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COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT

CONVENTION ON INTERNATIONAL FINANCIAL LEASING

Comments by Governments and one professional association
on the text of the preliminary draft uniform rules on
international financial leasing as this emerged from the
second session of governmental experts

Rome, January 1987

1.- Following the second session of the Unidroit committee of governmental experts for the preparation of a draft Convention on international financial leasing, held in Rome from 14 to 18 April 1986, a number of comments have been received by the Unidroit Secretariat on the text of the preliminary draft uniform rules as it emerged from that session. These comments have been submitted by the Governments of Austria, Portugal and Switzerland and by the Hong Kong Equipment Leasing Association. For ease of presentation, these comments are grouped together below under the provisions of the preliminary draft uniform rules (Appendix to Study LIX - Doc. 33) to which they relate.

Preamble

2.- The Portuguese Government's comments on the third clause of the preamble indicate that they find the words "are ill-suited" preferable to the words "need to be adapted". They feel that the words "need to be adapted" could lead to the conclusion that the Convention seeks to do nothing more than to adapt the rules of the contract of hire to fit financial leasing, whereas, in their opinion, the Convention should not, even implicitly, take a position on the legal nature of "leasing".

Article 1

3.- The Hong Kong Equipment Leasing Association in its comments on Article 1 states that this article does not provide for the situation where at the time of negotiating a lease the lessee has already entered into a contract of sale and purchase with the supplier and where, accordingly, in order for the lease to take effect, this contract has to be novated to the lessor.

Note by the Unidroit Secretariat: This type of situation is indeed intended to be within the purview of Article 1 (1) of the uniform rules.

4.- It asks why the words "for business or professional purposes" are included in Article 1 (1)(b), pointing out that a financial lease could be entered into by a lessor and lessee where the lessee was in fact utilising the equipment for a non-business purpose, such as the lease of a motor yacht for pleasure purposes.

Note by the Unidroit Secretariat: The words "for business or professional purposes" were included in Article 1 (1)(b) to make it clear that the uniform rules did not purport to extend to consumer leases, the rules applicable to which clearly involved different considerations from those relevant to non-consumer transactions.

5.- It further asks whether Article 1 (2)(c) is intended to exclude a leasing agreement under which the rentals are calculated on a floating rate basis.

Note by the Unidroit Secretariat: The language chosen in Article 1 (2)(c) - the calculation of the rentals must "take into account" the amortisation of all or part of the cost of the equipment - was deliberately flexible so as to encompass as many variations on the basic pattern of a finance lease as possible; hence it is submitted that the language of this provision should not be read as excluding a leasing agreement under which the rentals are calculated on such a floating rate basis.

Article 2

6.- The Hong Kong Equipment Leasing Association suggests that the words "closest relationship to" in the third line of Article 2 (2) should be substituted by the words "most real and substantial connection with".

Note by the Unidroit Secretariat: The language employed in Article 2 (2) is directly modelled on that used in Article 10(a) of the United Nations Convention on Contracts for the International Sale of Goods concluded in Vienna on 11 April 1980 and Article 8(a) of the Unidroit Convention on Agency in the International Sale of Goods concluded in Geneva on 17 February 1983.

Article 3

7.- The Hong Kong Equipment Leasing Association suggests that the words "at any time during or at the end of the primary lease period" might be included after the word "equipment" in the last line of Article 3.

Note by the Unidroit Secretariat: This suggestion would be in line with the intention behind this provision.

Article 4

8.- The Austrian Government suggests that an additional clause should be added on to Article 4 (1) which would as a result read as follows (the additional words being underlined):

"The supply agreement may not be varied without the consent of the lessee except the variation does not affect the lessee's rights."

Note by the Unidroit Secretariat: This provision was never intended to interfere with the parties' right to negotiate better terms for themselves, all the more so as the negotiation of such better terms between the supplier and the lessor could well, for example, have the effect of improving the terms of the leasing agreement for the lessee, notably in the shape of lower rentals. The effect of the rule contained in Article 4 was to prevent variation of the parties' respective "agreements" in such a way as would be to the detriment of the party not party to the variation. However, the drafters of the uniform rules have hitherto not considered it to be feasible or worthwhile to formulate a workable distinction between the negative and the positive impact of individual variations on the position of such a party (see Study LIX - Doc. 25, §71).

9.- Article 4 (2) could be deleted in the opinion of the Austrian Government.

Note by the Unidroit Secretariat: This is not the first time that the deletion of this provision has been put forward. It is perhaps accordingly appropriate to refer the reader to the discussion of the fate of a similar proposal made at the first session of governmental experts in Study LIX - Doc. 25, at §§72-73.

Article 5

10.- The Austrian Government feels that Article 5 (1) needs to be clarified, so as to make it clear that it does not affect national law regarding bankruptcy. It takes the view that the lessor's real rights in the equipment should have neither more nor less effect than such real rights would generally have under the applicable national law.

11.- The Hong Kong Equipment Leasing Association expresses itself to be unclear as to the meaning of the words "real rights", although it assumes that they refer to the lessor's rights in the equipment as owner. It

points out, moreover that simply to refer to the lessee's trustee in bankruptcy in this Article would appear to restrict the reference to where the lessee is an individual, suggesting that this reference should perhaps therefore be expanded to include a liquidator of the lessee in cases where the lessee might happen to be a corporation.

12.- To the mind of the Austrian Government Article 5 (2) does not have great practical importance in so far as rules on public notice exist only in Saskatchewan. It also feels that the reference to the main place of business is not appropriate and that the provision should therefore be deleted.

Note by the Unidroit Secretariat: It is not true to say that only Saskatchewan has enacted public notice rules for finance leases. Already within Canada Saskatchewan was not the first province to legislate in this field, Ontario having already shown the way with the Personal Property Security Act, 1967. This in turn was inspired by Article 9 of the Uniform Commercial Code of the United States of America, which makes leases by way of security subject to registration. Such public notice rules are, however, not a speciality of the Common law. In France finance leases ("opérations de crédit-bail") were made subject to registration by décret n° 72-665 of 4.VII.1972, as also in Portugal by decreto-lei n° 171/79 of 6.VI.1979. Other public notice rules exist in respect of finance leases under legislation passed in Belgium and Korea.

13.- The Hong Kong Equipment Leasing Association argues that Article 5 (4) should be restricted to permitting any creditor of the lessee to have a lien or any other similar possessory security interest in the equipment but should not otherwise permit the creation of any other kind of security interest (i.e. by way of mortgage, charge or hypothecation) over the equipment.

Article 7

14.- The Austrian Government suggests that Article 7 (1) should only deal with damage caused by the equipment, while recognising that the lessor may of course owe the lessee contractual duties, which are not (expressly) provided for in the preliminary draft uniform rules.

15.- The Portuguese Government proposes the alteration of the drafting of Article 7 (1)(a) to avoid it appearing to take yet another position on the legal nature of leasing. It would propose replacing the words "merely by acting in its capacity of lessor" by the words "that would fall within its scope if it concerned only a contract of hire".

16.- Referring to Article 7 (1)(c) and the fact that the only example of the lessor's liability that it gives is as an owner, the Austrian Government suggests that a second example should be given, referring to any product liability which might be imposed on the lessor in its capacity as importer of the equipment, arguing that this might be of greater practical importance than the other instance of the lessor's liability cited, namely as owner.

17.- As regards the two alternative versions of Article 7 (2) put forward at the second session of governmental experts (see Appendix to Study LIX - Doc. 33), both the Austrian and the Portuguese Governments indicate their preference for Alternative I, the Portuguese Government expressing the opinion that Alternative II might damage the interests of the lessor through baseless claims being put forward to a superior title or right, whereas the Swiss Government comes down in favour of Alternative II. It argues that frequently only legal proceedings will be able to establish whether or not the person in question has in fact a superior title or right and that in such proceedings the lessor's intervention (and the liability that it may incur) is necessary, in particular in the interests of the lessee.

Article 8

18.- The Hong Kong Equipment Leasing Association suggests that the words "of equipment of the relevant kind or type" be included after the words "user" in the second line of Article 8 (1).

19.- It further suggests that the words "or hold the equipment unconditionally to the order of the lessor" be added at the end of Article 8 (2).

Article 9

20.- The same association points out that its comments regarding the words "professional or business purposes" that it raises in relation to Article 1 (1)(b) (see §4 supra) also apply in relation to Article 9 (1).

21.- Noting that the question of whether the lessee is given the right to vary the supply agreement is left open in Article 9 (2), the Portuguese Government points out that, on the one hand, to deny the lessee this right would be tantamount to placing a severe limitation on the possibility generally reserved to the lessee to go against the supplier but, on the

other hand, to grant the lessee this right would be to enable the lessee to defeat the lessor's interest in seeing the leasing agreement performed (a significant reduction in the price under the supply agreement would entail a corresponding reduction in the lessor's financial return on the transaction). It concludes that the risks inherent in an intermediate formula (for instance, "substantially vary") would probably be preferable to the drawbacks of either of the present alternative solutions.

22.- The Swiss Government sees a case for it to be expressly provided in Article 9 (2) that the lessee is not entitled to vary the supply agreement, noting that this right could in fact be given to the lessor, even though this is not done in the preliminary draft uniform rules (Article 4 (1)).

Article 10

23.- The Hong Kong Equipment Leasing Association declares itself to be unhappy with the concern behind all the provisions contained in Article 10. So far as it understands the concept of a finance lease, it is that the lessor is merely acting as the financier in the transaction in respect of equipment which the lessee has chosen from a particular supplier and in which the lessee has negotiated the terms and conditions of the supply contract directly with the supplier. It concludes that the lessor should, accordingly, not be involved in any dispute concerning the condition quality or merchantability of the equipment, while recognising, however that the lessee should obviously not be required to pay rentals for equipment which it cannot obtain the effective use of. On the other hand, the lessor should, in its opinion, be fully compensated for any and all expenses it may have incurred by virtue of entering into the lease contract with the lessee, such as paying the supplier for the equipment which it may well have had to do under an irrevocable letter of credit prior to delivery of the equipment to the lessee and its inspection. One way it suggests for dealing with this is for the lessee to pay off the lessor the full purchase price it has paid for the equipment together with all its other costs and expenses related to the entering into of the leasing agreement and for the lessor thereafter to assign all its rights under the supply contract as against the supplier to the lessee such that the lessee can thereafter pursue whatever action it thinks fit against the supplier. At the moment the Hong Kong Equipment Leasing Association does not believe these matters have been fully covered under Article 10 to the satisfaction of the lessor who appears, it notes, to be required to carry some equipment risk.

24.- The Austrian Government, referring to Article 10 (1) and (2),

proposes that the lessee's right to reject the equipment should be subject to the same time-limit as the warranty given in respect of the equipment.

25.- As regards the alternative solutions proposed in Article 10 (3), the Austrian Government indicates its preference for Alternative II, whereas the Swiss Government finds Alternative I better on the ground that it is hard to conceive of what has been paid being given back without the contract first being terminated, while, nevertheless, admitting that Alternative II has the advantage of offering the lessee an additional possibility.

Article 11

26.- The Austrian Government draws attention to a mistake in the drafting of Article 11 (2). The reference to "paragraph 4 of this article" should be to "paragraph 5 of this article".

27.- Observing that very often the lessor will never have possessed the equipment, the Hong Kong Equipment Leasing Association suggests that the word "recover" appearing at the beginning of Article 11 (2)(a) be replaced by the word "obtain"

28.- The Austrian Government feels that it should be made clear that the compensation mentioned in Article 11 (2)(b) must take account of the value of the equipment where the lessor has recovered possession thereof.

29.- The Portuguese Government proposes that the word "disproportionate" as employed in Article 11 (3) should be qualified so as to indicate that it is not just any difference in the amount of compensation payable under the leasing agreement from that allowed under Article 11 (2)(b) that is intended to be caught by this provision but only such differences as are manifestly unjustified.

Note by the Unidroit Secretariat: It is perhaps worth recalling that in the corresponding provision (Article 9 (1)(d)) of the preliminary draft uniform rules as adopted by the Unidroit Study Group on the leasing contract at its third session, held in September/October 1980, the word corresponding to "disproportionate", "unreasonable" was indeed qualified by the adjective "wholly" ("The 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").

30.- The Hong Kong Equipment Leasing Association states that it does not fully understand what is intended to be covered in Article 11 (4). It asks whether the intention is to make a distinction between terminating the lease agreement and terminating the lease of the equipment under the leasing agreement or whether the intention is something else. It points out that, if the lessor is entitled to terminate the leasing of the equipment under the leasing agreement by virtue of a breach by the lessee, it will obviously certainly wish to accelerate payment of the outstanding balance of the rentals.

Note by the Unidroit Secretariat: The idea behind Article 11 (4) is to avoid what was considered to be the injustice that would have been wrought by allowing the lessor, upon substantial default by the lessee, both to terminate the leasing agreement - and thus to obtain possession of the equipment, which it would then sell or re-lease - and to benefit from an acceleration clause. It therefore in effect requires the lessor to elect between the exercise of one or the other of these remedies.

Article 12

31.- The Austrian Government suggests replacing the words "or otherwise deal with" in Article 12 (1) by the words "or otherwise dispose of".

32.- The Swiss Government finds it hard to imagine an assignment of the equipment (the Swiss Government's underlining) by the lessor which would not relieve it of any of its duties under the leasing agreement nor alter the nature of this agreement.

Note by the Unidroit Secretariat: It is perhaps worth recalling the original reason for the inclusion of this provision in the uniform rules. This was to ensure that that species of financial lease known as a leveraged lease be not left outside the ambit of the uniform rules, in Article 1 (1) effectively delimited by reference to three parties (lessor, lessee, supplier). The significance of the lessor's right of assignment in the context of such a lease lies in the fact that, in exchange for putting up a large proportion of the capital necessary to make the purchase of the item of equipment to be leased, an additional party or additional parties agree to take an assignment from the lessor of the benefit of the stream of rentals provided for under the leasing agreement. The lessor as owner of the leased equipment meanwhile is entitled to such tax indemnification benefits as are available in respect of finance leases.

The English text of this provision which goes back to the corresponding provision (Article 10)^(*) of the preliminary draft uniform rules adopted by the study group at its third session, the original of which was drafted in English, has consistently raised problems for translation into French. Thus, whereas the opening sentence of the English text of Article 12 (1) states:

"The lessor may transfer or otherwise deal with all or any of its rights in the equipment or under the leasing agreement (emphasis added),

the French text talks rather about the lessor being able to assign the equipment or all or any of its rights under the leasing agreement. ("Le crédit-bailleur peut céder le matériel ou tout ou partie des créances qu'il tient du contrat de crédit-bail").

In the light of the foregoing, it is respectfully submitted that the Swiss Government's comment on this provision springs from what may have been an infelicitous rendering in French of the idea which the English text of Article 12 (1) seeks to convey.

33. - The Hong Kong Equipment Leasing Association asks why Article 12 (1) restricts an assignment by the lessor to its being able to assign its right and benefit in the equipment or under the leasing agreement and is not similarly extended to an assignment of the lessor's duties. It argues that such an assignment of the lessor's duties should surely also be permitted subject to the agreement of the lessee.

Note by the Unidroit Secretariat: The original intention behind the inclusion of this provision in the uniform rules has already been expounded in this paper (see § 32 supra). The answer to the query lodged by the Hong Kong Equipment Leasing Association is accordingly very simple: the drafters of the uniform rules did not see any need to regulate the matter of the lessor's assignment of its duties under the leasing agreement, in the same way as they did not see fit to regulate a whole host of other aspects of the contractual relations between the various parties to the atypical leasing transaction addressed by the uniform rules. Their aim has never been to lay down an exhaustive regulation of this transaction

(*) This provision reads as follows:

"The lessor may, with the consent of the lessee, transfer its right, title and interest in the leasing agreement to a third party. Such an assignment may alter neither the nature of the leasing agreement nor its legal treatment as provided in this Convention."

but rather, more modestly, to establish a limited number of essential criteria from which it would henceforth be possible to deduce its atypical credentials. The question of the lessor's assignment of its duties under the leasing agreement was not felt to require regulation in this context. This is not to say that the drafters of the uniform rules intended the inference to be drawn that the possibility of such an assignment by the lessor was thereby excluded. On the contrary, this, like many other contractual matters, was simply left to be determined by the parties.

Admittedly, the equation was somewhat altered at the last session of governmental experts with the acceptance of the proposal of one delegation for the inclusion of a provision affirming the lessee's right of assignment (Article 12 (2)). This right, though, is necessarily circumscribed, being made expressly subject to the lessor's consent and any rights of third parties.

Article 13

34.- The Austrian Government expresses its general approval of the terms of Article 13 (1). It nevertheless feels that there needs to be some guarantee that all three parties are sufficiently aware whether or not the future Convention is applicable. It accordingly proposes that an exclusion of the Convention either by the terms of the agreement between the lessor and the lessee or by those of the agreement between the lessor and the supplier should only be effective where the third party (either the supplier or the lessee respectively) is given notice of such an exclusion.

35.- Commenting on Article 13 (2), the Swiss Government suggests that other provisions might be stated to be mandatory in character, in the interests of the lessee and so as to take account of the nature of leasing transactions as contemplated by the preliminary draft. This observation is, in particular, true of Article 7 (2), dealing with the lessor's liability for certain disturbances of the lessee's quiet possession, which would appear to be strictly bound up with its capacity of owner of the equipment.

Article 14

36.- The Austrian Government feels that it will in practice be difficult to discern any general principles on which the preliminary draft uniform rules are based and accordingly suggests that the words "in conformity with the general principles on which it is based" could be deleted.

Note by the Unidroit Secretariat: One of the principal difficulties for which the uniform rules were contemplated as a corrective was the inadequacy of the legal treatment hitherto reserved to the type of leasing transaction addressed therein. In the absence of recognition of its sui generis status, it was invariably dragged this way or that into one or other of the classical contractual schemata from which it had evolved. The uniform rules do not claim to represent an exhaustive regulation of the subject-matter addressed therein. Such broad terms of reference were in any event always considered to be inopportune in so far as leasing has proved itself to be particularly flexible and liable to constant evolution. The uniform rules accordingly only constitute a basic, minimal legal framework and have all along been intended to be largely permissive, in recognition of the importance of the parties, responsible for the creation of the financial leasing mechanism in the first place and for its subsequent manifold developments, being left maximum freedom of contractual manoeuvre. Lacunae will therefore inevitably arise in the interstices of the uniform rules so that it is essential, if the uniform rules' objective of conferring a sui generis legal status on financial leasing is not to be compromised by judges falling back for the resolution of these lacunae on those very principles drawn from neighbouring legal concepts the inapplicability of which to financial leasing provided the whole impetus for the drafting of uniform rules in the first place, for judges, in fashioning their approach to these questions, to seek inspiration from the general principles underlying the uniform rules, to wit essentially the indicia of the sui generis status instanced in the uniform rules' treatment of the issues addressed therein.

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37.- At the second session of governmental experts the committee was seized of a set of draft final provisions capable of embodiment in a draft Convention to be built around the uniform rules (Study LIX - Doc. 27). In the event there was not time for the committee to consider these draft provisions. The Austrian Government in its comments nevertheless states that of the alternative versions proffered for an Article I it would prefer Alternative II.