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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

STUDY GROUP

ON THE

LEASING CONTRACT

REPORT

by the UNIDROIT Secretariat  
on the second session of the  
Group held in Rome on  
1 and 2 February 1979

Rome, August 1980



1.- The second session of the UNIDROIT Study Group for the preparation of uniform rules on the leasing contract met in Rome at the seat of UNIDROIT on 1 and 2 February 1979. Its composition was as follows:

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Mr Riccardo MONACO                      Secretary-General

Mr Malcolm EVANS                        Deputy Secretary-General

Mr Martin J. STANFORD                   Research Officer, Secretary to the Study Group

Ms Marie-Christine RAULT                Research Officer.

2.- The Study Group was seized of the following papers:

- (i) Draft Agenda of the session (Leasing Study Group - 2<sup>nd</sup> session / AG);
- (ii) 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 (Study LIX - Doc. 7, UNIDROIT 1978);
- (iii) Tentative draft uniform rules on the sui generis form of leasing transaction, drawn up by the UNIDROIT Secretariat, with the assistance of Professor László Réczei, Chairman of the Study Group on the Leasing contract, in the light of the discussions of the Study Group at its first session (Study LIX - Doc. 8, UNIDROIT 1979).

3.- After the President of UNIDROIT had declared the session opened and the Chairman had ascertained the Group's approval of the draft agenda proposed for the session by the UNIDROIT Secretariat, the Chairman went on to introduce the tentative draft uniform rules on the sui generis form of leasing transaction laid before the Study Group. He explained, first, that the authors of the draft had sought to avoid the pitfalls associated with definitions by

setting out instead to give a description of the sui generis transaction which the proposed uniform rules were designed to cover. He hoped that the description chosen would prove satisfactory to the different countries, in view of the considerable divergences between what was at present understood by financial leasing in one country and what was understood by it in another country.

He pointed out, secondly, that one of the basic difficulties faced in preparing this, as indeed any international uniform law text concerned which matters were suitable for treatment therein and which matters were best left to municipal law, above all in view of the desirability of achieving a text with as broad a chance of acceptance as possible. It was his opinion that this objective was best met by restricting the proposed text to a relatively small number of provisions, dealing only with the basic points, and this was indeed the technique which had been followed in the preparation of the tentative draft. For instance the proposed rules had not attempted to provide an exhaustive treatment of the mutual rights and obligations of the parties, as it had been judged wiser to leave this to the parties. Of particular importance, on the other hand, in the proposed text was the proposal for the mutual recognition of the validity of leasing transactions.

4.- The Chairman having invited comment on the tentative draft, the provisions of which were, he stressed, in no way to be regarded as exhaustive, the idea was mooted of prefacing the proposed text with a preamble stating that the leasing transaction covered by the rules was to be treated as a sui generis transaction and not, as had hitherto been the case, as two separate contracts, to wit a supply contract and a contract of bailment. This would advance the aim declared at the Group's first session of ensuring that the leasing transaction to be covered by the rules would be treated by the courts as something new and quite distinct and not as something which simply partook of the various characteristics traditionally assigned to it by the different legal systems. It was suggested as an alternative solution, in order to simplify drafting, that the words "sui generis" be worked into the opening words of the proposed Article 1 (the two formulae put forward were: "Financial leasing is a sui generis triangular transaction ..." and "Financial leasing is a sui generis contract containing or establishing a triangular transaction ..."). However, it was finally agreed that a preamble was the most appropriate solution, all the more so as it could also be used to specify that the proposed rules were not designed to deal with the revenue and accounting aspects of leasing but only with its private law aspects.

5.- As regards the opening chapeau of Article 1 of the tentative draft, it was felt that there was little point beginning the draft with a definition of the term "financial leasing" if, as was indeed the case, this term did not reappear in the draft. Rather was it necessary better to latch this definition onto the body of the proposed rules. It was thus proposed amending the opening words of Article 1 to read: "This Convention applies to financial leasing transactions, that is triangular transactions in which ...". However the objection was raised that use of the label "financial leasing" could prove a source of confusion in view of the many nuances which that term embraced. It was nevertheless recalled that it had been the Group's decision to deal specifically with that one kind of leasing transaction, the word "financial" thus having the merit, in conjunction with that sub-paragraph of the definition providing that the contract had to take the period of the depreciation of the equipment into consideration, of making that point quite clear.

6.- Whereas the everyday terminology employed in respect of the parties to leasing transactions was "manufacturer/producer", "lessor" and "lessee", the tentative draft had instead opted for a new terminology: "supplier", "financier" and "user", in line with the view expressed at the first session that, if the traditional appellations of hire contracts were preserved, this would lead courts to apply the general rules relating to hire contracts in every case where there was a lacuna in the uniform rules, whereas it was precisely the Group's intention that the said rules should establish once and for all the novel sui generis nature of financial leasing and consequently of the rules to be applied thereto. It was explained that the terms "financier" and "utilisateur/user" had been taken from a proposal made by Mr Bey at the first session and that the term "supplier" had been built into the Leaseurope definition submitted to the first session in order, as had been specifically requested by the Group on that occasion, to highlight the triangular nature of the transaction covered by the rules from the very outset. The term "supplier" had moreover been considered to be preferable to "manufacturer/producer" because the user would not always obtain the equipment direct from the manufacturer/producer but would in many cases be supplied by a distributor. The use in the tentative draft of this novel terminology should not be the cause of any confusion as the role of each of the parties was clearly defined in this opening article.

7.- There was a feeling that the label "financier" might give rise to confusion in view of its mental associations with financial institutions, and at the same time that it might unnecessarily restrict the scope of the uniform rules' application by cutting out manufacturers acting as third party lessors and brokers acting in a similar capacity. While lessors in France were obliged to have the status of financial institutions in order to be covered by the "crédit-bail" legislation of 1966, in the United States and indeed elsewhere

there were many manufacturers who leased through wholly-owned subsidiaries and not through a financial institution, so that the broader terminology of "lessor" / "lessee" might be regarded as the more appropriate for the purposes of a universal definition. This approach however risked reopening the whole question of whether the uniform rules should only deal with trilateral leasing transactions or whether they should also aim to cover bilateral producer/user transactions. It was recalled that it had been agreed at the first session of the Group to leave out of consideration the bilateral type of lease in favour of the more original sui generis triangular transaction necessarily involving a third party acting as a financier. It was explained moreover that what the tentative draft had in mind when it spoke of a "financier" was not so much that specific type of financier commonly known as a finance company, which under the law of certain countries was subject to central bank control and had to appear in particular lists, but rather the more general concept of the party who acts as the source of finance in the context of the particular transaction. As a solution it was proposed replacing the words "a financier" in the opening line of Article 1 by the words "a party (the financier)", so as to make it perfectly clear that the term "financier" was being used as a term of art. The words which came immediately thereafter would then describe what in practice was meant by this term of art in the context of the uniform rules, namely a person who, "on the specifications of the user, purchases from a supplier...". The term "financier" in the context of the uniform rules would thus mainly be a label serving to denote any person engaging in the said type of activity. It was moreover suggested that such a method should fit in particularly well with the American philosophy, given the deliberate choice in Article 9 of the Uniform Commercial Code of new labels with a view to ensuring that the courts would not treat them in the same way as the terms, such as "debtor" and "creditor", which had been used in the past.

8.- As regards the first characteristic of the type of leasing transaction covered by the uniform rules listed in Article 1 of the tentative draft, namely "the choice of the equipment and the supplier lies with the user", the question was raised whether it was entirely desirable to leave the choice of the supplier to the discretion of the user or whether, in view of the financial implications for the financier of the user's choice, it would not be wiser to make the user's choice of supplier subject to the financier's approval. In reply it was pointed out that the first characteristic was a definitional ingredient and implied neither a right nor a duty. It merely reflected the fact that in a finance lease it was in practice the user who chose the supplier, although without the lessor thereby being committed to enter into the leasing transaction. Where the particular supplier chosen by a user did not inspire trust in the lessor, the latter would in practice simply refuse the transaction.

9.- As regards the second characteristic listed in Article 1, doubts were raised as to whether the formula "the equipment is purchased by the financier" was entirely accurate in describing the case, frequent in the leasing of plant, where the land on which the plant was to be built was indeed purchased by the financier but where the latter would then have the plant constructed on the land by a third party builder. As a solution it was agreed to replace the word "purchased" by the word "acquired". Concern was however expressed lest the Group should run the risk of blurring the very real distinction which was made in Common Law countries between the leasing of real estate, that is property attached to the ground, and the leasing of movable property, a distinction which was at the root of a whole series of consequential distinctions, for instance as regards depreciation. It was stressed that this distinction seemed to be particularly crucial in respect of the leasing of plant, as, whereas equipment which was leased as a chattel but which was subsequently to be annexed to land would qualify as an equipment leasing transaction in Common Law countries and accordingly would seem to fall within the scope of the uniform rules, the same would not be true of the leasing of a chattel which began life as a fixture. Whilst it was agreed that the proposed rules were principally designed to cover the leasing of movables - and it was indeed suggested that the word "plant" in the opening chapeau be amended to read "movable plant" or that the preamble, which it had been agreed to introduce, should specifically exclude the application of the uniform rules to real estate - it was however pointed out that perhaps the best solution would be simply to leave the matter open, so that, while the rules were never specifically intended to apply to real estate leasing, their application was not specifically excluded in respect of such transactions. Whilst it might in this way turn out that the uniform rules, on the interpretation given to them by the courts of one country, would apply to real estate as well as to movables, it was the general view that the disadvantages inherent in such an approach were surely outweighed by the advantages of not having to introduce terms like "movables" and "immovables", with the considerably different meanings attributed to these terms in the different legal systems, into the draft.

10.- The third sub-paragraph of Article 1 was passed without comment.

11.- It was explained that the purpose of the fourth sub-paragraph of Article 1 was to introduce a set minimum term for the leasing transactions to be covered by the uniform rules. It was agreed that these should not apply to short-term leases nor to that type of lease where the duration of the contract was tied to the amortisation period for the particular item of equipment, as such a lease would be treated under United States law as a conditional sale. However, it was the unanimous view of the Group that such a provision was not necessary and should therefore be deleted, in the first place because it was felt that the introduction of a fixed minimum term, of for instance two years, would be to introduce an unduly restrictive element



into the uniform rules and, secondly, because this point was considered to be satisfactorily dealt with by the following sub-paragraph providing that the uniform rules applied to that type of lease the term of which took the amortisation period of the equipment into consideration, and not therefore to a lease the term of which was tied to the amortisation period. By thus leaving the relationship between the term of the lease and the depreciation period as vague as possible this solution had the added advantage of better accommodating the United States' position. It was pointed out that it would also tie in well with legislation being prepared in Italy to deal with the growing trend on the part of leasing companies and individuals to use very short-term leases so as to maximise the tax benefits available in respect of leased equipment, the tax depreciation periods for which were fixed by legislation. It was the intention under this legislation to introduce a term for the duration of leases which would no longer be tied to the tax depreciation period fixed in respect of the particular equipment but would be rather related to the tax depreciation period.

12.- As regards the fifth sub-paragraph of Article 1, it was felt that the term "amortisation" was to be preferred to "depreciation" in that it conveyed more accurately the notion that was intended. This point was considered to be all the more valid given the international character of the proposed instrument, in view of the considerable advantages that were associated with the employment of terminology with which as many people in as many different countries as possible were familiar.

13.- It was recalled that the sixth sub-paragraph of Article 1 had been the subject of lengthy discussion at the previous session of the Study Group. To be more specific would, it was added, only create opposition from one country or another, so that to leave the matter open, by stating that there were various options, was probably the only way of dealing with the question in a manner that would be acceptable to everyone.

14.- It was explained that the purpose of Article 2 was simply to state that the qualification of the leasing transaction for the purposes of Article 1 should be the same irrespective of whether it was concluded on the basis of separate contracts between the financier and the supplier and between the financier and the user respectively or on the basis of one triangular contract. It was agreed that reasons of presentation dictated that the provisions of this article should be added on to Article 1 as an extra sub-paragraph of that provision.

15.- The two paragraphs of Article 3 offered alternative solutions to the question of the mutual recognition of the validity of a leasing transaction, the first setting out the more general rule that a leasing transaction which is recognised in one Contracting State as a valid leasing transaction as understood by Article 1 should also be so recognised for the purposes of the uniform rules in any other Contracting State, while the second laid down the more restrictive rule whereby a leasing transaction which has been validly concluded in accordance with the criteria of Article 1 under the law of the place of business of the user, provided that this is the law of a Contracting State, should also, as a general rule, be so recognised in any other Contracting State. The more restrictive formulation was preferred, the more general rule meeting the objection that it offered too broad a solution in requiring a transaction that was recognised as valid under Article 1 in one Contracting State to be also so recognised in all other Contracting States, regardless of whether or not this first State had any connection with the transaction. The unfortunate consequence of such a broad rule, it was explained, could well be that, even where a given leasing transaction would not be recognised as valid in, say, the three Contracting States which had the closest connection with it, it would nevertheless suffice that its validity was upheld in a fourth Contracting State, with which the particular transaction might have absolutely no connection whatsoever, for it to be automatically validated thereby in any other Contracting State. It was therefore felt that the rule expressed in Article 3, paragraph 1 needed to be narrowed down by the introduction of a connecting factor between the particular leasing transaction and the Contracting State whose validation of the transaction would automatically oblige other Contracting States to recognise it as valid too. One suggestion for such a connecting factor was the law of the place of business of the user but the general preference within the Group was rather for lex loci contractus. Under this proposal a leasing transaction upheld in one Contracting State as a valid transaction under Article 1 would only have to be upheld in other Contracting States if that first State was the State in which it was concluded.

16.- This however in turn raised the question whether the proposed connecting factor was intended to be exhaustive of the grounds for the validity of a leasing transaction as understood by Article 1, that is whether it was intended to make it the sole connecting factor for the validity of leasing transactions as understood by Article 1 and thus preclude the possibility of a transaction being validated for the purposes of Article 1 on other grounds, for instance by reference to the law of the place of business of the user or the law of the place of intended delivery. It was considered that to make the lex loci contractus the sole criterion for determining the validation of a leasing transaction under Article 1 would make Article 3 unduly restrictive in that the place where the transaction was concluded

was sometimes quite coincidental and did not necessarily tie in with the essential place of performance. Moreover, in the case of cross-border leases concluded with users in developing countries, an important factor to be borne in mind was that developing countries would normally be highly suspicious about applying the law of the place where the transaction was concluded in the case of equipment supplied by a developed country, as the law of a developed country was not always regarded as being favourable to a developing country.

17.- It was agreed however that, while the essential purpose of Article 3 was to enshrine the very basis of any future international Convention on this subject in a mutual commitment on the part of all Contracting States to recognise the validity of any leasing transaction recognised as valid for the purposes of Article 1 in the country where it had been concluded, this last-mentioned country also being a Contracting State, this rule was not intended to lay down an exhaustive conflicts rule for the validity of leasing transactions under Article 1. Thus in cases where a given leasing transaction was not recognised as valid for the purposes of Article 1 under the lex loci contractus, its validity as such could still be established by reference to other criteria of the law of conflicts, for example according to the law of another State with a close connection to the transaction. It was pointed out that each State was sovereign under its own national law in deciding whether to accord or to deny validity to a transaction not recognised as valid under the law of another State.

18.- The second part of Article 4 of the tentative draft, laying down that, once the leasing transaction had been concluded, the financier's agreement was required for any variation of the specifications given by the user to the supplier was felt to take insufficient account of the user's need to keep abreast of any improvements and updatings of the equipment leased by him. It was accordingly proposed separating the two parts of Article 4 into separate sentences, the second of which would be amended so as to read:

"The specifications given by the user to the supplier may only be varied without the consent of the financier if the variation does not affect the purchase price of the equipment."

19.- However, it was pointed out that, to the extent that the purpose of the second part of Article 4 was to protect the interests of the financier, the latter, regardless of whether the purchase price was or was not affected by any variation in the specifications given by the user to the supplier, had as owner of the equipment a legitimate interest to be informed

of anything that happened to his property. The user would, therefore, it would seem, in any event have to give notice to the financier before varying the specifications he had given to the supplier, as he was not the owner of the equipment. It was moreover essential for the financier to be able to assess the position of his prospective debtor at the moment when it was proposed concluding the leasing agreement, which made the implications of the proposed amendment to Article 4 all the more alarming for the financier in that its effect would be to bestow on the user a right, apparently unlimited in time, to aggravate the situation of the financier as he saw fit in the light of technological progress. This, it was feared, would seriously upset the balance between the rights of the two parties to the leasing agreement: just as the user was entitled to be able, under the leasing agreement, to use the equipment best suited for the purpose for which he had leased it and therefore the most up-to-date model available, the financier, under the leasing agreement, had to be given a corresponding opportunity to declare his opposition to any proposed variation in the terms of the agreement which would have the effect of increasing his responsibilities, always of course subject to the proviso that the financier's consent was not withheld unreasonably or in bad faith.

20.- It was felt that the financier and the supplier should be free to vary the terms of their agreement without having to seek the prior approval of the user so long as the variation proposed by them would not affect the user, as, for instance, a variation regarding the terms of the payment of the purchase price. However, discussion of such matters would, it was thought, normally take place before the leasing agreement itself was concluded, whereas Article 4 sought only to make the user's consent to a variation of the agreement between the supplier and the financier indispensable where such a variation occurred after the whole leasing transaction had been concluded. It was argued that this was not necessarily so, as, for instance, in the case of a buy-back arrangement between the financier and the supplier, which the parties might decide to vary after the leasing agreement had been concluded, which, it was felt, they should be free to do without first having to seek the user's approval, given that the latter would not be affected by such a variation. It would in fact be quite normal for the financier and the supplier to make such private agreements given that they would often have been dealing with one another on a continuous basis for some time. Moreover, there would be many instances when the effect of such agreements between the financier and the supplier would be to give the user better financial terms, as, for instance, in the case of the aforementioned buy-back arrangement, under which the financier and the supplier would agree that, in the event of the user committing a breach of his contract with the financier, the supplier would take back the equipment, thus giving the financier a guarantee which he was then able to translate into better terms for the user. Some doubt, however, was expressed

as regards whether such a variation of the agreement between the supplier and the financier during the life of the leasing transaction would necessarily always have the same effect, so that the question might perhaps arise in this context of the extent to which it would be necessary to examine the need to alter the calculations on the basis of which the amount of the rentals paid by the user had been determined. It was agreed to be advisable in this situation to avoid laying down a hard and fast rule and rather to leave the parties free to improve their mutual rights and obligations as they saw fit, particularly as one probable result of enabling the financier and the supplier to vary their agreement without having to seek the user's prior approval, so long as the variation proposed by them did not affect the user, would be that a parallel right would have to be given to the user and the supplier, in respect of variations of the specifications given by the user to the supplier which did not affect the financier.

21.- It was accordingly agreed that it would be best to leave Article 4 as it stood, apart from one change, the effect of which would be to allow the parties to vary their respective agreements to the extent that this reflected the negotiation of better terms, although not if this would worsen the situation of one of the parties. It was accordingly agreed to add the words "unless otherwise agreed" to the text of Article 4.

22.- It was explained that Article 5 had been modelled on the Uniform Commercial Code of the United States of America, in compliance with the wish expressed at the first meeting of the Study Group, where both Mr Coogan and Mr Gavalda had pointed to the great flexibility afforded by this model, in that it both gave protection to third parties coming into contact with the equipment and at the same time did not unduly tie the hands of the financier, who was, for instance, only obliged to register according to the type of equipment.

23.- One member of the Group expressed his total opposition to the introduction of a public notice system for leasing transactions, arguing that it had not been found necessary to introduce such a system in respect of other financing contracts. In his opinion, the expense of filing under a public notice system would mean that only bad contracts and bad customers would normally be registered so that filing would not give the guarantee that was being sought. It was argued, on the other hand, that a public notice system was the only effective means of informing innocent third parties coming into contact with the equipment that the particular asset was subject to a reservation of title, as there was otherwise a very great

danger that such third parties might regard the said equipment as an asset of the user. This problem was particularly acute in the case of financial institutions desiring to lend to the user on the security of his assets, as a physical inspection of all the equipment of the financial institution's potential debtor in such a case was simply not feasible. Balance-sheets too were inadequate for this purpose, serving a quite different function, that of a general public notice, from the function that was had in mind here, namely that of a notice to a specific kind of third party.

24.- The question was asked whether there was not a contradiction between the provision of Article 1 stating that the financier is owner of the equipment throughout the term of the lease contract and the proposal in Article 5 (1) to make the **enforceability** of the financier's title against third parties dependent on his having given public notice of the transaction. It was, however, the general view that there was no contradiction between these two provisions: the one recognised the financier's ownership of the equipment while the other meant that, in order to have priority over innocent third parties as regards his ownership, the financier was obliged to give public notice of such ownership.

25.- It was felt that the draft revealed a certain incoherence when the provisions of Article 5 instituting a public notice system were viewed in conjunction with the provisions of Article 7 confirming the financier's right to protect his title by affixing a plaque to his property, as though the authors of the draft were not really sure which public notice system was better. Experience, moreover, in the opinion of one member of the Group, had demonstrated the ineffectiveness of the plaque as the basis of a public notice system.

26.- The major criticism levelled against the proposed Article 5, however, was that its provisions went into overmuch detail in defining the type of public notice requirement to be laid down in respect of the leasing transactions covered by the uniform rules and that to this extent they would be intolerably burdensome for the financier, while not being particularly precise either. In particular, the requirement that the notice should be signed by both the financier and the user could be expected to be the source of considerable difficulties in the case of cross-border leases concluded by correspondence, given that it was difficult to imagine such a requirement being met unless both financier and user lived in the same country. Attention was also drawn to the difficulties that could be expected to arise in respect of cross-border leases in determining what was to be treated as the correct mailing address of the user for the purposes of the proposed Article 5 (1),

as the place of business of the user could quite well be in a different country from the place where the equipment was to be used by him. This raised the question of the extent to which the giving of the wrong address would invalidate the entire public notice. Moreover, the requirement that the notice should contain a statement indicating the type or describing the items of equipment needed, it was felt, to be made more specific, as, in the present wording, it was difficult to gauge whether only a summary description of the equipment would suffice or whether, on the other hand, all the equipment would have to be described.

27.- It was accordingly suggested that a better solution would be to leave each Contracting State free to organise its own public notice system, all the more so as certain States had already passed legislation setting up domestic public notice systems. A commentary on the proposed uniform rules could then contain guidelines as to the desirable components of such a system, which could be based on the items included in draft Article 5. Thus all that would need to be stated in Article 5 would be the pure, abstract principle of the giving of public notice in the form of a minimum requirement, together with the penalty for non-compliance with this requirement. It was suggested that, if it was thought desirable to add a little detail to this rule, then it might also be provided that the notice to be given should permit the identification of the parties and of the equipment, although without specifying the manner in which they should be identified.

28.- A proposal was made that the uniform rules should contain a special rule for leased assets which, by their very nature, were subject to registration, for example ships and aircraft, whereby such assets would be exempt from the Article 5 public notice requirement, since they would otherwise effectively be liable to double registration. One possible solution advocated was the introduction of a provision according to which, where leased assets were already subject to a special public notice requirement in the State where they were to be used, the public notice requirement laid down in the uniform rules would not be applicable.

29.- It followed from the Group's decision to cut down Article 5 (1) that Article 5 (2) automatically fell.

30.- The French text of Article 5 (3) was found to be confusing in that it was not immediately clear which "immeuble" the words "immeuble concerné" referred to, i.e. whether it was the "immeuble par incorporation" or, as was in fact the intention, the real property of which the leased equipment was to become a fixture. This provision proved to be the source of a division of

opinion among the members of the Group. On the one hand, the view was expressed that it should be left unchanged, on the ground that, in conjunction with Article 6, it succeeded in striking an admirable balance between the different interests of the parties in play, first, that of the financier wishing to detach the fixture from the property to which it had become attached and to repossess it (covered by Article 6), secondly, that of the owner of the real property concerned lest his property be damaged as a result of the act of severance (covered by Article 6) and, thirdly, that of an innocent third party lending money to the owner of the real property on the security of that same realty, probably believing that the equipment annexed thereto was in the ownership of the owner of the real property (covered by Article 5 (3)). On the other hand, the predominant view within the Group was that, whilst it was right that the uniform rules should clearly enunciate the principle that public notice was required for leased equipment that becomes affixed to realty, it was undesirable that they should go into detail as regards the specific contents of such notice, beyond perhaps, in line with the suggestion made in respect of Article 5 (1), the statement that the notice should permit the identification of the parties and of the property in question.

31.- States would thus be left free to organise their own systems of public notice both in respect of the situation covered by Article 5 (1) and in respect of that covered by Article 5 (3) of the tentative draft. The first three paragraphs of Article 5 could thus be reduced to a single provision, for which the following wording was suggested:

"1. The financier's title to the equipment provided for the use of the user shall only be enforceable against third parties if he has given the public notice defined by national law".

32.- This however still left open the question of which national law should govern the public notice requirement to be laid down in the uniform rules. Some favoured the law of the place of business of the financier but this met the objection that, if one of the principal objectives of a public notice system was to protect innocent third parties dealing with the user of leased equipment, it was unrealistic to require such third parties to consult a register in the country where the financier had his place of business because they would not necessarily be aware of the financier's existence.

33.- It was therefore proposed that, in line with the long established rule of private international law, the governing law should be the lex rei sitae. However, this choice needed narrowing down further, in the opinion of one member of the Group, who suggested that, if it was broadly the intention



to equate the leasing transaction covered by the uniform rules with a secured transaction, then it would be better to provide that public notice should be given in the place where the leased equipment was intended to be used or, in the special case where it was to be affixed to realty, in the place where the real property was located.

34.- This still left the problem of which law should govern the public notice requirement in the type of case where the financier leased goods to a user in country A in the belief that they were to be used in country A but where the user then removed them to country B without the knowledge or prior consent of the financier. Whereas, in the case where, at the time when the leasing contract was signed, the financier knew that the goods were intended to be used in a different country from the one where the user had his place of business it would be reasonable to require the financier, in order to protect his title, to give public notice of the lease in the country where the goods were intended to be used, this would clearly not be so where the financier could have had no prior intimation that, in order to protect his title, he should give public notice in some other country too. In the case where the user fraudulently removed the equipment to and dealt with it in such a second country, it was proposed that the ordinary conflict of laws rule should apply. Thus the impact of any dealing in the second country would fall to be governed by the law of the second country, which, after recognising the title created in the first country, would then have to decide whether that title was to be overridden under the terms of its own law.

35.- In an effort to give effect to the various points made during the Group's examination of Article 5 (1), (2) and (3), Mr Bey proposed the following redraft of Article 5 (1) designed to cover the subject-matter previously regulated in Article 5 (1) and (3) of the tentative draft:

#### Article 5

(1) The financier's title to the equipment provided for the use of the user shall not be enforceable against third parties if he has not given public notice of the contract providing for the said use in accordance with the requirements laid down by the law of the place where the property is to be used. Such notice shall permit the identification of the parties and the individualisation of the property."

36.- In support of this text Mr Bey pointed out, first, that it pinpointed the object of the public notice requirement which all but one of the members of the Group favoured embodying in the proposed uniform rules, namely the contract between the financier and the user; secondly, that it made it clear that the choice of the type of public notice requirement and of the method to be employed in connection with this requirement were left to the law of the place where the property was to be used, i.e. the lex rei sitae; thirdly, that the only aspect of this public notice requirement which it was proposed to spell out in the uniform rules was that it should permit the identification of the parties and the individualisation of the property, so that the contract between the financier and the user would have to be relatively specific on these points. He pointed out that as a public notice system it had the undoubted advantage of not being unduly restrictive, in that it would not require the drawing up of special documents and would not create too many administrative difficulties, as it would suffice to send the contract between the financier and the user to the authority empowered under national law to receive such a public notice.

37.- It was felt that the words "the individualisation" should be deleted. It should be sufficient that the notice enabled the property to be identified, it being important to avoid a procedure which required a precise description of the property, in the same way as had been done in Article 9 of the Uniform Commercial Code, under which a notice could be filed that related simply to the types of property to be leased.

38.- The question was raised whether the proposed text dealt adequately with the case of fixtures. It was pointed out that this case was covered by the use of the word "property", it being stated that it was intended to be governed by the law of the place where the property was to be used. In order to clarify this point it was agreed to amend the French text of the proposed provision so that the words "et suivant les modalités déterminées" would be inserted between the words "dans les conditions fixées" and the words "par la loi du lieu d'exploitation des biens ..."; it was agreed that the addition to the French text would not require any amendment of the English text in which the word "requirements" was sufficient to cover both "conditions" and procedural "modalités" in the French.

39.- The proposed text as thus amended was accordingly adopted as the new article, it being agreed to delete paragraph 4 of Article 5 of the tentative draft, because this type of provision was generally intended to deal with those who bought from dealers in goods, whereas in the case of a lease the user was not the type of person who would be entitled to dispose of the equipment in the ordinary course of business as his trading stock.

40.- Article 6 of the tentative draft met with general approval, although it was pointed out that it would be necessary for the determination of the financier's priority ("... to the extent that the financier has priority over the claim ...") to specify the applicable law. It was agreed that the applicable law for this purpose should, in accordance with national practice in this matter, be the law of the State where the real property was situated.

41.- Agreement on this point was however not reached without the expression of considerable differences of opinion on the extent to which the tentative draft already laid down a priorities rule in Article 5. Thus one member of the Group thought that the financier's priority in the context of Article 6 should be linked to his compliance with the public notice requirement laid down in Article 5, so that, where the financier had indeed complied with this requirement, he would take priority in respect of equipment which had become a fixture of realty over the claim of any person with an interest in the realty. In cases where the financier had complied with his duty to give public notice of his title under Article 5, he thought it would be unfair to make the financier pay for the consequences of the user's breach of his contractual duties towards other parties, notably the owner of the realty of which his property had become a fixture, by compelling him to meet the expense arising from the severance of his property from the said realty, as, once the financier had given public notice of his title, the owner of the realty was presumed, like all other innocent third parties, to have been informed of such title.

42.- Another member of the Group pointed out that, apart from the deleted paragraph 4, Article 5 in no way purported to regulate the complex question of priorities and that there was therefore no priority rule in Article 5 to which Article 6 could be taken to refer. Article 5, in his view, simply set out the financier's duty to protect his title by public notice and did not purport to state that, if he complied with this duty, his title would necessarily be enforceable against all classes of third party. A distinction had to be drawn between what was necessary to perfect a title to render it as complete as possible and a priorities rule deciding against which third parties that perfected title should be binding. It could not be inferred from the public notice requirement of Article 5 that title of which public notice was given in accordance with that provision would necessarily be effective against the whole world. Indeed, as already mentioned, paragraph 4 of Article 5 gave just one such case of a third party who would take free of the financier's title, even though the latter had given public notice thereof, namely a purchaser in the ordinary course of business. There were many such other cases where, regardless of the owner

having taken all steps necessary to perfect his title, this would not suffice to give him priority over all classes of subsequent interest, for example the claims of the revenue authorities.

43.- While there could be no gainsaying the importance of the question of priorities in this regard - one member of the Group recalled that, under the civil codes of those countries which had taken the French Civil Code as their model, a lessor of movable property which was to be used by the lessee as a fixture of the real property which he leased from a third person ran the risk of losing his title to the said movable property if he failed to inform the third party owner of the realty of his interest in the movable property at the time of its incorporation in the realty, the real property owner otherwise taking free of the title of the owner of the movable property - it was the general opinion that it was a question of such complexity that it would be undesirable to attempt to regulate it in the proposed rules, particularly in the light of the policy adopted in respect of Article 5, namely to avoid going into too much detail in the uniform rules and to leave questions of detail to be regulated by the applicable national law, and that it should therefore be left to be dealt with in accordance with the applicable national law.

44.- It was further agreed that, for reasons of presentation, the article should be divided into two sentences at the end of the fourth line, that is after the words "... remove his equipment from the real property".

45.- Although Article 7 was not intended to lay down anything more than a permissive rule and although it was recalled that Belgian law actually required the affixing of such a plaque in respect of leasing transactions, it was generally considered not to have any place in the proposed uniform rules, first because Article 5 already set out the basic public notice requirement to be laid down in respect of leasing transactions covered by the rules and secondly because it was felt that this was a matter best left to be decided by the parties in their contract. It was accordingly deleted.

46.- In reply to a query as to the precise meaning to be given to the words "obligations ... extra-contractuelles" in the French text of paragraph 1 of Article 3, it was explained that this expression was intended to cover "obligations délictuelles et quasi-délictuelles".

47.- The wording of paragraph 1 was amended to take account of the fact that, under English law for instance, duties would not normally flow from ownership but rather from the delivery of possession or the supply of goods. The words "his ownership" were accordingly amended so as to read "the supply by him."

48.- It was agreed that paragraph 2 of Article 8 should be deleted, in that, first, the first part of the paragraph ("The financier shall in particular ... during the term of his contract with the user") merely gave a specific illustration of the general proposition already stated in paragraph 1 and, secondly, the second part of the paragraph was inconsistent not only with the general immunity from civil liability conferred on the financier by paragraph 1 but also with the statement in the first sub-paragraph of Article 1 that "the choice of the equipment and the supplier lies with the user". It was felt to be thoroughly inconsonant with a logical and fair distribution of the risks attendant upon the conferment of this choice on the user in Article 1 for it to be the financier who should have to bear the unfortunate consequences of the user's exercise of this choice turning out to have been a bad one, as for instance in the case of equipment affected by a latent defect which could not reasonably have been discovered at the time of delivery. This, it was pointed out, was a matter for which the supplier was rather to be regarded as responsible.

49.- There was some discussion of the possible need to qualify the financier's immunity from civil liability conferred by paragraph 1 in those cases where he himself chose the equipment and the supplier. It was thought that this would however happen only in the rarest of cases, as the user would almost always insist on himself selecting the equipment to be used, and that it was in any event covered by the provisions of Article 8 (4).

50.- Some doubt emerged in the minds of members of the Study Group regarding both the precise substantive ambit of the duty laid upon the financier in the third paragraph of Article 8 of the tentative draft, which, in view of the Group's decision to delete the preceding paragraph, automatically became the now paragraph 2 of Article 8, and the specific time at or during which the financier owed this duty.

51.- As regards the second of these two points, namely the temporal limits of the financier's duty to ensure the user's quiet possession of the equipment, it was pointed out that the wording employed was open both to the interpretation that the duty was owed only at the moment when the leasing agreement was concluded and to the interpretation that the duty was owed rather as from the time when the equipment was delivered to the user.

It was explained that it had been the intention of the drafters of this provision, in using the words "... equipment provided for his use", to indicate that this duty was intended to subsist from the time when the equipment was put at the disposal of the user throughout the term of the leasing agreement.

52.- As regards the first point, namely the precise substantive ambit of the duty laid upon the financier by this paragraph, the view was expressed that the term "quiet possession" could be interpreted in a broad sense as covering disturbances caused by the financier himself, by the public authorities, notably through requisition or expropriation, by other third parties, for instance neighbours, and by the fact that the equipment on delivery was unfit for the purpose for which it was intended. It was however not the opinion of the Group that the financier should be held liable for disturbances resulting either from unlawful acts of third parties or for acts of third parties not due to the fault of the financier, for example expropriation by the public authorities, that is conduct which would normally frustrate the contract at law and bring it to an end, because that could not be regarded as being the fault of either party. Equally if the equipment delivered was defective, the Group's intention had been not that the financier should be made responsible for this but rather that this should be the user's responsibility, since he had the choice of the equipment and would under the uniform rules have direct remedies against the supplier. The purpose of this paragraph was rather to make the financier liable where the user's possession of the equipment was disturbed as a result of the lawful act of a third party, that is where the financier did not have the right to dispose of the equipment in question or where his right to do so was qualified in some way, and because of that a third party was entitled to claim possession of the equipment by virtue of a paramount title, for example where the financier lacked title or where, though he had title, a third party had the right to repossess the equipment or to stop it from being used because it was in breach of a patent or trademark. The duty laid down in this paragraph was accordingly to be seen as the analogue in the context of leasing contracts of the implied warranty of quiet possession in a contract of sale.

53.- In order to clarify this point the Group agreed that the paragraph should be amended so as to read:

"2.- The financier shall, notwithstanding the provisions of the first paragraph of the present article, be liable to the user where the latter's quiet possession is disturbed by the lawful act of a party having a superior title or right."

54.- The question was raised whether this paragraph should not however contain some provision regarding whether or not the user should be entitled to cease or withhold payment of his rentals where his quiet possession of the equipment was disturbed. It was explained that the French Civil Code, for instance, established a correlation between the duty it laid expressly on the lessor to ensure the lessee's quiet possession and the right which compliance with this duty gave him to receive rentals from the lessee. It was recalled that, in the event of the user's quiet possession being disturbed, for example because of the equipment being defective, the user might be given the right either to withhold payment of his rentals or to request the court to reduce them. The opinion of the Group, however, was that Article 8 was concerned with the duties of the financier and breaches of duty by the financier and that, while the user might have the right to cease or to withhold payment of his rentals for breach of such a duty, such a right might also be given because the ability to continue performance of the contract was frustrated by an act beyond the control of either the financier or the user and in any event this was a quite separate matter from the question of the duties of the financier which could probably best be left to be dealt with in accordance with the general contract law principles of national law.

55.- The fourth paragraph of Article 8, which, in view of the deletion of the second paragraph of that article, had now become paragraph 3, was a further exception to the basic exemption from liability granted to the financier in paragraph 1. Apart from the need to introduce the same amendment as that made to paragraph 1, namely the replacement of the words "his ownership" by the words "the supply by him", this provision met with the wholehearted approval of the Group. It was in particular felt to be thoroughly consistent with the first sub-paragraph of Article 1: where the financier left the choice of the equipment and the supplier to the user, then it was normal that the latter should be liable for the consequences of his choice proving to have been a bad one, but where the financier had himself interfered with this choice, whether directly or indirectly, then it was just as fair and logical that the financier should bear the consequences of his interference in this choice.

56.- Articles 9 and 10 had to be viewed together as they were virtually identical in structure, the difference between them lying in the fact that, whilst Article 9 dealt with failure by the supplier to deliver the equipment contracted for, Article 10 covered the case where, although the equipment was in fact delivered, it proved to be unfit for the purpose for which it had been intended. The main feature, indeed the great novelty of these two articles was their conferment on the user of an independent direct statutory right of action against the supplier, regardless of the fact that he was not party to the supply contract, because of the sui generis character of tripartite leasing operations in which both the equipment and the supplier were chosen by the user.

57.- It was felt that the direct right of action against the supplier conferred on the user by Article 9 for non-delivery of the equipment should however also lie where the equipment was in fact delivered, but late, as it was reasonable for the user to expect to be compensated in that case too. Paragraph 2 of Article 9 did not cover this case, simply providing that before remedies could be exercised for non-delivery a further reasonable opportunity for delivery had to be given. It was agreed that the scope of Article 9 should be extended accordingly.

58.- In the view of the Group, the nature of the remedies available under Articles 9 and 10 needed to be clarified. Given the separate relationships inherent in a leasing operation, these remedies were best divided into three distinct groups: first, the user's remedies against the supplier; secondly, those of the user against the financier; and, thirdly, the financier's remedies against the supplier.

59.- As against the supplier the user's remedy for non-delivery or late delivery could only be one of damages, given that he was not party to the supply contract. For the delivery of equipment not in conformity with that contracted for in the supply contract, on the other hand, it would be necessary to grant the user a right to reject such equipment, since there was no contractual nexus from which such a right could otherwise be extracted. The effect of the user's exercise of this right would be to produce non-delivery with the consequent application of the provisions on non-delivery. This would however clearly also have an impact on the user's remedies against the financier in that, where, after the supplier had been allowed an extended period of time, in accordance with Article 9 (2) of the tentative draft, in which to make an effective delivery, he had still failed to do so, the user would, in addition to his separate right of action against the supplier for damages for non-delivery, have the right to terminate the leasing agreement, whereas, if in this extended time the supplier had made an effective tender, then the user's remedy would have been restricted to a right to claim damages from the supplier for delay in delivery.

60.- However, as regards the user's remedies against the financier for non-delivery or late delivery the Group's thinking was more divided. The majority felt that, in the event of non-delivery, the user's initial remedy should be to withhold payment of his rentals pending delivery, given that possession was the very basis of the leasing agreement, but that, where the equipment was still not delivered even after, in accordance with Article 9 (2), the supplier had been allowed an extended period of time in which to do so, then the user should be entitled to terminate the leasing agreement. Mr Bey, whilst agreeing with the rest of the Group as regards giving the user the



right to terminate the leasing agreement, nevertheless dissented from the view that the user should also be given the right to withhold payment of his rentals pending delivery of the equipment. In his opinion, the user already had the means to obtain compensation for his loss through his direct right of action for damages against the supplier and it was not reasonable that he should expect to be compensated twice over, once by the supplier and then again by the financier. He felt that the user's remedies against the financier should be limited to the right to terminate the leasing agreement and should not include any further right to compensation. The user, to his mind, should therefore be under an obligation to go on paying his rentals until such time as the court had given judgment. This was necessary, in his view, to safeguard the security of business transactions. He added that, if it should turn out that the supplier had in the meantime become insolvent, it was a logical consequence of the principle enshrined in the first sub-paragraph of Article 1 that the user should bear the consequences of his right of choice.

61.- The financier's remedies against the supplier would finally, it was agreed by all, be his normal sale of goods remedies. These, it was felt, need not, however, be dealt with in the proposed uniform rules, as they were already exhaustively dealt with by domestic and international law, save to provide, as had indeed been done in paragraph 4 of Articles 9 and 10, that the financier's pursuit of these remedies should be exercised in a joint action with the user. It was also agreed that the user's exercise of his direct right of action against the supplier should not be allowed to interfere with the supply contract. It was moreover pointed out that there was one way in which the user's direct right of action against the supplier should be seen as subordinate to the financier's exercise of his sale of goods' remedies against the supplier and to the court's determination of that action by the financier against the supplier, namely the case where it emerged that the supplier's failure to deliver had been the result of the financier's breach of the supply contract, for example non-payment of the purchase price. In that case the user's right of action against the supplier would of course no longer lie.

62.- The embodiment in the tentative draft of the principle that all actions brought under Articles 9 and 10 should be brought in the joint names of the financier and the user simply reflected what had been agreed at the Group's first session. Subject to Mr Bey's dissenting opinion, this agreement was confirmed. Mr Bey, however, thought that the principle of the joint action was inconsistent with the uniform rules' declared aim of enshrining the sui generis nature of triangular financial leasing operations in appropriately

sui generis solutions and in particular with the proposal to give the user a new independent direct right of action against the supplier, as the main reason for creating this new direct right of action had been precisely to resolve the problem which had hitherto arisen out of the fact that the user could previously only claim compensation from the supplier either by suing in the financier's name or by bringing a joint action with the financier. This, he pointed out, had been a legal subterfuge to which it had been necessary to resort in order to get round an otherwise insuperable problem but, once paragraph 1 of Articles 9 and 10 had established the novel principle of the user's direct right of action against the supplier, this was a problem which no longer existed and there was therefore no longer any justification for the user to have to join the financier's name to any action which he wished henceforth to bring against the supplier.

63.- Moreover, the financier's role in the whole leasing operation being at all times almost incidental, he considered that it was essential to leave the user the absolute freedom implied by his central, dynamic role in the operation to deal with all technical aspects of the equipment, which necessarily included assessing whether the equipment delivered was defective and dealing with non-delivery and late delivery, subject only to the proviso that the user's exercise of this freedom must not harm the interests of the financier. To his way of thinking, such freedom was inconsistent with an obligation for the user to join the financier's name to any action he might wish to bring under the uniform rules against the supplier: he felt that it was a natural corollary of this freedom that the user should also enjoy complete freedom as regards the manner in which he saw fit to bring the direct action which it was proposed conferring on him. One member of the Group pointed out that it would however always be possible for the financier to assign his rights to the user so that there would not necessarily always have to be three parties before the court and the user would be free to pursue his remedy as he saw fit. This, Mr Bey thought, was nevertheless still inconsistent with the idea of conferring upon the user an independent direct right of action against the supplier, in that it made the user's exercise of his right of action dependent on the financier, and was above all to be deplored to the extent that, instead of following through with the Group's declared objective of creating something new that would be in keeping with the sui generis character of the tripartite leasing operation, the Group thereby seemed simply to be falling back on the classical contractual models. He thought this was particularly undesirable in view of the fact that, even though leasing contracts still provided for the user to act against the supplier only in the financier's name, the French Court of Cassation had recently recognised the existence of an independent direct right of action against the supplier in favour of the user.

64.- By way of explanation of the desirability of incorporating the principle of the joint action in the uniform rules, Mr Goode recalled that, at its first session, the Study Group had reached the conclusion that, as the financier and the user each had separate interests in the equipment - both of them were deriving income therefrom, the financier in the form of rentals and the user in the form of the use to which he intended to put the equipment - each of which might be adversely affected if one were to pursue his remedies independently of the other, claims should in principle be made by both parties acting jointly. In the case of the delivery of defective equipment, for instance, while the value of the asset owned by the financier would be diminished on the one hand, his true loss could not on the other hand be calculated without reference to the leasing agreement, because if, for example, he were to remain entitled to collect his rentals notwithstanding the defects in the equipment for which he was not responsible, then his loss was of a residual character: it would only become a loss if the lease were not fully consummated and rentals not paid by the user. On the other hand, if the lease were to be prematurely terminated because of default by the user, the financier would suffer loss if the equipment were less valuable because of the defects in it. Similarly in a claim by the financier against the supplier the measure of his loss would depend very much on the extent to which he remained able to collect rental payments from the user notwithstanding the defects in the equipment. It was therefore not sensible to have a system in which one party could sue the supplier without the other party being before the court at the same time. It was better for the court to have all the parties involved in the tripartite transaction before it at one and the same time, particularly with a view to avoiding the risk of the duplication of damages. The joint action would indeed be a logical consequence of the Group's decision to recognise the truly tripartite character of the sui generis form of leasing transaction rather than to go on treating the transaction simply as two isolated contracts.

65.- As one possible solution to the problem arising out of the distinction drawn between the direct right of action on the one hand and the joint right of action on the other hand, it was suggested drawing up a clause permitting the parties to resort to arbitration and establishing a procedure which would from the outset enable the different parties involved to appoint arbitrators with a view to the litigation being settled by one and the same proceedings. This proposal however failed to earn support.

66.- Mr Bey's opposition to the principle of the joint action not having been appeased by Mr Goode's explanation, the Chairman, having noted that he and the majority of the Group favoured the principle of the joint action for the reasons advanced by Mr Goode and having accepted the latter's offer to submit a redraft of Articles 9 and 10, requested Mr Bey to submit an alternative redraft of Articles 9 and 10, so that the Group could compare their different solutions at its next session. Mr Bey agreed to this request. It was agreed that it was better for Articles 9 and 10 to be redrafted together given the similarity of the solutions proposed in each of them.

67.- Strong support was expressed for the principle contained in the second sentence of paragraph 4 of Articles 9 and 10 to be maintained in the proposed redraft. It was seen as a most important safeguard against the possibility of the financier and the supplier acting together to prevent the user from exercising his direct right of action against the supplier. It was explained that, under English procedure, where, in order to ensure that the need to have all the interested parties before the court should not be undermined, the action had to be brought in the joint names of two parties, as proposed in Articles 9 (4) and 10 (4), if one party refused to allow himself to be joined as plaintiff then he could alternatively be joined as defendant.

68.- Some paragraphs of Articles 9 and 10 of the tentative draft, it was agreed, would probably disappear in the redraft. For instance, the view was expressed that paragraph 3 of Articles 9 and 10 would probably be superfluous in view of paragraph 4 of the same articles.

69.- One member of the Group wondered whether Article 10 (1) would not perhaps have to be cut down in the proposed redraft, at least in so far as the financier's liability was concerned, in view of the general exemption from liability for defects given to the financier under Article 8 (1). However, another member stressed the practical importance of this provision given the great number of cases in which the financier never saw the equipment, the user as a result acting in a way on behalf of the financier to check the conformity of the equipment with that contracted for.

70.- The question arose whether the wording of Article 10 (2), and in particular the words "which is not in conformity with that contracted for," were broad enough to embrace the supplier's implied contractual duty to ensure that the goods supplied by him were of "merchantable quality". While the language of Article 10 (2) was quite clear in bestowing a direct right of

action on the user in respect of those matters expressly specified in the supply contract, as much was not clear in respect of terms implied under the supply contract. It was however agreed that for the same reasons as had led the Group to establish a direct right of action in favour of the user in respect of the express terms of the supply contract, namely the fact that the user was not party to the supply contract but was nevertheless alone responsible for the choice of both equipment and supplier, the same direct right of action should also lie under the uniform rules in respect of the implied duty of "merchantable quality". The effectiveness of the direct right of action conferred on the user would otherwise be considerably reduced. It was therefore agreed that the proposed redraft of Articles 9 and 10 should specify that the user's direct right of action against the supplier should lie in respect of all matters pertaining to the equipment which were imposed on the supplier in his contract with the financier. This, it was pointed out, could be achieved quite simply by amending the aforementioned words of Article 10 (2) to read: "which is not in conformity with that contracted for in the supply contract".

71.- It was suggested that it would be wise when redrafting Article 10 to specify that, just as the user had the duty upon delivery to check the conformity of the equipment with that contracted for, so too he should have the duty of informing the financier of any defect he discovered in the course of this check within a reasonable time of his discovery thereof, particularly in view of the time-limits which were often applicable in such cases, although it might perhaps be argued that such a duty was already implicit in the duty to check the equipment laid on the user under Article 10 (1) of the tentative draft. As a solution it was agreed that in the redraft of Articles 9 and 10 it should be provided that, as in a sale contract, notice of rejection had to be given within a reasonable time. Thus, where the user wished to terminate the leasing agreement because the equipment had not been tendered in conformity with the supply contract and the supplier had not taken the opportunity to re-tender within the extended period of time granted him under Article 9 (2), the user's right to terminate the leasing agreement would be conditional on his having given notice of rejection to the financier within a reasonable time. Such a provision would moreover, it was pointed out, flow logically from the practice followed in leasing operations, according to which the financier only paid the purchase price of the equipment after the user had informed him that he had in fact received the equipment and that it was in conformity with that contracted for. However, one difficulty inherent in the solution proposed would be that, whilst it was theoretically possible for the user at delivery to certify whether or not the equipment was at first sight in conformity with that contracted for, experience had shown that he would not usually be able at so early a stage to certify whether or not the equipment was in fact fit for the purpose for which it was intended, as some defects would only emerge once the user had actually begun using the equipment.

72.- The opinion was voiced that Article 11 (1), or at least its second sentence, was perhaps a little too complicated. However, it was pointed out that, while there could be no gainsaying that it was indeed a complex provision, this was surely appropriate in view of the complexities of the question with which it sought to deal. It was nevertheless agreed that the second sentence could be slightly lightened, without any loss in meaning, by the deletion of the final seven words of that sentence, namely "providing for their use by the user", which were superfluous given that the paragraph in question spoke of only one contract so that there was no danger of any confusion.

73.- The question was raised whether Article 11 (1) might not be seen simply as a definition of the financier's loss and entitlement to compensation in the event of the user's wrongful breach of the leasing agreement but also as a sort of penal clause and thus as an attempt to limit or even take away the parties' freedom to stipulate their own penal clause in their contract. This, it was felt, would be frowned on by national law and it was therefore agreed that, so as to avoid the risk of such an interpretation and to make it clear that Article 11 (1) was in no way intended to interfere with the parties' freedom to stipulate their own penal clause in the leasing agreement, the provision in question should be prefaced by the phrase "Without prejudice to any other penalty laid down in the leasing agreement".

74.- It was agreed that it would be necessary to delete the phrase "and of such residual value as the equipment would have had on the expiry of the contract" in Article 11 (1) because of the completely different attitudes adopted with regard to the role of the residual value in leasing transactions in the civil law countries on the one hand and in the Anglo-Saxon countries on the other. In the former the residual value was fixed in the leasing agreement, as the price at which the user was entitled to exercise the purchase option granted him under the agreement, whereas in the latter the fact that the fixing in the leasing agreement of the residual value of the equipment would destroy the transaction's qualification as a genuine leasing transaction - as opposed to a conditional sale or a hire-purchase agreement or the equivalent - meant effectively that the residual value could not be fixed in the leasing agreement with the result that it was the financier who was entitled to the residual value on the normal expiry of the leasing agreement. This divergence in practice was reflected in the contrasting positions adopted within the Study Group by Mr Bey on the one hand and by Mr Goode on the other with regard to the aforementioned phrase. On the one hand, Mr Bey favoured its deletion, arguing that from the

standpoint of his country's practice the compensation referred to in Article 11 (1), namely "such compensation from the user as will put the financier back as nearly as possible into the position in which he would have been had his contract with the user run its full term", would be the total amount of the rentals due under the leasing agreement plus the residual value of the equipment as fixed in the leasing agreement, against which sum the financier would have to give credit for the proceeds of the sale or the releasing of the repossessed equipment. Mr Goode, on the other hand, given the different way in which the residual value of the equipment was handled in the Anglo-Saxon countries, argued for the retention of the said phrase, on the ground that as, if the lease had run its full term, the financier would, in addition to receiving the total amount of the rentals due under the leasing agreement, have been left with the residual value of the equipment, it would be unfair for him to have to give full credit, as against the rentals which he would normally have received, for the proceeds of the sale or of the releasing of the repossessed equipment; he should rather, as proposed in Article 11 (1) of the tentative draft, have to give credit for the amount by which these proceeds exceeded the residual value which he would in any event have had at the end of the lease if it had run its full term. It was agreed that, on account of the substantial practical differences between these two rival approaches to the role of the residual value of the equipment in the leasing transaction, this part of Article 11 (1) would have to be redrafted in such a way as to take account of both systems.

75.- It was agreed that, as with Article 11 (1), the parties were to be free to contract out of Article 11 (2).

76.- This provision met with general approval, although it was suggested that, as the parties were to be free to qualify it by contract, it might be useful to stipulate a period of notice, for example 14 days, in respect of the user's duty to bring his rentals up to date. However, it was argued that the flexibility required of an international instrument designed to regulate cross-border business transactions would be incompatible with the fixing of such a definite period, given the particular difficulties that might well be expected to arise in the context of cross-border leases as regards, for example, the distances involved as well, perhaps, as the need to obtain the appropriate administrative authorisation before being able to transfer the sums of money involved. It was therefore proposed requiring that the financier's notice to the user should be "reasonable" but this raised problems for Mr Bey who feared lest the introduction of the word "raisonnable" would make the courts feel obliged to refer to subjective criteria which, he was sure, would lead to speculation, confusion and uncertainty, in particular causing the period of notice to vary from anything

from eight days to a year and perhaps even more, depending on the particular difficulties pleaded in the particular case by the user. This, he felt, was to place too heavy a burden on the financier when it was after all the user's default which had brought about the problem in the first place. For him the term "timeously / dans un bref délai" used in Article 11 (2) was preferable by far, implying for him a period of between eight and 14 days, which to his mind was appropriate for a notice which was after all nothing more than a reminder of something which the user was in any event already under a duty to do.

77.- It was agreed that the word "intérêts" in the French text of Article 11 (2) should be amended to read "intérêts moratoires" so as to make it clear that the interest in question was interest incurred because of the user's delay in paying his rentals. It was explained that "intérêts moratoires" were subject to special rules under French law, the fact that such interest had been paid discharging the payer from any duty under his contract to pay a penalty stipulated thereunder.

78.- One member of the Group, however, considered that this provision was largely academic and could even perhaps be deleted, as leasing contracts always gave the financier the fullest power to do virtually anything he wanted in the event of the user's default, providing inter alia for termination, interest on overdue payments and all the rights which the financier wished to secure, so that in practice nothing that was stated in Article 11 (2) would ever have to be invoked. This point of view was not shared. It was pointed out that these rules, if and when they became an international Convention, would be binding on and take precedence over all domestic law of the States parties thereto, so that a user in bad faith would be able to claim that the terms of his contract with regard, for example, to the period of notice to be given to the user prior to termination did not satisfy the requirements of the uniform rules, i.e. Article 11 (2), with the result that the financier's termination of the leasing agreement was also in breach of the uniform rules.

79.- A proposal was made by Mr Bey for the addition of a third paragraph onto Article 11 to cover the user's duty to return the equipment to the financier in the event of his breach of the leasing agreement. He pointed out that this matter was alluded to briefly in Article 11 (1), when speaking of the financier's right "... to possession of the equipment" but felt that it was desirable that this positive duty of the user should be spelled out expressly in the uniform rules rather than be left to be merely implied as a consequence of what was already stated in Article 11 (1). As the text of



such a new Article 11 (3) Mr Bey proposed the following draft:

"In the event of the user's breach of the leasing agreement, the user shall have the duty to return the equipment to the financier in good working order, subject to normal wear and tear, failing this, the user shall be liable to the financier for equivalent compensation."

He explained that the last part of his proposal was designed to cover the case where the user's breach of the agreement was due to an accident resulting in the destruction of the equipment.

80.- Doubt was expressed, however, as to the need for such a provision, given, first, that its import seemed to be already implied by Article 11 (1) and, secondly, that such a clause would in any event be included as "normal wear and tear conditions" in the leasing agreement. The objection was also raised that the introduction of such a provision would have the unfortunate result of making the user obliged by law to carry out a penalty against himself.

81.- It was moreover considered to be essential in formulating such a provision to eliminate any risk of the duplication of damages, given that the user was already obliged under Article 11 (1) to pay the financier such compensation as would put him back as nearly as possible into the position in which he would have been had their contract run its full term. Mr Bey however considered that no such risk was inherent in his proposal, two separate obligations being involved, first, the user's obligation to pay the financier the compensation set out in Article 11 (1) and, secondly, the user's obligation to return the equipment, which he proposed covering in a new Article 11 (3).

82.- It was finally agreed that, while there did seem to be a majority within the Group who considered the proposed Article 11 (3) to be already implied by Article 11 (1), such a provision should be included in the revised version of the tentative draft pending a decision by the Group at its next session regarding whether or not it should be retained.

83.- The suggestion was made that an additional question which the Group might wish to discuss at its next meeting, with a view to its coverage in the uniform rules, was the question of what should happen where the equipment was accidentally destroyed half-way through the leasing agreement. This raised serious difficulties, he pointed out. Whilst it was to be assumed that insurance would cover the value of the equipment, this still left the problem of how the insurance monies should be applied and what should be the

effect of the destruction of the equipment on the leasing agreement. Furthermore, if the insurance monies were to be applied in restoring the equipment, the question arose as to whether a new contract came into existence between the parties to the original leasing agreement or whether the original contract should go on applying to the new equipment. It was recalled, however, that this question had been raised on the occasion of the first session of the Group when it had been judged opportune to leave it to be settled by the parties in their contract.

84.- A general question which arose in respect of the tentative draft concerned which of its provisions were to be considered as mandatory and which were to be regarded as merely supplementary to the intention of the parties as expressed in their contract. This raised the related question of whether it was not desirable that the uniform rules should give some explicit guidance on this matter. One member of the Group declared his opposition to the idea of making the uniform rules supplementary as he believed that they would thereby lose much of their interest and, in particular, that such an idea contradicted the Group's declared intention of establishing a new legal framework for sui generis leasing transactions that could be implemented by the vast number of States still without any basic legislation in this field.

85.- There was nevertheless general agreement that, in recognition of the fact that any international regulation adopted in the field of international economic relations was subordinate to the intention of the parties as expressed in their contract and to the usages and practices established between them, part of the uniform rules would have to be made supplementary and that, to this effect, an additional article would have to be prepared specifying which of its provisions were intended to be merely supplementary of the terms agreed by the parties. Some provisions equally would have to be mandatory, most notably Article 3 of the tentative draft relating to the mutual recognition of the validity of leasing transactions as understood by Article 1.

86.- Notwithstanding this broad measure of general agreement, a difference of opinion emerged within the Group as regards the precise extent to which the uniform rules were to be supplementary. Thus, Mr Goode felt that, even as regards so fundamental a part of the uniform rules as the provision establishing the user's direct right of action against the supplier, the fact that it had to be competent for a contracting party to give up his rights by agreement if he chose to do so meant that nothing in the uniform rules could be interpreted as preventing the user and the supplier from contracting in such a way as to exclude the direct right of action created by the uniform

rules. It was argued that there was therefore no reason why the entire uniform rules, with the obvious exception of Article 3, should not be capable of being qualified by the terms agreed between the parties, with the uniform rules thus being seen as a permissive legal framework, which for transactions between businessmen seemed a perfectly reasonable approach.

87.- Mr Bey, on the other hand, was of the opinion that some of the uniform rules would have to be regarded as fundamental and mandatory in order to ensure that the parties did not, by contracting out of virtually all the uniform rules, turn what they nevertheless termed a "leasing transaction" into something which bore none of the features of the uniform rules at all, as otherwise the result would be to produce a legal monstrosity and perhaps even to make the uniform rules an instrument of fraud. This would create a serious problem for the courts faced with the task of deciding whether what was termed a leasing transaction was indeed so, which was precisely one of the problems which the preparation of the uniform rules was designed to overcome.

88.- In reply, Mr Goode explained that the suggestion that the uniform rules should be seen as a permissive legal framework should not be interpreted as meaning that the parties were to be given the power to exclude the uniform rules as an operative instrument. However, it seemed inconsistent with the fact that the parties to a contract of sale were free to exclude virtually all their obligations that the rights which it was proposed conferring on the user under the uniform rules should be non-excludable, as it was argued that the user's situation vis-à-vis the supplier was in many ways no different from that of any ordinary buyer vis-à-vis the seller.

89.- Mr Bey considered that the most important factor in this connection was, as with any other contract, to distinguish between which features of the leasing transaction were fundamental and which were not, or, as French law termed it, which matters were "de l'essence du contrat" and which were simply "de la nature du contrat". Thus, in the sale contract, while the parties were indeed free to contract out of virtually all their obligations, there were nevertheless certain fundamental obligations which the parties could not exclude, that is the obligation for the seller to deliver what had been bought on the one hand and the obligation for the purchaser to pay the price on the other hand. Equally in the leasing transaction there were some obligations that were, in his opinion, so characteristic of this transaction that the parties should not be free to contract out of them. Mr Goode, however, while pointing out that English law too considered that there were certain fundamental obligations in a contract which could not be excluded

without the very existence of that contract thereby being negated, nevertheless considered that these were matters best left to the general principles of the national law concerned. The purpose of uniform law being precisely to eliminate problems arising out of conflicts of laws, the Chairman feared, however, lest the uniform rules risked becoming the source of still greater conflicts if each time a problem arose it was left to be resolved according to domestic law. He was of the opinion that it was therefore important to admit as few possibilities of such conflicts of laws in the uniform rules as possible and rather to seek to unify the substantive law on this subject as much as possible.

90.- Finally it was agreed that the UNIDROIT Secretariat, in conjunction with the Chairman of the Group, should prepare a revised version of the tentative draft to take account of the various proposals for the amendment of the latter made by the Group during this session; further that this revised text should be circulated for comment among the members of the Group after which a third session of the Group would be convened. It was hoped that it would then be possible to lay the final text of a draft set of uniform rules on the sui generis form of leasing transaction before the UNIDROIT Governing Council, subject to whose approval the said text, accompanied by an explanatory report, could then be forwarded to Governments and to the interested business circles for comment. Subsequently it would be up to the Governing Council, in the light of the reactions elicited by this process of consultation, to take a decision on the future of the draft, in particular whether or not to convene a committee of governmental experts to consider it further.