the opening of legal proceedings resulting from the insolvency of one of the parties.

38.- The Chairman concluded that there seemed to be no great differences between the different legal systems on this question and that the small differences that had been alluded to could be dealt with later when the Group came to discuss the protection of the property rights of the lessor.

(v) Will it be necessary to create separate definitions for a leasing contract for its strictly legal, its fiscal and its accounting aspects? To what extent should some rules be prepared relating to the fiscal and accounting aspects of leasing?

39.- Mr. Stanford drew the Group's attention in the context of this question to the views expressed by certain members of the Governing Council at its 56th session, as reflected in § 6 of the Note prepared for the Group's attention by the Secretariat (Study LIX - Doc. 3, UNIDROIT 1977), and in particular to the view set forth by the member who "addressing his attention to the /restricted exploratory/ working group's recommendation that any uniform rules on this subject would have to eliminate as completely as possible those aspects of leasing relating to fiscal problems, remarked on the difficulties that would be met here: this would entail in his view
the preparation of a set of articles especially designed to eliminate the effect of any such uniform rules on fiscal problems, given the intertwined character of private law and revenue law in this domain.

40. Mr. Goode was against the idea of creating separate definitions. He felt that this would merely cause even more confusion than already existed and cast doubts on the Group's very competence to propose a definition of leasing, for example, for accounting purposes, suggesting that this was a task perhaps best left to professional accountants. Moreover, whilst he would be pleased if the legal framework which it was the Group's intention to formulate should, once completed, have the effect of persuading revenue authorities in the individual countries to attempt to harmonise their own treatment of leasing with a view to bringing it into line with the regime proposed by the Group, he felt that, provided that the said legal framework proved to be functional - something which would, he added, have to be measured against the extent to which it reflected the substance of the leasing transaction itself rather than the purely technical legal form which it presently bore under the different legal systems - then what it proposed for the strictly legal aspects of leasing ought equally to hold good for the fiscal and accounting implications of the same operation.

41. In noting the very considerable difficulties inherent in this question, Mr. Cooper pointed out that it was in his view virtually impossible to separate the revenue aspects from other aspects of leasing, not only in his own country but also he imagined in any other country where depreciation was taken by the lessor on goods which revenue authorities would normally consider as being the property of the lessee. While he doubted whether uniform rules could solve such a question, he indicated that it was a very important problem which would necessarily lurk very closely in the background of the Group's work.

42. Mr. Peter feared that the Group would run into serious difficulties if it did not distinguish clearly between the legal and the fiscal and accounting problems associated with leasing. He felt that, in the interest of achieving results, the Group should concentrate its attention on the legal aspects of leasing, first because, as Mr. Goode had said, he doubted whether the Group could really be regarded as competent to draft fiscal and accounting rules on the subject and, secondly, because there were already groups of experts that had for a number of years now been working on the accounting aspects of leasing; indeed in the United States he mentioned that the group responsible for the controversial FASB 13 ruling had spent some ten years reaching that result.
43.- While finding himself in agreement with Mr. Peter on the desirability of attention being concentrated on the preparation of a legal definition, to the exclusion of separate fiscal and accounting definitions, Mr. Fantozzi nevertheless pointed to what he saw as an inevitable link between such a legal definition and the fiscal consequences thereof, in that the attitude of revenue authorities towards leasing would obviously be conditioned by any such legal definition. Referring in this connection to the specific problem of depreciation, he pointed out that it would, for example, follow clearly from the Group deciding that for the purposes of its definition goods leased should remain the property of the lessor that the lessee should also be able to depreciate said goods and where, as was the case in Italy and other countries, the rate of depreciation was fixed by law, then it would be necessary to decide whether this rate should be based on the nature of the item leased or on the type of business of the lessee or else on the fact that the lessee was a finance company. For these reasons he felt that it was important for the Group, when formulating its legal definition of leasing, given the fiscal consequences that would necessarily flow from such a definition, clearly to decide whether the contract which it intended to regulate was simply a hire contract, albeit with certain special clauses, or rather a sui generis contract, in which case it was imperative to spell out the particular characteristics of such a contract.

44.- Mr. Coote felt that it was important for the Group to bear in mind both in the specific context of leasing as in a wider context that Governments, in attributing fiscal consequences for such practical ends as the stimulation of certain types of investment, formulated their own rules as to what should qualify for the investment allowances typical of such policies, rules which reflected differences in economic policy and practices from country to country. He accordingly doubted whether what was laid down in a general legal structure could ever totally influence the fiscal treatment adopted by the Government of a particular State towards a particular type of transaction. To this extent he therefore expressed his reservations regarding the thesis put forward by Mr. Fantozzi. He pointed out that, even were the Group to establish a definition of leasing that was intended to apply for fiscal purposes too, all that a Government desirous of allowing certain types of transaction to qualify for tax relief, notwithstanding their not fitting the terms of such a definition, would have to do would be simply to provide that the benefit of such relief should be extended to operations that were not leasing operations in the sense of that definition but possessed certain additional characteristics. This, he felt, highlighted the futility of any attempt to establish a definition and a framework intended to cover both the strictly legal and also the fiscal aspects of leasing, to the extent that such an exercise would necessarily lead to interference with the way different Governments choose to organise such aspects of their
economic policy as tax relief and depreciation allowances and would consequently to that extent be disregarded by them. His view was accordingly that the Group should concentrate on the legal aspects of leasing, whilst obviously at the same time bearing in mind the impact of fiscal and accounting considerations thereon.

45.- Mr. Cervialda supported the proposal for concentrating on the legal aspects of leasing, agreeing that the fiscal and accounting aspects were best left to the sovereignty of the individual States. He nevertheless suggested that, to the extent that the Group felt itself to have competence over such matters, it might be useful for it to make recommendations regarding the fiscal treatment to be applied to international leasing operations.

(vi) Should the scope of the uniform rules be limited to capital goods and professional parties or should consumer goods be included? Should the scope of such rules extend to cover the leasing of aircraft, ships and rolling stock?

46.- Mr. Peter, reflecting the overall feeling of the Group, observed that it was significant that the discussions had hitherto appeared to focus essentially on the leasing of capital goods and he accordingly felt that it was better to exclude the leasing of consumer goods from the scope of the proposed uniform rules in view of the quite different and particular range of issues raised by such operations. On the other hand, whilst acknowledging the difficulty of classifying aircraft, ships and rolling stock in exactly the same category as the general species of capital goods, he nevertheless proposed that they should be included in the general scope of the proposed uniform rules.

(vii) What provisions should be drafted regarding the ownership of the leased goods during the course of the leasing contract?

47.- Mr. Stanford explained that this question had to be read in conjunction with Question (vii) and in particular in relation to points (12) and (13) of the recommendations adopted by the restricted exploratory working group of the Governing Council on the leasing contract at its session in March 1977. The Secretariat's reason for framing these two questions separately was simply inspired by the desire to reflect the said working group's feeling that the leasing contract was essentially a contract concerned with financing the use of goods and that the question of what happened on the expiry of the contract, namely the triple option usually open to the lessee, was something quite independent of and separate from this essential characteristic of the contract itself.
48.- The Chairman stated that the problem lay essentially in how to ensure protection of the lessor’s title against innocent third parties dealing with the lessee on the basis of the latter’s apparent ownership of the leased assets.

49.- Agreeing that the lessor should be regarded as retaining ownership of the leased goods throughout the duration of the contract, Mr. Goode nevertheless felt that, to the extent that this question was concerned with what conditions should be fulfilled for the lessor’s retention of title to be upheld against third parties, it was also closely related to the question of what types of lease should be treated as leases for security. In this connexion he noted that it might well be considered useful for lessees not even intended to be for security to be susceptible to registration provided they exceeded a certain duration.

50.- Messrs. Gavalda and Boy explained that French law had organised a system of double publicity for leasing in the interest of protecting not only the lessor’s title but also third parties who could otherwise, in their dealings with the lessee, be expected to rely to their detriment on the appearance of his ownership of the leased equipment created by their having been placed in his possession. The aspect of this system of publicity incumbent on the lessor consisted in a statutory duty to register each contract of “crédit-bail” to which he was party at the registry of the commercial court of the place of business of the lessee in question. Registration for such purposes required not only mention of his title to the goods leased but also on outline of the general characteristics of such goods. The duty of publicity on the other hand incumbent on the lessee required the latter to mention in his balance-sheet the existence and nature of all goods in his possession under the terms of leasing contracts as well as the fact that title to such goods was vested in the lessor. Whereas the penalty for non-compliance with the duty incumbent on the lessee lay in the realm of civil law and consisted in the loss of his right to assert title to the goods, the penalty for non-compliance with the duty incumbent on the lessor was criminal, involving either a fine or imprisonment of from ten days to one month. The duty incumbent on the lessee, it was pointed out, assumed immense practical significance in that it would normally enable one trading partner to obtain a fair better idea of the solvability of the other, by revealing whether or not the latter was the actual owner of equipment in his possession. It was however added that in practice neither of these forms of publicity were in many cases complied with, often simply because lessees preferred to keep certain large sums of money off their balance-sheets or because the financial situation of certain lessees appeared outwardly quite impeccable.
51. The system whereby retention of title clauses were subject to registration in the Federal Republic of Germany did not, it was pointed out, exist in France, with the result that such clauses were ineffective in the event of insolvency proceedings being opened against the lessee. The importance of this factor could be measured, it was added, against the fact that about 25% of a French leasing company's litigation arose out of insolvency cases.

52. In reply to a question from the chair, Mr. Peter stated that an organised system of public registration for retention of title clauses did exist in Switzerland but only for transactions involving consumer goods. He felt that the question of reservation of title was irrelevant in this context however, given that the Group had agreed on the principle of the lessor's remaining the owner of goods leased by him. Retention of title, in his view, became relevant only in cases where title was necessarily to pass on the full amount of the purchase price being paid. He felt furthermore that the nature of a leasing contract remained the same irrespective of its being entered in a register or not.

53. Mr. Goode saw this question as going considerably wider than leasing and as raising the whole question of whether there should be retention of title to goods with effect against third parties. As he had already explained, retention of title in England under a lease was not treated as a security interest and therefore, as registration under English law was confined to security interests, retention of title was not only not required to be registered but indeed there was no machinery whereby it could be registered. He felt that the Group would have to look into the circumstances in which the lessor's title should have to be registered in order to be protected. American law, he pointed out, distinguished between registration of title and registration of a security interest: while the registering of title involved registering according to the type of asset, something which was not practical for assets at large, the registration of a security interest was made against the name of a particular debtor. Another distinction operated in this field in the United States was, he added, that the registration requirement only applied to leases that were effectively for security, whereas if a lease was not for security, then there was no registration requirement because it was not treated as a security interest at all. He was attracted in this light by the argument that any lease other than a short-term lease should be required to be registered in order to be effective against third parties.

54. Mr. Coogan pointed out that in the United States registration was not always required. It was required for most purchase money security interests which he likened to the European retention of title. However, in the United States even if goods were on the property of one party yet belonged
to another, no registration was required if the reason for the separation of ownership and possession was a true lease, whereas registration would be required if the reason was instead a security interest, although he added that on the introduction of the Uniform Commercial Code there was a minority of States which by mistake only partially repealed old laws requiring some form of registration for all leases but these formed only a minority. This created the inconsistency, to which Mr. Goode had referred, whereby third parties who would normally be entitled to presume from the presence of goods on the property of one party that those goods belonged to that same party, could not in fact rely on such a presumption in the event of the goods being the subject of a true lease.

55. — Mr. Hey explained that the problem of the protection of the lessor's title was a very real problem in France too, particularly when, in the absence of registration, a remedy had to be sought among the general rules of law. Thus where, for instance, a lessee sold leased goods in breach of his contract with the lessor to a third party, the only remedy open to the lessor in the absence of registration in France would lie through the criminal action of fraudulent conversion. There would in such a case, he stressed, be no civil law remedy available to the lessor. This, he argued, pinpointed the purpose of publicity, namely to ensure that a third party purchaser in good faith from the lessee of leased goods would thereby automatically be considered to be in bad faith. Registration thus fulfilled a double purpose, in first protecting potential third parties dealing with the co-contractant of a lessor by putting them on their guard as regards his apparent solvability, and, secondly, in protecting the lessor himself against any dishonest disposition of his goods by his lessee. This system of registration, he noted, played very much the same rôle in France for leasing contracts as that played in the United States by security interests.

56. — Mr. Goode observed that French law and the Common law started from entirely different premises in this field however, as whereas the underlying principle of French law was that "en fait de meubles possession vaut titre", the basic Common law rule in this field was "nemo dat quod non habet" whereby the owner could assert his title against a bona fide third party purchaser even where he had parted with possession. The consequence of this distinction, he pointed out, was that French law introduced registration to enable the lessor to protect his title whilst English law, if it introduced registration, would do so for the purpose of protecting innocent third parties.
57.- In the light of Mr. Goode’s remarks, Mr. Gavaldán stressed the fact that the system of publicity inaugurated in France by the decree of 1972 inured to the benefit of innocent third parties as well as lessors. Examples of third parties who derived protection from this system were trading partners, third party buyers from lessees and an owner-lessee of business premises who at the same time held a chattel mortgage in respect of the equipment used in those premises. He added that a third party dealing with a lessee, for instance a person dealing with the lessee of business premises who was to all outward appearances the owner of the equipment used by him in such premises, was all the more protected in that by consulting the balance-sheet of the latter he should normally be able to see straight away to what extent this person was the owner and to what extent he was simply the lessee of equipment in his possession. This was far more effective, he added, in the example just cited, then any number of easily removable or destroyable plaques attached to individual items of equipment. He pointed to the significance of the fact that this duty laid on lessees to disclose their balance-sheets only applied to transactions between merchants (“commerçants”) and he felt it was a thoroughly reasonable precaution to be expected of a businessman to consult the balance-sheet of a prospective co-contractant prior to committing himself to a transaction with the latter.

58.- Mr. Bey specified that, whereas the balance-sheet publicity imposed on the lessee was compulsory, the statutory duty of registration incumbent on the lessor was not compulsory save as regards its civil effects, the lessor losing the right to assert his title for failure to register. However, the lessor could always, under the terms of Article 8 of the decree passed in 1972, assert his title by proving that the third party in question knew or ought to have known of his title to the goods in question, for instance by the existence of a plaque attached thereto or perhaps through the fact that the balance-sheet of the lessor would have disclosed that he was at the time deprecating the said goods.

59.- The President of UNIDROIT wondered whether a drawback to the balance-sheet type of publicity might not lie in the fact that balance-sheets were normally annual and would not therefore show those leasing operations entered into between one financial year and the next.

60.- Mr. Bey pointed out that for sizeable operations a normally prudent businessman would in any event ask certain questions regarding the lessee’s financial situation and in particular regarding the ownership of valuable assets being used by him, and that what was really important about the balance-sheet method of publicity was therefore not so much the actual formality involved but rather the purpose behind it, in creating certain customs. He added that a third party could furthermore request to see the quarterly balance-sheet required of certain firms.
61.- Mr. Goode explained that under English law where there was a registration requirement, it would normally be the case that, if the person required to register failed to do so, the result would not differ simply because a third party acquired with or without knowledge of the right that should have been registered. The reason for this rule was to make the register the determining factor in order to avoid factual disputes as to whether the third party did or did not have notice.

62.- In reply to a query from Mr. Goode, Mr. Bey explained that the importance in the present context of the balance-sheet under French law arose at two distinct levels. At the first of these two levels, the actual conclusion of the leasing transaction, with the lessor's purchase of the equipment to be leased, produced effects on both the owner/lessor and the lessee. The former accordingly had to enter the equipment in his credit account as a fixed asset and was qua owner the person entitled to take depreciation. Under French revenue law such depreciation was to be taken on an annual basis spread out over the economic life-span of the equipment divided up into equal portions. Thus, he explained, an item with a five-year life-span would be depreciated by one-fifth each year. The effect of this depreciation was to reduce the rate of corporation tax applicable to the lessor. On the other hand, for the lessee the leasing transaction represented a simple contract of hire in respect of which he was liable to pay rentals. Such rentals were considered as working expenses and as such reduced the lessee's corporation tax liability. The second level at which the importance of the balance sheet arose in France affected only the lessee: this was the duty created by the legislation passed in 1967 and, more particularly, in 1972, whereby the lessee, on pain of incurring criminal sanctions, was required to give publicity to those leasing operations to which he was party qua lessee by entering in his balance-sheet the total sum of the rentals outstanding on any item of equipment possessed by him under the terms of a "crédit-bail" transaction, although not their residual value. This requirement was with a view to enabling any person considering concluding a commercial transaction to obtain a full picture of the genuineness or otherwise of the ostensible ownership of particular assets in the possession and use of his prospective co-contractant. A businessman would thus in future simply have to examine his prospective co-contractant's balance-sheet and then, should he find the replies of the latter regarding for example precisely which of his assets were subject to "crédit-bail" transactions anything less than forthcoming, he could apply to the registry of the commercial court of the lessee's place of business for a detailed description of the items on lease to the lessee, as well as the name of the person owning them. He pointed out that it was interesting to note that the only sums relating to leasing transactions which had to be entered in balance sheets were thus sums on which payment was outstanding, sums which could well be less in value than the actual value of the item leased, particularly towards the term of the lease, whence the interest of the option
to purchase and of the possibility of checking on the lessee's leasing commitments at the registry of the commercial court of his place of business. Should the lessee decide to exercise an option granted in his favour, the item previously leased would automatically enter among his assets - although without any possibility for him to depreciate it as this had already been done by the erstwhile lessor - and as such would have a higher value than the sum featuring on the expense side of his balance-sheet as outstanding rentals.

63.- Mr. Gavalda, whilst of the opinion that the French system as expounded by Mr. Bey was very practical, nevertheless recognised that as such it was merely a model necessarily tied to the accounting structure of one country. Without calling for a uniform model on the question of publicity, he felt that it was nevertheless important that the Group should go on record as recommending the "publicity" of leasing operations in each contracting State to any future instrument on this subject, while leaving it to each State to organise its own individual system of publicity in a way that would be equivalent to the standard laid down by such an instrument.

64.- Mr. Bey agreed with the previous speaker as to the need to require that leasing operations be publicised, while leaving individual States to organise their own method of achieving this end. He wondered whether the system of publicity which he believed existed in the Federal Republic of Germany for reservations of title could not perhaps also be used for leasing operations.

65.- Mr. Peter agreed with the idea of publicising leasing transactions so long as it did not involve the registering of leasing contracts in an official registry but simply the balance-sheet type of publicity to which the previous speaker had referred. Resort to official registries in general implied a sale contract where title had already passed, and was therefore not at all appropriate for leasing contracts, where title did not pass. Swiss legal theory considered that there was no reservation of title in a leasing contract, as title remained vested in the lessor. In reply to a remark from the chair arguing that "publicity" was a very important means of protecting the lessor's title, he pointed out that was not the case in Switzerland.

66.- Mr. Bey, referring to the example of the lien exercisable by the lessor of real property cited by Mr. Gavalda in support of the case for publicising the lessor's title, pointed out that under French law, as he believed also under Swiss law, the lessor of such real property was entitled to exercise a lien over the moveables housed in his real property once the lessee fell into arrears with his rentals. The end-result of publicity in
such a case would be to destroy the good faith of the lessor in respect of such of those moveables as were in fact the property of someone other than his lessee, thus highlighting the purpose served by such publicity, namely the incentive it offered for such a landlord to keep himself fully informed. Another instance of the value of "publicity" in protecting the lessor's title would be the case where a lessee sold the goods belonging to his lessor, something that was quite possible under French law, since, unless the lessor could prove bad faith on the part of the purchaser of his erstwhile property, he could not seek to have the sale contract rescinded. Whereas leasing companies were initially lukewarm about the idea of registration, disliking its compulsoriness and its cost, they now had to recognize that its advantages largely outweighed its disadvantages. He accordingly reiterated his attachment to the idea of the Group formulating a standard requirement of external publicity, as opposed to the merely internal balance-sheet method, while leaving it to individual States to choose their own methods of achieving such a standard.

67.- Mr. Peter replied that in Switzerland as regards the first example cited by Mr. Bey, a leasing company, in order to protect its title to equipment leased by it to a firm that occupied premises belonging to someone else, had simply to send a letter to the latter person at the outset of the lease, failing which its title would be forfeit. In reply to a question from the chair as to what would be the effect of such a letter as regards someone to whom the erstwhile owner of the premises of the equipment lessee had in the meantime sold such premises, Mr. Peter felt that the equipment leasing company would not in Switzerland lose its protection as against the new owner of its lessee's premises provided it had complied with its requirements as regards the original owner. Regarding the second example cited by Mr. Bey, Mr. Peter pointed out that there was at present no protection available in Switzerland for lessors against such third party purchasers of their property, although he was not convinced that, even were there a register designed to protect the title of lessors that all Swiss lessors would necessarily use it, in the interest, for example, of cutting costs.

68.- Mr. Bey felt that, regardless of whether individual leasing companies might prefer not to use a registry set up to protect their title to goods leased by them, as was, he pointed out, the policy of certain leasing companies in France when dealing with high standing lessees, it was absolutely fundamental for the Group, in the interest of achieving a logical set of rules on this subject to lay down the requirement that leasing contracts should be publicised, while leaving the details of each national system of publicity to be settled in accordance with the preference of each particular country.
69.- Mr. van Hoogstraten was not entirely convinced that a system of publicity would solve all the problems that the Group had in mind. He felt in particular that the existence of a register protecting the lessor's title might not for example solve the problem of a lessor seeking by virtue of such a register to assert his title to goods leased by him where national law at the same time recognised a lien in favour of the landlord of industrial premises over the chattels used in such premises by his lessee, regardless of whether or not these chattels actually belonged to the lessor; in such a case he pointed out that there could well be a struggle between the rival claims of the equipment lessor and the landlord of the premises used by the lessee of the equipment lessor that might prove extremely hard to settle, in the absence, that is, of a clear-cut substantive rule setting out the terms on which an equipment lessor's title would be protected.

70.- Mr. Bey, in response to the previous speaker, indicated that he had understood the Group's unanimous feeling on this point to be precisely that the protection of the lessor's title should flow automatically from the fact of the lessor's ownership of the leased property. He felt moreover that, given that leasing created certain appearances which did not correspond to legal reality, publicity offered the only means of alerting third parties and protecting the lessor's title. He failed to see any other means whereby this objective could be achieved. He felt that either one accepted that the mere fact of being the owner of leased goods entailed the protection of his title against everyone regardless of any form of lien that might be recognised under national law or else that, on the ground that a leasing operation created certain appearances in respect of which it was desirable to protect both third parties and the lessor's title, a system of publicity should be set up.

71.- Mr. Goode, expressing his agreement regarding the need to provide for the publicity of leasing transactions, pointed out that publicity served two distinct purposes and could take two distinct forms, as it did in France and also in England in other areas. First, as for instance by means of the balance-sheet method, it served as a general public notice of the overall financial position of a company, while secondly it served to protect a specific interest created under a specific transaction in order to make the lessor's title effective against third parties. Different methods existed to secure these different purposes, just as the sanctions provided for non-compliance differed according to which method was employed. As regards the method which consisted in registration, he strongly favoured the American system under which registration was required not in respect of an individual transaction but rather in respect of a transaction of a given type, as the registration of each and every transaction could be extremely onerous and expensive. In addition he thought, as he had indicated earlier, that it might
be worthwhile for the Group to ponder whether the registration that it had in mind should be advocated for leasing in particular or whether it simply rather formed part of the wider problem of protecting non-possessory security interests over movables in general. He suggested in this regard that an additional reason for introducing such a system in the rules proposed for leasing might be seen in the impetus this could generate for a generalisation of the concept of registration.

72.- The Chairman saw the problem under discussion as one essentially going to the burden of proof that should be laid on a lessor seeking to assert his title to leased goods, and he interpreted the opinion of the Group in this regard as being that the lessor should not be obliged to rebut the presumption of a third party's bona fide acquisition of his property. He thought that the question of whether this problem was best affronted by means of publicity, albeit his personal preference, or by some other technique was a matter that could be left until later.

73.- Mr. Peter felt that, if the main purpose was to protect the lessor's ownership, one means which would cover probably most of the practical cases arising would be for the lessor's title to be recognised in the contract itself. He saw shortcomings in a register-based system as an effective means of protecting the lessor against a dishonest disposition of the leased assets by his lessee to a bona fide third party, as for instance where the leased assets are sold by the lessee in breach of the lease to a foreign company so that a registration made in the country of the lessee would be without any effect on the bona fide of the third party in question. In his opinion, registration would not help very much without some means of protection being found for the contract itself.

74.- Mr. Goode considered that it was important to be clear as regards the different categories of third party against whom protection was desired. Even under a registration system it would probably be found necessary to recognise that a buyer in the ordinary course of business should acquire good title, because in the ordinary course of commercial dealings in goods it would be unreasonable to expect someone buying goods from a dealer in that type of goods to search a public register every time that he wished to make a purchase. On the other hand, other categories of third party, he maintained, could be expected to search a register, for example banks lending money on the security of assets and taking a mortgage or a charge. Short of the creditor taking physical possession he regarded registration as being the only feasible means of giving notice in such a case, because the placing of a placard on a particular asset would certainly not in his view suffice as a means of giving notice to a bank which did not have the facilities for carrying out a physical inspection of particular assets. He concluded that
some system of registration was necessary to give protection, not against buyers in the ordinary course of business but against such other categories of third party as financiers and banks, a distinction that was, he believed, already made under the system of Article 9 of the Uniform Commercial Code.

75.- Mr. Coogan explained that the special protection afforded by Article 9 to buyers in the ordinary course of business was limited to a special kind of buyer, namely a manufacturer or retailer holding goods for sale, who would not often be found in connection with the class of collateral being dealt with by the Group. Thus as regards equipment being used by a manufacturer in his factory in the manufacture of certain goods, no presumption would arise in favour of third party buyers from such a manufacturer that the latter actually had the right to sell them such equipment. As regards notice, he felt that the fact that some form of public registration had now come to be accepted in so many fields where thirty or forty years earlier it would not have been accepted might be seen as a sign that people were now ready for the type of publicity being envisaged by the Group. One of the reasons why the American system of publicity had come to be so widely accepted was, he pointed out, that it did not require great specificity as to exactly what was covered by a transaction: the theory of the Uniform Commercial Code was thus not to give a searcher specific information as to whether a particular item was subject to a security interest but rather to put him on notice that, once he has found out that the party with whom he is considering doing business has created a security interest in a type of equipment, he must enquire further. He explained that just as this system's acceptance by the American business community could be directly traced to its having been cast in such a skeleton form, he was quite sure that any system of registration proposed by the Group that required a description of each particular item would for the same reason not prove acceptable.

76.- In the context of the case for protecting third parties dealing with lessees, Mr. van Hoogstraten drew attention to the problem that could in his view arise where a factory goes bankrupt, leaving the workers there with what could be a formidable claim against the factory for what was owing to them under their contracts of employment at the time of bankruptcy. He pointed out that such workers would certainly not have consulted any register of the type contemplated by the Group before being engaged to work at the factory and yet nevertheless would under the national law of many countries be given the rank of privileged creditors in respect of their claims. He accordingly urged the Group at some stage to look into the relationship between the protection of the lessee and of those who are creditors of the lessor.
77.- The Chairman noted by way of conclusion that everyone was agreed on the need to protect the lessor's ownership by some means of publicity. He felt that the type of protection and the type of publicity to be provided or whether to leave the matter to the individual national legal systems could therefore be decided later on the basis of a preliminary draft set of articles.

(viii) What provisions should be drafted regarding the ownership of the leased goods on the expiry of the leasing contract?

78.- The Chairman introduced discussion on this question by suggesting that there were three possibilities on the expiry of the contract, namely the renewal of the contract at a lower rent, the purchase of the goods at their residual market value or their restitution in a reasonably good condition. One solution to this question, he thought, would be simply to state that there were these three possibilities and then leave the choice to the parties.

79.- Mr. Coogan stated that under United States law an option to renew or to buy at anything less than the market value of the goods would automatically turn the transaction in question into a lease for security, on the ground that the residual had thereby in effect been transferred to the lessee so that he had to all intents and purposes become owner of the item. This possibility, he therefore thought, would be unacceptable to the United States.

80.- Mr. Goode said that, while the question had never actually been tested in English law, a transaction providing for the renewal of a lease for an indefinite period even at a nominal rental would generally not be regarded under English law as destroying that transaction's character as a lease. He added however that, as English law did not treat a conditional sale as a security interest, its approach could to that extent be distinguished from the approach adopted by United States law.
81.- Mr. Bey pointed out that all three possibilities mentioned by
the Chairman were available under French law, although purely, he stressed,
as options. He explained that nowhere did French law require there to be
these three solutions which, he argued, rather flowed naturally from the basic
contractual mechanism at work in leasing, namely the contract of hire.
He saw the fact that leasing was essentially based on a hire relationship
as leading logically, for instance, to the lessee having normally, upon expiry
of the lease, to return the leased goods to his lessor. The French law on
"crédit-bail" did however require this hire contract to contain an unilateral
promise to sell ("promesse unilatérale de vente"), at the residual financial
value of the goods involved, for the transaction to qualify as a "crédit-bail"
operation. He drew attention in this regard to the fact that the sale price
indicated by this legislation would not necessarily reflect the goods'
residual market value but rather their residual financial value, as a result of
the fact that "crédit-bail" was conceived under French law as a financial
operation. While there therefore had to be this unilateral promise to sell
in the leasing contract for the operation to be classified as "crédit-bail",
given that the basis of the operation always remained a hiring, he went on,
it was quite natural that lessees did not always wish to and were in no way
obliged to take up this option to buy, sometimes simply preferring to return
the goods or at other times preferring to seek a renewal of the lease. This
third possibility, namely the renewal of the lease, was brought into operation
solely, he pointed out, by the will of the parties: they were in this respect
entirely free to determine the terms on which they wished to enter into such
a new relationship, whether on the basis of their original terms or by substi-
tuting entirely new terms, as also to fix the length of the new lease. He
felt, however, that in such a case the contract really lost its character as
"crédit-bail" to revert to a simple hiring.

82.- Mr. Gavalda emphasised that the important point to bear in mind
in this context was in reality the fact that without the option to purchase no
transaction under French law could be qualified as "crédit-bail".

83.- Mr. Coogan, enlarging on his previous statement, explained that
the test under United States law would be whether there was a residual of
some importance or, in other words, whether the leased article had a useful
life on expiry of the lease, unless, that is, the residual were sold either
through a right to grant its further use at its market value or in a full
bargain between the lessor and the lessee. He pointed out, however, that there
was a difference in this regard between the view that would be taken for
fiscal purposes and the view that would be taken for security purposes.
Thus whereas revenue practice would in the United States militate against
an option being extended at anything other than a price to be arrived at
after the expiry of the lease, for security purposes there would probably be no objection to an option at a price corresponding to the figure which the parties had agreed in an arms length dealing at the beginning of the lease as representing the probable value of the residual. It would also be important in this context to consider the effect of the FASB 13 ruling, since problems would also arise in this context regarding the classification of an individual transaction for accounting purposes: thus, if the accountants took the view that the particular transaction was indeed a purchase, this would create problems regarding its classification as a lease for legal purposes, even though it would not entirely preclude such a course.

84.- Mr. Peter, referring to the provision in the Leaseurope definition stating simply that "various options can be offered at the end of the contract", pointed out that this could be helpful to individual national legislators called upon to introduce an eventual uniform law on leasing into their internal law, by leaving room for national peculiarities at the same time as relaxing somewhat the rigidity at present so often evinced on this subject by individual national legal systems.

85.- Mr. Coogen explained that United States law had nothing against an option as such being included in a lease, but was concerned rather as regards the price at which such an option was exercisable. Thus, an option exercisable at a price which the parties reasonably expected to represent the goods' residual value at the expiry of the lease would normally be accepted, save sometimes from the revenue standpoint in the specific context of a leveraged lease. The leveraged lease, he explained, was a system whereby a partnership was formed by individuals with a high income in order to acquire expensive equipment, which they could do by putting up a very modest amount of money, so that as owners they were entitled to take the full amount of depreciation. Thus, for equipment which cost $1 million, a company which put up 10% of that sum would obtain depreciation on 100% by virtue of the fact that the other 90% was borrowed. Very often this was borrowed, he explained, on a non-recourse basis where the lending institution was sufficiently sure of the credit of the lessee as not to look to the credit of the real owners of the equipment. This led to severe criticism by the revenue authorities who considered that some high-income individuals were obtaining a windfall. Thus from year to year it had been cut back to the point where it was now almost impossible for individuals to do this, save through a leasing corporation able to find a lender willing to do it on a non-recourse basis or on a recourse basis where the leasing corporation had the credit to support it on that basis. The leveraged lease was thus a product born purely of fiscal considerations, representing an attempt by the taxpayer to obtain a deduction far in excess of the amount of the depreciation that could really be attributable to his contribution. Consequently, given the
revenue authorities' lack of enthusiasm for such stratagems, the tests sometimes applied in this field were very severe. He took the view, however, that these tests would not necessarily be the tests that would be applied for other than fiscal purposes.

86.

The Chairman noted that, whilst it would in the light of the foregoing discussion, seem unacceptable for a future uniform law on leasing to provide specifically for an option to purchase, there would not seem to be the same objection to it simply stating that various options could be stipulated by the parties, as this would merely represent a permissive rule and not a specific direction to the parties.

87.

Mr. Boy feared lest in this way the Group were gradually eliminating all those aspects by which leasing was distinguishable from the legal institutions on which it was based, as he felt that the principal result of treating leasing as nothing more than a contract of hire would be to leave out the real contract of leasing. He therefore saw the Group's task as being rather to create a specific legal framework for leasing by reference to those factors distinguishing it from neighbouring legal institutions.

88.

Indicating that he shared the fears voiced by the previous speaker, Mr. Goode thought that the question as to whether or not the presence of an option was acceptable was one that could not be asked in the abstract and that one had also to ask for which purpose the presence of an option was acceptable or not acceptable. Thus he pointed out that while the presence of an option could be unacceptable if one wished to avoid a transaction being classified as a registrable security, that did not prevent it from being acceptable for a whole range of other purposes. He accordingly felt that it was important to recognize that of the number of practical problems which the Group had set itself to solve there were some that were common to all forms of lease, with or without an option to purchase, just as there were others such as registration that might have to be confined to certain types of lease, conceivably to those intended as security perhaps with features such as an option to purchase that destroyed their character as genuine leases. Thus whereas the Group's approach had hitherto seemed to him to tend rather to group everything together under single concepts, he suggested that it might be better for it rather to examine the problems that it desired to solve than simply to seek to define in the abstract the desirable features of a lease.

89.

Suggesting a slightly different approach, Mr. Coogan agreed that there were certain problems that were common to all leases and, he believed, no law that really tackled these problems. In the United States there was a great deal of leasing governed by almost no statutes. Leasing, he pointed
out, was thus only governed by the terms of the Uniform Commercial Code where the lease was classified as a security interest and even those provisions were very fragmentary so that they had often to be filled out by case-law.

He accordingly felt that it was better to examine the characteristics of leasing in general and to endeavour to exclude as little as possible, stressing that his experience with the Uniform Commercial Code had taught him that the exclusion of certain types of transaction placed these same transactions in a sort of limbo, as the passing of a uniform statute inevitably led to the repeal of other statutes which would previously have governed those transactions excluded from the new uniform statute. For example, when Article 9 of the U.C.C. was being considered, there were, he explained, certain groups, such as insurance companies and railroad equipment trusts, who were against a new set of laws upsetting the status quo in respect of their activities. As a result, when Article 9 was introduced and the fragments of the old law pertaining for instance to railroad equipment trusts were repealed, it became extremely difficult to discover exactly which laws were thenceforth applicable to such railroad equipment trusts. The same was true of security interests on bank deposits where it now appeared that it might be necessary to resurrect much of the law that it had been thought Article 9 had supplanted. He would accordingly be reluctant to exclude any types of lease and hoped it might prove possible to obtain answers to leasing problems generally, regardless of whether or not the lease contained an option to purchase or was one for security. He emphasised that there were a great many such problems, such as the rights of the lessor in the event of the lessee defaulting on his payments.

90. - Mr. Bey drew attention to a point of fundamental importance in France as, he believed, in other countries, namely that "crédit-bail" as conceived under French law depended for its very existence on the strictly financial nature of this operation, without which it would revert to simple hiring.

91. - Mr. van Hoogstraten, in view of the fact that the main result of the framing of a definition for leasing would be that those transactions which did not meet the test of that definition would not be regarded as leases and given that, whereas as a general rule the parties to a lease were free to renew that lease, under United States law that freedom was subject to the meeting of certain requirements in order for the transaction to be upheld as a lease, was thereby convinced of the need to avoid framing a set of rules whereby the features of a lease were so delimited that only certain transactions would be upheld as leases. He felt that the Group, in framing rules that would confer certainty as regards one form of lease, should not thereby prevent everything that did not comply with the test of that definition from being accepted as a lease for other purposes, such as fiscal purposes.
Whilst accordingly approving of the Group's decision to concentrate its attention on one form of lease, he at the same time signified his opposition to the idea of its working on the basis of an unitary concept of a lease with all transactions falling outside this concept thereby being automatically denied the classification of a lease.

92. - The Chairman, citing the 1964 Uniform Law on the International Sale of Goods as a warning against following a method of uniformisation that simply created a mongrel largely unacceptable to anyone, indicated that he accordingly favoured the establishment of a limited number of rules with all other points being left to national law. In particular he felt that the question of the option to purchase was therefore perhaps best left out of a future uniform law by adopting the method employed in the Leaseurope definition.

93. - Mr. Coogen emphasized that, even should the result of the Group's endeavours prove to be unacceptable in the United States, he nevertheless did not foresee any difficulty in the United States making a contribution to the preparation of a uniform law on this subject, since, while the law regarding leasing there was recognised to be unsatisfactory, it was nevertheless not felt to raise particularly insuperable problems, as was shown, he suggested, by the hundred billion dollars' worth of leasing business outstanding there.

94. - Mr. Goode felt that it was important to accept that differences between legal systems would arise in the process that lay ahead but that there nevertheless remained a great deal of common ground and a good many problems which could be resolved in a similar fashion whether the option were given or not. He therefore considered that it would be undesirable ab initio to deny the character of a lease to a transaction simply because of the presence of an option to purchase, while recognizing that it might prove necessary to apply a distinction between those leases that contained such an option and those that did not when tackling individual problems. He felt that the same solutions were not necessarily good for all aspects of leasing and this was why he favoured the adoption of different criteria for different problems.

95. - In reply to a question from the chair, Messrs. Gavalda and Bey specified that the Court of Cassation in France had more than once held that a transaction could not be classified as "crédit-bail" without the presence of an option to purchase. Mr. Bey went on to express his opinion that the essential problem in this context hinged on the view to be taken of the nature of the leasing operation and that once the Group had made up its mind on this point the other problems would be that much easier to resolve. Any examination of the nature of leasing had, he argued, to start out from its foundation in the contract of hire as providing the best means, in his view, of highlighting the essential factor determining the atypicality of leasing by
comparison with the traditional schema of hire contracts, namely the possibility this offered the parties of overcoming the limitations which would otherwise have been implicit in their choice of hire as the legal framework in which to situate their relations and which, within the traditional schema of hire, they could only exceed by denaturing the said contract with all the attendant risks such as the lessor's loss of his title to the leased goods. The basis, he maintained, of this transition from a simple contract of hire to leasing consisted precisely in the financial role played by the latter. No accordingly felt that it was important for the Group to acknowledge as a basic starting point the simple fact, which he regarded moreover as being accepted in all countries, that financial leasing was essentially a financial operation with the result that it could not be situated within the schema of the classical contract of hire.

96. Miss Dugueaux pointed out that, whereas the type of financial leasing prevalent in continental Europe would to a certain extent seem to be classified in the United States as a conditional sale, in continental Europe any transfer of title under a financial lease including an option to purchase would only take place at such time as the lessee exercised his option and without any possibility of there being retroactive attribution of title. She suspected that the fact that Civil Law countries did not permit the retroactive attribution of title under a financial lease could well constitute a fundamental difference between the legal systems of continental Europe and that of the United States in this regard. She accordingly expressed her interest in knowing from what moment in time United States law would operate the transfer of title under a financial lease which included an option to purchase, as she pointed out that, whereas French and Belgian law did not recognise retroactive attribution of title under such a financial lease, they did recognise it for a conditional sale.

97. Mr. Bev stated that, whereas under the French Civil Code and the civil codes of those other countries that were based thereon the payment of rentals was regarded as the consideration offered in return for the quiet enjoyment of an item leased, in "crédit-bail", on the other hand, the payment of rentals had absolutely no direct relationship with the quiet enjoyment of the item leased, since it was not the sole consideration received in return for the granting of quiet enjoyment: the real consideration received by the lessor in a "crédit-bail" operation lay in his thereby being able to amortise the capital invested and the costs incurred by him in such operations together with a profit margin. The consideration received by the lessee, on the other hand, in a "crédit-bail" operation lay economically, if not legally, in his purchasing, in proportion to his periodical payments, a fraction of the item leased, so that at the expiry of the duration of the lease - a calculation that in "crédit-bail" operations was not determined freely by
the parties but rather, he added, in relation to the investment represented by the individual operation and the economic life-term of the particular item leased - he was entitled either to acquire the item leased or to return it, as he wished. However, he stressed that even if, at the expiry of the lease, the lessee elected to return the item leased to the lessor, the latter would sustain no financial harm thereby as over the duration of the contract he would already have amortised not only the capital invested by him in the operation but also the expenses which he had incurred in connexion therewith, as well as covering his profit margin. This demonstrated in his view that "crédit-bail" was for both parties a financial operation which, while clothing itself in the legal form of a hire contract, enabled title to remain vested in the lessor at the same time as passing the risks to the lessee in view, above all, of his having himself selected the equipment. The relations between the parties accordingly derived their equilibrium, he argued, from the financial nature of the operation.

98.- Mr. Goode wondered whether the apparent division of opinion on this subject within the Group was real. He understood that it had from the outset been agreed that the Group would not aim to cover the whole area of leasing but would instead concentrate its attention on what was generally known as a financial lease, and accordingly on that part of leasing which involved the provision of credit. The problem arose out of the fact that there were different ways of doing financial leasing. Thus in the United Kingdom, for instance, financial leases could not include an option to purchase, just as in France the inclusion in a financial lease of such an option was a requirement laid down by statute. Both types of lease were, however, financial, he pointed out, in the sense that the rent that was fixed thereunder was not geared to the use value of the goods but was rather intended to amortise the cost which the operation represented for the lessor as well as ensuring him a return on the operation. As regards these two types of financial lease, there were certain policy considerations which, he felt, would probably apply equally to both, for example since the lessor's interest was essentially financial, the liability that would ordinarily attach to him for defects in the equipment might well be regarded as resting rather on the physical supplier. There were equally other problems, such as registration, in respect of which he thought that it might possibly be deemed advisable to distinguish as between those financial leases with an option and those without. He would not therefore wish to see financial leases with an option excluded from the Group's purview, but pointed out that it might be necessary for the boundaries of definition to shift somewhat according to the particular problem being tackled.
99. Mr. Coogan pondered the usefulness of a set of rules that would have quite different consequences in one country from those that they would have in another. He pointed out that the adoption of the French solution, for instance, would automatically be unacceptable in the United States from the standpoint of a lessor wishing to take depreciation on an item leased by him, barring that is the improbable eventuality of a rewriting of the entire tax philosophy of the United States. The mere fact that the incidents and the risks of ownership were transferred to the extent implicit in adoption of the French solution would entail, he pointed out, that the person to take depreciation for tax purposes would under such a system be the lessee, just as the transaction would thereby be turned into one in respect of which the registration requirements of the U.C.C. would apply. While he did not consider this to constitute a particularly impossible obstacle in view of the fact that the French type of financial leasing was already subject to a system of registration which did not appear to be that much more onerous than the system which would apply to the same type of transaction in the United States, from the standpoint of the rights of the parties at the termination of the lease he did however feel that the two systems seemed to represent irreconcilable poles, since if the transaction were to be regarded as a secured transaction under United States law the usual rights of redemption would apply on the part of the lessee so that if he had paid an amount equal to the "loan" he would be entitled to any excess received over and above that amount in the disposition of the asset. While he therefore recognised that it might be possible to devise a uniform framework on leasing that would fit for certain purposes, this would not, he noted, prevent it from having different legal consequences depending on the other legislation of those countries which adopted it. In this respect he instanced the difference, rightly pointed out by Miss Dusseaux, between the concept of ownership in the context of financial leases incorporating an option to purchase of, on the one hand, the United States revenue authorities and, on the other, of the continental European legal systems. He nevertheless still felt that the best solution lay in the Group's seeking a common viewpoint, regardless of whether or not the actual degree of uniformity that could be achieved might in terms of not results be less than perfect.

100. Mr. Peter felt that the matter of whether there should or should not be an option to purchase was an issue of such importance in the leasing business that some means of dealing with it in the proposed uniform rules would have to be found. He urged that, in the interests of making progress and of satisfying as wide a spectrum of opinion as possible, the best solution would seem to lie in recognising that various options were available without the nature of the contract thereby being altered. Regarding the remarks that had been made in favour of the thesis that saw leasing as being essentially a financial operation, he recalled the dissatisfaction that had always been voiced regarding this classification in the United Kingdom in particular,
where it had been stressed that a lease was more than just a financial operation and was above all to be regarded as a lease. He noted furthermore that there seemed to be nothing which actually forbade the inclusion of an option to purchase in a lease in the United States and that the problem that arose there in this regard was concerned rather with the manner in which the option was provided and was, in his view, a tax problem rather than a legal problem.

101.- Mr. Bey noted that there seemed to be general agreement that leasing was a technique of supplying finance and he felt that recognition of this was important as justifying the series of exceptions which uniform legislation on leasing would entail to the basic underlying contractual framework involved, to wit hire. He accordingly favoured leasing being described in the definition of the proposed uniform rules as an operation for the supplying of finance; he felt, moreover, that this would justify the inclusion of an option.

102.- The Chairman noted that, whereas the Group had at the outset agreed to define the contract giving rise to legal relations between the various parties involved, he now detected support rather for the idea of defining the operation as inter alia, a means of avoiding the problem of the option. He accordingly suggested as a provisional solution that the Group should draft a definition of both the contract and the operation, and then decide subsequently which it felt to be the more appropriate and the more acceptable.

103.- Mr. Peter agreed with Mr. Bey as regards the need to define the operation rather than the contract and suggested that the French law of 1966 offered a very workable basis on which to found such a definition, although he felt that the system of option to purchase embodied in this legislation was best left out in favour of the open solution proposed in the Leaseurope definition in view of the difficulties that this would raise for the acceptability of the whole legal framework to be built around the definition.

104.- Mr. Bey felt that, if the Group's definition were to be based on that contained in the French law of 1966 and therefore centred on the concept of leasing as an operation for the supplying of finance but which used the basic contractual mechanism of hire, it would be possible thereunder, at the end of the leasing contract, for the item leased to be purchased by the lessee just as it would be possible for it not to be purchased by him at such a moment. This would not only leave the door open to other possibilities but also presented the advantage of not denaturing the basic financial nature of the operation which also thereby preserved its character as a hiring operation.
105.- The Chairman wondered whether the idea put forward by Mr. Bey of simply leaving the possibility open for the lessee to purchase the item leased on the expiry of the lease differed in any real sense from the option to purchase being regarded as part of the basic concept of leasing.

106.- Mr. Bey pointed out that a leasing contract which did not from the very outset give the lessee an option to purchase by virtue of an unilateral promise to sell on the part of the lessor would not be classified as "crédit-bail" for the purposes of French law - as would also be the case were the promise bilateral rather than unilateral - but rather as hire-purchase, a disguised sale or an instalment sale, with the important consequence that title to the goods would thus be regarded as having been transferred at the very outset of the transaction and the lessor as having forfeited his title from that moment onwards. He accordingly felt that if the Group could once agree as a starting point that leasing was a financial operation, then there should be no problem in providing that, on the expiry of the lease, there should be three possibilities: either, where the parties had agreed at the outset of the operation that the lessee should be granted an option to purchase in their contract, the lessee could exercise this option, or the lessee could return the leased goods to the lessor or else the lease could be renewed. In his view, the operation thus remained financial in character whilst at the same time preserving its outward appearance as a hiring.

107.- Miss Dusseaux stressed that the problem of French and Belgian law in this field stemmed essentially from their lack of a retention of title system, with the result that they were forced back on expedients that usually only approximated to the more effective regime for instance known in the Federal Republic of Germany. Thus, under French and Belgian law, barring the enactment of special legislation for specific cases, there was effectively no means whereby a lessor could for instance retain title until such time as his lessee had paid his full quota of instalments on the price of a certain item of equipment, by virtue of the rule under which there was retroactive attribution of any such transfer of title to the outset of the transaction in question. This was consequently, she explained, a problem that went considerably wider than just leasing. She envisaged difficulties, therefore, should the Group decide to leave the option to purchase out of the rules that they intended to draft, as regards the effect this would have in legal systems like those of France and Belgium which enforced the rule providing for the retroactive attribution of transfers of title in those cases to which she had just alluded.
108. — Mr. Goode noted that all jurisdictions seemed to recognise the concept of the financial lease just as they also all seemed to have a concept of what constituted a sale as opposed to a financial lease: the only difference seemed to lie in the fact that some jurisdictions allowed one to consider a financial lease more than others with a financial lease before the transaction became classified as a sale. In the interest of making progress, he therefore suggested that it should simply be accepted for the time being that these differences existed and that the Group should rather concentrate on what was common to all jurisdictions, namely the financial structuring of the operation, designed not as a rental but as a means of securing the return to the lessor of his capital investment together with a profit margin, and with the lessee’s payments being structured by reference to this fact and the duration of the contract by reference to the desirability to amortise the asset over its economic life-term.

109. — Mr. Coogan felt that the tenor of the discussions on this point illustrated the immense difficulty of completely separating the tax aspects from the other aspects of leasing. He saw the discussions basically as coming down to the fact that the French law on "crédit-bail" permitted the lessor to take depreciation under circumstances where the American lessor would not be able to do so, on the ground that too many of the incidents of ownership had already been transferred to the lessee.

110. — Mr. Bey felt that the Group seemed to be distinguishing between two concepts of ownership that, while differing in their formulation and in their effects, nevertheless rested on the same foundations, namely the concept of legal ownership, with its tax and accounting implications, and the Anglo-Saxon and German concept of economic ownership which stressed the material reality of the situation rather than the theoretical structure superimposed on this reality by the continental legal systems. Leasing nevertheless under both concepts remained, he stressed, a financial operation with the lessor receiving rentals which in reality represented for him the re-payment of a loan and with the lessee in return for the payment of these rentals enjoying the use of goods of which he would upon the expiry of the contract have the right to become the owner. He accordingly agreed with Mr. Goode that the Group should first concentrate on those aspects of leasing where there was a common position among the various legal systems, with points of difference being left until later. He felt that the definition proposed by Leaseurope remained the best starting point in this connexion given that it had the approval of the member associations of 15 countries.
111.- Mr. Goode, recalling that prior to the passing of the French law of 1966 on "crédit-bail" many of the transactions which were now covered by that legislation would have been regarded by the French courts as disguised sales, wondered which transactions in the wake of that law would now be treated by the French courts as disguised sales rather than as "crédit-bail" transactions.

112.- Mr. Bey replied that the rules governing this question in France prior to 1966 were to be found in the well affirmed case-law of the Court of Cassation which had devised various criteria for detecting whether or not the parties had arranged their relations within the framework of what was in effect an artificial hire contract simply so as to evade the risk of the lessor losing his title to the goods in the event of the lessee's insolvency. One such criterion was whether the rentals owed by the lessee under the contract were disproportionate to his quiet enjoyment of the goods, whilst another was whether the residual value fixed for the goods did not correspond to their actual market value. Sometimes, he pointed out, the satisfaction of one criterion was regarded as sufficient proof of a fraudulent intention on the part of the parties, whereas on other occasions the Court of Cassation required the satisfaction of more than one criterion in order to establish such proof. Applying these criteria to a leasing operation not protected by the 1966 legislation, however, he guessed that, where these criteria were satisfied, then a French court nowadays would hold such an operation to be either a disguised sale, an instalment sale or a credit sale, and in this last case valid on the ground of public policy because of the mandatory character of the rules in this field. This demonstrated, in his view, the remarkable extent to which the French law of 1966 had gone in protecting the lessee: in effect it had legalized what prior to its passing would have been considered to be a fraud on the creditors of an insolvent lessee, namely the arrangement by the parties of their legal relations in such a way that the goods which were the subject of these same relations would in no way appear as the assets of the lessee in the event of his becoming insolvent. In fact the "crédit-bail" system both enabled the lessee to dispose of the asset leased from the outset virtually as though it was his property and permitted the lessor to carry out what in effect from an economic viewpoint amounted to a lending operation. However, as a footnote to his remarks regarding the criteria employed by the Court of Cassation prior to 1966 in distinguishing between a genuine lease and a disguised sale, he felt that it was instructive to note that there were also decisions, and notably that of the Court of La Rochelle, that predated 1966 which held that the leasing operation was in fact to be regarded as a hiring, regardless of what at first sight might have appeared to be the excessive nature of the rentals fixed thereunder, given that these rentals inured not only to the benefit of the lessor but also to that of the lessee in the sense that he was able to deduct them for tax purposes under the heading of his general expenses.
113.- Mr. Goode found difficulty in understanding how what prior to 1966 the French courts would, in view of the whole economic effect of the transaction, have held to be a disguised sale suddenly and almost magically became transformed in character by virtue of the statute of 1966 into a fully protected "crédit-bail" operation. It seemed to him that the change of label effected by this legislation was marked by no corresponding change in the actual economic substance of the operation, even though he did not doubt that this was partly explained by the fact that there were compensating provisions as to registration of the lease which were designed to prevent fraud on third parties.

114.- Mr. Roy sought to allay Mr. Goode's bewilderment by pointing out that the case-law to which he had alluded in his previous intervention was essentially a case-law of the 19th century preoccupied with a very different type of contracting party from the parties to be found in modern "crédit-bail" operations. It was a case-law, he explained, that had been framed in an attempt to combat the fraudulent machinations of basically very small firms, which he felt could in no way be compared with the large-scale enterprises nowadays involved in "crédit-bail". Not only, though, did he feel that it was necessary to bear in mind this essential difference in the type of contracting party envisaged in the case-law formulated by the Court of Cassation in the 19th and early 20th centuries but also the different purpose of the operations which it was the aim of this case-law to cover from the essentially financial purpose of the modern "crédit-bail" operation.

115.- Mr. Peters disagreed with the idea that the French legislator in 1966 had simply affixed a new label to something that already existed. He regarded this intervention of the French legislator rather as recognition of the existence of new commercial techniques and facts. He pointed out that there was simply no way in which a firm in Europe in 1945 could obtain the use over a number of years of any type of equipment that it might require. It was just this need that was filled by the advent of specialised leasing companies willing to purchase equipment selected by their customers and then to lease this equipment out to these customers for a number of years.

116.- Mr. Coogan wondered how important it was in the countries of continental Europe that depreciation be taken by the lessor, as he remarked that the continental system seemed to take away from the lessor one thing which the United States system gave him, namely the residual, which was often considered as a very real form of compensation to the lessee.
117.- Mr. Bey replied that he did not feel it mattered one way or the other from the continental European standpoint that depreciation be taken by the lessor. Of fundamental importance for Latin countries, on the other hand, was the fact that the fiscal and accounting consequences of the leasing operation were linked to the legal nature of the operation. Accordingly, if one was working on the basis that leasing was essentially a contract of hire, it was important to follow the logic of this contract through on the fiscal and accounting levels too: leased equipment should, on this basis, he maintained, feature among the capital assets of a lessor qua owner, while depreciation, being linked to the individual item of equipment in question, should be taken by the lessor again qua owner, in accordance with the rules laid down by the revenue authorities of the particular country. In France, for example, he explained that the unwritten but generally followed revenue rule was that the period of depreciation available for a particular item of equipment was linked to its economic life-term. On the other hand, rentals paid under a leasing contract were in France regarded as working expenses and would as such feature as overhead expenses in the accounts of the lessee. This situation was, however, abnormal on two counts: first, because it failed to reflect the financial reality of the operation, so that some large French leasing companies nowadays resorted to a dual accounting system, involving not only the classical system but also the financial system modelled on that employed in the United States, so as to give an accurate picture of the real assets of the company in question. The real asset of a leasing company was, he maintained, not so much the equipment on which it was able to take depreciation, this being more in the nature of a fixed asset, but rather the rentals which it went on receiving in return for the use being made of its equipment. The second drawback to the situation in France as he had sketched it earlier arose from its failure to reflect the economic reality of the transaction. He pointed out that "publicity" was one means that had been employed in an effort to counter this difficulty. He recognised that the economic reality of leasing did not correspond to its legal reality but submitted that this should be seen as a reflection of the rationalist Latin concept whereby the legal and fiscal situation in respect of a given transaction should flow from the legal norm laid down in its regard.

118.- Mr. Govalda felt that even the introduction in France of a reservation of title system such as the one that existed in the Federal Republic of Germany would not have lessened the demand for leasing, as he believed that an increasing number of European industrialists and businessmen, for interalia, fiscal reasons, sought to avoid being owners of their equipment and of their premises in the Roman law sense of ownership. Thus, by resorting to leasing, such industrialists and businessmen expressed their desire to put off until the end of the contract their decision as to whether - for technological, social, political and other reasons - to become owners or - where the economic situation no longer made such a decision attractive - not to do so.
He emphasised that this indicated that, apart from the financial and security aspects underlying the development of leasing, there were also powerful reasons of industrial strategy militating in its favour. Thus an American subsidiary in France, unsure of the social, economic and political situation there in three or four years’ time, could quite reasonably prefer to leave the matter of ownership open by means of an option until such time. He accordingly saw this question as being tied above all to the mobility of businesses, particularly in the context of the Common Market, and felt that, as something that clearly therefore went very much wider than a simple legal mechanism, the option to purchase issue was one that would have to be faced up to.

119.- The Chairman pointed out that under Hungarian law the maximum duration permitted for a contractual option was six months, which could well raise problems, in the light of what had been said, for contracts subject to Hungarian law. After the Chairman had confirmed that this six-months' time-limit only began to run, however, from the time when the option was exercised, Mr. Bey pointed out that such a time-limit need not raise any problems as it would still be quite feasible to conclude a hire contract, say, for four years and then to allow the lessee six months in which to make up his mind whether or not he wished to become owner of the item previously leased.

The Chairman noted that there seemed to be agreement among members of the Group on two points, namely that leasing was above all a financial transaction and, secondly, that the sums paid under the leasing contract bore no direct relationship to the use-value as such of the equipment leased but rather to the amortisation of the cost of such equipment. He pointed out that it would be possible to judge the case for introducing other elements into the Group’s definition of leasing at such time as it began the task of actually drafting rules.

(ix) What provisions should be drafted regarding the case where the supplier fails to deliver the goods covered by the leasing contract?

120.- Mr. Stanford pointed out that this question was closely inter-related to questions (x) and (xi) and that it would accordingly be necessary to bear these in mind when considering the solution to be adopted in respect of the present point.

121.- After the Chairman had explained that the question here was whether only the lessor should be entitled to proceed against the supplier for failure to deliver or whether the lessee should be given a direct right of action against the supplier in such a case, Mr. Bey expressed the point of view that the answer to this question flowed from the essential originality of the leasing transaction, namely its basically financial character with the
lessor amortising the capital he has invested in the form of a purchase of an item of equipment for professional purposes and earning a profit over the term of the contract. The lessee, on the other hand, behaves, in an economic, if not in a legal sense, like the genuine owner of the equipment from the very outset, in selecting both the supplier and the equipment according to his particular technical requirements. The logical question which flowed from this situation was whether the owner/lessor ought not therefore to be exempted from any liability in the event of the supplier's becoming insolvent or failing to fulfil his contractual duties, just as he felt that it was logical that from the moment that the lessee had to pay rentals, regardless of the state of the equipment, the rights inuring to the lessor under the sale contract with the supplier should be regarded as being transferred to the lessee. He felt that logic required the lessee in such circumstances to be able to proceed against the supplier for satisfaction of his requirements in respect of the equipment. Inversely he felt that the financial nature of the operation for the lessor required the lessee to continue with payment of his rentals irrespective of the state of the equipment. The legal means of effecting this transfer of rights would, in his opinion, have to be drawn from the customary institutions employed in the field of transfer of rights and debts as well as in the field of agency.

122.- Mr. Coogan, confessing that he had never seen any problems in this field in the United States, explained that common practice was nevertheless for the lessor to assign to the lessee his contractual rights against the supplier of the equipment. This would require a careful and continuing examination by the financier, however, as to the precise extent to which his rights had in fact been successfully assigned.

123.- Mr. van Hoogstraten felt that the rights of the lessor against the supplier in a leasing transaction had to be transferred to the lessee, since in very large commercial transactions involving the sale of expensive equipment it was always difficult to define one precise moment at which one could state that the contract was concluded. This then raised the question of whether this transfer of rights should be relegated to the contract itself, by means of a provision making it a duty for the lessor to transfer these rights to his lessee, or whether there should not rather be a statutory transfer of these rights. He indicated his preference for the latter of these two possibilities.

124.- Mr. Goode felt that the situation was somewhat more complex than it had been depicted hitherto, and that the lessor should be entitled to proceed against the supplier for repayment of his purchase price where the sale contract stipulated that payment had to be made before delivery and then the supplier failed to deliver and perhaps became insolvent, particularly
as the lessee would not thus be able to use the equipment to generate the income with which to pay the rentals under the lease. Therefore, the transfer of the lessor's rights to the lessee would only be appropriate in so far as to secure to the lessee the right to secure delivery or perhaps compensation for the consequential loss resulting from non-delivery. He felt it would make no sense to hold a lessee liable to pay rentals if the leased equipment had not been delivered.

125.- Mr. Gavalda agreed with what he noted to be the apparently unanimous view of the Group as to the desirability of giving the lessee a direct right of action against the supplier. The difficulty he foresaw lay, in the particular context of a text designed to be uniform, in obtaining unanimous agreement on all the legal means capable of achieving this objective. He accordingly favoured it being established in the proposed uniform rules that the lessee should be enabled, either by statute or, in the absence of such statutory authority, by a compulsory clause to be included in the leasing contract by the parties thereto, to bring a direct action against the supplier.

126.- In reply to a query from the chair as to who should be entitled to grant the supplier an extension of the time-limit fixed for delivery, it was at first suggested that this should be the purchaser. However, in the opinion of Mr. Bey, the logic of the leasing transaction required that this right should never be vested in the owner/lessor of the equipment, concerning as it did a matter tied up with the technical side of the transaction, with the choice of the supplier, with the choice of the equipment and with the technical operational requirements of the lessee in regard to the equipment. He felt that it was absolutely vital for each party to this complex triangular transaction to preserve his own particular sphere of intervention.

127.- The Chairman accordingly proposed that it should be provided that the owner/lessor be precluded from exercising such a right to grant an extension of the time-limit for delivery fixed between the parties as indeed from making any other purported alteration in the contractual terms agreed between the parties, except in those cases where the lessee has consented thereto. This solution would, he submitted, highlight the triangular nature of the legal relations involved in the leasing transaction. This proposal found the support of Mr. Bey. Mr. Peter indicated his wholehearted endorsement of the view put forward by Mr. Bey, stressing that the lessor was in no way involved in the technical discussions between the other two parties and could not accordingly be held liable as regards the consequences of these discussions. The Chairman noted the agreement of the Group that this principle should be embodied in the text of the uniform rules.
128. — Mr. Bey, referring to Mr. Goode's earlier remarks, specified that in practice lessors in mounting these operations arranged matters in such a way that payment was made conditional upon delivery, that is either the placing of the goods at the disposal of the user by the supplier or the user's performance of his duty to take delivery of the goods from the supplier. This was all the more important given that many countries required the making out of a certificate of delivery attested by both the party making as well as the party taking delivery. Thus delivery as between supplier and lessee was made a condition for the avoidance of the sale contract between supplier and lessor.

129. — Mr. Goode however replied that a supplier might well stipulate that he was not prepared to supply except on the basis of receiving payment in advance of delivery. He therefore suggested that this was a situation in which neither the lessor nor the lessee was the sole person interested and that, having a joint interest, they should both be required to act in conjunction for the preservation of that joint interest.

130. — Mr. Coogan pointed to the practical drawbacks of simply transferring to the lessee the owner's rights as against the supplier, for example in the case of a contract for the construction and supply of a supertanker concluded between a manufacturer and a person destined to become the lessee, who then assigns his rights to a financier who thereby becomes owner/lessor: this could well entail the setting up by the lessor of a whole department to monitor and supervise the continuing relations between lessee and lessor, involving as these might not just the occasional negotiations but rather a constant stream of change-orders and consequently the danger for the lessor that the risks of the operation might substantially be altered in his regard. In such circumstances the lessor, given his lack of technical expertise in respect of supertankers, would hire an expert to advise on his continuing need for technical advice with regard to the specific transaction, for instance prior to granting his consent to a change sought in the design of the tanker. Whilst he accordingly saw no objection to the parties being able to provide in their contract for the transfer of rights from the lessor to the lessee, he felt that this was a matter which was too complex simply to be left to the operation of law.

131. — Mr. Bey felt that the example cited by the previous speaker should be seen not so much as the general rule but rather as the perfect instance of the exception to the general rule in this matter: it illustrated a transaction that was so complex that, in view of the size of the investment it represented for the lessor and the fact that its technical complexities were such that in the event of default by the lessee the market value of the equipment involved would be zero, the lessor was obliged to intervene at the
technical level in order to assure himself that the transaction was indeed financially viable. As an example of this question of the transfer of guarantees and the responsibility for technical risks he suggested the real estate lease situation, where the lessee would either have the property that he was subsequently to take on lease built for him or would build it himself; in such a case, given the complexity of the operation and the high costs involved, the lessor would normally intervene at the technical level by engaging his own civil engineers. The legal consequences would be different however, since, whereas a lessee who freely chooses to handle the technical side of the operation off his own back would thereby remain liable to pay his rentals in the event of the equipment leased proving to be defective or in the event of the supplier failing to deliver and would therefore be entitled to bring such actions as might enable him to determine the person really liable for such defects or such a failure to deliver, a lessor who intervenes at the technical level would, to an extent proportionate to the degree of his intervention at that level, become liable for such defects in the equipment or for the supplier's failure to deliver.

132. Mr. van Hoogstraten thought that the example cited by Mr. Coogan was an excellent reason for avoiding describing leasing as a financial transaction, as he felt that lessors too had an interest in both the quality and the value of the equipment to be supplied to lessees and for that reason themselves organised means for checking whether the equipment fulfilled the basic requirements of the particular lessee. He nevertheless recognised that the situation could vary from contract to contract and felt that the problem under discussion was one that had to be resolved essentially in terms of the triangular nature of the transaction.

133. Mr. Goode was not sure that a provision for the transfer of rights would be sufficient, because the parties' interests were not the same. Thus, under English law, in a case of delay in delivery of the leased goods, the right of action would be vested in the lessor but his damages would be purely nominal in general, because unless that held up the operation of the lease and delayed his rentals the loss suffered by the lessee through not obtaining delivery on time would not represent the measure of loss which the lessor could recover in a claim against the supplier, so that for the lessor simply to transfer to the lessee his right of action for delay would not give the lessee the remedy that he needed, because in taking the transfer of that right he would merely take the measure of damages recoverable by the lessor against the supplier which would not be sufficient to compensate his loss. The issue raised was accordingly not so much one of the transference of certain rights from lessor to lessee but rather of the giving of a particular right to the lessee against the supplier and the conjunction of the lessor and the lessee in a duty each to lend his name to proceedings necessary for the protection of the other's interests, a phenomenon which, Mr. Coogan observed, was not in fact uncommon.
134. -- The Chairman accordingly proposed that, once the two contracts making up the leasing transaction, to wit the lease contract between lessor and lessee and the sale contract between lessor and supplier, had been concluded, it should thereafter be impossible either for the lessor as buyer to modify his contract with the supplier without first consulting the lessee or for the lessee on whose specifications the leased goods had been supplied to alter his choice without first consulting the lessor: such modifications could thus only be made by the lessor and lessee acting jointly. He thought this would be an excellent adjunction to the conferment on the lessee of a direct right of action against the supplier, as it would avoid the danger that might otherwise arise of a supplier, on being sued directly by the lessee, replying that he could not be held liable because he and the buyer, lessor had in the meantime, albeit unknown to the lessee, modified the terms of their original sale agreement as regards the particular point at issue.

135. -- Mr. Bey saw the problem as being compounded of two basic elements, one the question of liability, as set out by Mr. Goode, and the other that of the consequences of that liability, to wit the compensation to be granted to the party who has sustained a loss. He pointed out that from the moment that the right exercised by the lessee against the supplier was regarded as being no more than the right of the lessor, it was clear that the lessee could claim no more from the supplier than could have been claimed by the lessor as buyer. However, by breaking down the legal elements of the transaction, it could, he submitted, be seen that the co-contractor of the lessor was the lessee and that under the terms of this legal relationship the lessee would have an action against his lessor where the supplier has failed to deliver the equipment leased or has delivered it in a state which renders it unfit for the purpose for which it was intended: by such an action the lessee would be entitled to seek to have the lease set aside as well as damages for the loss sustained by him. The lessor in his turn would then seek compensation for the direct loss thus sustained by himself from the person responsible for this loss under the terms of the original sale relationship between himself and the supplier, by bringing an action against the latter. In this action the lessor would seek compensation not only for his own loss but in some way for that sustained by his lessee as well. The transference to the lessee of the lessor's right as buyer to proceed against the supplier could thus be seen as an indirect means of compensating the lessee.

136. -- Mr. Goode felt that the whole Group shared Mr. Bey's concern that the lessor should not be held liable to the lessee in respect of those matters, such as non-delivery, for which responsibility should rather be attributed to the supplier, on the ground that the lessor had no control over these matters and would therefore be unwilling to shoulder any responsibility therefor, and in this context he mentioned that all leasing contracts to his knowledge actually excluded any liability on the part of the
lessor for non-delivery. Nevertheless he feared lest the effect of Mr. Bey's line of thinking would be to place on the lessor the risk of the insolvency of the supplier, which he suspected was not the real intention of the Group, bearing in mind the fact that the supplier was selected by the lessee.

137.- Mr. Bey explained that in his preceding intervention he had simply sought to develop the basic postulate put forward by the Chairman, in showing how the lessee in proceeding against the supplier would merely be exercising the lessor's contractual right of action against the supplier qua buyer. This was, however, quite different from the other possibility being put forward, to wit the conferment on the lessee of a direct statutory right of action against the supplier: in those circumstances the position of the lessor would be safeguarded by his right to continue receiving his rentals, while the lessee would by exercising his own right of action be able to recover his own loss from the supplier.

138.- Miss Dusseaux pointed out that this same problem, namely the lack of a genuine contractual relationship between the supplier and the user, had arisen when the Commission of the European Communities was tackling the question of consumer credit. On that occasion it was decided to treat the relationship between the supplier and the user as a business relationship, as evidences for instance by the user himself selecting the goods he required from the supplier, and that it was this business relationship, and not any particular contract, which provided the basis of the right of action exercisable by the user against the supplier.

139.- Mr. Gavala suggested that, in the interest of making the end-product of the Group's efforts acceptable on as broad a scale as possible, it might be better to adopt a general formula along the lines of the one that he had suggested earlier (v. § 124 supra): in particular he feared lest the notion of a direct right of action for the lessee against the supplier, albeit well-known in French law, might be less common and therefore less acceptable to the legal systems of other countries that might be interested in the Institute's work on this subject. He accordingly urged the avoidance of a concept with such a specific legal connotation as the "action directe" in favour of a more open solution, establishing that the lessee should be enabled to exercise his own right of action against the supplier, while leaving it to national law to decide whether this right was best conferred by statute or rather should be made a compulsory clause in the lease contract.

140.- Mr. Bey felt that everyone would agree that it was morally and equitably appropriate for a direct right of action to be recognised in favour of the lessee against the supplier, without specifying the legal means to be
employed to achieve such an end. Regarding the suggestion of Miss Dusseaux, he considered that a simple business relationship unconnected to a legal framework was rather too vague a basis for liability.

141.- Mr. van Hoogstraten suggested that, once the contract between the lessor and the supplier has provided not only that the lessor should pay the supplier the price of the equipment to be supplied but also that the supplier should follow all the lessee’s indications regarding the type of equipment to be supplied and the place where it should be delivered, this last provision amounting in his view almost to a ‘stipulation pour autrui’, mutual rights and obligations are thereby created as between the lessee and the supplier once the lessee has contacted the supplier, so that a breach of these obligations by the supplier should accordingly entitle the lessee to proceed directly in his own right against the latter, irrespective of the creation of any special statutory ‘action directe’. He was aware, in the light of Miss Dusseaux’s intervention, that this thesis had not been accepted for the Communities’ work on consumer credit but he nevertheless wondered whether for present purposes it might not be possible to establish a provision whereby mutual rights and obligations are created as between the lessee and the supplier once the former has contacted the latter pursuant to the terms of the contract between the lessee and supplier, providing that the supplier should follow the specifications given by the lessee.

142.- Mr. Goode pointed out that there was no need to establish a contract between the lessee and the supplier simply in order to give one a right of action against the other; if as a matter of policy it should be considered necessary to give a right of action, the law was quite capable of doing so, as in the case of the proposed E.E.C. directive on consumer credit which lays down that if a financier advances money to a ‘customer for the purchase of goods by way of loan, pursuant to an arrangement with a supplier, the financier shall be jointly liable with the supplier in the event of the goods proving to be defective. He pointed out that this was thus a liability to be imposed by law without proof of any contractual relations between the financier and the borrower in relation to the goods. He saw no reason why such a technique could not be employed in the present context.

143.- The Chairman noted that the statutory creation of such a legal nexus was moreover the perfect means of establishing the triangular nature of the leasing transaction which it was the Group’s intention to cover.
144.- Mr. Bey agreed that the creation of such a right of action by statute was indeed the logical result when the existing legal institutions showed themselves in the specific context of leasing to be incapable of engineering this right of action without the intervention of the lessor/buyer. However, he also considered that, since the conferment of this direct right of action on the lessee would weaken the position of the lessor/buyer vis-à-vis the supplier/seller, it was important, in the interest of maintaining the economic balance of the triangular operation, for it to be provided that, as a corollary of and in consideration for his receipt of this direct right of action against the supplier, the lessee should be under a duty to pay the sums due under his leasing contract up until the expiry thereof. The alternative to such a rule, he feared, would be that the supplier who delivers an item of equipment that proves to be unfit for the purpose for which it was intended would have to be sued twice over in respect of the same item of equipment.

145.- Mr. Gavalda failed to see what difference it would make to provide that the lessee's direct right of action should be subordinated to his payment of his rentals up until the time fixed for the expiry of his contract. He pointed out that, in the one case, if the lessee received delivery, then he would be under an obligation, enforceable by the lessor, to pay these rentals, whilst, in the other case, if the supplier should fail to make delivery, the lessee would then be able to sue for delivery under the direct right of action which the Group proposed giving him and should he fail to pay his rentals once he has actually taken delivery, then the lessor had his own remedies against the lessee. In any event, he maintained, the lessee would always be under a duty to pay his rentals so that he failed to see what would be the purpose of the additional provision proposed by Mr. Bey.

146.- Mr. Bey referred to the doctrine of exceptio non adimpleti contractus whereby if one person hires out goods to another person which meet with the latter's satisfaction then the lessee is under an obligation, as his part of the bargain, to pay his rentals, whereas if the goods hired out prove to be defective and to that extent fail to give satisfaction to the lessee, then in the first place, according to the French Court of Cassation, there has been no delivery at all and, even on the basis that something has been delivered, these are goods that are unfit for the purpose for which they were intended and as such the lessee is entitled to withhold his rentals up until such time as the lessor carries out his duty to deliver goods which conform to the terms of the contract. In the context of triangular financial leasing he therefore felt that the fact that in the event of non-delivery the lessor's rights vis-à-vis the supplier were transferred to the lessee meant that the lessor had thereby fulfilled his obligations to the lessee with the result that the lessee was under the corresponding duty.
to fulfil his own obligation to the lessor, namely the payment of his rentals. He explained that otherwise the lessee would make an undue profit at the expense of the lessor in that, with the latter's rights vis-à-vis the supplier having been transferred to the lessee, the latter would be able to obtain damages from the supplier without paying any rentals to the lessor.

147. — Mr. Cavada remained unconvinced that Mr. Bey's proposal would in any way add to the lessee's existing obligations, and in particular the obligation, once he has received delivery of the goods specified by him, to pay his rentals.

148. — The Chairman noted by way of conclusion that there was general agreement that the lessee should be enabled to exercise a direct right of action against the supplier in the event of non-delivery.

(x) What provisions should be drafted regarding the case where the goods on delivery to the lessee prove to be defective or unsuitable for the purpose for which they were intended?

149. — After the Chairman had ventured the suggestion that, as it was the lessee who was responsible for the choice of the equipment to be used by him and for the giving of specifications to the supplier regarding his technical requirements in respect of such equipment, the proper solution to this question should be, like that proposed in respect of the previous question, the conferment of a direct right of action on the lessee, Mr. Goode pointed out that this nevertheless begged the further question of how one should evaluate the separate interests of the lessor and the lessee. He explained that the supplying of defective goods was detrimental not only to the lessee's economic interests but also to the lessor's reversionary economic interest as owner, so that two entirely distinct rights of action had to be given in respect of the same defect.

150. — Mr. Coogan added that the point made by the previous speaker was a factor which could assume particular importance for the lessor with regard to the value to be set on the residual. He explained that the allegation of defects was sometimes almost a systematic scheme adopted with a view to obtaining more money than the lessor had been prepared to give at the initial stage, at a time when the equipment was finished to the point where the lessor was in a sorry bargaining position that should he refuse to increase the amount he could find himself with an unmerchantable piece of equipment on his hands. However, he thought that this was a contractual problem and not one that could be covered by statute.
151. The Chairman wondered whether the proposal put forward in respect of the previous question by Mr. Gayalda might not offer a useful formula in respect of the present question too, namely the transference of the lessor's rights vis-à-vis the supplier to the lessee either by statute or alternatively by a compulsory term to be incorporated in the leasing contract.

152. Mr. Goode pointed out that there were two claims which the lessee might wish to pursue against the supplier, one derived from the sale contract itself and embodying all the technical provisions of the merchandise and the other a direct right of action, independent of the sale contract, for other loss, such as delay in delivery. He accordingly thought that, in so far as the Group should decide to provide for a transfer of the lessor's rights vis-à-vis the supplier to the lessee, such a transfer should not be required to take place beyond the extent necessary for the protection of the lessee's interest, as the lessor himself, as he had explained earlier, had an interest in retaining certain of his rights vis-à-vis the supplier. The problem, as he saw it, lay in how these rights of the lessor and the lessee were to be divided in a situation, such as the supply of defective goods, where both parties had an interest in the condition of the goods and claims which might require satisfaction by an award of damages.

153. Mr. Hey stated that only three types of action were possible in respect of the technical, as opposed to the financial, problems that might arise from a leasing transaction. The first of these arose where the goods delivered were defective and as such unfit for the purpose for which they were intended or where the goods were not delivered at all; the remedy available in France for this case would be to apply to the court for the sale contract to be rescinded and for damages to be awarded. The second type of action would arise where the goods had been delivered but only partially served the purpose for which they were intended: as a rule the buyer under French law could in these circumstances bring an "action en rescision du prix" requesting the court to reduce the price of the goods to a sum reflecting the reduction in their value to the buyer. The third remedy available was a simple action for damages in respect of the seller's breach of the guarantees owed by him under the terms of his contract. In the context of that type of leasing transaction in which the lessor is a financier seeking to recoup his capital as well as a certain return thereon and the lessee is legally the user but economically the owner of the goods leased, to his mind the lessee should not be able to exercise a direct right of action against the supplier either in respect of the first or the second of the remedies he had mentioned above, as this would leave the lessor too much at the mercy of his lessee. In these circumstances the only way for the lessee to bring proceedings against the supplier was, he concluded, by exercising the
lessor's right of action under the sale contract and the sole legal means whereby this was possible in his view was through the "mandat d'ester", with the lessee effectively acting as the lessor's agent in suing the supplier. The lessee could thus obtain damages by incorporating his own loss in the claim of his lessor. On the other hand, in respect of the third type of remedy he had envisaged above, namely an action for damages where, for example, the supplier has failed to deliver or has failed to come to repair the equipment leased, he thought that should be a right of action exercisable by the lessee in his own right. He saw problems, however, if the Group were to decide to confer a direct right of action on the lessee in respect of all the three types of action he had mentioned, particularly for the repercussions that such a step would have on the sale contract concluded between the supplier and the lessor. He pointed out that this would in effect mean that the lessee could himself for instance call for the rescission of the sale contract together with restitution of the purchase price. He doubted the appropriateness of giving the lessee a direct right of action in such a case, to the extent that the lessor's interests, quite different in nature from those of the lessee, were not at the same time safeguarded. Thus, if the lessee were to be given a direct right of action against the supplier in respect of the defects inherent in the goods on their delivery, it would be necessary at the same time to safeguard the lessor's right under his sale contract with the supplier to recover damages in respect of his own loss, notably the reimbursement of the purchase price paid by him.

154.- The Chairman agreed with the previous speaker that the lessor should in no way be deprived of his rights as buyer vis-à-vis the supplier by the conferment of a right of action on the lessee against the supplier. He suggested that any right that might be conferred on the lessee in this context by the proposed uniform rules should be seen simply as a parallel right to the right of action which would in any event continue to be vested in the lessor by virtue of the sale contract. Mr. Rey remarked that it was important however to ensure that the supplier should not be obliged to pay damages twice over in respect of the same item of equipment and concluded that there would have to be some form of apportionment of the possible rights of action between lessor and lessee, with a clear distinction being drawn between the bases of these different rights of action.

155.- Miss Dusseaux felt that the essential principle to bear in mind here was that the lessor, to the extent that he has sustained a loss, should himself exercise those rights of action which are his under the terms of the contract of sale, just as the lessee, to the extent that he has sustained a loss through non-delivery or through the delivery of goods that were defective in some way, should exercise those rights of action which arise from the loss that he has thereby sustained. She was accordingly against the
transference to one party of those rights which would normally have been
exercised by the other, and in particular against the conferment on the
lessee of a direct right of action in respect of those claims regarding
which his interests clearly did not coincide with those of his lessor.

156.- Mr. Goode suggested as a solution that, given that it was
recognised that both parties had an interest and given the desirability that
all parties having an interest in a dispute should be before the court at one
time, it be provided that any action should be brought in the names of both
lesser and lessee, each being required to lend his name to the action so
far as is necessary for the protection of the other's interest, so that the
relationship between the two interests can be resolved at the same time.
He felt that this solution would in particular answer the problem raised
by Mr. Bey, who in his turn observed that the tenor of the proposal put
forward by Mr. Goode amounted essentially to a "mandat-d'aster".

157.- Mr. Goode pointed out that one type of right where the division
of interest as between the parties was a matter of some complexity was the
right to reject. While the right to reject goods for non-conformity with
the contract was a right generally vested in the buyer, in the special
triangular context of leasing the lessee would himself wish to have this
right, although the fact that the effect of rejection was to place the goods
back into the control of the supplier meant that the lessor would have an
interest qua buyer in exercising this right as well. The interests of the
parties might therefore conflict, and, to the extent that the buyer has paid
the purchase price in advance, the conferment of the right to reject on the
lessee, involving as this would the return of the goods to the supplier,
would expose the lessor to serious risk, particularly where the supplier is
in financial difficulties. Another aspect of the right of rejection that
would, he thought, have to be dealt with was the distinct right of rejection,
unless excluded, as between the lessor and the lessee. He suggested that the
question of the right of rejection was accordingly one that should be dealt
with prior to that of damages.

158.- Mr. Bey supported the point made by the previous speaker. He felt
that it was important to look at this problem above all from the standpoint
of practice, rather than in abstract legal terms. The fact that the goods
delivered were defective thus prejudiced both the lessee to the extent that
he could not use them for the purpose for which he had intended to use them,
and the lessor to the extent that he had purchased goods that were unusable
by the person for whom he had purchased them. He felt that the pursuit
of a solution that would be legally and economically equitable for both lessor
and lessee had necessarily to take the lessee, given his central position in
the transaction, as its starting point. One possibility would accordingly
be to enable the lessee to act in the name of the lessor with a view to seeking compensation both for his own loss and also in some way for that sustained by the lessor, in an action for the avoidance of the sale contract with damages. In the other possibility envisaged by the Group, namely that of establishing a direct legal relationship between the supplier and the lessee, the right of action thereby conferred on the latter against his supplier would be a right of action exercisable by the lessee in his own right with a view simply to obtaining damages and would to that extent be without any effect on the lessor's title and the subsistence of the original sale contract. This would in its turn however mean that the lessee would not carry out his lease contract with the lessor, the latter thereby sustaining a loss as regards the return that he would otherwise have obtained on the capital invested by him in the operation, not to mention the serious risk of loss to which his capital itself would be exposed. Thus to the extent that a direct statutory right of action was to be conferred on the lessee in respect of the loss sustained by him as a result of the delivery of defective goods, this right of action should be limited to a claim for damages and should not prejudice the subsistence of the lessor's right of action qua buyer for avoidance of the sale contract together with damages to compensate him for the loss of the financial return which he would otherwise have made over the lease. This however still left the question of whether, where the supplier has in the meantime become insolvent, the lessor, given the special circumstances of his intervention in the operation, should thereby necessarily lose the capital invested by him in the operation. He pointed out that this raised the question as to whether on the ground of equity this was a liability which should be borne by the lessee, as the party who had chosen both the supplier and the equipment in question.

159.- The Chairman accordingly requested Mr. Bey to draft the text of an article on this matter, taking account of the point made by Mr. Goode, and to forward this text to the Secretariat of UNIDROIT.

(xi) Should any provisions be drafted regarding the extent to which a leasing company should be given immunity from duties and liabilities that would ordinarily fall upon it as the legal supplier of the leased goods, and, as a corollary, the extent to which these duties and liabilities should be transferred to the physical supplier?

160.- Mr. Goode explained that there were two aspects to this point, namely those duties and liabilities that were owed to the lessee and those duties and liabilities owed to third parties who might be injured by a defective product. It could be argued that, because it is the lessee who selects the supplier and the equipment, it would be quite inappropriate to impose
liability on the lessor in respect of the duty that would ordinarily be incumbent on the person supplying goods to ensure that they were fit for the purpose for which they were intended: it was, he pointed out, for the lessee to satisfy himself that the equipment was in good working order, and indeed he believed that many leases contained a warranty given by the lessee to the lessor that he was so satisfied, so that the lessor could then safely pay the purchase price to the supplier. As to the wider question of products liability, he felt that it could be argued that, as the lessor was neither involved in the physical handling of goods nor in a distributive chain, he should not be liable for injuries sustained by third parties through a defect in the equipment.

161.- Mr. Bey pointed out that, in respect of the wording of this question, it was better to say "... as a corollary, the extent to which these duties and liabilities should be borne by the physical supplier" rather than "... should be transferred to the physical supplier". As regards the idea of giving the lessor exemption from duties and liabilities that would normally be incumbent on him as the legal supplier of leased goods and of transferring these duties and liabilities to the physical supplier, he mentioned that the French Court of Cassation had, in respect of hire contracts, fixed limits on the extent to which the lessor could exempt himself from certain of these duties and liabilities, notably the lessee's right to quiet enjoyment of the leased goods. However, he felt that, notwithstanding the financial lease's essentially being based on the hire contract, it flowed logically from the fact that in a financial lease it is the lessor who chooses his own equipment that it is likewise the lessee who must bear the responsibility for the technical risks deriving from his choice.

162.- Mr. van Hoogstraten saw the problem here as being essentially tied up with the extent to which the lessor should be regarded as the owner of the equipment leased. While he recognised that the solution to one of the problems arising out of this situation could be the agency relationship existing between lessor and lessee, just as the solution to another such problem might be seen in the fact that, the lessor's ownership being virtually bare ownership, it could to that extent be argued that it would not be appropriate for the same consequences to attach thereto as would be attached to normal complete ownership, he nevertheless expressed as his preference that a common solution should be sought to the overall problem. He felt for instance that product liability in respect of leased equipment should be borne by the lessee, as the person in possession, rather than by the lessor. He proposed that the Group should enumerate a list containing all the cases in respect of which it would be inappropriate for the duties and liabilities that would normally attach to the lessor by virtue of his being the legal supplier of the leased goods so to attach.
153.- Mr. Bey stressed the importance of avoiding creating rules that would prove totally unacceptable to the countries interested in leasing. For instance, he pointed out that if it was the Group's intention to situate leasing within the context of hire contracts, then it would be inadvisable to develop rules that so departed from the basic regime applicable to hire contracts as to create simply a monstrosity that would render the rules unacceptable. He felt that, if the intention was to situate leasing within the context of hire, then it was vital to respect the essential elements of hire contracts. Otherwise he suggested that it was better to define leasing as a sui generis operation and to steer clear of hire completely.

164.- Mr. Peter perceived a contradiction in the remarks made by the previous speaker, to the extent that, as the entire Group seemed to be agreed as regards the sui generis character of leasing, he failed to see why it should be necessary to follow the schema of a particular type of contract, such as hire, in drawing up uniform rules to govern this sui generis type of activity. His view of the problem under discussion was that, precisely because of the sui generis nature of financial leasing, the lessor was in no position to bear the risks that were normally associated with ownership.

165.- Mr. Goode agreed with the previous speaker that the type of leasing the Group had decided to regulate was sui generis, so that there was no need to follow the normal consequences of bailment. He pointed out that it was hard to see what duties and liabilities actually remained the responsibility of the lessor, apart from the fiscal responsibilities deriving from his ownership of the item leased and the duty he owed to the lessee to allow him quiet possession so long as he continues to pay his rentals: non-delivery of the goods or their non-conformity with the terms of the contract could hardly, in the light of the previous discussions, he suggested, be laid at the door of the lessor and, in any event, even if they were, the most likely end-result would simply be the entering of a cross-claim by the lessor.

166.- Mr. Galvade, expressing his agreement with the previous speaker's remarks, pointed out that leasing had created a totally new form of ownership, with the legal and economic ownership of the same item passing into separate hands, the former remaining with the lessor, while the latter, involving the physical fact of actually enjoying the use of the item in question, passed, together with all the appurtenant risks, to the lessee. It was always possible, under the purchase option permitted by certain legal systems, he pointed out, for the two forms of ownership moreover to unite in the hands of the same person at the end of the contract. As he had pointed out earlier, one of the reasons compelling businessmen to take goods on a leasing arrangement was in fact their desire not to acquire the goods' legal ownership, for the time being at least. This new type of ownership was, he submitted, the prime reason underlying the quite unusual allocation of duties and liabilities called for in respect of financial leases.
167. - Mr. Coogan thought that the incorporation in the proposed uniform rules of this continental concept of separate economic and legal ownership would, as a concept that was unknown to the courts in the United States for instance, provide a considerable stumbling block for Anglo-American acceptance.

168. - Mr. Peter explained that this concept of the division of the ownership of a leased asset into its economic and legal ownership had to be seen in its proper context, namely the fiscal context. In fact it was a concept that operated for fiscal purposes alone and had indeed originated in the Federal Republic of Germany as a fiscal "faute de mieux". He suggested that to have recourse to this notion in the present context would create far more problems than it would solve. He advocated instead the creation of something new, in keeping with the sui generis novelty of the leasing transaction. He denied moreover that ownership was divisible in a leasing transaction, on the ground that the lessor always remained the owner of the leased asset.

169. - Mr. van Hoogstraten reminded his colleagues that it was their task, given the very special nature of the finance lessor's ownership, to strip away whole elements of this ownership and to transfer certain of its consequences to the lessee; if, on the other hand, the Group simply worked on the basis of traditional notions of ownership, there was, he pointed out, a very strong possibility that a judge, called upon in the future to interpret the proposed uniform rules, would reach a conclusion quite opposed to what had been the Group's intention at the time of drafting.

170. - Mr. Rey pointed out that the sole responsibility incumbent on the lessor is that of paying the price agreed under the sale contract for the item of equipment that is to be leased. It had already been shown that, given the special circumstances prevailing in respect of the financial lease and in particular the lessee's exercising, at the outset of the transaction, of rights which would normally only be exercisable by a buyer, the lessor could not be expected to bear the responsibility for two of the fundamental duties of a lessor in the normal hire situation, namely, first, the duty to ensure delivery of the goods, together with the ancillary rights necessary to make use of them and, secondly, the duty to ensure quiet enjoyment, notably by the elimination of any factors calculated to destroy or to limit such enjoyment, such as hidden defects. Mr. Cavallo added that another duty which necessarily remained the responsibility of the finance lessor was that relating to the legal guarantees which he owed in respect of the equipment leased, for instance the guarantee that the equipment in question was free of any charge.
171.- In reply to a question raised by the chair as to whether it was really necessary to regulate the question under discussion in the proposed uniform rules, Mr. Peter expressed the view that it was not absolutely necessary, so long as the general principle was set out therein, as it would then be for the individual States to draw the necessary consequences; this view received the backing of Mr. Gavaldà, who felt that, in view of the difficulties that he anticipated arising should the Group seek a uniform means of resolving the problems raised by the present question, the Group here should make use of a method often employed in the preparation of international instruments, consisting in the setting out, in the form of a general rule, of the end-result it wished to achieve, without going into detail regarding the precise legal technique to be employed to achieve this end-result, thus obliging the individual States themselves to select the legal mechanism most appropriate to their particular legal system. He felt that this approach was valid for all aspects of the problem under discussion save where the position of the various legal systems seemed to converge on one particular technique, as seemed, he noted, to be the case with the "action directe".

172.- The President of UNIDROIT pointed out that it might be important to spell out that it was also a duty of the lessor to take back the leased asset at the end of the lease, since, the lessor already having amortised the asset over the duration of the lease, it was quite feasible that he might no longer be interested in taking it back, for instance on account of the cost that would be involved, thus bringing his interests into conflict with those of the lessee who might well wish to have the asset hitherto leased by him removed from his factory so as to be able to replace it with something more up-to-date.

173.- Mr. Coogan suggested that a useful analogy was perhaps to be found in respect of the question as to who should bear the different civil responsibilities arising out of a leasing transaction in the law as it stood with regard to real estate leases, where it was accepted that the person in occupation of the property qua lessee assumed certain risks that would normally only be associated with ownership. He saw no reason why this principle should not be extended to cover the case of the lessee in a financial lease situation, although he recognised that one difficulty in this solution could well arise over the precise scope of the term "ownership", which he described as a slippery and inexact word involving such a bundle of rights that it was almost meaningless in many ways.

174.- Mr. Goode felt that it was important, as one of the single most crucial legal aspects of leasing, that the question as to whether the lessor should be relieved from all the duties and liabilities that would normally attach to ownership, save that of allowing the lessee to remain in quiet possession of the leased asset so long as he performs his duties under the lease,
should be explicitly regulated in the proposed uniform rules. He feared lest the Group would otherwise find itself locked into the unsatisfactory results of the existing situation. The Chairman, on the other hand, was of the opinion that the answer to this problem would follow logically from the Group's definition of the leasing operation and from the individual rules that would be drafted on the basis of its replies to the questions raised in the Secretariat's paper regarding the various aspects of this problem. He suggested however that, if Mr. Goode continued to have misgivings on this point, there was no reason why a provision could not be drafted thereon, regarding the maintenance or deletion of which the Group could decide at a later stage.

Mr. Goode explained that his difficulty on this point arose in connection with the fact that, while the Group was agreed that the proposed uniform rules should in fact recognise the sui generis character of the financial lease, this was something which had as yet been recognised under no legal system, with the result that, as matters stood, there was likewise no legal system under which sui generis legal consequences would as yet be attributed to the financial lease. He therefore doubted very much whether the mere proclamation in the proposed rules of the distinct sui generis character of the financial lease would suffice in itself to achieve the associated sui generis legal consequence that the Group seemed to desire on this point. He rather felt that it was necessary for the rules specifically to state that various defined legal consequences would follow from the fact of the special features present in a financial lease by comparison with the traditional form of lease.

175.- Mr. Bey for his part explained that he had understood the Group already to have decided to attribute certain specific sui generis legal consequences to the financial lease. For instance he mentioned what he understood to have been its decision to give the lessee a direct right of action for damages against the supplier, whilst at the same time recognising that the relationship between lessor and lessee was a hire relationship that could alternatively be described as a "concession d'usage". He also understood the Group to have decided to relieve the lessor in general from the liability that would normally attach to him by virtue of his ownership of the leased asset, and, as a corollary, that the lessee should be able to exercise the right of action of the lessor against the supplier in the event of the leased asset proving on delivery to be defective.

176.- Mr. Goode saw the Group's decision as having been rather to recognise that the lessor and the lessee both have an interest in pursuing remedies for defective goods. The lessor would have an interest in pursuing a claim against the supplier in the event of the goods delivered proving to be defective because this would mean that the value of his asset was much reduced: the lessee's claim in the event of the delivery of defective goods derived rather from his consequent inability to use the asset and
perhaps, ultimately, to acquire the asset with the value that it would have possessed had it been free from such defects. He would prefer to see the lessee's right of action against the supplier characterised as an independent, original claim given by law to the lessee, rather than as a claim derived exclusively from the rights of the lessor, who had his own independent interests. The Chairman added that in such a case it was no longer necessary to talk of relieving the lessor from liability for defective goods, as the rule of law that Mr. Goode proposed establishing would entail that he never was liable for such defects.

177.—Mr. van Hoogstraten supported the view that the principle of the lessor's being in general relieved from the duties and liabilities that would normally attach to him qua owner of the leased assets should be spelled out in the text of the proposed rules. He explained that he was against the Chairman's proposal that this need not be expressly stated in the proposed rules, because the courts would in that case be forced to deduce the solution to the problem raised in this question from the general notions of, for instance, the law of hire, which could, he suggested, have rather unfortunate consequences in the light of the Group's desire to see financial leasing accorded a sui generis status.

178.—Mr. Peter suggested that the general conditions of the three parties involved could well provide a strong argument in favour of simply stating the general principle in the proposed rules, as, to the extent that the aforementioned general conditions did not contradict this principle, the various practical applications of this principle could then be clarified by reference to these general conditions.

179.—Mr. Coogan wondered whether the net effect of Mr. Goode's proposal would not be to increase the total potential liability of the supplier who supplies to a finance lessor over what it would have been had he supplied the same goods to a person who would have used them himself, rather than leasing them out. Mr. Goode replied that he did not think the total potential liability of the supplier would differ in either case, although this was not to say that the means of calculating this liability would be the same in both cases. He explained that a person purchasing an asset in a simple bilateral transaction which then prove to be defective would have first a right of action in respect of the consequent diminution in the value of the asset and secondly perhaps also consequential claims for such matters as his loss of the use of the asset during the time necessary for its repair, whereas in the tripartite financial lease these claims would have to be divided between two parties, the claim for the diminution in the capital-value of the asset lying with the lessor and the claim for loss of income and other consequences with the lessee. He did not however think that the fact that
these claims were combined in the same person or were divided between two persons would alter the net financial result for the supplier. The only real difference he could see arising out of a division of the aforementioned claims would be that the supplier would thus have to deal with two plaintiffs rather than one.

180.- Mr. Goode doubted the adequacy of Mr. Peter's proposal for leaving the problem as to whether the lessor should be relieved of the liability that would normally attach to him as owner to be dealt with in the general conditions of the parties. He pointed out that many countries were now either passing legislation or considering the passing of legislation to restrict the ability of the parties to contract out of their liabilities. For instance, the United Kingdom Parliament had recently enacted the Unfair Contract Terms Act which provided that even in a business transaction, as opposed to just a consumer transaction, clauses which seek to exempt one party from liability or seek to enable him to offer performance substantially different from that which the other party was reasonably entitled to expect, will not be enforceable except to the extent that they are reasonable. Under the terms of such legislation, a clause in a lease purporting to exclude the lessor's liability in respect of matters such as those under discussion would therefore in future have to be shown to be reasonable before it could be upheld. He felt that it was better for the Group to deal with these problems clearly and specifically in the proposed rules rather than, as would be the case were Mr. Peter's proposal accepted, leaving their solution to the vagaries of national law.

181.- The Chairman suggested the adoption of the principle that, in the case of a leased asset being delivered in a defective condition, any right of action in respect of the consequent diminution in its value should be given to the lessor just as any right of action in respect of consequent loss of income should be given to the lessee. Mr. Goode, on the other hand, reiterated his view that any action should be brought in the joint names of both lessor and lessee so that by having both claims dealt with together the measurement of one claim could thus be made inextricably dependent on measurement of the other, thus avoiding any duplication of damages at the expense of the supplier. In reply to a query from the chair as to what should be the rule where the lessor is unwilling to join his name to the action of the lessee, Mr. Goode thought that a lessor would in such a case have no cause for complaint if the lessee's action were disposed of. He stressed, on the other hand, how important it would be in such a case to ensure that the lessor could not then bring a separate action against the supplier in respect of the same defect. The Chairman nevertheless wondered how this problem would be solved in those legal systems which consider the lessee as the agent of the lessor in such a case. Mr. Goode did not think that agency notions were particularly relevant in such a case, as the lessee, in bringing an action against the supplier, was acting to protect his own interests and not to protect those of his lessor.
182.- Mr. Bey first of all pointed out that the recognition of an agency relationship between lessor and lessee could be of common interest to both parties. He felt, secondly, that one solution that would be in keeping both with the Group's basic desire to avoid going into too much detail and with the fundamental concerns of the parties to the tripartite financial lease would be to lay down the rule that "the owner shall not be liable for the consequences resulting from a poor choice having been made as regards the item to be leased and/or the person selling this item. The lessee shall have a right of action for damages against the seller". He felt that such a solution had the merit of preserving the correct balance in the consequences of a finance lease.

183.- The Chairman, pointing out by way of conclusion that it was unnecessary at this stage to adopt a specific text, indicated that he nevertheless felt that the preceding discussion had sufficiently clarified the matter for a general principle to be drafted thereon.

(xii) What provisions should be drafted regarding the physical risks arising in connexion with the leased goods?

184.- The Chairman noted that this question had already been answered in the course of discussion regarding the previous point. The Group was of the opinion, he concluded, that the lessor should not be liable for such risks.

(xiii) What provisions should be drafted where the leased goods have been lost during the course of the leasing contract through the act of a third party?

185.- After the Chairman had proposed that the question should be widened to take in the case of the leased asset being lost not only through the act of a third party but also through _via major_, Mr. Goode noted that there were various facets to this question, the first of which, namely the effect which the destruction of the leased asset should have on the lease, ought perhaps best to be left to general contract law. A second question that arose, although he was not sure whether it was one that should actually be dealt with in the proposed rules, concerned which of the parties should be given the right of action against a third party who wrongfully damages or destroys a leased asset, i.e. whether it should be the lessee, or the lessor, or, as he was inclined to think, both parties acting jointly. It would also be possible, he added, to envisage the lessor and the lessee each being given a separate right of action, with each party being entitled to sue for his respective loss. However in this connection he mentioned that, in the analogous context of the law of bailment, there had already been a good deal of litigation in England as to the precise measure of loss recoverable by a
bailie in such circumstances, the result of which was that a bailie was entitled to sue a third party for the full value of the loss occasioned, for the benefit of himself and the lessor, subject to his duty to account thereafter to the bailor for any amount recovered in excess of his own interest.

The Chairman at this point interjected that this was another case where it would perhaps be appropriate to divide the right of action broadly along the lines of allowing the lessor to exercise the right of action deriving from the loss in the value of the leased asset and the lessee to exercise that deriving from the loss of income and other consequential loss brought about by the destruction or damage of the asset. Mr. Goode, expressing himself to be broadly in agreement with the Chairman's proposal, went on to point out that the third facet of the question being examined, although here again he stressed that he was not sure of the extent to which it should be dealt with in the proposed rules, arose out of the fact that most leasing contracts contain provisions for insurance. This raised difficult questions as to who should collect the insurance monies and how these monies should be applied, as well as as to how, in the event of the insurance company insisting on the replacement of the asset damaged or destroyed, rather than its paying out a sum of money as the value of that asset, the rights of the parties should attach in relation to the replacement asset, i.e. whether the original leasing contract should attach to the replacement asset as it did to the original asset or whether adjustments would have to be made.

186. Mr. van Hoogstraten saw two distinct aspects to the problem raised in this question, first the case of the goods being damaged or destroyed on their way from the supplier to the lessee and, secondly, the case of the goods being damaged or destroyed at a time when they were already in use by the lessee, for instance where an aeroplane crashes into the premises where the leased asset is housed thereby causing damage to or destroying the goods. He favoured a solution of a more or less procedural character, whereby every action relating to the leased asset would be brought by the lessee, but with the latter at the same time having not only the right but also the duty to seek compensation in respect of any loss sustained through the same event by the lessor, as well as the subsequent duty of accounting for the outcome of his suit to the lessor. He felt that this would greatly simplify matters, first in that it would mean that the person responsible for the damage or destruction of the leased goods would only be brought to court once and, secondly, at the suit of the person who, given his "economic" ownership of the leased goods, is perhaps, in the view of the Group, to be considered as the person who sustains the major share of the loss, whilst at the same time safeguarding the separate capital interest of the lessor. He recalled that, as in the case of parents acting for their children, it was not at all unknown for the law to permit one person to bring a suit on behalf of another party.
187. Mr. Cavalda saw this as a question that could perhaps best be dealt with in a provision laying down a duty of insurance in respect of the leased asset. This then raised the question, given the different kinds of insurance policy employed in connection with a leasing transaction, namely, first, the type of policy generally taken out in respect of the equipment itself; and, secondly, that taken out against loss of its use ("assurance - perte d'exploitation"), of which type of policy should be made the responsibility of the lessee and how the insurance monies should be divided up. In his opinion the insurance of the equipment was a responsibility that devolved logically on the lessee, as the person who would be required to replace the leased asset in the event of it being lost, whereas insurance against the loss of use of the equipment devolved equally logically on the lessee.

188. In reply to a query from the chair, Mr. Bey pointed out that there was in France no statutory duty on the parties to a leasing contract to take out an insurance policy as a result of their contract. Such questions were in France left to be resolved in accordance with the general "droit commun", the French legislator never having intended to provide an exhaustive set of rules for the relations between the parties to a leasing contract. As regards Mr. Goede's remarks, he pointed out that a hire contract would be automatically terminated under French law by the fact of the equipment's being lost, irrespective of the parties' intentions, which seemed logical given that the subject-matter of the contract had disappeared. The problem in this connection as he saw it was one of deciding what was the basis of the resultant claim. If this claim was one that sounded in contract, it followed that the holder of the insurance policy should be enabled to bring the action appropriate to his case. However, in reality such an action was brought by statutory subrogation, the claimant acting for the insurance company. Such a claim would be either for the replacement of the item lost or for a sum of money representing the value thereof. He pointed out that practical problems had not however arisen on this point. In practice in France the situation was that, under the terms of the leasing contract, the lessee took out an insurance policy against the loss of the equipment, of which he then notified the lessor by sending him a copy of the policy. The lessee in addition may take out a liability insurance policy ("assurance-responsabilité"), under which the premiums are attributed directly to the lessor, so that, in the event of the equipment being lost, the insurance monies are applied in his favour to the extent of the financial value of the asset at the date of its loss, with the remainder being returned to the lessee. There is also a credit insurance policy ("assurance - crédit"), under the terms of which, where the equipment has only been partially destroyed but sufficiently to prevent the lessee from being able to use it to pay his rentals, the insurance company thereupon pays the rentals in the lessee's place. He stressed nevertheless that he did not feel that the question of insurance was of sufficient importance to merit attention in the proposed uniform rules.
189.- Mr. Gavilé on the other hand believed that the rules which it was the Group's intention to draw up should include one making it compulsory for an insurance policy to be taken out in respect of the equipment itself; in regard to the ever-increasing phenomenon of policies being taken out against the risk of the equipment not being able to be used at some future time ("assurance-perte d'exploitation"), he felt that this was rather something which should be left to the contractual freedom of the parties, with the lessee being left free to decide for himself whether or not to take out such a policy. The same was true, he felt, of the credit insurance policies ("assurance-crédit") mentioned by Mr. Bey, which were clearly to the advantage of the lessor and should be left as optional.

190.- Mr. Peter felt that it was important to recognize the principle that insurance policies linked to the equipment and to the use thereof should be the responsibility of the lessee. Because there were many cases in which the lessee could include a new item of equipment under the cover of an existing insurance policy, he was not however in favour of obliging a lessee to take out a new policy for each new item of equipment leased by him.

191.- Further to Mr. Bey's remarks (§ 188), Mr. Goode pointed out that, whilst English law, like French law, provided for the frustration of the contract in the event of the destruction of or some other accident affecting the leased asset, in practice the terms of the lease required the lessee to go on paying his rentals notwithstanding such destruction or accident and irrespective of whether or not the latter occurred through the fault of the lessee.

192.- In the light of the foregoing discussion, the Chairman concluded that the question of insurance was one that should not be dealt with in the proposed rules but should rather be left to the decision of the parties when drawing up their contract.

(xiv). What provisions should be drafted for the case where the lessee fails to perform his duties under the leasing contract? In particular, what effect should be given to compensation clauses in leasing contracts designed to protect the lessor in such cases?

193.- Mr. Peter indicated his feeling that this was a practical point of considerable importance and as such should be dealt with in the rules, albeit without going into over much detail. One solution might be to limit the amount which the lessor could recover in the event of the lessee's non-performance to the amount of his capital outlay together with interest thereon, which he considered to be just given that the basis of the leasing contract was that the amount and number of the rentals which the lessee undertook to pay to the lessor were usually calculated specifically to ensure that the lessor recouped his capital outlay together with interest thereon.
194. — Mr. van Hoogstraten saw the question as whether and to what extent the Group should envisage setting limits on what the parties to a lease can provide in their contract or whether this was not rather a matter best left to the contractual freedom of the parties. The Chairman saw this as just one of the questions in respect of which the Group would subsequently have to reach a decision as regards whether or not to lay down a mandatory rule of law or simply to draw up a rule that could be displaced by a provision to the contrary in the contract itself.

195. — Mr. Bey saw two aspects to this question. First, there was the question of the effect which a breach of the leasing contract through the default of the lessee should have on the relations of the parties to that contract: the logical result, in his view, of regarding the leasing contract as a kind of hire contract or "cession d'usage" was the termination of the contract with the lessee having to return the leased asset to the lessor, although the parties should, subject to this basic principle, be left free to arrange the details of this operation, for example whether the leased item should be collected by the lessor at the expense of the lessee or otherwise, for themselves. The second aspect of the question under consideration, he continued, was the consequence of the lessee's default. He felt that here it was vital to recall the operation's financial nature, with the lessor through the lessee's rentals aiming to recoup his initial capital outlay together with a profit margin. In computing the amount which the lessor should be entitled to recover from the lessee on the latter's default, he felt that it was important to take into consideration the market value of the returned asset, even though this could not be expected to cover by itself both the lessor's capital outlay and profit margin. Accordingly the lessee in default should, in his view, be obliged to pay damages to the extent necessary to make up this shortfall. As regards whether this objective of compensating the lessor for the lessee's breach was best secured by leaving the court to apply the general rules of law governing breach of contract or by leaving the parties to stipulate a minimum payments clause, his preference was for the latter, although he agreed that such a clause would have to depend for its validity on its not constituting an unjust enrichment for the lessor. He explained his preference by reference to the fact that, regardless of whether the assessment of the compensation payable by the lessee to the lessor were or were not left to the court, the parties would still include a minimum payment clause in their contract as a deterrent against the lessee's defaulting. What it was important to establish was that a limit should be set on the amount recoverable by the lessor under such minimum payment clauses: he suggested that the lessor should not be entitled to receive more than the amount of his capital outlay and profit margin as well as the costs incurred by him as a result of the operation. From this total he proposed deducting the sum of the rentals already paid by the lessee together with the residual market value of the asset at the time of the breach. He thus proposed the drafting of a rule laying down that, in the event of the lessee's default, the latter
should be obliged to return the leased asset to the lessor and to compensate him within the bounds of equity for the loss sustained by him through the lessee's default.

196.- In reply to a query from the chair as to whether Mr. Bay thought this duty to return the leased asset should also apply in the event of the lessee's breach only, say, six months before the expiry of the contract, Mr. Bay stated that this duty was at all times a logical corollary of the Group's desire for the leasing contract to be treated essentially as a hire contract. Legally and financially this duty could have very serious implications for the lessor: for instance, once there has been a breach of contract by the lessee entitling the lessor to repossess the leased asset, the lessee is no longer, in the absence of a further contract providing for the safekeeping of the asset by the lessee until such time as the lessor collects it, liable for any damage sustained by the asset after that time. He reiterated his feeling that the proposed rules should state that where the lessee has committed a breach of the contract the lessor shall repossess his equipment and be compensated for the loss he has sustained through such breach, leaving the details to be settled by the parties and by national law.

197.- Mr. Cavalda supported Mr. Bay's proposal particularly as, in the light of the statute recently passed in France giving the court a wide measure of discretion in revising the sums fixed in such minimum payment clauses, he doubted whether this much-debated question of minimum payment clauses was one on which the French legislator would be willing to alter its position anew. Mr. Bay added that the law on this matter in France could indeed be considered as a rule of public policy.

198.- Mr. Goode favoured the stating of a general principle without going overmuch into the detail which, as regards this particular point was complex, as, for instance, the fact that credit should be given not necessarily for the value of the repossessed equipment as such but rather for the amount by which their value exceeds what the residual value would have been if the contract had run its normal term, discounted to allow for the fact that their value was being received earlier than anticipated. He accordingly favoured a rule stating that the lessor must as nearly as possible be put into the position in which he would have been if the lease had run its full term and been fully performed whilst account should be taken both of such sum as the lessor would have received after repossessing and disposing of the equipment if he had acted in a commercially reasonable manner - it was right, he felt, that the lessor should have a duty to take reasonable steps to mitigate his loss, although he was against setting out this duty any more precisely than the formula he had indicated - and of such residual value as he would in any event have received if the contract had run its full term.
199.- After the Chairman had indicated that he found the tenor of Mr. Goode's proposal thoroughly acceptable and that he did not feel it precluded giving effect to Mr. Bey's desire for a rule stating that the lessee shall, upon the lessee's default, be entitled to repossess his equipment, Mr. van Hoogstraten nevertheless wondered whether Mr. Goode's proposal did adequate justice to the lessee, particularly given the upset in his planning calculations caused through no fault of his own by his having to repossess his equipment at an unforeseen moment during the term of the lease, at a time, that is, when it would be extremely difficult to find someone to take the asset off his hands, at least at a price that bore some relation to his calculations when he embarked on the operation in the first place. He accordingly favoured a general rule stating that, in the event of the lessee's default, he should be obliged to compensate the lessor for his resulting loss, the measure of this compensation being left to the assessment of the court.

200.- Mr. Goode explained that his formula did not merely provide for repossession by the lessor but rather that the lessor should be entitled to recover the discounted value of the unpaid rentals, after giving credit against that sum for the sum he would have received from disposing of the repossessed asset in a commercially reasonable manner but after adding back the residual value that the asset would have had for him had the lease run its full term. The aim of his proposal, he stressed, was to ensure that the lessor should receive by way of compensation the same sum as he would have received had he received the total number of rentals provided for up to the contractual expiry of the lease.

201.- Mr. Coogan felt that it was important to remember that some bankruptcy statutes limited the amount of damages recoverable on the breach of a lease. Thus in the United States, the maximum recoverable in a reorganization currently stood at a sum equal to three years' rentals, whereas under the proposed Bankruptcy Act this sum would be reduced to the equivalent of one year's rentals.

(xv) Should any restrictions be imposed on the lessor's powers to repossess and dispose of the leased goods upon termination of the lease, whether for default or otherwise?

202.- While the Chairman felt that this was a matter perhaps best left to the contract, Mr. Coogan expressed the view that it was basically covered by the formula put forward by Mr. Goode in respect of the previous question.
203.- Mr. Gaivalda pointed out that one means of defeating the lessee’s repossession of his equipment permitted under French law was for the lessee’s trustee in bankruptcy to elect to go on paying the rentals in the lessee’s stead.

204.- Mr. Bey felt that where the lease has been terminated for default by the lessee there could be no question of imposing restrictions on the lessor’s absolute right as owner to dispose of his property as he saw fit: the lessee could only benefit from restrictions as regards the lessor’s right to dispose of the equipment so long as he continued fully to perform the terms of his lease.

205.- Mr. Goode specified that what had been decided as regards the previous question, namely that the computation of the damages recoverable by the lessor on the lessee’s default should be based on what the lessor would have received if he had disposed of the equipment in a commercially reasonable manner, was in no way intended to limit the range of possibilities open to the lessor in dealing with his property on the termination of the lease. Clearly, however, a lessor who elected on termination of the lease to destroy his equipment could not then expect his damages to be assessed as though the equipment was of no value at the time of its destruction.

206.- Mr. van Hoogstraten, recalling the limitations imposed under the law of many countries as regards instalment sales on the seller’s right to repossess his property in the event of the buyer’s default, proposed that the proposed rules should perhaps spell out the precise degree of seriousness that would be required before a default by the lessee would entitle the lessor to repossess. He accordingly urged the inclusion of a provision stating that the lessor could not declare the termination of the lease unless, for instance, the lessee had clearly not been paying his rentals, although nowhere he is simply a fort night late in his payment of one rental.

207.- Mr. Peter pointed out that the legislation referred to by Mr. van Hoogstraten was drafted essentially with a view to the protection of consumers, whereas in the present case the transaction was one concluded between businessmen. He accordingly did not himself feel that the preparation of such a rule was called for in the present context, although, to the extent that a precise figure was being sought as regards the amount of arrears that might justify the lessor’s declaration of the termination of the lease, he put forward the figure of three months.
208.- The Chairman's view was that the matter was essentially one of detail but that, once the lessee had fallen into, say, one month's arrears, the lessor should in any event be required to send a letter to the lessee calling upon him to bring his rentals up to date before any question could arise of the lessor seeking to repossess his equipment.

209.- Mr. Goode reminded the Group that, in the type of transaction it had in mind, namely international operations between commercial parties involving expensive equipment, no commercial lessor would want to be put to the trouble and the expense of terminating and repossessing unless there were good commercial reasons for doing so. He accordingly thought that it would be quite adequate for the proposed rules simply to provide for a right to terminate and to repossess in the events stipulated in the lease.

210.- Mr. Coogan pointed to the difficulties that would be experienced in writing terms that were admittedly not uncommon in consumer legislation into legislation for the commercial type of lease contemplated here: he mentioned for instance the possibility that, while the rentals might not be due for some time, an event might occur indicating such a drastic deterioration in the credit of the lessee that the lessor would feel that he would have to be free to take the necessary action. Given the commercial expertise of both parties to a commercial lease, he accordingly favoured leaving this matter to the parties.

211.- The President of UNIDROIT wondered whether restrictions should be envisaged as regards the lessor's right to repossess where the leased equipment has been expressly manufactured for a highly specialised business, perhaps covered by a patent, carried on by the lessee and where the leasing out of such equipment to another lessee would seriously prejudice the economic interests of the original lessee. Mr. Boy thought that there was not much likelihood of this sort of unfair competition problem arising in the context of a lease as lessors, he explained, made a practice of only repossessing the standard type of equipment, added to which they would only usually lease non-standard equipment to lessees of a particularly high standing. He pointed out that where, on the other hand, notwithstanding his breach of the lease, the lessee for one reason or another was able to go on enjoying the use of the leased equipment, without, by reason of the breach, paying any rentals, the solution adopted by the Court of Appeals of Paris was to allow the lessor compensation for the lessee's user, ("indemnité de jouissance"). He did not think the Chairman's proposal, for making the lessor's declaration of the termination of the lease dependent on his first having sent the lessee a letter reminding him to bring
his rentals up to date, would be acceptable in France where, as almost all leases made it a breach of contract entailing the termination of the lease for the lessee to fail to pay his rental on the date on which it fell due under the terms of the contract, the mere fact of the rental's falling due would constitute sufficient formal notice to the lessee without the lessor having in addition to send him a letter. The reasoning underlying this rule was to strengthen the lessor's hand in the negotiations subsequent to such default, particularly as regards the lessee's trustee in bankruptcy who, by virtue of a rule of French public policy, was entitled to elect to carry on performance of the lessee's subsisting contractual obligations by signifying his willingness to meet the payments entailed thereunder.

212.- The Chairman brought discussion on this question to a close by noting that there did not seem to be any need to provide a special rule thereon in the proposed uniform rules.

(xvi) What provisions should be drafted regarding the lessor's reservation of title against third parties, including the general body of creditors upon insolvency of the lessee (see also question (vii) above)?

213.- Referring to the discussion on Question (vii), the Chairman reminded the Group of its decision to prepare a rule providing for some form of public notice to protect the lessor's title as against third parties, with the possibility of the detailed application of such a rule being left to the individual national legal systems. He put forward the idea that perhaps the rule to be drafted should only apply to the extent that the country concerned did not already have legislation of its own providing a system of public notice that would protect the lessor's title in such circumstances.

214.- Mr. Goode held the view that this point was part of the wider question of non-possessory security over moveables, although such the advocating of a solution to it in the specific context of leasing could serve a useful function in generating impetus for a general system of public notice of non-possessory security interests.

215.- Mr. Gavarda attached great importance to the proposed rules providing for a system of public notice, above all in the context of international leasing, where, he explained, there was enormous potential for development in the coming years, particularly in trade with third world countries, and where the availability of credit insurance did not alter the fact that very great difficulties lay in the path of obtaining banking information as regards
the credit of would-be lessees in certain countries. He accordingly stressed
the moral significance of a system of public notice in this context. He did
not feel that any one system of public notice could be imposed on all countries
but was rather in favour of the proposed rules proclaiming the principle of
the need to provide for public notice in respect of leasing operations, while
leaving each country to organise its own equivalence of such a public notice
requirement.

216.- Mr. van Hoogstraten felt that such a rule should make it clear
that, in an international leasing operation, the leased asset should, in view
of the problems that a person dealing with a lessee in an international context
would otherwise have in knowing in which country to start looking for the lessor,
be registered in the country where it was physically located.

217.- Regarding the proposal made by the Chairman, Mr. Bey remarked that
its implementation could raise problems in so far as the fact that a particular
country at present had no organised public notice system would seem to indicate
that it would by the same token lack the requisite infrastructure to accommo-
date the new system being put forward by the Chairman. As regards the proposal
of Mr. van Hoogstraten, he warned against exaggerating the importance of inter-
national leasing at the present time. While he recognised that both the sums
and legal problems involved in such operations were very considerable indeed,
he pointed out that what he termed "pure" international leasing operations were
not as yet mounted all that frequently and that this trend was likely to con-
tinue with the gradual reduction of the fiscal incentives favouring the mount-
ing of such operations. For his part he fully endorsed Mr. Gaivala's proposal
for a provision establishing the obligation to set up a public notice system at
the national level, based on the principle that title to the leased asset remains
vested throughout the contract in the lessor and with the detailed implementation
of such a system being left up to the individual countries concerned. The objec-
tive of such a system would be to inform third parties of the true position of
the firm using the leased asset.

218.- The Chairman, in the light of Mr. Bey's remarks, pointed out that
a public notice system was not a means of informing third parties but rather
created a presumption that third parties had been informed.

219.- Mr. Coogan saw great potential in the present context in the French
system of making notations on the parties' accounting statements, which, he poin-
ted out, was an idea that had hitherto been only explored in the United States.
220. - Mr. Cavelo, referring to what had already been said on the point raised by Mr. Coopen in respect of Question (vii), pointed out that French law provided for two types of public notice built into the parties' accounting statements, one incumbent on the lessor and the other on the lessee. That incumbent on the lessor entailed that there should be a reference in his balance-sheet to assets leased out by him as lessor, while that incumbent on the lessee meant that, on request from a party proposing to do business with him, the lessee had a duty to let such person see his balance-sheet, in the general working expenditure account of which he would find a reference to any charges or rentals arising under equipment or real estate leasing transactions. The interest of this duty incumbent on the lessee lay in the opportunity it afforded his prospective business partners to go behind the apparent ownership of assets in his possession and thus obtain a better picture of his real financial situation: such a look at the lessee's balance-sheet would automatically reveal any lease obligations, whereupon the onus would be on the party proposing to deal with the lessee to inquire further, in particular as regards the name of the company from which the asset or assets in question had been leased. This would then enable him to check out at the registry of the relevant court of commerce the precise nature of these leasing commitments, in particular the size of the rentals.

221. - Mr. Goode indicated that, while he found the balance-sheet method very useful in so far as it gave a general picture of a company's financial position, he did not feel that it could by itself satisfy the public notice requirement for a specific article in which a third party proposed acquiring an interest, because of the considerable time-lags between one balance-sheet and another. He accordingly believed that some other form of public notice had to be sought for this latter case. The Group's proposal, for leaving this matter to be dealt with essentially at the national level, did not strike him as serving any useful purpose, in that so many countries still lacked a system for giving public notice of retention of title. He accordingly felt that it would be highly desirable for the Group to set in motion some pressure towards a system of registration, for while such systems of public notice as the simple affixing of a plaque might be adequate in protecting the rights of a third party who was to take physical possession of the particular asset, this was no longer the case in the modern commercial world where parties wished to take security over assets which they had no facilities to inspect.
222.- Mr. Coogan pointed out that in the period prior to the adoption of the Uniform Commercial Code the United States had a variegated assortment of public notice systems. Some States followed the English rule that where title was retained, as against a security interest where title was already vested in the debtor and was then transferred to the secured party, no form of public notice was required. There was considerable resistance to publicising the assignment of accounts receivable in the early days of its popularity as a means of financing. In fact the situation just before the Uniform Commercial Code became effective was that about one-half of the States upheld such an assignment at the time it was made without any requirement for public notice, while the other half held that it was not enforceable against third parties unless it had been registered. One of the difficulties was that under the old system the amount of detail required was very cumbersome, which aroused legitimate objections among the business community. The compromise achieved in the Code was not to make it necessary to give all the details, but simply to give notice to the interested person that there was a security interest in a certain type of equipment, so that if his interest was in that particular kind of equipment the onus was then on him to find out the details of such a security interest from either the debtor or the secured party. This style of system, which granted security for up to five years in respect of a wide range of transactions, greatly reduced opposition to the whole concept of requiring some form of public notice. He thought that its basic simplicity could prove attractive to nations currently without any system of public notice, whilst at the same time leaving them free to go further if they should so wish. It might be helpful to give adopting nations an outline of the mechanisms that might be employed in this respect and he pointed out the advantages as regards the establishment of priorities of notice being given before the transaction was completed.

223.- Mr. Gavalda pointed out that, prior to the passing of the law of 1972 making the registration of "crédit-bail" operations compulsory, the system of notice used in France had been that of affixing a plaque to the asset leased. This system, which, he pointed out, was still used for instance in Belgium, was liable however to produce unpleasant surprises. The system put forward by Mr. Coogan, on the other hand, seemed in its flexibility perfectly compatible with the spirit of the public notice system now in force in France, and would, he was sure, serve as a very useful model to be offered to States.

224.- Mr. Bey stressed his absolute opposition to the idea of employing the system of ownership plaques, because of the possibility this gave a dishonest lessee to remove or hide the evidence of his non-ownership and above all, to the extent that the sanction for failure to affix such a plaque to
one's property would be the forfeiture of one's title thereto, because of
the effect that such a dishonest act by the lessor would have on the estate
of the lessee. He felt that the only viable system of public notice was
one where protection of the lessor's title was made dependent on his complying
with a formal requirement to be carried out under the auspices of an authority
external to the parties, in other words by means of a system of registration.

(xvii) Should any provisions be drafted regarding whether or not leased
movables remain personality regardless of their being affixed to reality sub-
sequent to the conclusion of the leasing contract?

225.- Mr. Coogan felt that any attempt to treat of relations between the
law of personal property and the law of real property at the international
level would, in view of the wide divergences between one country and another
on this issue, prove to be almost insurmountable. He pointed out that such an
attempt had, at the purely federal level, been made in the Uniform Commercial
Code but that a number of States had simply refused to adopt the provision
in question, on the ground that it toyed with their own law of real property.
He instanced the endless difficulties implicit in merely attempting to produce
a unitary definition of what different legal systems understood by the terms
"personal property" and "real property". He suggested that such a quest was
better left to the realm of metaphysics, citing a Massachusetts case where two
refrigerators were installed in the walls of different apartments in the same
building, each refrigerator being installed by the same company and each being
financed by the same company: in each case the debtor defaulted on his payments
and in each case the financier sought repossession. In the first case, he
explained, the jury found that the refrigerator was personal property and as
such could be repossessed, whereas in the second case the jury found that the
refrigerator had been affixed with the intention of turning it into real
property. Both cases went before the Massachusetts Supreme Judicial Court which
affirmed both, on the basis that they were both questions of fact and that on
such questions it could not reverse the jury's findings. He accordingly pro-
posed that a solution to the present question should only be sought on a
country-by-country basis.

226.- While the Chairman favoured leaving this matter out of the proposed
rules, the President of UNIDROIT felt that, given the quantity of leased assets
acquired specifically for use in factories and thus destined to be affixed to
realty, it was a question to which an answer had to be found in the interest
of protecting the lessor's title.
227.- After the Chairman had expressed the view that once the leased assets were severed from whatever reality they had been affixed to they became personality once more, Mr. Goode, indicating that he too thought that this question would be very hard to solve, suggested that perhaps the most the Group could usefully do would be to provide a right for the lessor to enter upon his lessee's premises under certain conditions for the purpose of severing the leased asset from the reality to which it had become affixed in order to facilitate its right of repossession.

228.- The Chairman found Mr. Goode's proposal particularly attractive, as he doubted the efficacy of any attempt in an international convention to define what was to be regarded as personality and what was to be regarded as reality: this, he felt, was a matter which could not be taken out of the competence of the individual national legal systems.

229.- Mr. van Hoogstraten, referring to the point raised by the President of UNIDROIT, felt that the only means of dealing with the case of leased equipment obtained specifically with a view to a user implying its incorporation in reality was to lay down a rule modifying the principle whereby under many legal systems such equipment would automatically be regarded as reality. He did not think that the rule proposed by Mr. Goode offered the lessor much protection on this particular score.

230.- Mr. Goode explained that, whilst it might at first sight seem quite reasonable that the lessor should be entitled to enter upon the land of even a third party for the purpose of removing his equipment provided that he pays for any damage caused by the removal of such equipment, to the extent, that is, that the conferment of such a right seeks to prevent the landowner's unjust enrichment through the addition of a chattel belonging to someone else, the issue was by no means so clear where a third party has been led to extend credit and to advance money to the landowner in the belief that the chattel affixed to the land was the landowner's own property. The Americans sought to deal with this problem by allowing registration of the security interest in the chattel to be made in the relevant land registry. This, he pointed out, worked perfectly well in cases where it was known where the chattel was to be affixed, which was, he suspected, the case with most leasing operations, although an insuperable problem could arise where the chattel was removed from its original location and installed elsewhere. He accordingly suggested that it might in the context of the proposed rules be found useful to provide that the lessor could protect his rights of ownership by registering in the land registry competent in respect of the land or building in which the chattel was to be affixed.
231.- After Mr. Gavalda had expressed his feeling that, with the over-increasing frequency with which leased equipment tended to be incorporated in reality, this was a vital question which could not simply be passed over in silence in the proposed rules, the Chairman noted by way of conclusion that, while he found Mr. Goode's last proposal most attractive, its embodiment in the proposed rules might raise serious difficulties for the acceptability of the latter, in view of the probably significant amendments that would be entailed to most countries' land registration rules. He nevertheless did not wish his misgivings on this particular score to affect the Group's manifest desire to draft a tentative provision on what was indisputably a most important point, leaving a decision regarding the feasibility of such a provision to be taken in the future.

(xviii) Should any provisions be drafted regarding whether or not encumbrances may be created over leased goods?

232.- Mr. Gavalda thought that the question of whether encumbrances such as liens should or should not be permitted over leased moveables was a matter that was probably best left to national law.

233.- Mr. Boy felt that the fundamental point to bear in mind in respect of this question was that the lessor, as owner of the leased asset, should be entitled to make such use of his property as he saw fit, so long as such user did not inflict loss on the lessee. This meant for example that where in order to raise finance for his company the lessor feels obliged to create a security over the leased asset, this must not inflict such economic loss on the lessee as would be occasioned by the secured creditor as a result seeking to exercise a right to distrain on the leased asset. The question raised was accordingly one of whether or not the particular context of leasing required some restriction to be set on the prerogatives normally attached to the right of ownership.

234.- Mr. Goode, explaining that there were many situations in which the lessor might wish to be able to charge the leased asset as an ancillary to charging the underlying receivables - for example, in order to mortgage his rentals, he might wish to give title to the underlying asset, so as to ensure that the mortgagee would be in the same position as regards enforcing the rentals as he himself would have been in - pointed out that no problems however arose on this score in English law, where it was quite clear that, while the lessor was always entitled to sell or charge the leased asset,
the purchaser or chargee would equally always take subject to the rights of the lessee in possession of the asset under the terms of a lease. Whilst admitting that there might, to the extent that as much was not clear in other countries, be a case for stating such a principle in the proposed rules, he did not himself feel that it was a question which it was necessary for the Group to tackle. Neither did he see any need to tackle the question of whether or not the lessee should be entitled to create encumbrances over the leased asset, as it was perfectly clear that the lessee was not entitled to create an encumbrance over an asset belonging to someone else. As regards Mr. Goode's last point, Mr. Coogan pointed out that there was however no reason why the lessee should not be entitled to create an encumbrance over his own interest, although he suspected that the point was largely academic.

235.- Mr. van Hoogstraten wondered whether it might not be necessary for the Group to tackle the problem of charges created not so much by the act of the parties but rather by the operation of law, for example fiscal charges arising out of fiscal debts owed either by the lessee or by the lessor, in view of the adverse effect that such debts could obviously have on the rights of the other party to the lease.

236.- Mr. Gavalda replied that the question raised by the previous speaker was rather academic in so far as lessors were obliged, as in France, to have the status of a bank or of a financial institution, as the number of cases of bankruptcy affecting banks or financial institutions was rare indeed. The question only really arose in his view in those countries where lessors were not subject to the rigorous requirements governing the conferment of the status of bank or financial institution.

237.- The Chairman concluded that this was a question which, to the extent that the creation of encumbrances did not adversely affect the performance of the lease as between lessor and lessee, did not need to be covered in the proposed rules.

(xix) Should any provisions be drafted regarding the assignment of leasing contracts?

238.- After Mr. Coogan had explained that the lessor very commonly assigned his interest as a means of secondary financing and Mr. Goode had suggested that the lessee’s interest should be capable of being assigned unless, as happened in most cases, the contract prohibited such assignment, the Chairman concluded that the Group was agreed that this was a matter best left to the contractual freedom of the parties.
Are there any other aspects of leasing contracts which merit the drafting of uniform rules?

239. - No comments were proffered regarding this question.

Which form of unification is to be preferred for the leasing contract: an international convention incorporating uniform rules or a model law?

240. - The Chairman felt that this was a matter which could only be decided at such time as the Group had before it the text of a tentative draft on the subject. Only at such a moment, he explained, would it be possible for the Group to take a decision regarding which points it felt stood a chance of being adopted on a sufficiently wide scale to merit incorporation in a convention to be submitted to a diplomatic Conference of adoption and which, on the other hand, it would be better to make the subject-matter of a model law.

241. - Mr. Gevalda wondered whether, to the extent that a total unification of the legal aspects of international leasing should prove to be impossible, it was intended to draft conflicts of law rules. He suggested that the expedient adopted as regards the unification of the law regarding bills of exchange, namely the partial unification of the substantive rules being complemented by conflicts of law rules on certain reserved aspects, could perhaps usefully be employed again in respect of leasing.

242. - Mr. van Hoogstraten explained that it had in fact been proposed that the Hague Conference on Private International Law should prepare conflicts rules on the subject of leasing but that it had been decided that the Conference should first see the substantive rules which it was the intention of UNIDROIT to prepare before embarking on conflicts rules, particularly, he added, with a view to obtaining a clearer picture of what exactly was involved in the leasing operation.

243. - In addition to the list of questions submitted by the Secretariat of UNIDROIT, the Group was also seized of the trilingual text (in English, French and German) of a definition of equipment leasing prepared by the European Federation of Equipment Leasing Company Associations (Leaseurope). The English
text of this definition reads as follows:

DEFINITION OF EQUIPMENT LEASING PREPARED BY LEASEEUROPE (EUROPEAN FEDERATION OF EQUIPMENT LEASING COMPANY ASSOCIATIONS)

1. Financial leasing transactions are contracts for the hire of plant, capital goods and equipment for professional use, which have been bought with this specific transaction in mind by companies which retain ownership of the assets. This means that:

- the choice of the equipment and supplier lies with the lessee;
- the latter should use the leased assets for professional purposes;
- the equipment should be purchased by the leasing company;
- the lessor is and remains owner of the equipment throughout the contract;
- the lessor should enter the equipment as an asset in his balance sheet and proceed with amortization;
- the risks pertaining to the equipment and its use are normally borne by the lessee.

2. Such contracts are concluded for a term which takes the period of depreciation of the leased assets into consideration.

3. Various options can be offered at the end of the contract.

4. Any tax or other regulations or legislation applied to leasing should not put it at a disadvantage.

244.- A preliminary point raised in the context of the Group's discussion of this definition concerned the purpose which the proposed draft was intended to serve. Noting that the Group seemed, by its apparent exclusion from the scope of its work of both the short-term lease concluded for periods of up to one year and the operating type of lease offering the lessee inter alia the opportunity of replacing the equipment supplied under his lease with a newer

(1) For the French and German texts the reader is referred to the Annexes to the present report.
model, to have decided to concentrate its attention on the medium - to long -
term type of lease in which the primary consideration for the lessor was to
obtain a full return on his capital investment. Mr. Coogan wondered what re-
main ing advantages this form of finance would in future present over the out-
right sale and purchase or more standard forms of finance, such as the pur chase
money security interest, now that the off - the - balance sheet treatment of such
leases seemed in the light of F.A.S.B. 13 to be doomed, he imagined, to extinc-
tion in most countries. He suggested that there might be some countries where
there were no adequate means of obtaining new equipment through the more stan-
dard forms of finance and to this extent the exercise proposed by the Group could
perhaps serve a useful purpose. He feared nevertheless lest the real advantage
of obtaining the use of equipment through a medium - to long - term lease might
not be regarded as the fiscal advantages it conferred on both parties.

245.- Mr. Gavalda felt that the essential purpose served by leasing of
the type envisaged by the Group was to give a new means of acquiring economic
ownership without legal ownership. He recognised that the role played by fiscal
considerations was very important but pointed out that these were linked neces-
sarily to the short-term economic and political considerations of each country
determining the degree of favour or disfavour with which leasing was regarded
in such country. The fiscal aspects of leasing whether at the national or the
international level would, in his view, have to be regulated separately from
the private law aspects of the subject. He saw it as the task of the Group to
confer a legal status on leasing that had the merit of simplicity.

246.- While recognising that leasing prospered notwithstanding its
widespread lack of a legal framework, Mr. Goode felt that the Group's task
could be seen as responding to the great need to define the relationships
making up and the rights and duties arising out of a leasing operation, as
well as perhaps to give certain exemptions from the responsibilities that
would flow from classifying leasing as a traditional form of bailment.

247.- As regards the introductory sentence of paragraph 1, one of the
main defects which the Group found in the text of the Leasurope definition
concerned inadequacies and inaccuracies in the terminology employed there.
Particular opposition was expressed to the idea of using terminology drawn from
the language of the classical contractual schemata, given the danger of the
Group thereby locking itself into the concepts typically associated with these
schemata. Use of the term "hire" was thus found inappropriate in so far as
it would lead national courts to regard financial leasing merely as a species
of hire contract and to apply their national rules governing hire contracts
in respect of any lacunae left by the uniform rules, whereas the Group had
agreed that it was vital above all to affirm in the proposed rules the sui generis
nature of financial leasing. Moreover, it would not be possible to draw all
the consequences set out in the six sub-paragraphs of paragraph 1 from a
simple hire contract. It was agreed that a more neutral term was required,
even at the risk of turning what was originally intended as a definition into
something more in the nature of a description. Various substitutes were put
Forward for the term "hire". The main French proposals were for "concession d'usage" and "mise à disposition" whilst in English the terms "supply" and "provision" were advanced. Doubts were expressed as to the appositeness of "mise à disposition", implying as it did that the lessee would have the right to dispose of the leased asset entirely as he saw fit and given its conceptual inconsistency with the "obligation de retraitement du bien" (duty to collect the goods) incumbent on either the lessor or lessee under French law. The drawbacks of a term like "mise à disposition" highlighted still further the undesirability of defining financial leasing by reference to a concept that already bore certain well-defined legal connotations under national law. As regards the term "supply", it was pointed out that, to the extent that it might prove desirable to insert a reference to the supplier in the definition (v. infra, § 252), it might cause confusion to talk in the same sentence about "the supply of plant ..." between lessor and lessee in respect of an item "bought from a supplier". The term "concession d'usage" had the merit, on the other hand, of encompassing hire contracts and was felt by the Group to offer a sufficiently neutral formula to be acceptable to both Civil and Common law systems.

The terms "lessor" and "lessee" could however no longer stand in the light of this alteration in the nomenclature of the contract between those two parties: the Group felt that the terms most appropriate for replacing them and at the same time bringing out the nature of the respective roles of the two parties involved were the terms "financier" and "user" respectively.

248.- The Group felt that the plurality of contracts and parties involved in financial leasing, the fact that not just one contractual relationship but rather a series of contractual relationships was set in motion by the complex operation known as financial leasing made it inaccurate for the English text of the Leasingopinion definition to refer to financial leasing transactions as mere "contracts"; in support of this thesis it pointed to the use of the terms "opérations" and "Geschäfte" in the French and German texts of the same definition. It accordingly decided to reword the opening phrase of the definition as: "Financial leasing is a transaction ....", notwithstanding the expression of certain reservations regarding the legal credentials of the term "transaction" as the basis of a legal definition (it was in this regard pointed out that the term "opération" - transaction - was used by no less an authority than Dean Ripert for the classification of banking contracts).

249.- It was at the same time recognised that the term "transaction", by itself somewhat vague, required qualification in order the more fully to bring out the sui generis nature of financial leasing. One proposal, for describing financial leasing as a financial transaction, was rejected, first, on the ground that, while the financial nature of the transaction was sometimes most important, on other occasions it was practically of no importance whatsoever and, secondly, for the reason that, whereas financial leasing served undoubtedly financial purposes in respect of the relations between lessor and lessee, the same was not true as regards relations between supplier and lessor and between supplier and lessee.
250.- The plurality of contracts making up a financial leasing transaction and the complex series of legal relationships which it set in train were nevertheless regarded as being so bound up with its *sui generis* classification as to merit its being defined as a "complex" transaction.

251.- Moreover, the participation in the transaction of three, and not just two parties was felt to be so integral an element of this *sui generis* classification that it was desirable that the type of leasing which the Group had in mind should also be defined by reference to its triangular nature.

252.- It was felt that the Leaseurope definition failed adequately to bring out the active role played in financial leasing by the supplier. It was explained that it was not uncommon for the conclusion of a lease to have its origins in the seeking out by the supplier of a prospective user for his product. While certain members of the Group considered that a reference to the supplier's role was implicit in the phrase "which have been bought with this specific transaction in mind", it was nevertheless recognised as being desirable that the supplier should be expressly referred to in the definition, given that not only would his name have to appear later in the draft but also given his part in an operation that was to a very considerable extent regarded as *sui generis* because of its triangular character. The solution proposed was that the phrase "from a supplier" should be inserted after the word "bought". This proposal was found to be acceptable by the Group.

253.- One member of the Group felt that the definition should also provide a positive solution to the problem of the supplier's relationship with the lessee. He explained that one of the special characteristics of the *sui generis* type of leasing was, given the purely financial nature of the role played by the buyer/lessor, the fact that the business negotiations regarding the item to be supplied were handled directly between supplier and lessee, with the responsibility for the giving of specifications in respect of the equipment to be supplied falling on the latter. Neither the Common law nor the Civil law however recognised that this created any contractual nexus between supplier and lessee, which raised fundamental problems in respect of the basis on which the lessee could sue the supplier in the event of the item supplied proving to be defective or inappropriate for the purpose for which it was intended by the lessee. The only means whereby a claim sounding in contract could at present be brought by the lessee against the supplier would be by virtue of a term in the sale contract between supplier and lessor providing for the transfer to the lessee of the buyer's rights of action under the sale contract against the seller. He indicated that he felt that it was most important rather to build such a legal relationship between supplier and lessee unequivocally into the definition and accordingly proposed that the latter should be amended to read:
Financial leasing is a triangular operation whereby goods, which must be professional equipment, are bought from a supplier, being chosen by the user, by a financier who grants the use of the goods to the user to whom he transfers all the rights and claims deriving from the contract of sale" (emphasis added). He recognised that this would still leave difficulties in respect of the enforceability of any undertakings given by the supplier to the lessee during the period preceding the intervention of the lessor, at a time, that is, when there could be no question of the lessee yet having the lessor's authority to act as his agent in dealing with the supplier, but he suggested that the problems raised by that particular point were perhaps too complex to be tackled here.

254.- One member of the Group was not entirely convinced of the absence of a legal tie binding the supplier and the lessee. In support of the thesis that the latter acts as agent of the lessor in dealing with the supplier he cited the description of financial leasing used by Professor Ole Lando of Copenhagen in the International Encyclopedia of Comparative Law (Volume III, Chapter 24, § 258):

"Financial leasing involves three parties, a seller, a financier (the lessor) and a lessee. Authorised by a financier a person who needs equipment for his enterprise orders it from the seller. The lessor buys it and leases it to the person who needs it (the lessee)."

255.- It was explained that there was however no set pattern in financial leasing as to whether the lessee approached first a financier and then a supplier or vice-versa: the question of finance was sometimes settled prior to the selection of the equipment, sometimes afterwards. The important factor was that the lessor concluded the sale contract only on the basis of a signed contract between himself and his future lessee. The latter might in some cases even have originally contracted to purchase the goods himself from the supplier and then changed his mind, the original sale contract simply being rescinded and replaced by one between the original supplier and a financier, with the original buyer becoming the lessee of the latter. Whilst it was accordingly true that in some cases the lessee might be given authority by a financier to buy goods on his behalf, this was not of sufficiently general application as a rule that a legal tie between lessee and supplier could be deduced therefrom.

256.- The Group moreover felt that the question of the lessee's entitlement to invoke against the supplier the lessor's rights of action under the sale contract was not an essential ingredient of the definition of financial leasing but was rather bound up with the legal consequences of that operation and as such should be dealt with later in the proposed rules. It was pointed
out that the embodiment of such a principle in the definition would very considerably narrow the scope of application of the proposed rules, in that many lessors would undoubtedly continue to prefer the greater operational flexibility assured by leaving the question of whether to keep all or some of their rights of action vis-à-vis the supplier to be decided in accordance with the particular requirements of the individual operation.

257.- The importance in the sui generis type of leasing envisaged by the Group of the fact that it is on the specifications of the lessee that the lessor purchases the item to be leased from the supplier was felt on the other hand to be such as to make it desirable that it should feature as part of the definition.

258.- Objections were raised to the phrase "which retain ownership of the assets" at the end of the introductory sentence of the first paragraph of the Leasewear definition, first to the extent that this might seem to imply the existence of an underlying sale contract between lessor and lessee and secondly on the ground that it was a pleonasm in view of the rest of the definition set out in paragraph 1, and in particular sub-paragraph 4 of paragraph 1. It was explained that the origins of this phrase were perhaps to be sought in the identical phrase to be found in the French legislation on "crédit-bail" on which the opening paragraph of the Leasewear definition seemed to be somewhat loosely based. This phrase had been added to the text of the original draft definition of "crédit-bail" as put forward in France, in response to the lobbying of lessors worried lest their title should be imperilled by the claims of their lessees' trustees in bankruptcy. It was argued moreover that the inclusion of such a phrase in the opening definition, regardless of the inherent pleonasm, could still serve a useful purpose in aiding understanding of the complexities of leasing in countries where it was less well entrenched than in France. It was however ultimately decided to delete it from the opening paragraph of the definition, given that it in no way added to what was clearly stated in sub-paragraph 4 of paragraph 1.

259.- As regards the phrase linking paragraph 1 to the six sub-paragraphs of that same paragraph, it was pointed out that as it stood it might seem to imply that all the principles set out in the sub-paragraphs followed necessarily from the opening sentence of paragraph 1, whereas it was felt that it would be more appropriate to regard them rather as particular characteristics of the transaction defined in the opening sentence. It was accordingly proposed to amend the relevant phrase to read:

"This transaction presents the following particular characteristics".
260.-- The Group accepted the principle set out in the first sub-paragraph of paragraph 1 of the Lessseurope definition without amendment.

261.-- As regards the second sub-paragraph of paragraph 1, intended to exclude consumer leasing from the scope of the definition, it was pointed out that, whereas the single word "professionnelles" was sufficient for this purpose in the French text, in English it would be preferable to specify "business or professional purposes", rather than just "professional purposes".

262.-- As regards the third sub-paragraph of paragraph 1, in the light of the Group's discussion of the sequence generally followed in leasing transactions and in particular the fact that the lessor will only conclude a sale contract on the basis of a signed contract between the prospective lessee and himself (v. § 255 supra), it was proposed specifying that it is on the basis of the contract between lessor and lessee providing for the latter's use of the equipment that the same is purchased. This, it was added, would further pinpoint the triangular nature of the transaction. Since, however, it was pointed out that in most cases such a contract would probably not yet have come into existence at the time of the purchase of the equipment, it was proposed that the original proposal for the amendment of this sub-paragraph be modified to take in the case of contracts for the use of equipment projected between lessor and lessee.

263.-- Various amendments were put forward in respect of the fourth sub-paragraph of paragraph 1. First, given the plurality of contracts making up the financial leasing transaction, it was felt desirable to specify that the term "contract" mentioned in this sub-paragraph refers to the contract between lessor and lessee. Secondly, in support of the deletion of the phrase "throughout the contract", it was pointed out that it could in its ambiguity lend itself to the a contrario argument that on the expiry of the contract between lessor and lessee title would pass to the lessee. Fear was on the other hand expressed lest the French and those countries whose legislation on leasing was modelled on that of the French might see the deletion of this phrase as destroying any possibility of the lessee ever becoming owner of the leased asset. Another objection raised in respect of this phrase concerned its apparent inconsistency with the possibility that existed under the law of certain countries, such as France, for the contract between lessor and lessee to be terminated in advance of its contractual expiry date, simply by the lessee's raising the option to purchase granted him under his contract. All legal systems moreover recognised the possibility for the lessor to elect to go on being owner of the leased asset after the expiry of his contract with the lessee. It was accordingly decided to delete the phrase "throughout the contract". It was felt that it should be perfectly clear from the principle as thus shown that the lessor's title to the equipment subsisted throughout such time as he
actually remained lessor of the equipment. Three minor amendments introduced concerned, first, the deletion of the phrase "and remains", regarded as being superfluous, secondly, the addition of the phrase "du bien" in the French text to align it with the corresponding part of the English text, and, thirdly, the addition of the adjective "concédé" (provided for use) after the said phrase "du bien", emphasising the fact that the protection afforded the lessor's title by this sub-paragraph is designed to cover the period of time during which the lessee has the use of the equipment under the terms of his contract with the lessor.

264.- The fifth sub-paragraph of paragraph 1 was considered to state an accounting rule important for its fiscal consequences rather than a desirable element of a legal definition. As such, it was thought better for it to feature as a separate article of the proposed rules, if indeed it had any place in an instrument designed to regulate the private law aspects of leasing. It was pointed out that it was generally the responsibility of the public authorities of each State to determine the fiscal and accounting regime applicable to a given legal situation. Moreover, the courts in France at least had recently demonstrated that they would not treat the fiscal and accounting characteristics of a given transaction as decisive pointers to that transaction's qualifying or not as "crédit-bail": while they would of course be interested in those aspects as factors aiding their assessment of the transaction, for the purpose of its legal qualification as "crédit-bail" they would look essentially at its legal features. In one recent French case, for example, the fact that the duration of the lease corresponded to the length of the economic amortisation of the goods in question was accorded no weight in the court's decision whether or not to recognise the transaction as "crédit-bail"; a recent Belgian appellate decision, on the other hand, laid down the reverse principle, that a leasing contract "is distinguished by the fact that the duration of the contract corresponds to the length of the economic amortisation of the goods".

265.- The use of the word "should" in the English text and of the word "doit" in the French text of the Leaseurope definition was in any event felt to be inappropriate, in that it implied a duty whereas the intention was only to set forth one of the particular characteristics of the transaction described in the opening sentence of the definition. It was explained that this resulted from an error in translating the word "muss" in the German text, which could be rectified by deleting the words "should" and "doit" from the English and French texts respectively and by altering the words "enter" and "proceed" in the English text to "enters" and "proceeds" respectively and by altering the words "comptabiliser" and "procéder" in the French text so as to make them read "comptabilise" and "procède".
266. - The point was also made that the fifth sub-paragraph only dealt with the fiscal and accounting consequences of leasing transactions as these affected the lessor, and that if it was the intention to treat of the fiscal and accounting aspects of leasing at all in the proposed rules, then it would be desirable to deal with them in as comprehensive and coherent a manner as possible. This would for instance mean giving equal consideration to the important fiscal and accounting consequences which a leasing transaction had on the lessee, notably his being able to treat his rentals as overhead expenses.

267. - To tackle the complex question of depreciation was moreover seen as risking the paralysis of the Group's whole work at some later stage. Reference was in particular made to the codes which existed in certain countries for the fixing of different periods of amortisation for different kinds of asset. It was on the other hand pointed out that, while the individual amortisation rules of a particular State clearly fell well outside the purview of the Group's inquiry, it might be necessary at some future stage for the purpose of defining financial leasing by comparison with other forms of commercial leasing to take account of the fact that in financial leasing the intention of the parties was to structure the rentals to be paid by the lessee in such a way as to amortise the capital cost of the leased asset, rather than to represent its use-value.

268. - The sixth sub-paragraph of paragraph 1 of the Leaseurope definition was considered to state a normal legal consequence of financial leasing rather than an essential ingredient of the definition of such a transaction. This did not alter the fact that the principle which it enshrined could from a certain angle be regarded as bringing out one of the features which most strongly distinguished the sui generis character of financial leasing as compared with the more classical contractual models on which it was based and to which it had hitherto been assimilated to a greater or lesser degree, namely the extreme bareness of the lessor's ownership and, as a corollary, the unusual extent to which so many of the attributes of ownership were exercised by the lessee. It was pointed out in this respect that a Swiss court had recently for the first time expressly recognised that the risks in a financial lease should be borne by the lessee as a result of the sui generis character of the transaction and in particular the fact that the lessee, rather than the lessor/purchaser, selects the equipment to be used by him as well as the supplier.

269. - The embodiment of such a principle in the definition would, in the Group's view, be additionally undesirable in narrowing down unnecessarily the scope of application of the proposed rules, in particular given that one of the principal attractions of leasing was its flexibility and that accordingly many a lessor might well in certain circumstances wish to offer to bear some of the risks himself as a means of making his lease more attractive.
270. The Group accordingly felt that the principles set out in the sixth sub-paragraph of paragraph 1 should rather feature as a separate article in the proposed rules, although, in particular in the light of its comments as expressed in § 269, it suggested prefacing the principle as stated in the Leasurope text by the phrase "unless otherwise agreed", so as to safeguard the contractual freedom of the parties.

271. A discrepancy was found between the terminology used in the English and German texts of the Leasurope definition on the one hand and that used in the French text on the other: while the English text spoke of "use" and the German text of "Benutzung", the French text employed the term "détention" which, it was pointed out, encompassed risks quite different from those covered by the terms "use" and "Benutzung". Thus, just as the fact that a leased vehicle runs someone over would be regarded as a risk flowing from the "use" or "Benutzung" of that vehicle, the case of a leased container that explodes and causes damage to a third party for reasons totally beyond the control of the lessee/user, for instance because of a hidden defect in the container, would on the other hand be seen as a risk flowing from the "détention" (possession) of that container. There was a current of opinion within the Group that wondered whether, in the light of the fact that it was agreed that ownership of the leased asset should remain vested in the lessee, he should not accordingly also attract a continuing potential liability for damage resulting from a product liability situation, that is where the damage would probably have occurred quite independently of the lessee's use of the equipment. The feeling was however that to attempt to provide for a division of the risks would probably raise so many complex problems as to prove impossible.

272. Moreover, the practice in almost all countries, it was pointed out, was for the internal and external risks pertaining to equipment and its use to be regarded as the responsibility of the person legally having charge of that equipment, i.e. in the financial leasing context the lessee. Most of the problems arising in this connection were in any event usually covered by insurance while the insurance policy was sometimes taken out by the lessee himself, many leasing companies having employed a different technique whereby, while the policy was taken out by the lessee in his own name, the actual premiums on it were paid by the lessee. The operation thus remained financially neutral for the lessor.

273. One potential area of difficulty for United States law foreseen as a possible consequence of the embodiment in the proposed rules of the principle that the risks pertaining to leased equipment and its use should normally be borne by the lessee was seen as lying in the fact that, while such a rule was indeed a common feature of American leases too, United States revenue practice tended to the conclusion that a leased asset in respect of which too many of the risks of ownership had been transferred under the lease to the lessee could not really be regarded as belonging any longer to the lessor.
274.- Noting that the second and third paragraphs of the Leaseurope definition in fact followed on from the six sub-paragraphs of paragraph 1 in depicting further particular characteristics of financial leasing as described in the opening sentence of paragraph 1, the Group proposed that they should rather be treated as the seventh and eighth sub-paragraphs of paragraph 1.

275.- The first of these, namely the second paragraph of the Leaseurope definition, was considered by the Group to contain a sufficiently flexible formula to fit both the continental position where the term of the lease was generally calculated in such a way as, by means of the rentals to be paid by the lessee, to amortise the capital cost of the asset (v. § 264 supra) and that of the United States where the vigilance of the Internal Revenue Service made it necessary for a transaction which the parties wished to see upheld as a lease to be structured on the other hand in such a way that the entire capital cost of the asset would not be recovered during the term of the lease.

276.- As regards the third paragraph of the Leaseurope definition on the other hand, various proposals were put forward. One of these, inspired by the French legislation on "crédit-bail", for which the presence in the lease of an option to purchase was considered a *sine qua non* for its classification as a "crédit-bail" transaction, would have had the effect of making the inclusion of various options mandatory rather than a faculty as proposed in the Leaseurope definition. This, however, was rejected on the ground that many leases simply did not provide for any option at the term of the lease, the lessor just preferring to take back his asset. An alternative proposal put forward was for the paragraph to be reworded in such a way as to imply the existence of various options. This proposal, whereby the opening words of the Leaseurope text were replaced by the phrase "The parties may choose from among various options...", was accepted.

277.- The Group objected to the phrase "at the end of the contract" in the third paragraph of the Leaseurope definition to the extent that it did not accord with the practice in continental countries of granting lessees an option to purchase exercisable during the term of the lease. It accordingly proposed that the said phrase should be amended to read: "either during the course or at the end of the contract".

278.- The Group was unanimously of the opinion that the fourth paragraph of the Leaseurope definition did not belong to a legal definition of financial leasing. It was added that this did not mean that it might not find a place, as a simple exhortation, in an eventual international convention accompanying uniform rules on the subject.
279.- As regards the Leaseurope definition viewed in general, the Group emphasised that it might ultimately find it necessary, in the light of the solutions which it hoped to find to the particular problems raised by the sui generis form of leasing and of the continually shifting patterns discernible in the evolution of leasing, to cast the scope of its proposed rules in somewhat broader form than was at present represented by the Leaseurope definition.

280.- A revised text of the Leaseurope definition has been drawn up by the Secretariat of UNIDROIT in the light of the amendments proposed by the Group. This text is set out in Annex III to the present report.

281.- In conclusion the Chairman, thanking the Secretariat of UNIDROIT for the excellent manner in which it had prepared the work of the Group, requested it to prepare a tentative draft set of uniform rules, on the basis of the views which the Group had expressed on the different points raised in the list of questions prepared by the Secretariat, for submission to its next session. He further requested the Secretariat to ensure that a representative of a developing country be invited to take part in the Group's future work.
ANNEX I

DEFINITION DU CREDIT-BAIL MOBILIER ELABOREE PAR
LEASRUPE

(PERIFICATION EUROPEENNE DES ASSOCIATIONS DES ETABLISSEMENTS DE CREDIT-BAIL)

1. Les opérations de crédit-bail sont les opérations de location de biens
   d'équipement, de matériaux, d'outillage à usage professionnel spécialem-
   ent achetés en vue de cette location par des entreprises qui en demeu-
   rent propriétaires. Ce qui veut dire que :

   - le choix du bien et du fournisseur est effectué par le locataire;
   - ce dernier achète le bien loué à des fins professionnelles;
   - l'achat du bien incombe à la société de crédit-bail;
   - pendant la durée du contrat, le bailleur est et demeure propriétaire;
   - le bailleur doit comptabiliser dans son bilan la valeur d'achat des
     matériaux donnés en location et procéder à leur amortissement;
   - les risques inhérents au matériel et à sa détention sont normalement
     à la charge du locataire.

2. Ces contrats sont conclus pour une durée tenant compte de la durée d'amor-
   tissement du bien loué.

3. A la fin du contrat, diverses options peuvent être prévues.

4. Des dispositions fiscales, réglementaires ou législatives applicables au
   crédit-bail ne peuvent défavoriser l'opération.
DEFINITION DES LEASINGS, ERSTELLT VON DER
LEASEEUROPE

(EUROPÄISCHE VEREINIGUNG DER VERBÄNDE VON LEASING-GESELLSCHAFTEN)

   - dem Leasingnehmer die Auswahl des Objektes und des Lieferers obliegt;
   - der Leasingnehmer das Leasingobjekt zur gewerblichen Nutzung verwendet;
   - das Objekt durch den Leasinggeber erworben wird;
   - der Leasinggeber während der Vertragsdauer Eigentümer ist und bleibt;
   - der Leasinggeber die Leasingobjekte aktivieren und die Abschreibung hierauf vornehmen muss;
   - die Risiken, die mit dem Objekt und seiner Benutzung in Verbindung stehen, normalerweise vom Leasingnehmer getragen werden.

2. Die Dauer derartiger Verträge wird unter Berücksichtigung der Abschreibungsdauer festgelegt.

3. Am Ende der Vertragsdauer können verschiedene Optionen vorgesehen werden.

4. Steuer- und Gesetzesbestimmungen für das Leasing sollten die Transaktion nicht benachteiligen.
Revised text of the Leasopera definition of equipment leasing drawn up by the Secretariat of UNIDROIT in the light of the amendments put forward by the Study Group.

Financial leasing is a complex triangular transaction whereby a financer, on the specifications of the user, purchases from a supplier plant, capital goods or equipment the use of which he grants to the user. This transaction presents the following particular characteristics:

- the choice of the equipment and supplier lies with the user;
- the latter uses the equipment for business or professional purposes;
- the equipment is purchased by the financer on the basis of a contract providing for their use which has either been concluded or is projected between the financer and the user;
- the financer is owner of the equipment provided for use;
- the contract between the financer and the user is concluded for a term which takes the period of depreciation of the equipment into consider-
- ration;
- the parties may choose from among various options either during the course or at the end of the contract between the financer and the user.