Preliminary draft uniform rules on international financial leasing
adopted by the Unidroit Study Group
for the preparation of uniform rules on the leasing contract:

Explanatory report

prepared by the Unidroit Secretariat

Rome, February 1985
A. GENERAL INTRODUCTION

I. Nature of leasing

1. - The essential function of a lease, whether of real or personal property, is on the one hand to enable the lessee to obtain use and enjoyment without paying the full capital cost, and on the other hand to enable the lessor through receipt of the lessee's rentals to receive a return on its capital investment while retaining title and therefore security in the goods or land. It thus involves the segregation of ownership and the right to beneficial use.

II. Growth of leasing

2. - Leasing, notwithstanding the comparatively recent emergence of the technique at present known by this term, in fact has a long history. Historical evidence suggests its widespread use by the ancient Sumerians circa 5000 B.C. Its modern development, though, as a generally acceptable alternative to the outright purchase of equipment, is rather to be traced back to the development of the railways in the middle of the 19th century. The United Kingdom wagon leasing companies of the late 1850's were among the very first registered limited liability companies to avail themselves of the new corporate form. Though their activity only spanned a relatively short period, the wagon leasing companies made a vital contribution to the rapid development of railway freight. A similar pattern occurred in the United States of America where railroad companies pushing ahead with new routes concentrated their financial resources on the provision of track and facilities and obtained their rolling stock on leases known initially as "car trusts" but which later became known as "equipment trusts". Certain manufacturers of specialized machinery, starting with the Bell Telephone Company in 1877, subsequently found another application of leasing as a means of protecting their monopoly or near-monopoly position by limiting the use of their products to lessees.

3. - It was in the post-World War II period, however, that the spectacular growth of leasing really got underway. This can be seen as one aspect of the more general phenomenon of the movement towards a credit economy and the acceptance of debt financing by the business community. The initial impetus to the growth of leasing in the wake of World War II was given by those businesses needing to replenish their equipment. The conventional means of responding to this need in the United States, the conditional sale, was simply not suitable, requiring almost invariably as it did a down-payment of 15-20%, a sum which many businesses did not then have. Until the 1960's the use of leasing was thus principally confined in the United States to capital-poor, high-risk companies, and the total annual volume of new equipment leases over that period in the United States probably did not exceed...
It was in the late 1950’s and with the advent of the 1960’s that leasing came of age with its acceptance by large industrial corporations, utilities, national banks and Governments, as well as the establishment of the first independent leasing companies, playing a role analogous to that of banks and other financial institutions, from which they nevertheless differed in that they aimed to buy and then lease equipment to their clients, rather than simply loaning them the necessary money to buy it. The first such company was founded in 1952 in San Francisco: the United States Leasing Corporation. It was through the expansion into Europe and the Far East of the first American leasing companies, and notably U.S. Leasing, that the first non-American leasing companies were established: Mercantile Leasing in the United Kingdom in 1960, Deutsche Leasing in the Federal Republic of Germany in 1962 and Orient Leasing in Japan in 1962. Manufacturer links provided the early impetus for these operations but leasing companies, whether or not linked to domestic financial institutions, soon began cultivating direct links with equipment users and leasing an ever wider variety of equipment to them.

4. The 1970’s and the beginning of the 1980’s are generally considered to mark the most rapid period of growth in leasing world-wide. Thus in the United States the amount of new equipment on lease rose from $15 billion in 1975, to $37 billion in 1980 and to more than $61 billion in 1983, with an increase of 15% over that figure being expected for 1984. The leasing industry’s contribution to total business fixed investment in the United States accordingly stands at 18.7%. As regards Western Europe, the leasing companies represented in the European Federation of Equipment Leasing Company Associations (Leaseurope), a federation which covers about 80% of the financial leasing industry in Western Europe, in 1972 purchased equipment for leasing to their customers costing some ECU 2.1 billion; by 1980 the total value of new equipment leased in the member countries of Leaseurope had climbed to ECU 12.2 billion. By 1983 the corresponding figure had reached ECU 19.6 billion. The pioneer of leasing in Asia has been Japan. In 1970 Japan’s 31 largest leasing companies signed contracts worth a total of $726 million. By 1976 this figure had grown to $1,938 billion and by 1981 to $7.5 billion. During the 1983 fiscal year ending on 31 March 1984, the total value of new leasing contracts concluded by member companies of the Japan Leasing Association amounted to $12.6 billion. The average annual growth rate of leasing contracts on a receivable basis over the past five years in Japan has been about 23%, and the number of Japanese leasing contracts has doubled over the past four years. A survey carried out by the Japanese Ministry of International Trade and Industry indicated that the leasing industry is second only to the electric utility industry in terms of spending on capital investment. Private-sector capital expenditure in the 1983 fiscal year was estimated at $165 billion, of which leasing contracts on a purchase-cost basis accounted for 5.76%. This ratio has been growing constantly in past years: in 1980 it stood at 3.03%, in 1981 at 3.62% and in 1982 at 4.7%. The Japanese leasing market is moreover expected to grow at an annual rate of about 20% in the coming years.

* The sign $ always refers to US dollars unless otherwise indicated.
5. — Developments elsewhere in the world have mirrored this trend of rapid growth, albeit from more recent beginnings. The Far East has seen some of the most startling figures in this regard. The setting up of the first leasing company in the People's Republic of China dates back only to 1981. Leasing contracts in 1983 in China were estimated to have totalled about $70 million on a purchase-cost basis. New financial leasing transactions concluded during the six months January-June 1983 in Hong Kong were for a value of $92 million, compared with a total value of $23 million for the whole of 1982. The comparable growth in the value of leasing contracts incorporating an option to purchase in Hong Kong was from $10 million for the whole of 1982 to $12 million for the period January-June 1983. The first leasing company in India was set up in 1973 by the end of 1983 there were more than 100 leasing companies operating in India. However, the size of the Indian leasing market at present is estimated to be less than a few hundred million dollars which leads observers to consider that there is much room for expansion of the Indian leasing industry in coming years. Where there were only five leasing companies in Indonesia in 1980, forty such companies are now registered there. This expansion was reflected in the 80% increase in the total value of new Indonesian leasing contracts on a purchase-cost basis, from $73 million in 1982 to $132 million in 1983. The most startling figures of all, however, are those for the Republic of Korea which show an 118% increase in the total value of new leasing contracts on an acquisition-cost basis, from $203 million in 1982 to $442 million in 1983. From the establishment of the first leasing company in Malaysia in 1973, the Equipment Leasing Association of Malaysia now counts about 140 member companies. New leasing contracts concluded in Malaysia in 1983 were estimated to have been for a value of $426 million. In the Philippines there were as of the end of June 1984 26 companies engaged exclusively in leasing business; however the total volume of business done in this line in the Philippines must also take account of the many firms, including finance companies, doing business as lessors along with other activities, which would swell the total number of entities engaging in leasing business in the Philippines to about 350. About a decade has passed since leasing operations began in the Republic of China (Taiwan) and 40 leasing companies were members of the Taipei Leasing Association at the end of 1983. Leasing contracts written by these companies that year amounted to $452 million, representing a 22% increase over the 1982 fiscal year for which the corresponding figures were $371 million. Leasing's share of private capital formation in the Republic of China (Taiwan) went up from 5.7% in 1982 to 6.8% in 1983. In Singapore new leasing contracts on a receivable basis for 1983, at $259 million, showed a 16% increase over the $223 million of 1982. The Leasing Association of Singapore counts 52 members. From the setting up of the first leasing company in Sri Lanka in 1980, the growth of leasing there has been rapid. There are now eight leasing companies doing business in Sri Lanka. The value of new leasing contracts written in Sri Lanka in the 1981 fiscal year was $2.7 million; by 1983 this figure had increased to $12 million. Only three Thai companies are actively engaged in leasing. There was nevertheless an increase of 7.4% in the value of newly leased equipment in 1983 on an acquisition-cost basis over 1982 (from $4.4 million to $4.7 million).
6. — While no other part of the world can yet match the rapid growth in the leasing market that has taken place in the Far East in recent years, recognition of the value of leasing has by now become so generalised that it now grows apace in most parts of the world. Thus by the end of 1982 approximately $3.5 billion were invested in leasing in South America, more than two thirds of which — $2.6 billion — were concentrated in Brazil. Of the remainder of the capital invested in leasing in South America, approximately $600 million were invested in Venezuela, $120 million in Colombia, $110 million in Chile and possibly $30 million in Ecuador. In Brazil the first leasing transactions date back to the second half of the 1960's. The Brazilian leasing market is made up of 56 leasing companies. The setting up of new companies requires specific authorisation from the Brazilian Central Bank which has not in fact been granting such authorisation. The first Venezuelan leasing company was founded in 1969 and most of the 35 leasing companies active in Venezuela in 1983 were founded in the 1970's. The first Colombian leasing company was set up in 1975 and there are now 27 leasing companies operating in Colombia. In Chile the first leasing company was founded in 1977 and by the end of 1983 a total of 15 leasing companies were operating in Chile. In Ecuador nine leasing companies were operating by the end of 1983. A dramatic fall of approximately $1 billion in the value of leasing investments in Brazil was registered in 1983, so that the year closed with Brazilian leasing investments valued at $1.63 billion. This fall was largely caused by the strong recession experienced by the Brazilian economy, the accelerated devaluation of the Brazilian currency and the difficulties experienced in funding leases in the domestic market. However, it is estimated that a proportion of this loss will be shown to have been made good when the figures for leasing investments in 1984 are published: enactment of new legislation and removal of the Brazilian Monetary Council's requirement that leasing companies bring into Brazil a certain proportion of new dollar loans for eight years in order to be able to issue debentures in the local currency in the local market are expected to bring the total amount invested in leasing in Brazil back up to $2 billion by the end of 1984.

III. Characteristics of leasing

7. — The multiplicity of types of equipment leasing owes more to the ingenuity of lessors forever on the lookout for new leasing products to fit freshly perceived market needs than to fundamental legal differences. Moreover, the singularly hybrid financial mechanism involved in leasing makes it a particularly fertile source for the development of new varieties on the basic model. However, the different types of leasing in general do little more than reflect functional distinctions between one type and another. One fundamental distinction which developed some importance in the course of Unidroit's work on this subject was that made between operating leasing, on the one hand, and financial leasing, on the other. Operating leasing in general involves equipment being let out on lease to a succession of different lessees, each of whom leases the equipment for the period for which it specifi-
cally needs it and pays rentals which reflect its use-value, the period of use being less than the useful economic life of the equipment. Responsibility for maintenance of the equipment under an operating lease would devolve on the lessor. Whereas such an operating lease is normally bilateral in character, involving only a lessor and a lessee, a financial lease normally involves three parties, a supplier and a lessee being joined by a financial lessor whose role in the transaction is limited to the injection of the capital necessary for the acquisition of the equipment and whose interest thereafter in the transaction is restricted to its recouping of its capital investment together with interest and a profit margin. The transaction therefore serves an essentially financial finality with the lessor's retention of ownership being barely more than nominal. This is reflected in the other typical features of a financial lease. Thus the minimum period of the actual leasing agreement under a financial lease corresponds approximately to the major part of the estimated working life of the equipment, so that there is only one lessee, responsibility for maintaining the equipment rests on the lessee and the rentals are calculated not on the use-value of the equipment but on the basis of their earning the lessor a total amount which, when account is taken of the rental cash-flows and capital allowances to which it is entitled, will recoup its capital outlay on the acquisition of the equipment and give it the desired return on capital. The rentals are so structured as to amortize the capital cost over the period — usually termed the "primary period" — of the lease and give the lessor its profit margin. This therefore assumes that the leased equipment will at the end of the lease have a relatively small market residual value. The law of some countries, particularly countries of a Civil law tradition either allows or even, in the case of some countries, requires the lessee to be granted a unilateral option to purchase the equipment at such time as the primary period of the lease has been completed, at a relatively low price predetermined in the lease, termed the residual value.

8. — It is in fact at the level of the granting of such purchase options that the main variants in leasing practice are to be found. As has been said earlier, a large number of countries, essentially Civil law jurisdictions, recognise an unilateral option to purchase the leased equipment under a financial lease in favour of the lessee, and indeed some of these countries, most notably France, Belgium, Brazil and Portugal have enshrined this right in legislation passed in order to confer a special legal status on such transactions — termed "crédit-bail", "location-financement", "arrendamento mercantil" and "locação financeira" in each of these countries respectively — as a result of which the inclusion of such an option in the contract between lessor and lessee has been made an indispensable ingredient of such transactions. This trend is in contradistinction to the situation in a large number of other countries, most notably those of a Common law tradition or whose law is inspired by the Common law: under the law of these countries the inclusion of such an option would irremediably alter the nature of the transaction, so that it would fail as a lease and would instead be treated as a conditional sale or hire-purchase transaction. It does indeed seem strange to non-Civil law eyes that the blessing of the French legislator in 1966 was
sufficient to confer legitimacy upon a transaction that had hitherto been struck down as a form of conditional sale by the Court of Cassation. However, that act of the French legislator, which has moreover provided the inspiration for legislation in other countries, not just Belgium, Brazil and Portugal, is significant in its wisdom of seeing the need for recognition of a sui generis derivation of private law which had in evolving assumed characteristics which were proper to bailment and to conditional sale but which was not logically amenable to classification within either one or the other of its precursors. In effect the French legislator had fixed its attention on a hybrid legal animal which, by its indiscriminate borrowing of characteristics from different, nay contrasting contractual techniques, was a perfect example of what is known as an innominate or, better still, atypical contract. The dynamic structure of the transaction is highly original in that the pivotal, driving role in the transaction is played by the lessee. It is the lessee who selects both equipment and supplier according to its requirements. The lessor’s role is limited, as has been stated earlier, to the injection of the necessary capital for the acquisition of the equipment required by the lessee. The technical specifications of the equipment are accordingly worked out directly between lessee and supplier and delivery is made directly by the latter to the former.

9. — The predominant type of leasing facility in any one country will depend principally on the fiscal treatment and on governmental restrictions applicable to leasing. Where there are no specific restrictive provisions relating to leasing activities, the legal owner of leased equipment will normally also be regarded as the economic owner and will be entitled to depreciate the equipment and benefit from any investment incentives. Lessees will wish to obtain as much of the residual benefit as possible which will tend to favour the granting of nominal purchase options. However, other types of residual treatment may also be in evidence, particularly for higher risk situations. The tax and regulatory environment thus play a very important role in determining the leasing arrangement which is appropriate at a given moment. For instance, lessors and lessees will sometimes be able to elect who should be considered the economic owner. This is the situation with regard to investment allowances in Australia and is a key element in the American “safe harbour” leasing ushered in by the Economic Recovery Tax Act (ERTA) of 1981.

IV. Reasons for use of leasing

10. — Many and various advantages have been attributed to leasing over the years. As has already been alluded to, the prevailing tax regime may sometimes provide a major incentive for companies to use leasing. Firms which are eligible for investment incentives on the acquisition of equipment, such as accelerated depreciation or investment allowances, but are unable to take immediate advantage of the benefit because of a shortage of taxable profits will thus turn to leasing. Through this means of finance they are able to enjoy the benefit of the investment incentive in the shape of lower rentals from a leasing company which is, or is part of a larger group which is, able to offset the depreciation or allowance
against its taxable income. These tax advantages have tended to overshadow the cashflow and other advantages of leasing in some countries. However, the statistics demonstrate that over the years leasing has grown swiftly and surely in those countries, such as France and Italy, where there are no such tax benefits.

11. — For the lessor the primary advantage of leasing over conventional forms of borrowing to finance equipment lies in the fact that the legal ownership of the asset remains with the leasing company during the lease. For a lessee the primary advantage of leasing is that it makes it for practical purposes the owner of the equipment during the lease. Leasing enables it to conserve its cash resources for financing stocks and working capital needs whilst allowing it to generate the necessary income to pay the lease rentals through and in proportion to its use of the equipment. The availability of lease finance to a lessee thus depends principally on the ability of its cash flow to serve the rental payments. Another often important reason behind the choice of leasing rather than more conventional forms of borrowing is the fact that it provides close to 100% finance, whereas on conditional sale or hire-purchase the buyer or hirer is expected to make a down payment, which it may simply not be able to afford. A further attraction of leasing, albeit of diminishing importance in certain countries, is that it is a form of off-balance sheet financing, thus enabling the lessee to present accounts showing a greater degree of liquidity than would be possible, for instance, with conditional sale, when the future instalments would have to appear as a liability in the balance sheet. One oft quoted advantage of leasing, in particular operating leasing, is that it enables equipment users to guard against obsolescence, changes in market conditions, and indeed any situation where the future is uncertain. This is clearly of considerable importance in an age where rapid technological progress is forever pouring newer and more up-to-date products onto the market. However, perhaps the single most important factor behind the popularity of leasing is that it is seen as a flexible financing tool that can be tailored to the lessee's particular cash flow requirements.

V. International leasing

12. — The July 1984 News Bulletin of the American Association of Equipment Lessors (AAEL) reported the results of an informal survey carried out by the AAEL which showed that American lessors financed $8-10 billion of equipment outside the United States during 1983. Mr Tom M. Clark in his address to the September 1984 Copenhagen annual working meeting of Leaseurope, entitled “International leasing in practice”, made the first attempt, on the basis of the AAEL survey, to estimate the extent of cross-border leasing activity. On his assumption of the international activities of leasing groups of other countries, principally the United Kingdom and France in Europe together with Japan and Australia elsewhere, being roughly comparable in overall size to those of American lessors, he concluded that, just as United States domestic leasing represents about 50% of the world market, so the total figure for new international leasing business in 1983 may be put at upwards of
§ 15 billion, which would mean, to give but one illustration of the immense potential of international leasing, more than the total new domestic business of members of the Leaseurope’s 16 national associations in 1983 (and we must remember that the companies represented in Leaseurope account for about 80% of the financial leasing business in Western Europe).

13. — From the days when Unidroit launched its questionnaire on leasing (in 1976) the development of international leasing has been dramatic. The Unidroit report on the replies to the aforesaid questionnaire indicated that:

"... notwithstanding trans-national leasing associations being formed with the specific objective of favouring the conclusion of international leasing between the members of such associations, the mounting of a truly international operation in Europe has hitherto been so fraught with difficulties as to render the incidence of such operations virtually minimal. It would appear that the only means in which a leasing operator can carry out cross-border leasing in Europe is through subsidiaries set up in accordance with the law of the country where he wishes to operate."

The difficulties which were mentioned in that report as obtruding with international leasing transactions were:

"first, the fiscal and legal uncertainty resulting from the inconsistent treatment of leasing from one country to another and . . . the almost total absence of any legal regulation specifically enacted for leasing; secondly, the currency problems attaching to the repatriation of the rentals paid by an overseas lessee; thirdly, the practical and legal problems involved in the repossession of goods leased abroad; and, fourthly, the problems associated with assessing the commercial reliability of a foreign lessee."

14. — However, by the beginning of the Eighties Mr Tom M. Clark in his already cited paper to the 1984 Leaseurope annual working meeting was able to report that

"cross-border leasing had come of age with many cross-border leases containing unique features which provided cost or non-financial advantages compared to other forms of finance for major assets."

Over the past few years numerous cross-border leases have been arranged for airlines all over the world. The majority of financial cross-border aircraft leases have, according to Mr Clark,

"reflected taxation advantages, but gradually the opportunities for exporting tax credits and accelerated depreciation benefits have been eliminated, although some ‘windows’ remain along with the non-tax reasons for leasing aircraft, such as increased security, broader spread of risk and balance of payment considerations."

Many other types of mobile asset have been the subject of cross-border leases in recent years, mainly ships, other transportation equipment, containers, computers and office machines. Mr Clark identified the main benefits which lessees have sought to obtain by financing their major equipment acquisitions by cross-border leases as follows:
“(i) Primary
Some straightforward domestic leasing benefits may be equally available in cross-border situations without giving rise to the sort of regulatory or fiscal problems which have restricted the growth of cross-border leasing in various countries.

(ii) Asset financing
Overseas lessors may have larger risk appetites as a result of being able to obtain a broader spread of business and access to a wider resale market for returned equipment.

(iii) Operating
Foreign lessors may be more prepared to take obsolescence risks for assets such as computers and containers.

(iv) Mobile
Cross-border leasing may be undertaken to meet a short term requirement for equipment in a foreign location. A common example is the leasing of construction equipment for an overseas site.

(v) Incidental
Domestic leases are from time to time unintentionally converted into cross-border leases through the temporary or permanent transfer of equipment to other countries.

(vi) Export aid
Equipment manufacturers and suppliers are increasingly using leasing as a sales-aid to expand exports.

(vii) Regulatory
Cross-border leasing has been used to avoid import and export restrictions on equipment and exchange controls on cross-border lending.

(viii) Undisclosed
Although the IMF has now changed its reporting requirements for leases, cross-border leasing is still used to reduce the impact of major imports on balance of payments statistics.

(ix) Independence
Multi-national groups, notably oil companies, have turned to leasing to establish a separate ownership presence and reduce the political risk of sequestration.

(x) Fiscal
Finally, the fiscal reasons for leasing described earlier in relation to aircraft.”
15. — Mr Clark concluded that:

"[t]he process of internationalisation of leasing is well under way. Many exporters and importers are now able to offer a leasing alternative to other types of equipment finance. The increased availability of cross-border facilities, combined with the overseas leasing operations of major groups, has boosted capital investment in both industrialised and developing countries.

Whilst many opportunities have been grasped, others will remain beyond our reach until the formidable legal, fiscal and regulatory barriers are removed. Some progress has been made, for example the OECD initiative on withholding taxes . . . and the work of Unidroit on uniform rules for international leasing contracts. However, much remains to be done."

B. UNIDROIT: DRAFTING OF UNIFORM RULES ON THE LEASING CONTRACT

1. Historical Background

16. — Unidroit's work on this subject goes back to February 1974 when the 53rd session of the Unidroit Governing Council was seized of a proposal from the Unidroit Secretariat recommending the preparation of a preliminary study looking into the desirability and the feasibility of drawing up uniform rules on leasing. The Secretariat's proposal highlighted the legal problems arising from the difficulty of classifying leasing within the classical contractual schemata and the unusual legal consequences flowing therefrom. The truth was that, while the classical contractual schemata had provided the source and the model for many of the typical features of the novel form of transaction known as the leasing contract, the latter in fusing these different characteristics ultimately outgrew its relationship with its original models and developed a separate, albeit hybrid legal personality of its own. This phenomenon pinpointed the essential reason for the unsatisfactory results obtained by the renewed attempts made to fit this new legal animal into one or other of the aforesaid classical contractual schemata, most notably bailment and conditional sale. Behind this failure moreover lay the veritable reason for the lack of success achieved by this approach and at the same time an important pointer in a more fruitful direction, namely the essential nature and function of leasing. This involved looking at the economic reality of leasing operations, rather than simply trying to force leasing one way or another into one or other of the classical contractual schemata from which it had borrowed so many of its leading characteristics. It was in the economic reality of the operation that lay the secret to a satisfactory resolution of the legal difficulties arising out of the need to decide which rules should be applicable to it. As the creation of the denizens of the financial world and as a financial mechanism that had come into being to meet a perceived market need, which therefore had not previously been able to be met by the existing methods of financing, it was not unreasonable to anticipate that more satisfactory results might be achieved by
fashioning the rules to be applicable to this new transaction in accordance with its economic reality rather than by endeavouring to assimilate it with contracts the very shortcomings of which had led to its creation.

17. — The aforesaid problems were compounded by the nebulousness and fragmentary nature of domestic law, and indeed by the general absence of any law specifically addressed to leasing. Where there was any legislation on the subject, it was not only rare but piece-meal, the national legislator at times tackling the fiscal aspects of leasing, at others looking at it from the accounting angle but only rarely from the strictly legal standpoint. The Governing Council gave the topic priority status on Unidroit's 1975-1977 triennial work programme, empowering the President of Unidroit to convene a working group to study an international unification of the applicable rules on the subject.

18. — The outcome of this decision was the preparation by the Unidroit Secretariat of a preliminary report illustrating the mechanics of the different kinds of leasing and the legal problems arising out of that sui generis type of leasing commonly referred to as financial leasing. This report was considered by a small working group of the Unidroit Governing Council (1) which met in Rome on 21 April 1975 to examine the feasibility of drawing up uniform international rules on the leasing contract. This group made a series of decisions: first, to exclude real estate leasing from the scope of the proposed exercise, because of what was seen as the limited incidence of such operations at the international level and because of the enormous difficulties that would inevitably be faced by any attempt to unify principles of the law of real property and the law of personal property in the same text; secondly, to exclude the leasing of ships, because of the special nature of the contract involved, which was considered to have more in common with charters; thirdly, to exclude the leasing of aircraft, also because of the special characteristics of the contract involved and in view of the work underway within the International Civil Aviation Organization (ICAO) on a study of the problems arising out of the lease of aircraft in international operations; fourthly, not to limit the scope of the work proposed to the tripartite financial leasing operation but, for the time being at least, to envisage also the bilateral type of leasing known as operating leasing; fifthly, not to attempt, in view of the enormous difficulties that would be involved, any uniformisation of the national legal rules pertaining to exclusively domestic leasing operations but rather to address specifically international leasing; sixthly, not to convene any more meetings on the subject pending the Unidroit Secretariat's gathering of further information, in particular from the banks specialising in such operations, regarding the precise nature of international leasing operations. The working group

(1) The members of this group, all members of the Unidroit Governing Council at the time, were: Mr Richard D. KEARNEY, Ambassador, Deputy Legal Adviser to the Department of State of the United States of America; Mr Tudor R. POPESCU, Professor of Law in the University of Bucharest; Mr Jean Georges SAUVEPLANNE, Professor of Law in the University of Utrecht and Mr Benjamin A. WORTLEY, Professor of Law in the University of Manchester.
finally authorised the Secretariat to circulate its preliminary report amongst experts with a request for comments.

19. — These decisions were endorsed by the Governing Council at its 54th session in April 1975 as a result of which in March 1976 the Secretariat sent out a questionnaire to leasing operators and experts the world over, designed both to clarify certain legal problems peculiar to leasing transactions in general and to throw light on the implications of cross-border leasing in particular. Unidroit was greatly assisted in the circulation of this questionnaire by the co-operation of Leaseurope and the International Chamber of Commerce in distributing it widely among their respective national associations. Replies to this questionnaire came in from all four corners of the world and were analysed by the Secretariat in a paper submitted to the Governing Council at its 55th session in September 1976. One of the major facts to emerge from this inquiry, as has been indicated above, was that the successful mounting of truly cross-border leasing transactions, as opposed to indirect international leasing transactions concluded through subsidiaries of the lessor incorporated in the country into which the latter wished to lease or by means of joint ventures, was still a rare occurrence, even if the sums involved in the small number of transactions actually mounted successfully were enormous, and that this was in no small measure due to the varying legal treatment accorded leasing from one country to another. Interest among those responding to the questionnaire leaned accordingly more towards a uniform international regulation of the rules governing leasing transactions in general rather than rules cast with international leasing specifically in mind. The primary purpose of the drafting of uniform rules was therefore seen as the resolution of the legal vacuum affecting leasing at the domestic level with a view to facilitating and thereby extending the possibilities for the use of this means of financing international trade.

20. — Twin doubts nevertheless persisted in the minds of members of the Governing Council regarding the aptness of this subject for unification, as regards first the feasibility of disentangling the private law aspects of leasing from its fiscal aspects, given the generally agreed unsuitability of the latter for an attempt at unification, all the more so in the same text as the private law aspects, and, secondly, the desirability of dealing separately from the general body of security interests in movables, a subject then being studied by the United Nations Commission on International Trade Law (UNCITRAL). In order to clarify these doubts the Governing Council set up a restricted exploratory working group.

(2) The Chairman of this group was Mr László RÉGHEL, Ambassador, Professor of Law in the University of Budapest, member of the Unidroit Governing Council (Hungary). Its members were: Mr Jean Georges SAUVEPLANNE, Professor of Law in the University of Utrecht, member of the Unidroit Governing Council; Mr Detlev F. VAGTS, Professor of Law in the University of Harvard, Counsellor on International Law to the Department of State of the United States of America, representative of Mr Richard D. Kearney, member of the Unidroit Governing Council (see above, footnote 1). Mr Fritz PETER, Honorary Chairman of Leaseurope, served as expert consultant to the group, which was moreover assisted by: Mr Paolo CLAROTTI, Head of the Banking Division at the Commission of the European Communities, and Mr Augusto FANTOZZI, Professor of Revenue Law in the University of Rome.
drawn from amongst its own membership but assisted by consultant experts from the world of leasing practice. The working group gave positive answers to both problems when it met in Rome from 16 to 18 March 1977. As regards the first problem, it was of the opinion that, notwithstanding the considerable importance of fiscal considerations in specifically international leasing transactions, there was a sui generis derivation of private law in tripartite financial leasing which merited the framing of special rules cast with its particular characteristics in mind and that it would be possible in the drafting of such rules to steer clear of those aspects of leasing which rather fell within the competence of the revenue authorities, the philosophies underlying revenue law and private law being quite distinct. As regards the second problem, the group felt that it was perfectly feasible to formulate a legal framework around the sui generis leasing transaction without such a definition bringing the transaction automatically under the scope of Article 9 of the Uniform Commercial Code of the United States of America and similarly inspired security interest legislation. In particular, security interests being closely tied to an underlying sale contract, the only potential security interest in the sui generis type of financial leasing would be the purchase money-security interest relating to the sale contract between supplier and lessor. The relationship between lessor and lessee under the leasing agreement itself, on the other hand, did not establish a security interest so long as no transfer of title took place.

21. — The working group accordingly recommended to the Governing Council that a study group should be set up with the assignment of drafting international uniform rules on the sui generis type of leasing transaction. It was felt that international uniform rules would realise a dual advantage in making it possible to leave the choice of the final form which the rules would take until a later stage, leaving open both the possibility that they be used to clarify the situation at the domestic level and the possibility that they be addressed to specifically international situations. The group also made a preliminary examination of the ground to be covered in the uniform rules, concluding with a number of policy recommendations to the Governing Council, among which the following may be singled out as being worthy of special mention:

(i) Clear concepts should be employed in the uniform rules so as to avoid an a posteriori classification of a lease as contemplated by the uniform rules under some quite different schema.

(ii) The principal aim of the uniform rules should be to regulate the tripartite leasing transaction in view of its sui generis characteristics in relation to the existing schemata with one or other of which it had hitherto generally been assimilated. Such tripartite operations involved a leasing company which, at the request and on the specifications of the lessee, acquired capital goods for the specific purpose of leasing them to the latter. Bipartite leasing operations should only find a place in the uniform rules to the extent that such operations did not fit within the schema of a nominate contract and where the operation fitted within such a schema, then it should be treated in accordance with the appropriate provisions of municipal law.
(iii) Leasing could be defined negatively for the purposes of the uniform rules as neither a credit transaction nor a sale nor a financing transaction, but rather a special form of rental providing the use of goods. The definition of leasing to be devised in such uniform rules could be based either on an identification of those characteristics which differentiated leasing from the existing contractual schemata with which it had hitherto been bracketed or on an enumeration of the requirements to be fulfilled before a transaction could be considered a leasing transaction for the purposes of the uniform rules, in the manner of the definition of “bill of exchange” in the 1930 Geneva Convention on Bills of Exchange and Promissory Notes, or else on an amalgam of the two.

(iv) The scope of the uniform rules should be limited to capital goods, thus to the exclusion of consumer transactions.

(v) The parties to the transaction should be professional parties and the item leased should have been leased for professional purposes only.

(vi) There was a case for excluding the leasing of aircraft, ships and rolling stock from the scope of the uniform rules, on the basis of the arguments advanced in the previous small working group of the Governing Council.

(vii) The leasing agreement to be addressed in the uniform rules should cover the use of an item leased for a length of time corresponding to its economic working life.

(viii) The lessor should remain the owner of the item leased, whatever agreements might be made with regard to the termination of the leasing agreement.

(ix) The lessee should not be obliged to purchase the item leased at the expiry of the leasing agreement, whereas equally the parties should be left free to include an option to purchase the item leased in the leasing agreement.

(x) Unless the contract provided otherwise, the lessee should have a direct right of action against the supplier in the event of the item leased not proving to be in conformity with the specifications given by the lessee.

(xi) The lessee should bear the physical risks arising in connection with the item leased, in view of the special situation obtaining in tripartite financial leasing. The general rule of the law of products liability according to which a lessor would be liable qua owner for any damage caused to a third party by the item leased should not apply to the special situation of the lessor in tripartite financial leasing.

(xii) Some means of protection of third party creditors of the lessee should be found, be it only in the form of a minimum requirement laying down the principle of registration but leaving the modalities of registration to be established by each country.

22. — The working group’s recommendation that a study group should be set up was endorsed by the Governing Council at its 56th session in May 1977. This study group, manned by eminent experts from legal and economic systems as diverse as those of Belgium, Brazil, France, Hungary, Italy, the Netherlands, Nigeria, Switzerland, the United Kingdom,
the United States of America and Yugoslavia, held four sessions in Rome, from 17 to 19 November 1977, on 1 and 2 February 1979, from 30 September to 2 October 1980 and from 27 to 30 March 1984. The Study Group elected Mr László Réczei, Professor of Law in the University of Budapest and a member of the Unidroit Governing Council, as its chairman. Mr Réczei had already chaired the restricted exploratory working group on the leasing contract which had met in March 1977.

23. — The first session of the Study Group was devoted to consideration of a list of questions drawn up by the Unidroit Secretariat and the definition of equipment leasing agreed upon after many years of debate by Leaseurope at its annual working meeting in Oslo that same year. The list of questions was designed to pinpoint the matters to be dealt with in the uniform rules. On the basis of the Leaseurope definition the Study Group was moreover able to draw up a provisional draft definition of the *sui generis* form of equipment leasing generally known as financial leasing, on which it had decided to concentrate its attention. Two other significant policy decisions were taken at this first session, to wit, first, that the Study Group should seek to provide rules for leasing operations in general rather than address specifically international leasing situations, given that there could be no solution to the problems bedevilling the development of international leasing so long as there remained no solution to the problems bedevilling leasing at the national level, and, secondly, that aircraft, ships and rolling stock should be included in the general scope of the uniform rules.

24. — The provisional draft definition agreed at the first session of the Study Group provided the starting point for the tentative draft uniform rules on the *sui generis* form of leasing transaction that were drawn up subsequently by the Unidroit Secretariat in tandem with the Chairman of the Study Group. For the other articles of this tentative draft the drafters sought to follow the general lines of the answers given by the Study Group to the aforementioned list of questions which it had considered at its first session. The provisions on public notice were, on the other hand, modelled on the equivalent provisions of the Uniform Commercial Code and the similarly inspired Personal Property Security Act of Ontario of 1967.

25. — This tentative draft was considered by the Study Group at its second session. Various proposals were put forward for its amendment at that session, notably regarding what was considered to be too detailed a public notice requirement for an intended international instrument. These proposals provided the inspiration for the subsequent work of revision carried out by the Unidroit Secretariat.

[3] For a full list of those taking part in the work of the Study Group for the preparation of uniform rules on the leasing contract, see below in the Appendix to this report.
26. – This revised text was then the subject of consultation both among the members of the Study Group and within a working group set up by Leasurope. This process of consultation yielded alternative revised texts, on the one hand, from two members of the Study Group and, on the other hand, from the Leasurope working group. A third alternative revised text was then drawn up by the Unidroit Secretariat in tandem with the Chairman of the Study Group in an effort to reconcile the different trends evidenced in these various alternatives. A preamble was added to the original draft in accordance with the wish expressed by the Study Group at its second session that it should be made clear that the uniform rules were only designed to deal with the private law aspects of leasing and did not presume to invade the specific competence normally reserved by the legislator in respect of the fiscal and accounting aspects of leasing.

27. – The alternative revised drafts were considered by the Study Group at its third session. At this session the Group was able, subject to some drafting improvements which it was agreed could be worked out between the different members of the Study Group, to adopt a set of preliminary draft uniform rules on the sui generis form of leasing transaction. While the title of the draft still referred to uniform rules, underlining the original intention of the drafters to approach the problem from the angle of seeking to remove the differences in legal treatment existing from one jurisdiction to another, seen as one of the major obstacles to international leasing’s realisation of its full potential, the preamble and the scope of application provisions were couched in the form of a draft international Convention and the uniform rules addressed specifically international leasing situations. This change of approach was prompted, on the one hand, by recognition of the reluctance of certain States to become parties to international instruments in respect of any other than international transactions and, on the other hand, by the desire to indicate the Study Group’s opinion that the uniform rules’ greatest chances of success lay with their embodiment in an international Convention, the feeling being that a model law would not greatly improve the present situation of considerable differences of legal treatment of leasing from one jurisdiction to another.

28. – The Study Group, in adopting the text of preliminary draft uniform rules, recommended that, instead of following the usual course of transmitting the text prepared by the Study Group directly to a committee of governmental experts for the hammering out of a final text for adoption at a diplomatic Conference, the Unidroit Governing Council should rather first give the uniform rules maximum exposure among the business and legal practitioners familiar with the everyday realities of leasing, inter alia by the organisation of symposia in different parts of the world. The purpose of these symposia would be to enable the text to be presented to and discussed by practitioners. The unripeness of the uniform rules for consideration by governmental experts pending such time as they had been given such exposure among practitioners was considered to flow principally from two, not wholly unrelated factors: first, the continuing sparseness of attempts at the domestic level to legislate in this field and, secondly, the continuing evolution of the leasing mechanism in view of
its well proven flexibility to meet constantly newly appearing market needs. Since this continuing process of evolution was largely the work of the denizens of the financial and business world, it was considered desirable to sound first the opinion of those responsible for this ongoing evolutionary process, in order to ascertain whether and to what extent the solutions advanced by the preliminary draft uniform rules were consonant with the realities of leasing practice.

29. — The Unidroit Governing Council at its 60th session in April 1981 endorsed this recommendation of the Study Group for the holding of symposia designed to give exposure to the uniform rules and the first in what was envisaged as a programme of symposia was held in New York on 7 and 8 May 1981. This symposium was sponsored by the American Law Institute-American Bar Association Committee on Continuing Professional Education. The audience assembled in New York was essentially composed of bankers, businessmen and practising lawyers having expertise in international leasing, mostly from the United States but also including some who had journeyed from Europe. Invitational in character, the symposium was structured in such a way as to permit a panel of speakers, largely made up of members of the Study Group (4), to introduce the provisions of the preliminary draft uniform rules and the audience to raise questions and indicate any criticism.

30. — The second in the programme of symposia, sponsored by Industrie-Leasing AG, the leasing subsidiary of the Swiss Bank Corporation and held in Zürich on 23 and 24 November 1981, (5) was addressed essentially to an audience of Western and Eastern European bankers, businessmen and practising lawyers, although some participants came from further afield, from Egypt for instance.

31. — Presentation of the uniform rules to, and discussion thereof among a numerous Far Eastern audience was also possible at the First World Leasing Convention, organised by Leasing Digest Conferences in conjunction with the Hong Kong Equipment Leasing As-

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(4) In New York the panel of speakers was made up as follows: Co-chairmen: Mr Peter F. COOGAN, member of the Study Group; Mr Ronald M. DEKOVEN, member of the Study Group; Members: Mr F. Allan FARNSWORTH, Professor of Law, Columbia University, New York, member of the Unidroit Governing Council; Mr Roy M. GOODE, member of the Study Group; Mr Kraig KLOSSON, Chairman, International Committee, American Association of Equipment Lessors; Mr Peter H. PFUND, Assistant Legal Adviser for Private International Law, Department of State of the United States of America; Mr László RÉCZEI, Chairman of the Study Group; Mr Martin J. STANFORD, Secretary to the Study Group; Mr Detlev F. VAGTS, member of the restricted exploratory working group of the Unidroit Governing Council on the leasing contract.

(5) The panel of speakers in Zürich was made up as follows: Chairman: Mr Fritz PETER, consultant expert to the Study Group; Members: Mr El Mokhtar BEY, member of the Study Group; Mr Tom M. Clark, then Chairman of Leaseurope; Mr Peter F COOGAN (see above); Mr Ronald M. DEKOVEN (see above); Mr Roy M. GOODE (see above); Mr Michel PELICHET, observer of the Study Group; Mr László RÉCZEI (see above); Mr Peter SEIFFERT, lawyer with Deutsche Anlagen-Leasing GmbH, Mainz; Mr Martin J. STANFORD (see above).
association in Hong Kong from 10 to 12 January 1983 (6).

32. — Further presentation and discussion of the uniform rules was also possible at the seminar on international equipment leasing organised for French-speaking African lawyers by the International Development Law Institute in Rome from 6 to 17 February 1984 (7).

33. — The Unidroit Secretariat in the meantime employed its best offices to ensure that the uniform rules received the maximum exposure world-wide by the publication of regular articles thereon in the annual editions of the World Leasing Yearbook from 1980 onwards and, where possible, in the press. (8) Regular and close ties of co-operation have at all stages of Unidroit's work on this subject been maintained with the national, supranational and regional associations and federations representative of the leasing industry, most notably Leaseurope (9), the Asian Leasing Association, the American Association of Equipment Lessors and the Federacion Latino Americana de Leasing (Felalease). On 12 June 1984 the Italian Finance Houses Association (Associazione Tecnica delle Società Finanziarie di Leasing e di Factoring), in conjunction with the law journal "Nuovi Investimenti", organised a one-day seminar on the Unidroit draft in Milan. The audience, made up of Italian leasing specialists, was thus able to hear presentation of the draft and make such criticism and comments as they saw fit. (10)

34. — Much constructive criticism of the uniform rules was made at these various venues. The most far-reaching proposal for their amendment was, however, made in New York where there was a call for the uniform rules to be broadened to encompass bilateral leases, most notably operating leases.

35. — This proposal for the broadening of the uniform rules was in the end rejected by the Study Group when it met for its fourth session. This session was designed to consider the case for the amendments proposed during the course of the programme of symposia and to enable the drafting to be improved. To this end the Study Group was seized of a revised version of the text adopted in October 1980 which had been prepared in Budapest in December 1983 by the Unidroit Secretariat in tandem with the Chairman of the Study

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(6) Presentation of the uniform rules in Hong Kong was in the hands of Mr Ronald M. DEKOVEN (see above), with additional information being supplied by Mr Martin J. STANFORD (see above).

(7) Presentation of the uniform rules was this time in the hands of Mr Martin J. STANFORD (see above) as Technical Coordinator of, and Visiting Instructor at the seminar.


(9) Unidroit has thus twice, in 1976 in Munich and in 1982 in Amsterdam, been given the opportunity to address annual working meetings of Leaseurope on the subject of the uniform rules.

(10) On this occasion presentation of the uniform rules was in the hands of Mr Ricardo MONACO, then Secretary-General of Unidroit; Mr Giorgio DE NOVA, member of the Study Group and Mr Martin J. STANFORD, Secretary to the Study Group.
Group. The aim of this revision had been to seek to give effect to the proposals for the uniform rules' amendment made during the course of the programme of symposia and other meetings. At this session the major decisions, apart from that of not widening the scope of application of the uniform rules in the way proposed at the New York symposium, were, first, to reintroduce that provision which had maintained its place right through the Study Group's work prior to the symposia and which sought to highlight the financial nature of the *sui generis* type of lease by indicating that the duration of the leasing agreement took account of the period of amortisation of the leased asset (Article 1 (2) (d) of the text adopted in October 1980: the present Article 2 (d)); secondly, the deletion of Article 2 of the text adopted in October 1980, (11) a provision that had aroused much criticism on the occasion of the symposia, mainly on account of what was considered to be its obscure drafting, but which sought to ensure that once a given transaction was regarded as subject to the uniform rules under the law of the State in which the leasing agreement was concluded or under the proper law of that agreement, then it was automatically subject to the uniform rules in any other Contracting State; thirdly, the deletion of Variant II of Article 4 of the text adopted in October 1980 (12) following much criticism of that variant during the symposia on the ground that it would put the risk of loss of title too heavily on the lessor; fourthly, the introduction of a clause requiring the lessor to elect between the exercise of the remedies given it under Article 12 (1) of the uniform rules and the benefit of a clause accelerating its entitlement to all or any of the lease rentals upon the lessee's default; fifthly, the introduction of an article by now common in international commercial law Conventions—designed to ensure, on the one hand, that the uniform rules are interpreted in accordance with their international uniform character and not on the basis of the legal principles and traditions of the legal system of the judge or arbitrator called upon to decide a given case and, on the other hand, the observance of good faith. Much additional effort during the fourth session of the Study Group went into improving the overall drafting of

(11) The text of Article 2 as adopted by the Study Group in October 1980 with subsequent modifications incorporated, with the agreement of the members of the Study Group, in the text published in March 1981 read as follows:

"Where a transaction is regarded as being subject to this Convention according to (a) the law of the State in which the leasing agreement was concluded or (b) the proper law of that agreement as determined by the rules of private international law of the forum, such a transaction shall also be regarded as being subject to this Convention in any other Contracting State."

(12) The text of Article 4, Variant II as adopted in October 1980 read as follows:

"The lessor's title to the equipment shall be enforceable against all third parties provided that the lessor has complied with such rules (if any) as to public notice as may be prescribed by the law of the State of the lessee's principal place of business. [Where the lessor has not so complied or where there are no such rules, its title is not enforceable against a person acquiring an interest in the equipment, by attachment or otherwise, unless the lessor proves that this interest was acquired in bad faith.]"
the uniform rules. The text adopted by the Study Group at this session was then, in accordance with Unidroit tradition, submitted for approval to the Unidroit Governing Council at its 63rd session held in May 1984. This approval was given by the Council which also authorised the convening of a committee of governmental experts responsible for hammering out the text of a draft Convention on international financial leasing. The first session of this committee will be held from 15 to 19 April 1985.

II. Some general remarks about the uniform rules

36. — The motives behind Unidroit's efforts to establish a uniform legal framework for the *sui generis* type of leasing essentially spring from two not entirely unrelated factors, one economic, the other legal. Economically, the investment potential of leasing at national level has already been very largely realised. Unfortunately, the often vast differences in the legal treatment of leasing from one jurisdiction to another and the general failure to adopt a consistent attitude to this problem on the part of legislators have played a considerable role in thwarting the potential of this hybrid mechanism at the international level to fuel those injections of capital investment so vitally needed in so many parts of the world to enable such countries to take advantage of the latest technology to modernise their industry and agriculture and to develop their economies in general. Some countries, notably France in 1966, Belgium in 1967, Brazil in 1974 and Portugal in 1979, have tackled the problem of legislating for leasing but in general most legal systems have simply tried to force leasing into the most appropriate of the existing contractual schemata, each jurisdiction tending to pursue the internal logic of its own legal system. This approach has caused much confusion regarding the precise legal nature of leasing, a confusion which was for a long time compounded by a reluctance to perceive the inadequacy of the legal treatment of leases resulting from the application to them of the principles of the classical contractual schemata with which they were bracketed. Thus in the United States of America the argument for a long time ran that leases could be adequately dealt with either under the law of bailment or under the provisions of Article 9 of the Uniform Commercial Code governing security interests, depending on whether the lease was intended to be by way of security or not. Isolated voices were to be heard arguing for the inappropriateness of the remedies provisions of Article 9 to those leases which did not closely approximate to transactions traditionally handled as security devices, but these voices were still not willing to recognise the existence of a category of lease that was amenable neither to classification within the category of bailment contracts nor to classification within the category of conditional sale/security interests. It is therefore illustrative of the fundamental transformation which American thinking, for example, has undergone on this subject during the drafting of the uniform rules when one considers that the National Conference of Commissioners on Uniform State Laws is at present drafting a uniform law on personal property leasing for adoption by the States of the Union.
37. — In distinguishing the *sui generis* type of lease from those neighbouring legal concepts with which it has hitherto generally been bracketed, two factors were felt by the drafters of the uniform rules to be of crucial importance: first, the dynamic role in the transaction played by the lessee who selects both equipment and supplier with the concomitant reduction in the role of the lessor whose ownership is stripped of virtually all its normal attributes, at least from an economic point of view, and whose interest in the transaction is limited to its recouping of its capital investment; secondly, the leasing agreement between lessor and lessee is concluded for a term which takes the period of economic amortisation of the equipment into consideration, whence the essentially financial nature of the transaction, in that the lessee's payment of its rentals is not merely consideration for its right to quiet possession of the equipment, as would be the case with a typical bailment for example, but also guarantees the lessor the amortisation of the capital invested by it in the acquisition of the equipment, together with its costs and profit margin.

38. — It is the atypical nature of these two quintessential features of the financial lease that were judged to merit the construction of a separate legal framework around this *sui generis* type of lease. From the very beginning of their work the drafters of the Unidroit text were aware of the need to avoid the pitfalls associated with most of the approaches hitherto taken in relation to this new contract and had to this end foremost in their minds the idea of reflecting in their text the economic reality of the transaction as evidenced by the parties in their respective contracts, the supply agreement between supplier and lessor and the leasing agreement between lessor and lessee. Given the dynamic, hybrid nature of the transaction in question, forever sprouting new varieties to respond to newly perceived market needs and to changes in market conditions, the drafters were moreover also keenly aware of the delicate nature of their task in that it would be vitally important to safeguard this inherent creative potential by avoiding anything like the imposition of a legislative straitjacket on the object of their exercise. This only served to reinforce the longstanding conviction of the drafters that their efforts would more usefully be employed in clarifying a limited number of fundamental points than in endeavouring to achieve a systematic unification of all legal aspects of the subject, all the more so as the more one went into detail the greater the differences between one legal system and another became. Concentration on a number of fundamental aspects of leasing could therefore for the same reason be reasonably expected to enhance the chances of success of the end-product of Unidroit's labours insomuch as it would increase its acceptability.

39. — The limited objectives of the Study Group nevertheless were still further concentrated by its need to build this minimal, basic legal framework precisely around those characteristic ingredients of the *sui generis* type of leasing transaction which would adequately distinguish it from the neighbouring legal concepts with which it has hitherto generally been bracketed. The atypical legal consequences of this *sui generis* legal status would then be spelled out in the body of the uniform rules. Here again, though, the Study Group de-
cided to restrict its efforts to a number of fundamental points, being moreover of the opinion that most of these were matters best left to be regulated by the parties in their agreements. Those areas where the Study Group judged it could usefully draw the atypical consequences upon the rights and duties of the parties flowing from the sui generis legal status conferred on tripartite financial leasing in the opening articles of the uniform rules affect *inter alia* the question of public notice regarding the lessor's title to the leased asset, the lessor's general immunity from those contractual and tortious duties that would normally flow from its position *qua* bailor of the equipment, the lessee's right to bring legal proceedings in its own name against the supplier in respect of any loss or damage which it has sustained through the supplier's failure to deliver the equipment in accordance with the terms of the supply agreement, the question of when the lessee is entitled to withhold payment of the rentals due under the leasing agreement, the lessor's remedies in the event of the lessee's default.

40. — One important policy decision taken by the Study Group, already alluded to in this report, was to decide that the substantive scope of application of the uniform rules should be limited to the tripartite type of leasing commonly known as financial leasing and not be broadened to encompass the bipartite type of leasing commonly known as operating leasing. As has already been pointed out, the Study Group had decided to limit its efforts to tripartite financial leasing on the ground that this raised far greater problems of originality and consequent awkwardness of fit in relation to the classical contractual schemata than bipartite operating leasing which was judged to be reasonably amenable to classification among bailment contracts. However, at the symposium in New York on 7 and 8 May 1981, American practitioners objected to the draft's exclusion of operating leasing. They pointed out that there was a good deal of operating leasing both in the United States of America and in Europe that was engaged in by lessors operating in exactly the same manner as they would in a full-pay-out (13) financial lease, this being particularly true in the case of container leases, many containers being leased directly by lessors on spot leases. There were moreover not infrequent cases where in the type of leasing in which lessors were active it was only possible to determine with certainty whether it was operating or financial leasing depending on what happened to the 20% or 30% residual factored in by the lessor at the beginning of the lease. It was argued that the need for the protection granted the lessor under the uniform rules, in particular as regards its title to the leased asset and its right to repossess in the event of the lessee's default and eventual bankruptcy, was just as important in the case of operating leases as it was in that of full-pay-out leases.

41. — The fear was also expressed that the uniform rules' exclusion of operating leasing might also induce lessors in given cases to seek to have the uniform rules held inappli-

(13) The term "full-pay-out" is another term common in leasing parlance, referring to a lease that enables the lessor over its "primary period" to recoup through the lessee's rental payments its capital investment in the equipment together with its costs and profit margin.
cable on the ground that the particular lease failed to meet one or other of the criteria laid down for a lease covered by the uniform rules. Particular reference was made in this regard to Article 2 (d) which provided that the term of the leasing agreement takes the period of the amortisation of the equipment into consideration. It was pointed out that what in respect of a given lease was to be considered as a term that took the period of the amortisation of the equipment into consideration could well prove to be a difficult question to answer, particularly where the lessor had factored in a 20% or 30% residual at the beginning of the lease. A broadening of the uniform rules so as to encompass operating leasing would, it was argued, help to ensure that a lease which on its face stated that the parties had agreed that it was governed by the provisions of the uniform rules, would in fact, once signed, be so interpreted.

42. — An argument advanced in support of a broadening of the scope of application of the uniform rules to embrace bipartite leasing was founded on the fact that there were many situations in which the lessor and the supplier, two of the three parties to the type of lease addressed in the uniform rules, would be the same person and there did not seem to be any good reason why such transactions should be excluded from the scope of the uniform rules through the mere fact that the role accomplished by two parties in the tripartite transaction was in this transaction accomplished by one and the same person.

43. — In support of the restriction of the uniform rules to the tripartite type of leasing commonly known as financial leasing, it is of considerable importance to bear in mind that this restriction was fundamental to the underlying philosophy of the whole draft, in that the reason for insulating the lessor in most cases from liability for the condition of the equipment was because its role was purely financial in nature, a consideration which would not apply were the lessor producing the equipment itself. Moreover, the reason for focussing on the sui generis type of leasing known as financial leasing was precisely to deal with those sui generis legal problems arising out of the complex, tripartite nature of financial leasing, such as the absence of contractual nexus between the supplier and the lessee, problems which did not arise with the bilateral lease. There was not the same need for an international Convention, for a law at all, where all the parties had to do was to write their contract, as was the case with the bilateral lease: the parties to such leases could be left to regulate the problems likely to arise out of their contract by themselves. This was manifestly not the case, on the other hand, with the more complex tripartite type of lease, where, for instance, the aforementioned absence of contractual nexus between lessee and supplier could raise many a problem at the international level regarding recognition of the basis of the lessee’s right of action against the supplier.

44. — One solution voiced during the third session of the Study Group was to incorporate a reservation in the future treaty enabling countries under the local law of which it would be appropriate for the provisions of the uniform rules to be extended to bilateral transactions so to extend the application of the uniform rules. Another possibility consid-
erally was the drafting of an optional protocol to the uniform rules to cover bipartite and operating leases.

45. — However, in the end on balance it was recognised by the Study Group that the facets of philosophical pyrotechnics which would be called for to accommodate both tripartite and bipartite leases, both financial and operating leases in the same text might prejudice the very chances of success of this project and that it would accordingly be wiser to deal with the two cases one at a time, that is, if after the work on tripartite financial leasing is completed it is judged opportune to draft uniform rules on bipartite and operating leasing too, then this might be considered at the appropriate time but not at the present when priority should rather be given to bringing the uniform rules on tripartite financial leasing to a successful conclusion.

46. — There may be some confusion regarding the apparent inconsistency between the title, on the one hand, and the formal layout, on the other hand, of the future international instrument prepared by the Study Group. Thus, while the title has always and still refers to the essential objective of the instrument prepared by the Study Group, namely the unification of the law in this regard, the text of the uniform rules is couched in the form of an international Convention, albeit with many of the provisions typically to be found in contemporary international commercial law Conventions missing. The use of the title “uniform rules” dates back to the restricted exploratory working group of the Unidroit Governing Council on the leasing contract which met in March 1977 and one of the recommendations of which was that the instrument to be prepared should be in the nature of international uniform rules so as to leave the choice of their precise scope of application until a later date (see above, § 21). However, at its third session the Study Group made two policy decisions in this regard. First, it decided that the uniform rules should address specifically international leasing situations, in recognition of the fact that certain States were only in the habit of becoming parties to international instruments the scope of application of which was limited to international transactions. Secondly, of the alternative end-products that the restricted exploratory working group of the Governing Council clearly had in mind in March 1977, the Study Group was of the opinion that a model law would not be appropriate insomuch as it would not give the same guarantees of removal of the vast differences between the legal treatment of the sui generis type of leasing from one jurisdiction to another as an international Convention. The Study Group’s decision to couch the uniform rules in the form of an international Convention therefore should be seen as an indication of its view that it is in this form that the uniform rules stand the greatest chances of success, in the sense of guaranteeing the removal of the aforementioned divergencies of legal treatment, and that it is therefore in this form that they should be presented to the international community. Nevertheless, since it clearly fell more within the competence of governmental experts than of the Study Group to make such a decision and to draw the necessary consequences, namely the drafting of the whole series of provisions, final clauses and otherwise that have now become common features of all international commercial law instruments,
the Study Group basically confined itself to its original terms of reference, namely the drafting of international uniform rules so as to leave a decision as to the precise character of the international instrument to be drawn up on the basis of its labours to the committee of governamental experts into the hands of which the uniform rules were duly transmitted by the Governing Council in May 1984. The title “uniform rules” was accordingly maintained in the final text of the uniform rules as adopted by the Study Group, although it will not escape the attention of the reader of the text that the Study Group did feel able at its fourth session to introduce one provision, namely Article 15, that in essence had less to do with its endeavours to construct a basic uniform legal framework around the *sui generis* type of leasing commonly referred to as financial leasing than with the incorporation of this basic uniform legal framework within the traditional framework of an international commercial law Convention.

47. — The Study Group’s efforts are thus essentially reflected in a minimal legal framework constructed in such a way around the basic features of the *sui generis* type of leasing transaction as to distinguish it once and for all from the neighbouring legal concepts with which it has hitherto generally been assimilated. It in no way sets out to provide an exhaustive legal regulation of this transaction. Whole areas of the law relating to this transaction will therefore remain outside the uniform rules, although, as is provided in Article 15, it is the intention of the drafters of the uniform rules that these matters should be resolved in accordance with the *sui generis* approach underlying the uniform rules. It is moreover a legal framework that was essentially conceived as being permissive in character, the opinion of the drafters of the uniform rules having always been that virtually all, if not all the provisions of the uniform rules could and should be liable to derogation, although a final decision on this matter was specifically left to be taken by governamental experts, as can be seen in the note to Article 14. In the spirit of encouraging, rather than stifling, further development and evolution of the superbly flexible mechanism at work in leasing it was nevertheless the intention of the drafters of the uniform rules that the basic, permissive legal framework which they had drawn up would be one that the parties to these transactions would be free to add to as they saw fit.

48. — An important objective ever in the forefront of the minds of the drafters of the uniform rules was the striking of an equitable balance between the competing interests of the different parties to the transaction. This search for balance and equity was conducted both in the context of the two contracts making up the complex tripartite financial leasing transaction, to wit the leasing agreement between lessor and lessee and the supply agreement between lessor and supplier, and in the mutual relations of the parties *inter se*. The uniform rules thus represent a delicately balanced structure, cast in the image of the economic reality of the transaction and which whilst inevitably reflecting the central, dynamic role of the lessee, accordingly seeks to achieve an overall apportionment of the rights and duties of all three parties to the transaction that mirrors their different roles and levels of responsibility in the transaction, or, as one member of the Study Group put it, a hierarchy of liabilities that corresponds to the hierarchy of initiatives taken by the different parties.
49. — One commentator on the uniform rules (14) has already drawn attention to their equitable distribution of the liability for product defects under a financial lease:

"The Convention defines the tripartite transaction as consisting of both the leasing agreement between the lessor and lessee and the supply agreement between the lessor and supplier. This broad coverage allows the Convention to consider both relationships together in fashioning its rules to achieve symmetry and equity between the parties. For example, the liability of the lessor for defective products may be limited while the supplier's liability is expanded; the lessee is still allowed recovery for product defects but the liability is more equitably distributed between the parties."

50. — The provisions of the uniform rules may conveniently be grouped in four parts (15). The first, comprising the preamble, Articles 1, 2, 3, 13 and 14 concerns essentially the scope of application, both substantive and geographic, of the uniform rules. In the second, which is made up of Articles 4, 7, 8, 9, 10, 11, 12 and 14, the uniform rules address essentially the rights and duties of the parties to the transaction inter se. The third part, governing the rights and duties of the parties to the leasing transaction with regard to third parties or outsiders, consists essentially of Articles 5, 6 and 7. A fourth part, which is as yet in an embryonic state for the reasons explained above (see § 46), concerns those matters connected with the application of the uniform rules as a future international Convention: Article 15 belongs to this part.

III. Commentary on the provisions of the uniform rules

Title

51. — The title of the uniform rules is at present: "Preliminary draft uniform rules on international financial leasing". Employment of the term "preliminary draft" is traditional within Unidroit for texts emanating from study groups that have not been considered by governmental experts.

Preamble

52. — Enshrined in the preamble is the basic philosophy underlying the uniform rules, namely that it is time that the sui generis type of leasing transaction addressed by the uniform rules receive an appropriate legal treatment cast with its particular characteristics in mind rather than, as hitherto, being generally forced this way or that into one or other of


the classical contractual schemata, most notably bailment and conditional sale, from which it has borrowed so many of its leading characteristics and within the comfortable logic of which it has therefore hitherto almost invariably been the tendency to try to accommodate it. The uniform rules are thus designed to distinguish the *sui generis* type of leasing once and for all from these neighbouring legal concepts, conferring upon it a legal status of its own consistent with the extent to which it differs from these same neighbouring concepts. This proclamation of the *sui generis* credentials of the type of leasing addressed by the uniform rules both prefigures the individual provisions of the uniform rules, thus serving to justify and to explain the atypical regulation of the relations between the parties proposed therein, and serves as an admonishment to those called upon to resolve legal issues arising in connection with the countless legal aspects of the *sui generis* type of leasing not specifically addressed in the uniform rules, that they should fashion their approach to the resolution of these issues in accordance with the philosophy underlying the uniform rules, that is, they should not simply fall back on the application of the rules proper to other types of contract by that same process of analogy that caused the need for this exercise in clarification in the first place, but should rather seek a solution consistent with the *sui generis* treatment and approach evidenced in the uniform rules. This last function of the preamble is most important in view of the strictly limited scope of the uniform rules. As has been indicated above (see above, § 38), it was agreed from the outset that the uniform rules should not set out to give an exhaustive legal regulation of the *sui generis* type of leasing but that they should rather seek to establish a basic minimal legal framework built around a limited number of fundamental points capable of bringing out the atypical credentials of the *sui generis* type of lease by comparison with the more traditional types of contract from which it had evolved. This policy decision of the drafter of the uniform rules owed as much to a desire to make the end-product of their labours as acceptable to as broad a spectrum of world opinion as possible as to an awareness of the extraordinary fertility of the fundamental mechanism at work in leasing when left in the hands of those denizens of the financial world responsible for its creation in the first place. It was the drafter’s concern that the inevitable lacunae that would with time show up in the fabric of the uniform rules as thus conceived should be approached from the same angle of the transaction’s separate legal identity. This particular concern of the drafter is given more direct expression in the provisions of Article 15 (2) of the uniform rules (see below, § 105).

53. — The *sui generis* type of leasing transaction addressed by the uniform rules is more specifically denominated in the title and the preamble by the term “international financial leasing”. Only international transactions were judged suitable for embodiment in a future international treaty, given the known reluctance of certain States to become parties to international instruments that by extending to domestic transactions may impinge on their domestic law. As for those States the primary concern of which would be for legislation to govern domestic leasing transactions, nay to establish a national legal framework for such transactions, it would be open to them to extend the application of the uniform
rules in such a way as to make them specifically applicable to domestic leasing situations too. The delimitation of the uniform rules by reference to international transactions should not therefore prejudice their undoubted potential as the basis of domestic legislation in those many States as yet with no legislative infrastructure for leasing.

54. — Financial leasing was singled out for special treatment in the uniform rules on the ground that, whereas other forms of leasing are generally amenable to classification among the classical contractual schemata — as is in general the case with operating leases (but see above, §§ 40-45) — financial leasing is a hybrid creature which partakes at one and the same time of characteristics associated with various neighbouring legal concepts but which through the unique way in which this fusion of different components has worked in the complex tripartite transaction that is financial leasing, is no longer logically amenable to classification among any single one of these schemata. The distinguishing features of this sui generis type of lease are set out in the individual provisions of Article 1 (1), Article 2 and Article 3. It is nevertheless important to bear in mind that just because the preamble chooses to identify the sui generis legal animal on which the drafters of the uniform rules decided to concentrate their attention with financial leasing is in no way to be interpreted as meaning that what the parties choose in their agreement to designate as a financial lease will necessarily come within the ambit of the uniform rules: on the contrary, the efforts made by the drafters in identifying such distinguishing features of the sui generis type of leasing transaction as follow in the opening articles of the uniform rules should rather be tempered by awareness that there are doubtless many other features of financial leases that have not found their place in Unidroit’s list of ingredients. This is inevitable since what follows in the opening articles of the uniform rules is not so much a definition of financial leasing as a description of those elements of the transaction that make out the case for a special treatment of the ensuing legal relations between the parties to such transactions. Once again the preamble is prefiguring the text of the uniform rules itself.

55. — Particularly noteworthy in the scheme of the uniform rules is the preamble’s introduction of the term “transaction” in relation to financial leasing. The term “contract” is generally much bandied about in connection with leasing but the reason for its inappropriateness is precisely one of the main arguments for the conferring of a sui generis legal status on that type of leasing commonly referred to as financial leasing: such a transaction is not necessarily made up of just one contract but, as is announced in Article 2 (a) of the uniform rules, may equally well comprise and usually does indeed comprise two contracts, one the agreement between the lessor and the lessee — termed the “leasing agreement” in the uniform rules (see Article 2 (c)) — and the other the agreement between the lessor and the supplier — termed the “supply agreement” in the uniform rules (see Article 4 (1)). However, what is involved is not so much two separate contracts as a single complex tripartite transaction setting in motion the interaction of two mutually interdependent agreements, and one of the principal concerns of the drafters of the uniform rules was to ensure
that the subject of its endeavours would henceforth be treated in this novel way. Treating the transaction as two separate contracts has hitherto proved to be the source of much distortion of the effective economic reality underlying the parties' intentions. The purely financial nature of the lessor's interest in the transaction and the case for its consequent insulation from that liability in contract or tort that would normally flow from its position as bailor would not, for example, emerge from the leasing agreement viewed in isolation: they only make sense when the motives of the parties to the two agreements are seen in the overall context of the single complex transaction that provides the link between the mutual rights and duties of the different parties.

56. — The statement in the preamble that the uniform rules relate to the private law aspects of financial leasing is designed to alert those called upon to apply and interpret the uniform rules that, given the different philosophies underlying the treatment of financial leases for accounting and revenue purposes from those underlying their treatment for private law purposes, the drafters of the uniform rules considered that it would have been both presumptuous and unrealistic to endeavour in the same text to deal with these divergent concerns. While the specific scope of the uniform rules is therefore delimited by reference to the private law aspects of financial leasing, this is not to preclude the possibility of the uniform rules impacting indirectly, albeit involuntarily, on such non-private law aspects of the subject as its accounting and revenue treatment.

Article 1

57. — The opening article of the uniform rules serves a dual purpose. First, in paragraph 1, it delimits the scope of application of the uniform rules by reference to the subject-matter addressed. Secondly, in paragraph 2, it delimits the geographic scope of application of the uniform rules. The subject-matter of the uniform rules already having been generically defined in the preamble as “international financial leasing”, paragraph 1 therefore sets out what may be regarded as a definition of “financial leasing”, while paragraph 2 sets forth the conditions that have to be met for a given financial leasing transaction to be regarded as “international” and as subject to the uniform rules.

58. — As has been stated earlier, the definition of the type of lease addressed by the uniform rules is closely modelled on the definition of “equipment leasing” adopted after protracted negotiations by Leaseurope in 1977. The fact that the drafting of this definition of the activities pursued by its members caused Leaseurope such difficulty is eloquent testimony of the different conceptions of leasing from one country to another, even within the relatively limited geographical confines of Western Europe.

59. — Whereas the provisions of paragraph 1 have many of the characteristic traits of a legal definition, this is deceptive. This is because, as announced in the preamble, the essential purpose of the uniform rules is to confer a distinct legal status on the sui generis
type of leasing transaction. The contents of Article 1 (1) should thus be seen not so much as a legal definition of "financial leasing" in the broad, loose, flexible sense in which that term is employed and understood in everyday parlance, for to embrace in one definition all the possible variations on the hybrid mechanism generally known as financial leasing would probably be to attempt the virtually impossible, but rather as a description of those features of the financial leasing transaction that establish its sui generis credentials by comparison with the neighbouring legal concepts with which through its provenance it has so much in common and with which it has accordingly in the past all too often been bracketed. This function of the definitional ingredients enumerated in Article 1 (1) is carried forward and completed in the provisions of Articles 2 and 3 (see below, §§ 67-72).

60. — The decision to concentrate on financial leasing entailed the exclusion from the scope of the uniform rules of operating leasing, for the reasons expounded above (see §§ 40-45). By implication short-term leasing, sometimes known as renting, is also excluded from the scope of the uniform rules, under the terms of Article 2 (d) which provides that in the type of lease governed by the uniform rules the leasing agreement takes the period of amortisation of the equipment into consideration. As will be stated below (see § 70) this clause is intended to limit the uniform rules to that type of lease in which, the lessor's role and interest in the transaction being purely financial in nature, the term fixed for the leasing agreement will reflect the economic working life of the leased asset and thus that period of time over which the lessor can calculate to recoup its capital outlay.

61. — One other form of lease excluded from the uniform rules is the bipartite lease. This results implicitly from the first feature of the sui generis type of lease singled out for attention in the uniform rules, to wit its tripartite nature. Indeed, while the employment of terminology normally associated with bailment contracts, such as "lessor" and "lessee", denotes that the essential but a priori basis of the transaction rests on a bailment relationship, between lessor and lessee, the formulation of the description of the type of lease addressed in the uniform rules in terms of a complex triangular relationship, rather than in terms of two separate contracts, enables the uniform rules to bring out, and to focus at once on the fundamental element of its originality, that is on that element which justifies the atypical legal regulation which follows in the succeeding articles: the essentially financial nature of the transaction. As noted by one commentator on the uniform rules, this means that

"the lessor's role is that of lender, the lessee's role is that of borrower. Instead of lending money directly for the purchase of equipment and then securing repayment of the debt through the pledge of the equipment as collateral, the lessor purchases the equipment, takes title in its own name, and then grants the use of it to the lessee in return for a promise to pay rentals." (16)

62. — The other side of the coin, as it were, to the lessor's limited financial role in the transaction is the lessee's extended, multifaceted, nay central role in the transaction. This consequently provides the other principal hallmark of the originality of the sui generis type of leasing transaction spelled out in paragraph 1, namely 'that it is on the specifications of the lessee that the lessor acquires the item to be leased from the supplier. In reality — and we have already had occasion to note the concern of the drafters of the uniform rules that their text should accurately reflect this economic reality — the technical specifications of the equipment are indeed worked out directly between lessee and supplier and delivery is made directly by the supplier to the lessee. This moreover highlights still further the dynamic role played by the lessee in the transaction, as echoed in Article 2 (b) below, namely that not only does the lessee choose the equipment but it also necessarily chooses the supplier. It is thus a relationship beyond the contractual pale that underpins to a large extent the logical basis of the atypical chain of rights and duties generated by the sui generis leasing transaction, in the sense that the lessee and the supplier are never at any stage co-contractants but are essentially responsible through their dealings for the selection, with a view to subsequent use, of a particular item of equipment, the lessor's role being confined to the injection of the necessary capital for the acquisition of the equipment. It is this quasi-contractual relationship between lessee and supplier which was felt to merit not only the shifting in the uniform rules of many of the rights and duties normally associated under a lease with a lessor onto the lessee but more specifically the conferment of a direct action for damages against the supplier at the suit of the lessee (see Article 10, below). This independent statutory right of action conferred upon the lessee by the uniform rules apart, the only legal link between the lessee and the supplier is in the triangular context of the complex financial leasing transaction through the lessor. This is the reason why the drafters of the uniform rules decided to articulate their legal framework for this sui generis type of lease in terms of a complex triangular transaction, rather than, as hitherto, in terms of two closely connected contracts. The lessor it is who is the co-contractant common to the two basic legal relationships underlying this complex transaction, bound as it is both to the supplier under the agreement, denominated in the uniform rules as the "supply agreement" (see Article 4 (1), § 73 below), providing for the acquisition of the item to be leased, and to the lessee under the agreement, denominated in the uniform rules as the "leasing agreement" (see Article 2 (c), § 69 below), providing for the use of the item acquired under the supply agreement.

63. — The subject-matter of the uniform rules is further delimited in function of the types of equipment which are the subject of the individual leases. The basic choice for the drafters of the uniform rules in this regard lay between real estate and personal property. In the event, for the reasons adduced above (see § 18), it was decided not to attempt to cover real estate leasing in the uniform rules, which were thus to concentrate instead on what is generally known as equipment leasing. In defining "equipment" the uniform rules adopt
the definition employed in the aforementioned Leaseurope definition, to wit plant, capital
goods or equipment. Such a definition must necessarily be interpreted in the light of the addi-
tional delimitation of the substantive scope of application of the uniform rules introduced
towards the end of paragraph 1, namely that the equipment must be of a type that can be
used by the lessee for business or professional purposes, the intention here being to exclude
the leasing of consumer movables, an exclusion justified by the quite different criteria appli-
cable to consumer and non-consumer transactions. However, this definition should also
necessarily be interpreted in the light of the decision of the drafters to exclude real estate
leasing from the substantive scope of application of the uniform rules, while the drafters
were clear in their own minds that the uniform rules were principally designed to cover the
leasing of movables, they nevertheless rejected the idea of spelling this out more explicitly in
the uniform rules on the ground that this would involve introducing terms like “movables”
and “immovables” into the uniform rules with the considerably differing meanings attrib-
uted to these notions from one legal system to another. The principal source of difficulty
on this score was the uniform rules’ reference to “plant”. “Plant” is defined in the Shorter
Oxford English Dictionary as “the fixtures, implements, machinery, and apparatus used in
carrying on any industrial process” (17). While there could be no doubt that plant that was
leased as a chattel but subsequently became annexed to land would qualify as equipment
and accordingly be covered by the uniform rules in common law jurisdictions, the same
was not necessarily felt to be true where the chattel leased began life as a fixture. The
drafters of the uniform rules were not attracted, for the reason adduced earlier in this para-
graph, by the idea of adding the qualification of “movable” before the word “plant” and in
the end decided that it would be better to leave the matter open. Thus, while the uniform
rules were never specifically intended to apply to real estate, their accidental application
to real estate could not be ruled out in those cases where this would follow from the inter-
pretation given to “plant” by the courts of a given country. It was the considered opinion
of the study group that the disadvantages inherent in such an approach were outweighed
by the aforementioned advantages of not having to introduce the slippery notions of “mov-
able” and “immovable” into the text of the uniform rules.

64. — Originally, the study group sought to drive home the need for special indicia of
the sui generis type of leasing transaction by inventing new terminology to denote the three
parties to the transaction. Thus, instead of the traditional appellations “manufacturer”,
“lessor” and “lessee” the uniform rules at one stage spoke of “supplier”, “financier” and
“user” respectively. This choice of labels was designed to reflect the essential role played by
each party in the overall transaction. The term “financier” was however considered to be

(17) The French text of article 1 (1) speaks of “outillage” defined in Le Robert as “ensemble,
assortiment d’outils nécessaires à l’exercice d’un métier, d’une activité manuelle, à la marche d’une entre-
prise, d’une exploitation".
dangerous as a label and, while maintaining the term "supplier", for the other two parties the Study Group therefore subsequently reverted to the more classical names of "lessor" and "lessee", preferring to distinguish these parties from the classical lessor and lessee by its description of their atypical functions in the context of the sui generis type of lease.

65. — As has been stated earlier (see § 57), paragraph 2 delimits the geographic scope of application of the uniform rules and in so doing sets forth the conditions to be met before a given transaction may be regarded as "international" and subject to the uniform rules. Once it was decided to tie the uniform rules to specifically international leasing situations it became necessary to decide which should be the criteria for determining whether a given financial-lease is to be regarded as international for the purposes of the uniform rules. The criterion normally employed to determine the international character of a legal relationship in modern international commercial law Conventions is that of the principal place of business of each of the parties to the relationship in question. The problem with applying this principle to the uniform rules derives from the fact that the transaction they address is tripartite, thus necessitating a choice between the three different places of business on which one's choice might fall, to wit the principal place of business of the supplier, that of the lessor and that of the lessee. It was finally decided to exclude the impact of the supplier's principal place of business on the basis that the fundamental legal relationship contained within the complex triangular leasing transaction is the leasing agreement between lessor and lessee (18) and that it is accordingly more appropriate to take the principal places of business of lessor and lessee as the decisive criteria for determining whether a given financial lease is international or not. In other words, the uniform rules are only to apply where the principal place of business of the lessor and that of the lessee are located in different States.

66. — There is however one further requirement that must be satisfied before the uniform rules will apply and this is set out in sub-paragraphs (a) and (b) of paragraph 2: a connecting factor must in addition be established between the uniform rules and the law of a Contracting State. Thus it is provided that the uniform rules will only apply if the States in which the lessor and lessee have their principal places of business are both States which have adopted the uniform rules or if the rules of private international law of the forum lead to the application to the leasing agreement of the law of a State which has adopted the uniform rules. This last-mentioned alternative connecting factor is based on the premise that, once the uniform rules are adopted by a State, then they should govern all financial leasing transactions of an international character as defined in the chapeau of this paragraph in preference to the domestic law which was conceived with only internal financial leasing transactions in mind. Thus when, by the operation of the rules of conflict,

(18) See also El Mokhtar BEY and Christian GAVALDA, Problématique juridique du leasing international in Gazette du Palais 1979, 1er sem., 143 at 144.
the law of a Contracting State is found to be applicable to the leasing agreement — and the leasing agreement is again chosen here as the relevant agreement in parallel with the selection of the principal places of business of the two parties to this agreement as the relevant factors in the chapeau of this paragraph — it is the uniform rules which are to apply to the financial leasing transaction.

Article 2

67. — Article 2 spells out four principal characteristics of the *sui generis* type of leasing transaction addressed by the uniform rules. It thus expands on the description given in Article 1 (1). These characteristics are merely intended as features illustrative of the type of *sui generis* lease singled out for attention by the drafters of the uniform rules and are not therefore intended to be exhaustive definitional ingredients. Sub-paragraph (a) highlights what will usually be the pluricontractual basis of the complex *sui generis* type of leasing transaction, made up of two sets of fundamental legal relationships, a contract of sale and a bailment contract each capable materially and legally of expression as a separate contract. Nevertheless, the economic finality of the transaction, and the interpenetration and interdependence of the relations between the three parties involved point in the direction of a single contract, setting out the rights and duties of each of the three parties, original and unorthodox as this view may seem to certain minds.

68. — Especial importance within the scheme of the uniform rules, and notably its shifting of the normal disposition of so many of the rights and duties of the parties under a classical bailment contract, attaches to sub-paragraph (b), as it is precisely because the lessee is itself responsible for the choice of the equipment, in the light of and with a view to its own operational requirements, and of the supplier, with whom it will discuss *inter alia* the conditions of and time to be allowed for delivery, alterations, improvements, the conditions of, and the time to be allowed for payment, while the lessor confines its contribution to the provision of the necessary finance, that, in line with the aforementioned principle that for each hierarchy of initiatives there must be a corresponding hierarchy of responsibilities, Article 7 proposes, subject to certain exceptions, notably where and to the extent that the lessor assumes a role in the selection of the equipment, that the lessor should be immune from liability in respect of those contractual and tortious duties that would ordinarily flow from its position *qua* bailor of the equipment.

69. — Sub-paragraph (c), stating that the equipment is acquired by the lessor in connection with an agreement (the leasing agreement) which either has been made or is to be made between the lessor and the lessee, underlines the fact that the complex leasing transaction addressed by the uniform rules will normally comprise two contracts and brings out the link between these two contracts, the lessor acquiring the equipment from the supplier in pursuance of the leasing agreement it has made with the lessee, who has already selected
the equipment. The lessee's selection of the equipment is moreover not necessarily concomitant with, or subsequent to the leasing agreement, but may in fact precede the conclusion of the leasing agreement, which testifies to the flexibility of leasing. Clearly there will be no separate leasing agreement and supply agreement in the case where the parties decide to regulate their relations in a single contract in accordance with the provisions of sub-paragraph (a). In that case the equipment is acquired by the lessor with a view to its use being granted to the lessee. The interdependence of the rights and duties of the parties is nevertheless self-evident in this case too. The drafters of the uniform rules preferred to talk about the equipment being "acquired" rather than being "purchased" as in an earlier version of their text, in that to say that the equipment was "purchased" by the lessor was not entirely accurate to describe the case, frequent in the leasing of plant, where the land on which the plant was to be built was indeed purchased by the lessor but where the plant would then be constructed on this land by a third party builder.

70. — Sub-paragraph (d) highlights the financial nature of the leasing transaction addressed by the uniform rules in indicating the link between the duration of the leasing agreement and the period of amortisation of the equipment. The lessor's calculations in setting the amount of the lessee's rentals are in the *sui generis* type of lease with which the uniform rules are concerned founded on the lessor's ability to amortise its capital investment in the transaction over the term of the leasing agreement, thus distinguishing this type of lease from the classical bailment lease, in which the lessee's payments of its rentals is merely consideration for its right to quiet possession of the equipment during the term of the lease, the lessor's amortisation of its capital investment in such equipment in such a case being normally spread over the terms of more than one contract. Some criticised this clause for its vagueness, arguing that the term of any financial lease will automatically take the period of amortisation of the equipment into consideration (writer's own italics). The drafters' choice of language was conditioned by their desire to indicate that, while the term of the leasing agreement took the period of amortisation of the equipment into consideration, it was nonetheless not equal to this period. This choice of language should be seen as an attempt to bridge the considerable differences between those legal systems for which this link between the term of the leasing agreement and the lessor's amortisation of its capital investment is fundamental and those others for which too close a link between these two elements would destroy the transaction's chances of being upheld as a lease and would instead turn it into a conditional sale. Others feared lest the incorporation of such a characteristic might be in contradiction with the drafters' declared objective of concentrating their attention on the private law aspects of financial leasing, to the exclusion of its revenue law and accounting aspects. This clause does not however presume to enter into the merits of one or other of the systems of fiscal amortisation practiced in respect of such leases: it simply seeks to bring out the essential way in which this link between the term of the leasing agreement and the period of amortisation of the equipment
characterizes the *sui generis* type of lease addressed by the uniform rules, notably in distinguishing it from short-term rentals in which the aforementioned financial calculation plays a much less important role. It was not therefore the intention of the drafters of the uniform rules that fiscal considerations should be brought into play in the application of this clause.

*Article 3*

71. — This article seeks to resolve the difficulties arising out of the fact that, whereas the inclusion of an option to purchase the leased asset in favour of the lessee is under some legal systems, mainly Civil law jurisdictions, an essential ingredient of the *sui generis* financial lease addressed in the uniform rules, under others, essentially Common law jurisdictions, its inclusion would have the effect of altering the nature of the transaction, turning it into hire-purchase or conditional sale. However, as Mr David Gill, Director of the Capital Markets Department of the International Finance Cooperation (IFC), stated in an address to the Second World Leasing Convention in Washington, D.C. in June 1984:

"Including a pre-negotiated lessee purchase option to be exercised at the end of the primary lease term can help introduce equipment leasing to business communities that have a preference for asset ownership."

He pointed out that a survey undertaken by the IFC of 37 countries had revealed the dimensions of the differences of national treatment prevailing in this regard: 11 countries permitted such purchase options in leases, 11 others required them and nine prohibited them from leases in the sense indicated above. Six developed countries permitted or required purchase options and six did not, while 16 developing countries did and three did not. In countries where purchase options were not permitted, in the sense that the inclusion of a purchase option would destroy the transaction's qualification as a lease, the IFC survey showed that once a lease expired a former lessee might nevertheless buy the asset formerly leased at its fair market value, even if not at a pre-negotiated price. The usual practice in such countries was, where the former lessee did not buy the asset formerly leased on the expiry of the lease, for the lessor to return a part of the proceeds from the sale of the asset to the former lessee.

72. — The entitlement of the parties to the leasing agreement to stipulate a purchase option at a pre-negotiated price in favour of the lessee in their contract was nevertheless considered to be such a fundamental characteristic of the tripartite financial lease in so many countries that until the final session of the Study Group it figured among the main characteristics of this transaction now grouped under Article 2, all the more so as in these countries it was seen as highlighting still further the financial nature of the transaction, the pre-negotiated price reflecting the amount paid by the lessee in rentals. The inclusion of
a purchase option thus represented an important part of the financial bargain for both lessor and lessee in these jurisdictions. However, given the width of the gulf separating the attitude of the different legal systems in this regard, it was decided at the last session of the Study Group that it was inappropriate to list the right of the parties to stipulate such a purchase option as a leading feature of the type of lease addressed by the uniform rules and that it would be more realistic to provide that the characterisation of the leasing transaction for the purposes of the uniform rules should not be affected by the granting or absence of an option to purchase the leased asset in the leasing agreement. The reasoning underlying this solution was that, as the uniform rules are specifically addressed to international transactions and are not therefore intended to interfere with the situation regarding wholly domestic transactions, there is no reason why the uniform rules should not apply regardless of the particular solution adopted in the matter of options to purchase in the individual country. The matter of the right to stipulate purchase options is thus left as open as possible. It should however be borne in mind that as an alternative to the exercising of an eventual purchase option a lessee will have two other options, one stated in the uniform rules, to wit to re-lease the equipment, normally at a much reduced and in some cases at a peppercorn rental, and the other, not stated because it is not in the nature of a right conferred by the leasing agreement but rather simply the lessee's duty in the event of its failure to exercise an eventual purchase option or to re-lease the equipment, to wit to return the leased asset to the lessor, who will then usually dispose of it on the second-hand market.

Article 4

73. — This article deals with the problem of the extent to which the parties should, once the leasing transaction has been concluded, be free to vary their respective agreements. Once again it gives vivid evidence of the interdependence of these two agreements, namely the leasing agreement and the supply agreement. Whereas we are able to be introduced to the leasing agreement somewhat earlier, in Article 2 (c), the first use of the term "supply agreement" to denote the contract between supplier and lessor, providing for the acquisition of the asset to be leased to the lessee, appears only in this article. The two limbs of this article recognise that, while there can clearly be no harm in the parties negotiating better terms for themselves, the general rule must nevertheless be that, in order to safeguard the interests of the lessee with regard to the supply agreement and those of the lessor with regard to the specifications agreed between the lessee and the supplier, any attempt to vary the supply agreement, once the leasing agreement has been made, must be sanctioned by the lessee (paragraph 1) and any attempt to vary the specifications given by the lessee to the
supplier, once the supply agreement has been made, must have the consent of the lessor (paragraph 2).

74. — This article seeks to strike a fair balance between the interests of all the parties involved in the transaction regarding any variations in their respective agreements — “agreements” here being understood in the broadest sense so as also to embrace the specifications given by the lessee to the supplier. Thus this article does not provide for the supplier’s consent to be given to any variation in the terms of the leasing agreement, as this is clearly a matter of no concern to him. On the other hand, given that it is the lessee who is to use the equipment, it is clearly vital that there should be no room left for collusion between the supplier and the lessor to the detriment of the lessee and for this reason the uniform rules propose to make any variation in the supply agreement subject to the lessee’s consent. Equally it is vital that the lessee should not be able to alter the lessor’s situation in regard to the transaction negatively without the lessor’s consent. Thus, just as it is legitimate for the lessee to seek to have the use of the best equipment available for the particular purpose for which it needs it, which usually means the most up-to-date model on the market, it is equally legitimate that the lessor should first be given an opportunity to declare its opinion on any consequential variation in the terms of the specifications given by the lessee to the supplier, for instance during the ongoing construction of the item intended to be leased, that might have the effect of increasing its responsibilities, provided that is that the lessor’s consent is not in such circumstances withheld unreasonably or in bad faith.

75. — As has been mentioned earlier (see § 73 above), this article is in no way intended to interfere with the parties’ right to negotiate better terms for themselves, all the more so as the negotiation of better terms between the supplier and the lessor, for example, could well be to improve the terms of the leasing agreement for the lessee, notably in the shape of lower rental payments. This would notably be the case, say, where the lessor and the supplier agree to vary their original agreement by the terms of a buy-back arrangement, thus enhancing the lessor’s guarantee and enabling it to pass this onto the lessee in the form of lower rentals. Such private arrangements between lessor and lessee are to be expected, given that they would often be dealing with one another on a continuous basis over a number of years. However, whereas the rule contained in Article 4 is designed to prevent the variation of the parties’ respective agreements inasmuch as the result of such variation would be to worsen the situation of the party not party to such variation, it was not considered feasible or worthwhile to formulate such a distinction between the negative and the positive impact of individual variations on the position of the party not party to the variation.

76. — The exception to the rule laid down in paragraph 1 looks ahead to the right granted to the lessor upon the lessee’s default in Article 12 (1) (e). This exception safe-
guards the lessor and the supplier's right to vary their agreement without the lessee's consent in the event of the lessee's default under the leasing agreement in those cases where the triangle is completed and the leasing agreement has been concluded but where the lessee is not in a position to give its consent to such a variation. This would most obviously be the case where, even before the equipment has been delivered, the lessee has announced its inability to pay its rentals, for instance by the filing of bankruptcy proceedings. Commercial efficacy here requires that the lessor should not find itself with its hands tied and an expensive item of equipment unusable.

Article 5

77. — One of the thorniest problems arising in connection with leases as indeed with all transactions involving the separation of ownership and possession in respect of property concerns how best to inform innocent third parties coming into contact with leased property, through their dealings with the lessee, that it is subject to a reservation of title, since failing such notification, appearances, that is the fact of the lessor's dispossession, would normally induce most third parties, for instance creditors of the lessee, to believe that they were dealing with the owner, rather than the lessee, of the asset in question. This problem was particularly acute in the case of financial institutions thinking about lending to the lessee on the security of its assets, as a physical inspection of all the equipment of the financial institution's potential debtor in such a case would simply not be feasible. Consideration was given to the use of plaques — moreover required for leased equipment under the legislation of more than one country — but experience had revealed the limitations of the affixing of plaques to leased equipment as the foundation of a full-proof system of notification, such plaques being relatively easy to remove. Balance-sheets were also considered but rejected as inadequate for this purpose, in view of the fact that they served a quite different function, that of a general public notice, from the function that was had in mind here, that is a notice to a specific kind of third party. The vast majority of opinion within the Study Group recognised the ultimate desirability of a system of registration, on the model of that contained in Article 9 of the Uniform Commercial Code of the United States of America, as the most effective means of giving such notice of the lessor's title to third parties. While the Article 9 model was much admired for its flexibility in giving protection to third parties whilst at the same time not unduly tying the hands of the lessor — obliged to register only according to the type of equipment — the drafters of the uniform rules nevertheless realised that to embody such a complex public notice system in a future international instrument might be rather difficult, all the more so since such public notice systems currently existed in a very small number of countries only. The Study Group then toyed with the idea of laying down merely the principle of public notice in the form of a minimum requirement,
coupled with the spelling out of the penalty for non-compliance but otherwise leaving each Contracting State free to organise the details of its own system. However, recognition of this desideratum was tempered by awareness of the political difficulties that would be encountered in seeking to impose such a system on Contracting States. The organisational and financial implications of such a requirement, in particular for developing countries most of which were not endowed with even the most basic public notice infrastructure capable of being adapted to meet such a requirement, were acknowledged as making such a solution in effect a realistic no-starter. The Study Group was nevertheless anxious that the uniform rules should give some indication of its conviction that a public notice system was the only real answer to this problem and thus, hopefully, perhaps give some momentum to the institution in due course of such systems in the various countries.

78. — Included among the definitional ingredients of the *sui generis* type of lease in an earlier version was a clause stating that the lessor was and remained owner of the equipment throughout the term of the leasing agreement. This statement was eventually felt to be superfluous insomuch as it was implicit in so many of the individual succeeding provisions of the uniform rules. This article is a case in point. It proclaims first and foremost the fundamental *a priori* principle of the lessor’s title to the equipment during the term of the leasing agreement. However, in the interest of protecting third parties, it provides that, where rules as to public notice are laid down in the country where the lessee has its principal place of business, then the lessor’s title will only be good against such third parties if the lessor has complied with such rules. Thus, if there are no rules as to public notice under the law of the country where the lessee has its principal place of business, the lessor’s title is automatically good against any third party. The onus is therefore by implication very much on a Contracting State wishing to protect its citizens in the most full-proof way to institute some method of public notice system in respect of leases.

79. — The Study Group was greatly exercised by the question of which connecting factor should determine the law to govern the public notice requirement embodied in Article 5. The law of the State of the lessor’s principal place of business was quickly rejected on the ground that, if one of the principal objectives of a public notice system was to protect third parties dealing with a lessee of equipment, it was unrealistic to require such third parties to consult a register or the like in the country where the lessor had its principal place of business, as in the circumstances they would not necessarily be aware of the lessor’s existence. The choice between the other two possibilities, namely the *lex rei sitae* and the law of the State of the lessee’s principal place of business, however, provoked much more prolonged deliberation. The major difficulty with the *lex rei sitae* as a suitable connecting factor arose in connection with mobile equipment and the case where the lessee might fraudulently remove the equipment from the country where the lessor had understood it was to be used to some other country. Thus eventually the law of the State of the lessee's
principal place of business was chosen as the most suitable connecting factor.

Article 6

80. — This article deals with the situation, frequent in practice, where leased equipment becomes affixed to realty, in particular where it is intended for use in a factory. This raises obvious problems for the lessor when seeking repossession of its property upon the lessee’s breach of its contractual duties. The solution adopted in Article 6, which is closely modelled on Article 9-313 of the Uniform Commercial Code and Section 36 (4) of the Ontario Personal Property Security Act of 1967, is to recognise the lessor’s right to remove its property from the realty to which it has become affixed, but at the cost of reimbursing the owner or encumbrancer of the realty, other than the lessee, for the cost of any damage occasioned by the act of severance, allowance naturally being made for the normal wear and tear of the realty.

81. — The uniform rules do not presume to define what is or is not to be considered a “fixture” nor do they attempt to lay down a priorities rule determining when the lessor’s claim in the realty is superior to that of any other person with an interest in the same realty, this last being judged to be of such complexity as not to have a place in an intended international instrument and as being best left to be determined by the applicable national law. In order to determine whether the lessor did indeed have priority over others with an interest in the realty to which its property had become affixed, it was agreed that, in accordance with national practice in this matter, this should be determined by the law of the State where the real property itself was situated.

Article 7

82. — This article deals with the question of the extent of the contractual and tortious liability that can be incurred by the lessor in respect of equipment that is defective or otherwise not in conformity with the supply agreement (19). Given that it is the lessee who relies on its own skill and judgment in selecting the equipment and supplier, and who typically conducts negotiations with the supplier as a reasonably informed user, and that if there is any reliance on another it is upon the supplier’s knowledge of the equipment or repre-

(19) The writer of this report acknowledges his debt to Professor Roy M. GOODE on whose paper delivered at the New York symposium mentioned above (printed in ALI-ABA Symposium Materials, Unification of the Law Governing International Leasing of Equipment 1981, 75 et seq.) he drew heavily in preparing this commentary; see also Amelia H. BOSS, op. cit., at 147 et seq.
sentations, so much so indeed that it is effectively the supplier who places the equipment in the stream of commerce, the drafters of the uniform rules were of the opinion that it is the supplier, not the lessor, whose function in the transaction remains at all times essentially financial, who should in principle be liable to the lessee if the equipment is defective or otherwise not in conformity with the supply agreement. The legal consequences of this conclusion for the lessee are spelled out in Article 10. Article 7, on the other hand, draws the legal consequences of this situation in terms of the lessor, who is as a general principle absolved of the duties in contract or tort that would ordinarily flow from its position as bailor of the equipment. It only gives immunity in respect of those duties that would ordinarily flow from the lessor's position qua bailor. It does not therefore deal, for instance, with the consequences of non-delivery which precede the bailment and are effectively dealt with elsewhere in the uniform rules. It is confined to those liabilities that would flow as a matter of law from the lessor's leasing out the equipment and not those liabilities that would be imposed by contract whether through express terms or terms implied in fact. The reason why the uniform rules speak of duties that would ordinarily flow from the lessor's position as bailor of the equipment rather than of duties that would ordinarily flow from its ownership lies in the fact that under most jurisdictions there are relatively few liabilities that flow from ownership, most liabilities being imposed on the lessor qua legal supplier of the equipment. The difficulty with extending the protection given to lessors under this article so as to encompass also duties that would ordinarily flow from the lessor's ownership is that many States are parties to special international legislation imposing duties on owners as such, notably in respect of pollution caused by ships, and it would clearly be difficult for such States to accept a rule in the uniform rules that ran counter to such special liability. Equally, for much the same reason, it was not intended that the general immunity granted to the lessor under this article should extend to breaches of statutory duty, for it was clearly questionable whether States would be prepared to accept such an exclusion of those special duties imposed by statute over and above those imposed by the general law of tort.

83. — The provisions of Article 7 (1) do not involve such a radical departure as might at first sight appear, since in practice financial leases invariably contain detailed provisions absolving the lessor from responsibility for defective or non-conforming equipment and require the lessee to indemnify the lessor against claims made by third parties. The general immunity conferred upon the lessor under Article 7 (1) is granted vis-à-vis both the lessee and third parties. Its impact is examined below, first as regards the general immunity conferred upon the lessor in respect of liability in contract or tort vis-à-vis the lessee, secondly as regards the general immunity conferred upon the lessor in respect of liability in contract or tort vis-à-vis third parties and thirdly as regards the exceptions to this general principle of the lessor's immunity laid down in paragraphs 2 and 3.
Lessor's liability to lessee

84. — In most jurisdictions the lessor, although not physically delivering the equipment, is treated as the legal supplier vis-à-vis the lessee and, unless otherwise provided by the leasing agreement, owes a duty to the lessee to ensure that the equipment is of merchantable quality and fit for its known purpose. Breach of this duty would normally entitle the lessee to damages and might give it a right to reject the equipment and withhold payment of its rentals or even terminate the leasing agreement completely. Where the equipment is not only defective but unsafe and causes death or personal injury to the lessee, or damage to the property of the lessee, the latter would usually have a concurrent claim in tort, though in most jurisdictions this would be dependent on proof of negligence on the part of the lessor. In some jurisdictions, notably the United States of America, the lessor might in addition find itself in certain circumstances exposed to a suit alleging strict liability on the ground that it was the lessor who was to be considered as having introduced the defective equipment into the stream of commerce. The effect of Article 7 (1) is in principle to exclude claims by the lessee against the lessor for defective equipment. Thus the lessor will not in principle be liable to the lessee in respect of the implied warranty of merchantable quality: the lessor will not normally be a merchant as to the type of equipment leased, being generally only a merchant in the extension of credit. Equally, the lessor will not in principle be liable to the lessee in respect of the implied warranty of fitness for the equipment's known purpose: the lessor will not normally have shown any skill or exercised any judgment upon which the lessee has relied in the selection of the equipment. Furthermore, the lessor will not in principle be liable to the lessee in tort: the lessor will usually not be involved in the selection of the equipment, have no technical expertise with regard to its physical characteristics nor take delivery of it nor even see it. However, it will probably be in its effect on the application of the doctrine of strict liability for defective goods that the general immunity conferred on the lessor may be expected to have its greatest impact. This general immunity will also in principle preclude the lessee from claiming contribution or indemnity from the lessor in respect of liability incurred by the lessee to a third party as a result of a defect in the equipment.

Lessor's liability to third parties

85. — A finance lessor will not as a rule incur liability to third parties who suffer injury or damage as a result of defects in the equipment. There being no contractual nexus between the lessor and such third parties, such a claim would lie only in tort and in most jurisdictions it would be necessary for the third party to show that the lessor had been guilty of negligence, for instance, in leasing equipment that it knew or ought to have known was unsafe. For the reasons adduced above (see § 84), the burden of proving negligence on the part of a finance lessor is usually a heavy one. The effect of Article 7 (1) is to exclude
claims against the lessor by third parties who suffer such injury or damage. Once again, given the limited circumstances in which a third party would be able to prove negligence on the part of a finance lessor, the major impact of this exclusion is accordingly likely to be in those jurisdictions, such as the United States, where the lessor might find itself in certain circumstances exposed to a suit alleging strict products liability. The principle underlying this exclusion is that such liability is not appropriate in the case of a lessor who is not responsible for the introduction of the equipment into the stream of commerce.

Exceptions to general principle of lessor's immunity

85. — The general principle of the lessor’s immunity spelled out in Article 7 (1) is tempered by two exceptions in paragraphs 2 and 3 of the same article. First, under paragraph 2, given that quiet possession goes to the essence of a lease, the lessor remains liable for any disturbance of the lessee’s quiet possession resulting from the lawful act of a third party, that is where the lessor did not have the right to dispose of the equipment or where its right to do so was qualified in some way, and because of that a third party was entitled to claim possession by virtue of a paramount title, for example where its use was in breach of a patent or trademark. Secondly, under paragraph 3, as a corollary of the philosophy underlying so much of the uniform rules and, in particular, the general immunity conferred upon the lessee under Article 7 (1), namely that the lessor’s intervention is limited to the financial level, it is logical that in those cases where the lessor has intervened at a technical level in the choice of the equipment, then it remains liable both to the lessee and to third parties to the extent of its intervention. Admittedly, such cases of intervention by the lessor at a technical level will be rare. Whether in a given case the lessor is to be considered to have intervened at a technical level in the choice of the equipment is a matter left to be resolved according to the applicable national law. As it is likely that this would be one of the provisions of the uniform rules that the parties would be able to contract out of (see Article 14 below), the impact of this exception is likely to be less significant on the lessor’s immunity of action from the lessee than on the lessor’s immunity of action from a third party who has sustained injury or damage by reason of a defect in the equipment.

Article 8

87. — The two paragraphs of this article spell out the lessee’s duty of care in relation to the equipment from the moment that it is delivered into the lessee’s hands until the time that it is returned to the lessor at the end of the leasing agreement. The duty of care imposed on the lessee is that of a normal user. The standard of care that must be displayed by the lessee to this end is specified to be “proper” care. This standard is further clarified by the additional statement that the lessee must keep the equipment in the same condition as it was in at the time of delivery, after allowance has been made for fair wear and tear. In
effect this means that the lessee is under a duty to keep the equipment in good working order. The practical significance of this provision will however be limited inasmuch as leasing agreements invariably contain detailed provisions as to possession, care and use of the equipment.

88. — There was also discussion of whether the uniform rules should cover the question of what should happen where the equipment was accidentally destroyed at some stage during the leasing agreement. While the value of the equipment would normally be covered by insurance, this still left the problems of how the insurance monies should be applied and what should be the effect of the destruction of the equipment on the leasing agreement: 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 agreement should go on applying to the restored equipment. It was the opinion of the drafters of the uniform rules that this was a matter best left to be settled by the parties in their contract.

Article 9

89. — The separation of the supply agreement from the leasing agreement under most national laws has the consequence that it is not in general a defence for the lessor to say that its failure to perform its duties under the leasing agreement was due to the supplier's breach of the supply agreement (20). The uniform rules instead treat the two agreements as interdependent elements of a complex triangular transaction and thus, in keeping with the policy of fixing liability primarily on the supplier, adverted to notably in the context of Article 7, Article 9 (1) absolves the lessor from liability for non-performance or imperfect performance of the leasing agreement where this results from the supplier's breach of the supply agreement. So, if the equipment is not delivered, is delivered late or in defective condition, the lessor incurs no positive liability for damages to the lessee. The opening words of this article nevertheless make it clear that the lessor's immunity from suit at the instance of the lessee granted under this provision is subject to the liability imposed on it under Article 11 (see below). On the other hand, it would be wrong to require the lessee to wait for delivery indefinitely or to have to make do with non-conforming equipment. Therefore, if the equipment delivered fails to conform to the terms of the supply agreement (Article 9 (1) (a)) or if the supplier still fails to tender the equipment within a reasonable time after the due delivery date or, if none was fixed, within a reasonable time after the making of the

(20) The writer of this report again acknowledges his indebtedness to another paper presented by Professor Roy M. GOODE at the aforementioned New York symposium on which he has drawn heavily in this commentary; see ALI-ABA Symposium Materials, op. cit., at 82.
leasing agreement (Article 9 (1) (b)), the lessee is entitled, as against the lessor, to reject the equipment and, furthermore, under Article 11 (2) (see below), to terminate the leasing agreement. In determining the due delivery date regard is to be had, in the first place, to the date fixed in the leasing agreement and, only if this contains no date, then in the second place, to that set in the supply agreement. The priority given to the date fixed in the leasing agreement reflects the fact that the remedy being granted to the lessee under Article 9 (1) is against the lessor. The reason why the drafters of the uniform rules considered it appropriate to grant the lessee this right to reject vis-à-vis the lessor rather than vis-à-vis the supplier flowed from the fact that the effect of such a right being granted vis-à-vis the supplier would have been to revest title to the equipment in the supplier, which would adversely affect the interests of the lessor.

90. — Paragraph 2 of this article makes the lessor’s right to reject vis-à-vis the lessor exercisable by notice. Such notice must be given to the lessor within a reasonable time after the lessee has discovered the non-conformity or ought with reasonable diligence to have discovered it. The lessor then has the right to cure the non-conformity by a fresh tender, provided this is made within a reasonable time after notice to reject. In connection with this right of the lessor to make a fresh tender, it was felt that it might be desirable to restrict the right to re-tender under this article so as not to subject the lessee to the possibility of an endless series of non-conforming tenders, each made within a reasonable time after notice of rejection of the previous tender.

Article 10

91. — After the wide immunity from liability granted the lessor under Article 7 (1) and Article 9 (1), founded on the principle that it is the supplier and not the lessor who should in principle be liable to the lessee for failure to deliver the equipment in conformity with the terms of the supply agreement (see § 82 above), the question still remained of how this principle should be converted into an effective right of action exercisable directly against the supplier at the instance of the lessee. In effect, unless some form of collateral contract can be deduced from the negotiations between the lessee and the supplier, there is no contractual nexus between these two parties. As a result it has hitherto been very difficult for the lessee to bring proceedings against the supplier. The techniques employed to get round this problem have involved the lessor agreeing either to assign its claim against the supplier to the lessee or to enforce its own rights as buyer against the supplier for the lessee’s benefit. Both these techniques are inadequate inasmuch as the claim pursued by or in the right of the lessor can only be for its recoverable loss, whereas what is sought to be recovered is the loss sustained by the lessee. Thus, for instance, where the equipment delivered is defective and the lessor has assigned its rights against the supplier to the lessee, the latter can nevertheless only exercise against the supplier such rights as could have been exercised against the supplier by the lessor and, where the lease incorporates the usual hell and high water
clause, whereby the lessee undertakes to pay its rentals come what may, the lessee will find its measure of recoverable loss limited to nominal damages, as the supplier will be able to assert its defence against the lessor, namely that the latter has not sustained any financial loss in that it is still entitled to recover its rentals from the lessee. Equally, where the lessor sues the supplier for the benefit of the lessee, it will still only be entitled to recover its loss qua buyer and not that sustained by the lessee.

92. — The solution adopted by the Study Group in Article 10 (1) was to cut through the privity problem by giving the lessee an independent, direct, statutory right of action against the supplier where the lessee suffers loss or damage through the supplier’s failure to deliver the equipment in accordance with the terms of the supply agreement. The uniform rules thus treat the supply agreement as creating stipulations for the benefit of a third party, in this case the lessee. The question then arose of which rights should be exercisable by the lessee against the supplier under this provision, that is whether the lessee should receive all the rights that would be available to the lessor under the supply agreement or only some of these rights. The conclusion reached by the drafters of the uniform rules was that the lessee should be entitled to exercise those rights which, while protecting its own interests, do not damage the interests of the lessor. Thus the second sentence of Article 10 (1) specifies that the direct right of action conferred upon the lessee by the first sentence shall in no way prejudice the lessor’s normal sale of goods remedies against the supplier. These remedies were not dealt with in the uniform rules since they are already exhaustively dealt with by domestic and international law. There was one clear case in which the lessee’s direct right of action against the supplier would have to be subordinate to the lessor’s exercise of its sale of goods remedies against the supplier, to wit the case where it emerged that the supplier’s failure to deliver had been the result of the lessor’s breach of the supply agreement, notably by non-payment of the purchase price. The rights given to the lessee under Article 10 are thus two-fold: first, a right to damages against the supplier for the latter’s breach of the supply agreement, under paragraph 1 and, secondly, a right to apply for specific performance of the supply agreement, under paragraph 2. The question of whether specific performance is the appropriate remedy in a given case is one that is left to be decided by the applicable national law: Where it is not, then damages can still be awarded under Article 10 (1). In the event that the lessee elects to apply for specific performance of the supply agreement, then it must give prompt notice of its institution of such proceedings to the lessor (Article 10 (2)).

93. — The Study Group discussed requiring proceedings against the supplier to be brought in the joint names of the lessor and the lessee so as to ensure that all the relevant interests were before the court when making its adjudication, particularly with a view to avoiding the risk of the duplication of damages. While the lessor and the lessee had separate interests in the equipment — both of them derive income from the equipment, the lessor in the form of rentals and the lessee in the form of the income generated by its use of the equipment — each of these separate interests might be adversely affected if one were to
pursue its remedies independently of the other. This view, however, did not command unanimous support, one member of the Study Group being of the opinion that the introduction of the principle of the joint action would be inconsistent with the uniform rules' intention of enshrining the *sui generis* nature of the financial lease in appropriately new solutions, notably in so far as one of the fundamental tenets of the philosophy underlying this decision hinged on the fact that the central, dynamic role in the transaction was at all times played by the lessee, who must accordingly be left complete freedom in dealing with all the technical aspects of the equipment. This, it was argued, necessarily included being able to sue the supplier where the latter failed to deliver the equipment in accordance with the terms of the supply agreement, without having to resort to the legal subterfuge of the lessor's assigning its rights to the lessee or acting against the supplier for the lessee's benefit. It appeared moreover that the idea of the joint action would raise difficulties of a procedural law nature for some Civil law jurisdictions.

94. — Attention was at a comparatively late stage in the preparation of the uniform rules drawn to a potential limitation on the cases in which the lessee's direct right of action against the supplier would effectively lie: this right of action would in fact only lie in those cases in which the law applicable to the supply agreement was the law of a State which was party to the future international Convention. Given that Article 1 had made the States of the principal places of business of the lessor and the lessee the sole connecting factors for the purposes of determining the applicability of the future Convention, it was pointed out that there would accordingly frequently be cases where the supply agreement, which clearly might well be subject to the law of the State of the supplier's principal place of business, might fall outside the scope of the future Convention, being subject to the law of a State which was not party thereto. This problem was not faced by the Study Group.

*Article 11*

95. — As we have seen, Article 9 largely insulates the lessor from liability towards the lessee for such non-performance or imperfect performance of the leasing agreement as results from the supplier's breach of the supply agreement. Under Article 11 this insulation of the lessor from liability towards the lessee is qualified. Thus, where the supplier's failure to make delivery in conformity with the terms of the supply agreement or its delivery of non-conforming equipment is properly attributable to the lessor's fault, notably in the latter's not having paid the purchase price, the lessee is entitled, under paragraph 1, to withhold payment of its rentals, although only to the extent justified by the loss that the lessee has actually sustained thereby. Where, even after the passing of a reasonable time following the delivery date as fixed in either the leasing agreement or the supply agreement or, if none is fixed, following the making of the leasing agreement the supplier still fails to make a tender of conforming equipment, then the lessee is also entitled, under paragraph 2, to terminate the leasing agreement and to recover all rentals and other monies paid in advance. Where the supplier's failure to deliver, delay in delivery or delivery of non-conforming
equipment is properly attributable to the lessor’s fault, then the second sentence of paragraph 2 leaves open the possibility for the lessee to sue the lessor for damages for any additional loss. The lessor thus, in essence, has to be at fault before its insulation from liability towards the lessee under Article 9 (1) will be dented, apart that is from the right to terminate the leasing agreement and to recover all rentals and other monies paid in advance given to the lessee where the supplier still fails to make a tender of conforming equipment even after the passing of that reasonable time referred to above, and which is a right conferred upon the lessee irrespective of whether the supplier’s breach of the supply agreement is conditioned by the fault of the lessor. In such a case the lessor would be left to seek recovery of such down payments or progress payments as it had made to the supplier under the supply agreement on its own. (21)

96. — Seen from the lessee’s point of view, (22) the effect of Article 11 is that, if the lessee wishes to keep the leasing agreement on foot it must continue to pay its rentals, even in the face of the supplier’s failure to deliver the equipment or tender of non-conforming equipment, save where this results from the lessor’s fault as expounded above (see § 95), in which case the lessee is entitled to withhold payment of its rentals, albeit only to the extent justified by the actual loss that the lessee has sustained by reason of the lessor’s failure (Article 11 (1)). Where, even after the reasonable time specified in Article 9 (1) (see § 95 above), the supplier still fails to make a tender of conforming equipment, then the lessee is no longer obliged to keep the leasing agreement on foot but may elect to terminate it, whereupon it becomes entitled to recover all rentals and other monies paid in advance (Article 11 (2), first sentence). This will normally be the limit of the lessee’s claim against the lessor arising out of the supplier’s breach of the supply agreement, except where this is properly attributable to the lessor’s fault (Article 11 (2), second sentence).

97. — In considering the apportionment of risk made as between the two interested parties, lessor and lessee, under this article, it is important to bear in mind that the reason why the lessee has to go on paying its rentals, even in the face of non-delivery or the tender of non-conforming equipment, is, provided that this breach of the terms of the supply agreement is not properly attributable to the lessor’s fault, that the leasing agreement has to go on operating so long as there is still an opportunity for the making of a conforming tender. This follows from the philosophy underlying the entire draft, namely that, given the lessor’s limited, financial role in the transaction, the parties responsible for the choice of equipment and the discussion of all technical matters pertaining thereto, including the terms of delivery and the terms of payment, are the lessee and the supplier. However, once there is no longer any possibility of a conforming tender under Article 9 (2), and it has thus be-

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(21) See Walter E. MAY, op. cit., at 348.
(22) See Professor Roy M. GOODE’s aforementioned paper delivered at the New York symposium, printed in ALI-ABA Symposium Materials, op. cit., at 83.
come clear that there is no consideration moving from the lessor for the lessee’s payment of its rentals, namely the delivery of the equipment contracted for in the supply agreement, the lessee’s proper remedy is to terminate the leasing agreement and to recover any rentals and other monies it has disbursed to the lessor. The lessee’s remedies against the supplier for the loss it has sustained as a result of the latter’s failure to supply the equipment contracted for are under Article 10, which also guarantees that the exercising of these remedies by the lessee shall not prejudice the lessor’s normal sale of goods remedies against the supplier. A possible gap in this triangular regime might arise in the situation where the lessee, in accordance with the right conferred upon it in Article 9 (1), rejects the equipment delivered by the supplier but either holds the supply agreement open for performance by a conforming tender or the lessor is still within time to make a conforming tender under Article 9 (2). It might be appropriate to extend the lessee’s right to withhold payment of its rentals to this situation, since it has rejected the equipment vis-à-vis the lessor and has not yet had the cure of non-conformity.

**Article 12**

98. This article deals with the consequences of a lessee’s default in the performance of its duties under the leasing agreement, notably the range of remedies this event opens up for the lessor. As such it may reasonably be considered as constituting what the Study Group saw as those elements of a liquidated damages clause which local law should not cut down. It sets out to detail the measure of the lessor’s loss. It is in no way intended to limit the parties’ freedom to stipulate a liquidated damages clause of their own in the leasing agreement, and as such was intended to be subject to derogation under Article 14. The list of remedies set forth in this article was moreover, in accordance with the overall philosophy underlying the uniform rules, not intended to be exhaustive, so that the parties would be free to negotiate additional remedies. (23) The opening chapeau of this article makes it clear that the rights and remedies specified in the subsequent paragraphs may be exercised separately or cumulatively, in other words in any combination chosen by the lessor. The uniform rules did not essay a definition of “default”, being of the opinion that, given the limited objectives of this article and the underlying philosophy of the draft, namely the establishment of a basic, rather than an exhaustive legal framework for the sui generis type of leasing transaction, this was a matter best left to the parties in their contract, all the more so since consumer transactions were excluded from the scope of the uniform rules under Article 1 (1) so that both parties to the type of leasing agreement had in mind here could safely be considered to be professionals. It was nevertheless pointed out

(23) One instance of such an additional remedy was given during the New York symposium: the lessor’s right upon default to exercise any cross-default rights it might have under other leasing agreements with the same lessee.
that, in the type of leasing done at the international level, the rule as regards what should
be considered as an event of default differed considerably from contract to contract, the es-
sential factor behind this differentiation lying in the degree of creditworthiness of the indi-
vidual lessee. Thus, the stronger the lessee, the more the lessor will be prepared to restrict
the circumstances deemed under the lease to constitute default, which thus might be limited
to non-payment of rentals or bankruptcy, whereas the weaker the economic situation of the
lessee the more a lessor is going to be inclined to press for a more extensive interpretation
of the events constituting default. It is moreover not that a lessor will press for the enforce-
ment of its contractual rights and remedies upon the mere first occurrence of an event
deemed in the contract to constitute default: leasing agreements customarily provide for the
lesser to give the lessee notice in such circumstances that an event has occurred which with
the passage of time will nevertheless become a default justifying its invocation of the rights
and remedies set out in their agreement. This again was accordingly considered to be a
matter that could be left to be settled by the parties’ agreement.

99. — The first remedy listed in Article 12 (1) (a) is for the lessor to terminate the
leasing agreement, although this right is only exercisable, under Article 12 (3), following the
expiry of a further reasonable period of time after the lessor’s giving the lessee notice of its
duty to remedy its default, that is, in so far as this may be remedied. This restriction on the
lesser’s right to terminate the leasing agreement is clearly designed to meet just that concern
mentioned in the previous paragraph, namely that the lessee’s mere failure, for instance,
to pay one of its rentals right on time should not automatically bring down on it straight
away the full force of the sanctions laid down in the leasing agreement. Clearly there will
be some cases where the lessee will be unable to remedy its default, for instance following
its bankruptcy, and in such cases the serving of such notice on the lessee and, in particular,
the need to await the expiry of a further reasonable period of time, may accordingly be
dispensed with. The word “reasonable” is employed on a number of occasions in the uni-
form rules, as it was considered inappropriate to set specific time-limits in an instrument
designed to be of international application, all the more so given the inevitable variations
there would be in the necessary administrative regulations to be complied with from one
country to another in respect, notably, of the transfer of funds and the differences in dis-
tance depending on the countries involved. It was argued that the importance of this remedy
might be relative in that under most leasing agreements by the time there is a default the les-
sor is under no continuing obligation, although an exception would be where the leasing
agreement anticipated future delivery of equipment.

100. — The second remedy granted to the lessor on the lessee’s default, under Article
12 (1) (b), is to take repossession of the equipment. This can be quite important where the
lessee is unwilling to part with possession and given the reluctance of Common law juris-
dictions to entertain applications for specific performance. The point was indeed raised,
although not discussed, whether, so as to meet this difficulty for jurisdictions of a Common
law tradition, the lessor should not in addition be granted some form of injunctive relief to compel delivery of the equipment where the lessee refuses to part with possession. Where a lessee is in default, repossession may often represent for the lessor, notwithstanding the fact that it is not a merchant and does not ordinarily deal in such equipment, its best guarantee of salvaging some of its investment, as the straitened circumstances that may well have determined the lessee's default are just as likely to affect its ability to meet a claim in damages. The third remedy granted to the lessor under Article 12 (1) (c), is to recover all accrued and unpaid rentals, that is as of the date of default, together with interest. Under Article 12 (1) (d), the lessor is moreover entitled to recover such compensation as will place it in the position in which it would have been at the normal expiry of the leasing agreement had the lessee fulfilled its part of the bargain. Clearly the remedies granted the lessor under paragraphs (b), (c) and (d) must be read together. Thus the remedy provided for under paragraph (d) is designed, not to give the lessor still further remedies in addition to those conferred under paragraphs (b) and (c), but rather to provide for the case where the leasing agreement is silent as to the lessor's measure of loss in the event of the lessee's default. It illustrates the basic attitude of the drafters of the uniform rules regarding what should be considered as a reasonable computation of the lessor's measure of loss in such circumstances. The lessor's role in the transaction is in principle at all times a narrowly financial one, that of recouping through the lessee's rentals its initial capital outlay together with its costs and a profit margin. It is accordingly a very serious upset for the lessor's financial calculations when, upon the lessee's default, that is through no fault of its own, it thus finds itself obliged to repossess the equipment at an unforeseen moment during the term of the leasing agreement. This upset will moreover be compounded by various other factors, responsibility for which should not reasonably be attributable to the lessor. For instance, the equipment will frequently have been constructed specially to the lessee's particular specifications, rendering the lessor's task of finding someone willing to take it off its hands all the more difficult, particularly at a price that will bear some relation to its calculations when it embarked on the transaction. Moreover, once there has been a breach of the leasing agreement by the lessee constituting default and thus entitling the lessor to repossess the leased asset, the lessee, in the absence of an additional agreement providing for the lessee's safekeeping of the asset pending the lessor's collection of it, would no longer be liable for any damage sustained by the asset after such time. The aim of the drafters of the uniform rules was to ensure that the net effect of the compensation due from the lessee upon the latter's default would be to place the lessor in the position in which it would have been had it received the total number of rentals agreed to be paid under the leasing agreement. Previous drafts attempted to spell out this amount in greater detail. The basic idea was that the lessor should be able to recover an amount equivalent to the discounted value of the unpaid rentals, after giving credit against that sum for the sum it would have received from disposing of the re-
possessed asset in a commercially reasonable manner. (24) At one stage the Study Group even toyed with the idea of specifying that the lessor should also give credit against the amount it would receive by way of the discounted value of the unpaid rentals for such residual value as the equipment would have had on the expiry of the leasing agreement. This idea was not pursued because of the widely divergent attitudes adopted in the matter of the role of the residual value in leasing agreements in Civil law jurisdictions, on the one hand, and in Common law jurisdictions, on the other. (25)

101. – The Study Group was at all times conscious of the fact that the law governing minimum payment clauses is in many countries considered a matter of public policy and that in recent years, both at the national and the supranational level, legislation has been passed giving the courts a wide measure of discretion in revising the sums fixed by the parties in their agreement. It was ostensibly on this ground that the Study Group at its last session decided to delete the sentence, referring to the compensation recoverable by the lessor under Article 12 (1) (d),

"[t]he leasing agreement may provide for the manner in which this compensation is to be computed and such provision shall be enforceable between the parties in all Contracting States, unless the court finds that it is wholly unreasonable." (writer's own italics)

It is submitted that the deletion of this clause was regrettable in so far as, far from seeking to oust the manifest right of the court to review the bargain struck between the parties, it sought simply to reflect the current practice of the lessor in attempting to articulate its measure of damages in the form of such a liquidated damages clause and to indicate, no more or no less, that in the opinion of the drafters of the uniform rules it was accordingly reasonable for the court to have regard, in the first place at least, to the provisions agreed between the parties on this matter, subject of course to its finding the remedy provided thereunder to be wholly unreasonable. Clearly the factors involved in the court making such an evaluation are complex. For instance, the economic conditions may well have changed by the time that the lessor comes to repossess its asset following the lessee's default so that the lessee's rental obligations as stipulated under the leasing agreement may be either higher or lower than the current market price for a similar period of time. The elusive nature of proving the fairness of a given liquidated damages clause in the light of such imponderables was

(24) One corollary of this method of calculation would be that any surplus realised by the lessor would, in conformity with the practice followed in these matters, be handed back to the erstwhile lessee.

(25) In Civil law jurisdictions the residual value is fixed in the leasing agreement, as the price at which the lessee is entitled to exercise the purchase option generally granted it under the leasing agreement, whereas in Common law jurisdictions the fact that this is only possible at the risk of converting what was intended as a lease into a conditional sale means that the residual value cannot be fixed in the leasing agreement and reverts to the lessor upon the expiry of the leasing agreement.
considered by the Study Group as confirming the case for the parties' negotiation of a remedy in anticipation of a default. The italicised words at the end of the deleted sentence were designed to remind the parties, in particular a lessor in a powerful bargaining position, not to overreach in their negotiation of such a remedy. Given the difficulties alluded to above regarding the computation of fair compensation in the wake of default rather than in anticipation of the same, the court in finding as to the wholly unreasonableness or otherwise of the individual liquidated damages clause stipulated by the parties was intended by the drafters of the uniform rules to have regard to the situation at the time when the leasing agreement was entered into, rather than the situation as it had developed by the time of default.

102. — The additional remedy granted the lessor, under Article 12 (1) (c), envisages a quite special set of circumstances, which have already been illustrated above (see § 76). The effect of Article 12 (2) is to alter the range of remedies exercisable by a lessor upon the lessee's default in those cases where the leasing agreement includes an acceleration clause entitling the lessor upon the lessee's default to require accelerated payment by the lessee of all or any of the outstanding rentals due under the agreement. In recognition of the injustice that would be wrought by allowing the lessor in such a case both to benefit from such an acceleration clause and to repossess the equipment (Article 12 (1) (b)) and recover such compensation as would place it in the position in which it would have been had the lessee performed its duties under the leasing agreement (Article 12 (1) (d)), Article 12 (2) requires the lessor to elect between the exercise of one or the other of these remedies.

Article 13

103. — This article deals with the important question of the lessor's assignment of all or part of its rights in the equipment or under the leasing agreement, and as such seeks to facilitate matters for those jurisdictions that place legal restrictions on the transfer of contractual rights. This question is particularly critical in those countries where a particular species of financial lease, the leveraged lease is common. In leveraged leases, whereas legal title to the equipment, and hence entitlement to the tax indemnification benefits associated with ownership, vests in the lessor, the latter will, by reason of the huge amounts of money involved, put up only a part of the capital cost represented by the purchase of the equipment. For the rest of the cost it will have recourse to one or more lenders who will assure their position by requiring an assignment to themselves of the stream of rentals provided for under the leasing agreement. It is clearly desirable that such transactions fall within the scope of the uniform rules, all the more so given that such transactions are frequently international in character. Such transfers are accordingly permitted under Article 13. Clearly such transfers can only affect the lessor's rights and not his duties under the leasing agreement and this is spelled out in the second sentence of Article 13. This article further speci-
ifies that such a transfer may not be used as a means of circumventing the application of the uniform rules: it states that such a transfer may not alter either the nature of the leasing agreement or its legal treatment as provided in the uniform rules. Thus, where, prior to the assignment, the uniform rules were already applicable, for instance, by virtue of the lessor having its principal place of business in a State different from that of the lessee and both of these States being Contracting States (Article 1 (2) (a)), the uniform rules would not cease to be applicable merely because, subsequent to the assignment, both the lessor and the lessee found their principal places of business suddenly to be in the same State. This result reflected the Study Group’s conviction that it was not possible to legislate for fraud at the international level.

Article 14

104. – This article is a provision found in most international commercial law Conventions. It reflects the idea that such Conventions should not as a rule deprive the parties of their freedom to choose alternative rules to govern their transaction. No decision was taken by the Study Group regarding which provisions of the uniform rules are to be regarded as mandatory. It was felt that this was a decision best left to be taken later. There was nevertheless a feeling within the Study Group that virtually all the provisions of the uniform rules should be amenable to exclusion, derogation or variation. The uniform rules have all along been intended as a basic, permissive legal framework essentially designed to distinguish leasing from the various neighbouring legal concepts with which it has hitherto invariably been confused, and as such are not therefore intended to be an exhaustive regulation of the legal problems arising in connection with financial leasing.

Article 15

105. – This article is another provision now become a common feature of international commercial law Conventions. It is addressed principally to those called upon to decide cases involving the application or interpretation of the uniform rules, i.e. judges and arbitrators. These are, on the one hand, exhorted to have regard to the international character of the uniform rules and thus avoid interpreting them in the light of the legal principles and traditions of their own legal system and, on the other hand, to ensure the observance of good faith, so vital to the development of international commerce (Article 15 (1)). Article 15 (2) seeks to ensure that the *sui generis* status conferred on the particular type of leasing covered by the uniform rules will not be jeopardised as regards all those many issues which have not been specifically dealt with in the uniform rules. Clearly it would be unfortunate if the objectives of the drafters of the uniform rules were to be thwarted by judges and arbitrators filling in these gaps on the basis of the solutions of their national law, the general
appropriateness of which to the *sui generis* type of lease provided the starting point for Unidroit's whole exercise in clarification. Article 15 (2) accordingly provides that matters not expressly settled in the uniform rules but which are nevertheless governed by the same shall be settled in conformity with the general principles on which they are based. Alternatively, where such general principles are not to be found in the uniform rules, these matters are to be settled in conformity with the law applicable by virtue of the rules of private international law: this with a view to avoiding judges in such cases automatically having recourse to their own domestic law.
APPENDIX

LIST OF THOSE TAKING PART IN THE UNIDROIT STUDY GROUP
FOR THE PREPARATION OF UNIFORM RULES
ON THE LEASING CONTRACT

Members of the Study Group

Mr László RECZEI — Professor of Law at the University of Budapest; Ambassador (retired); former member of the Unidroit Governing Council;
Chairman of the Study Group —
Szerb u. -17 — H-1036 Budapest (1) (2) (3) (4) (*)

Mr Luiz Olavo BAPTISTA — Attorney; President of the São Paulo Bar Association; Professor of International Commercial Law at the Getulio Vargas Foundation, São Paulo —
Avenida São Luiz 50, 24º andar, CJ 242 — 01085 São Paulo, S.P. (3)

Mr El Mokhtar BEY — Directeur juridique et du contentieux juridictionnel du Groupe LOCAFRAINE
43-47 Avenue de la Grande Armée —
75782 Paris Cédex 16 (1) (2) (3) (4)

Mr Peter F. COOGAN — Member of the Massachusetts bar; Member of the Permanent Editorial Board for the Uniform Commercial Code; Representative of the Department of State, United States of America —
Messrs Murphy, Weir and Butler, 101 California St., 39th floor,
P.O.Box 26822, San Francisco — California 94126-6822 (1) (3) (4)

Mr Ronald M. DEKOVEN — Member of the Illinois bar; Representative of the Department of State, United States of America —
Messrs Shearman and Sterling, Citicorp Center, 153 E. 53rd St., New York —
New York 10022 (3) (4)

Mr Giorgio DE NOVA — Professor of Civil Law, University of Pavia —
Corso Strada Nuova 65 — 27100 Pavia (4)

Mr Christian GAVALDA — Professor of Commercial and Banking Law and Director of the Business Law Research Centre in the University of Paris I, Panthéon-Sorbonne
12 Place du Panthéon —
75006 Paris (1) (3)

(*) The appearance of the number (1) after the name of a person indicates that that person attended the first session of the Study Group; (2) that he or she attended the second session; (3) that he or she attended the third session; (4) that he or she attended the fourth session.
Mr Royston M. GOODE — Crowther Professor of Credit and Commercial Law and Director of the Centre for Commercial Law Studies,
Queen Mary College, University of London —
339 Mile End Road — London E1 4 NS (1) (2) (3) (4)

Ms Tinuade OYEKUNLE — Director, International and Comparative Law Division, Federal Ministry of Justice —
New Secretariat, P.M.B. 12517 Ikoyi — Lagos (2) (3) (4)

Mr Fritz PETER — Chairman of the Board of Directors, Industrie-Leasing AG; Honorary Chairman of the European Federation of Equipment Leasing Company Associations (Leaseurope),
*Expert consultant to the Study Group* — Industrie-Leasing AG, Badenerstrasse 329/Albisriederplatz —
CH-8040 Zürich (1) (2) (3) (4)

**Observers**

Mr Massimo ALDERIGHI — Attorney —
Studio Legale Tributario A. Fantozzi — L. Biscozzi,
Via Sicilia 66 — 00187 Roma (3)

Mr Sergio BIANCONI — Attorney; Deputy Head, Legal Service, Italian Banking Association; representative of the Banking Federation of the European Community —
Piazza del Gesù 49 — 00186 Roma (3)

Ms Caroline BILLIQUON de NUZILLET — Attaché, Legal Secretariat/representative of the International Chamber of Commerce —
38 cours Albert 1er — 75008 Paris (2)

Mr Jesús BLANCO CAMPANA — Legal Adviser to the Spanish Ministry of Justice; Professor of Law, University of Madrid —
Calle S. Bernardo 45 — Madrid 8 (1)

Mr Franco CAVALARI — Branch Deputy Director, Banca Nazionale del Lavoro, Direzione Generale, Ufficio Studi —
Via V. Veneto 119 — 00187 Roma (3)

Mr Renato CLARIZIA — Professor of Law, University of Urbino; Secretary-General, Italian Leasing Association (Assilea) —
Via d’Ara Coeli 3 — 00186 Roma (3) (4)
Ms Mireille DUSSEAX — Administrator principal, Commission of the European Communities, Directorate-General XV (Financial Institutions and Fiscal Matters)/representative of the Commission of the European Communities — 8 square de Meus — B-1030 Bruxelles (1) (2) (3) (4)

Mr Augusto FANTOZZI — Attorney; Professor of Revenue Law at the University of Rome — Via Sicilia 66 — 00187 Roma (1) (2)

Mr Paolo FERRO LUZZI — Professor of Commercial Law, University of Perugia — Via Condotti 91 — 00187 Roma (3)

Mr Mario GIOVANOLI — Representative of the Bank for International Settlements — P.O. Box 2258 — CH-4002 Basel (4)

Mr Sanford G. HENRY — International consultant — leasing; lately Vice-President, United States Leasing International, Inc. (Europe, Africa and the Middle East); Harthvest International, Inc. — 43 Charles St. — London W1X 7 PB (2) (3) (4)

Mr Matthias H. van HOOGSTRATEN (*) — late Secretary-General/representative of the Hague Conference on Private International Law — 2e Javstraat — 2585 AM The Hague (1)

Mr Salvatore MACCARONE — Attorney; Legal Adviser, Italian Banking Association; representative of the Banking Federation of the European Community — Piazza del Gesù 49 — 00186 Roma (3)

Mr Michel PELICHET — Deputy Secretary-General/representative of the Hague Conference on Private International Law — 2e Javstraat — 2585 AM The Hague (3) (4)

Ms Jelena VILUS — Professor of International Commercial Law, Faculty of Law, Novi Sad; Institute of Comparative Law, Belgrade — Terazije 41 — Beograd (2)

Unidroit Secretariat

Mr Mario MATTEUCCI — Honorary President (1) (2) (3) (4)

Mr Riccardo MONACO — President (1) (2) (3) (4)

Mr Malcolm EVANS — Deputy Secretary-General (1) (2) (3) (4)

Mr Martin J. STANFORD — Research Officer, Secretary to the Study Group (1) (2) (3) (4)

(*) Subsequently deceased
Ms Marie-Christine RAULT — former Research Officer (1) (2)
Mr François MENGIN — former Research Officer (3)
Ms Loretta MALINTOPPI — former Assistant (3)
Ms Frédérique MESTRE VANEGAS — Assistant (4)
Ms Pamela ESPOSITO — former Intern (3)