

UNIDROIT 1987
Study LIX - Doc. 46
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U n i d r o i t

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT

CONVENTION ON INTERNATIONAL FINANCIAL LEASING

(Third session, 27 - 30 April 1987)

Summary report

prepared by the Unidroit Secretariat

Rome, June 1987

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CORRIGENDUM

At page 25, paragraph 38, line 15: for the words "the lessee's right to quiet possession" read "the lessor's warranty of quiet possession"

1. - Pursuant to the decision of the Unidroit Governing Council, taken at its 63rd session held in Rome from 2 to 4 May 1984, to set up a committee of governmental experts to finalise the text of the preliminary draft uniform rules on international financial leasing adopted by a Unidroit study group, the first two sessions of the Unidroit committee of governmental experts for the preparation of a draft Convention on international financial leasing were held in Rome at the seat of the Institute from 15 to 19 April 1985 and from 14 to 18 April 1986 respectively. The third and final session of this committee was held in Rome at the seat of Unidroit from 27 to 30 April 1987.⁽¹⁾ As during the previous two sessions, the committee was chaired by Mr László Réczei (Hungary), with Mr Royston M. Goode (United Kingdom) acting as deputy chairman and chairman of the drafting committee. It was in this dual capacity that Mr Goode chaired the final two sessions of the committee, held on 30 April, at which the committee proceeded to its final reading on the basis of a revised text proposed by the drafting committee.

2. - The following Governments, international organisations and professional associations were represented at the session:

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(1) As prior to the second session of the committee, a co-ordination meeting of the Council of Ministers of the European Communities was held in Brussels on 7 April 1987 with a view to permitting an exchange of views amongst EEC member States on those aspects of the Unidroit preliminary draft uniform rules left undecided at the second session of governmental experts. This exchange of views was conducted on the basis not only of the comments submitted by EEC Governments, namely the Governments of the Federal Republic of Germany and Portugal, for consideration at the third session of governmental experts but also of those other comments submitted for such consideration, notably the proposals made by the Government of the United States of America. This co-ordination meeting was itself prepared by an information meeting on the co-ordination of banking legislation on financial leasing convened by the Commission of the European Communities in Brussels on 6 April 1987.

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3. - The committee was seized of the following materials:

- Draft final provisions capable of embodiment in a draft Convention to be built around the preliminary draft uniform rules on international financial leasing as these emerged from the first session of governmental experts (drawn up by the Unidroit Secretariat) (Study LIX - Doc. 27);
- Committee of governmental experts for the preparation of a draft Convention on international financial leasing (second session, 14-18 April 1986): summary report prepared by the Unidroit Secretariat (Study LIX - Doc. 33);
- 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 (Study LIX - Doc. 34);
- Comments by the Government of the Federal Republic of Germany on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 35);
- Observations and proposals by the Government of the United States of America on the text of the preliminary draft uniform rules on international financial leasing as proposed by the drafting committee at the second session of governmental experts (Study LIX - Doc. 36);

(*) namely the Governments of Austria, Portugal and Switzerland

(**) namely the Hong Kong Equipment Leasing Association

- Comments by the Government of Sweden on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 37);
- Comments and proposals by the Colombian Leasing Federation (Fedeleasing) on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 38);
- Comments by the Federation of Latin American Leasing Companies (Felalease) on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 39);
- Comments by the Government of the Netherlands on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 40);
- Comments by the Government of the Netherlands on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts: addendum (Study LIX - Doc. 40 Add.);
- Comments by the Government of the Polish People's Republic on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 41);
- Letter received by the Unidroit Secretariat from Mr Stephen McGairl, Partner, Freshfields, Paris on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Misc. 1);
- Note submitted by Mr Ibrahim F.I. Shihata, Vice President and General Counsel, World Bank for the attention of the committee of governmental experts at its third session (Study LIX - Doc. 42);
- Proposals by the French delegation with regard to the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 43);

- Note by the Unidroit Secretariat for the attention of the committee of governmental experts at its third session (Study LIX - Doc. 44);
- Comments by the Japanese Government on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 45).

4. - After adopting the draft agenda (set out below as Appendix I to this report) and guided notably by the aforementioned materials, the committee proceeded to a third reading of the text adopted by the Unidroit study group as revised at its first and second sessions (set out in the Appendix to Study LIX - Doc. 33). The various proposals for the amendment of this text tabled in the course of this reading were referred to a drafting committee, manned by representatives of the delegations of Belgium, China, Finland, France, Hungary, the United Kingdom and the United States of America. The revised text proposed by the drafting committee was laid before the committee of governmental experts on the final day of the session. Subject to reservations regarding certain provisions which it was agreed to place inside square brackets for decision at the diplomatic Conference and regarding which more will be said later in this report, in the paragraphs devoted to the provisions in question (Articles 5 (3)(a); 7 (2) and 14 (1)), the committee was able, on the basis of this revised text, to adopt the text of a draft Convention on international financial leasing. This text, together with the Unidroit draft Convention on international factoring, will now be laid before a diplomatic Conference for adoption. At the closing session of the committee, the representative of Canada was able to announce his Authorities' decision to host this Conference. The Conference will be held at the Government Conference Centre in Ottawa from 9 to 28 May 1988. The committee of governmental experts recorded its debt of gratitude to the Government of Canada for its generous decision to host the Conference.

5. - It should be noted that the committee of governmental experts did not in the event find time to discuss the draft final provisions drawn up by the Unidroit Secretariat (Study LIX - Doc. 27). This was in any event recognised as being a task normally left exclusively to those attending the diplomatic Conference.

6. - It is not the purpose of this report to give a detailed account of the discussions of the committee at its third session nor to highlight every drafting amendment made to the text at the third session: it rather seeks to indicate the substantive changes introduced in the text at the session and to explain the difficulties that underlay the failure to reach unanimity on certain provisions.

7. - The first change introduced at the third session of the committee concerned *the title* of the prospective international instrument. Hitherto it had borne the title "preliminary draft uniform rules" in keeping with its status as the product of a Unidroit study group. Now finalised by the committee of governmental experts, it is styled a draft Convention, its full title accordingly reading "Draft Convention on international financial leasing".

8. - Apart from a minor drafting change of style to the final clause of the preamble, designed to make it shorter, the only substantial amendment to *the preamble* consisted in the deletion of the first alternative left inside square brackets in the fourth clause at the conclusion of the second session. The words "are ill-suited" employed in the first alternative were considered inopportune in so far as they carried a connotation of criticism of those legal systems in which the rules of law applied to financial leasing were essentially those drawn from the law of bailment, albeit in an adapted form corresponding to the extent to which financial leasing had evolved from the basic bailment pattern. The words "need to be adapted" were felt better to correspond to reality both as regards domestic legislation regarding financial leasing and the rules of law applied thereto by the courts, on the one hand, and as regards the provisions contained in the Unidroit draft Convention, on the other. The rules, concepts and terminology of the law of bailment had been largely taken over by the legislator and the courts in fashioning their basic approach to this new financial technique and this trend had been continued in the Unidroit draft Convention. However, at the same time there was recognition that the conceptual framework of the law of bailment was inadequate to reflect the novel economic reality of financial leasing and that it accordingly needed to be adapted to make it better fit this reality.

9. - While *the chapter heading of Chapter I* was re-named "Sphere (rather than "Scope") of application" to bring it into line with other recent international uniform law Conventions, such as the 1983 Unidroit Convention on Agency in the International Sale of Goods, it was acknowledged that when the draft Convention was finalised it would also be necessary for the "General provisions" at present located in Chapter III and comprising Articles 14 and 15 to be brought forward to a position immediately following the present Article 3, and amalgamated with Chapter I which would then have to be re-named "Sphere of application and general provisions", again on the model of other recent international uniform law Conventions like the aforementioned 1983 Unidroit Convention.

10. - In *the chapeau of Article 1 (1)* the words "as defined in paragraph 2 of this article" were added. Their introduction was intended to make it clear that the term "financial leasing transaction" employed in

Article 1 (1) was not to be understood narrowly in the sense traditionally ascribed to it in commercial parlance, notably in distinguishing it from operating leasing, but was rather to be read as a term of art encompassing the presence of at least the three ingredients listed in Article 1 (2). This amendment has to be seen in the light of the recent trend for leasing transactions of the atypical kind to be qualified as "operating" leases even when bearing some of the hallmarks previously specially associated with "financial" leases. It was accordingly to be seen as an amendment designed to guarantee the future Convention as broad a sphere of application as possible.

11. - The only amendment to *Article 1 (1)(a)* consisted in a slight reformulation of that provision's word order, designed to make it clearer.

12. - The words "for business or professional purposes" which appeared in the text of *Article 1 (1)(b)* as it emerged from the second session of governmental experts were deleted at the committee's third session, the idea behind them being relocated in a new separate provision, *Article 1 (3)*, the language of which is modelled on that of Article 2 (a) of the 1980 United Nations Convention on Contracts for the International Sale of Goods.

13. - In the *chapeau* to *Article 1 (2)* the word "possesses" employed in the text that emerged from the second session was replaced at the third session by the word "includes" so as to make it clear that the list of ingredients typifying the transaction addressed by the draft Convention set out in this paragraph is not intended to be exhaustive and that the future Convention may therefore apply to transactions typified by additional characteristics. Essentially the same reason lay behind the decision taken at the third session to delete the word "main" which had hitherto appeared before the word "characteristics". The deletion of this word was, however, principally motivated by a desire to avoid factual disputes as to whether in a given financial leasing transaction the three characteristics listed under *Article 1 (2)* were to be considered as "main" characteristics, thus jeopardising the application of the future Convention, which should rather always apply where the characteristics set out under *Article 1 (2)* were present.

14. - The word order of *Article 1 (2)(a)* was reformulated in the positive so as to bring it into line stylistically with the other subparagraphs of *Article 1 (2)*. This reformulation was in no way designed to affect the sense of this clause, however.

15. - Three amendments were made to *Article 1 (2)(c)* at the third session. The first of these, the substitution of the word "calculated" for the word "fixed", was designed to lessen the scope for ambiguity in the

draft Convention's sphere of application provisions, notably so as to avoid any idea that the rentals payable under the leasing agreement had necessarily to be fixed in amount and as regards the date when they fell due. The second change to this provision involved the introduction of the words "in particular" after the words "take into account"; this addition was designed to build flexibility into the future Convention's sphere of application, notably to allow for other factors than those indicated in this clause to be taken into account in the calculation of the rentals payable under the leasing agreement, for instance the cost of the transaction. (2) The only other change to Article 1 (2)(c) made at the third session involved the reinstatement of the word "substantial" before the word "part". This was designed to reflect the fact that it is an essential ingredient of the atypical leasing transaction addressed by the draft Convention that if not all then at least a substantial part of the cost of the equipment is amortised via the lessee's rentals over the term of the leasing agreement. This is one of the main ways in which a financial lease differs from an operating lease and the committee of governmental experts took the view that this distinguishing feature should be brought out more clearly in the wording of this clause. It was agreed that the lingering doubts expressed at the final session of the committee by three representatives as regards the wording of this provision should be reflected in the explanatory report for consideration by the diplomatic Conference.

16. - Three amendments were made to Article 3 at the third session. The first of these involved the introduction of the word "subsequently" before the word "acquires"; this was done to bring the English text more into line with its French counterpart and is designed to cover the case where an option is conferred on the lessee, say, under a separate agreement or under a variation of the leasing agreement. The second change made to Article 3 consisted in the replacement of the word "right" by the word "option" so as to make it clear that this provision was not designed to cover a situation where the lessee's right derived from an obligation to buy the leased asset, because that would be a sale contract. In the final

(2) This addition would also facilitate the extension of the application of the future Convention to those leasing arrangements at present under consideration for coverage under the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA): among the Draft Operational Regulations adopted by the preparatory committee of the signatory States of the MIGA Convention in September 1986 was one recommending the coverage under MIGA of leasing arrangements under which the rentals payable are "substantially dependent on the production, revenues or profits from the investment project."

change to Article 3 the words "and whether or not for a nominal price or rental" were added at the end of this provision. This addition was designed to meet the concern voiced by certain representatives that in some jurisdictions what constitutes a sale is a matter of controversy and that in these jurisdictions an economic test is applied whereby if the option fee or renewed rental is purely nominal then the transaction is characterised as a sale, with the concomitant risk that the future Convention might not prove to be applicable to such transactions. This amendment was thus designed to avoid the cases for the future Convention's application being substantially narrowed in the aforementioned jurisdictions. The amendment made by the committee served two purposes: first, it indicates that the mere fact that the option fee or the renewed rental is nominal does not take the transaction in question outside the future Convention and, secondly, it serves as an indication to courts not to apply general economic tests with a view to excluding from the future Convention what it was intended to cover, namely those transactions which while in form leases might in some jurisdictions be regarded as sales.

17. - The chapter heading of Chapter II was renamed "Rights and duties of the parties" at the third session.

18. - Article 4 lost its second paragraph at the third session, basically on the ground that it was hard to conceive how the lessee could affect the terms of the supply agreement in so far as it was not a party to that agreement but also because, in so far as the lessor was a party to the supply agreement, it was merely stating the obvious to provide that the lessor's consent should be given to any variation of the specifications given by the lessee to the supplier. More generally, it was agreed in the context of the committee's discussion of Article 9 that the question of the lessee's variation of the terms of the supply agreement should not be governed by the future Convention, but rather be left to be settled by the terms of the parties' own agreement and in accordance with the applicable law.

19. - Article 5 (2) and (3) were revised at the third session: whereas in previous drafts the law of the State of the lessee's principal place of business had been the sole applicable law for the purpose of determining any public notice requirement regarding the validity of the lessor's real rights in the equipment, under the new Article 5 (3) equipment is divided into three different categories for the purpose of determining this applicable law: first, equipment, such as ships and aircraft, subject to registration pursuant to the law of a State (it should be noted that the term registration in this context is being used not in the sense of registration of rights in, ownership of, or of a security interest

in an asset but in the sense of registration of a particular asset) (*Article 5 (3)(a)*); secondly, all other mobile equipment normally used in more than one jurisdiction (*Article 5 (3)(b)*); and, finally, all other equipment (*Article 5 (3)(c)*). The first category of equipment is made subject to the law of the State of registration. The second category, in so far as it refers to goods without a fixed *situs*, cannot be made subject to the *lex rei sitae* and is accordingly made subject to the law of the State where the lessee has its principal place of business. For the residual category of equipment the applicable law, in line with the traditional conflicts of law rule, is the *lex rei sitae*.

20. - In view of the complexities inherent in the subject of registration - for instance, the fact that the system of registration tends to vary from country to country and the fact that it is possible to have more than one place of registration - and the committee of governmental experts' awareness of its own limited expertise in these matters, it was agreed that the provisions of *Article 5 (3)(a)* should be forwarded in square brackets to a group of technical experts to meet in advance of the diplomatic Conference, the remit of this group being to examine whether the solution with which the committee had come up in *Article 5 (3)(a)* would be workable in practice.

21. - The term "mobile" as employed in *Article 5 (3)(b)* aroused much criticism, on the ground that virtually all equipment apart from fixtures could be considered to be mobile. As a result it was proposed clarifying it by the addition of the words "normally used in more than one State" on the lines of the formula employed in *Article 9* of the Uniform Commercial Code of the United States of America and similarly inspired Canadian legislation. There was also a proposal that it should be replaced by these words altogether. In view of the difficulty encountered in reaching a decision on this point, it was felt wiser in the circumstances to forward both expressions "mobile" and "normally used in more than one State" within square brackets to the diplomatic Conference for decision.

22. - In view of the uncertainty expressed in some quarters as regards the precise purport of *Article 5 (4)* it was agreed that the explanatory report should make it clear that this provision did not give a lien creditor or a secured creditor of the lessee priority over the lessor but merely set forth a conflicts rule whereby the question was left to be dealt with by the applicable law. So as to avoid any inference under *Article 5 (4)* that the provisions of *Article 5* might affect the rights of creditors of the lessor or the supplier having a lien on or a security interest in the equipment, it was decided at the third session to delete the words "of the lessee" which had previously appeared in this clause after the word "creditor".

23. - The only amendment to *Article 6* introduced at the third session consisted in the replacement of the words "the owner of the land" by the words "a person having real rights in the land". This change was designed to ensure that the scope of this provision was not limited to owners of the realty but also covered any person having an interest therein.

24. - The provisions of *Article 7 (1)(a) and (b)* were comprehensively redrafted at the third session, albeit without any substantive change being intended. The elements previously combined in *Article 7 (1)(a)* were separated into their twin components, namely, on the one hand, the intention to confer immunity on the lessor *qua* lessor in respect of liability that it might otherwise incur vis-à-vis the lessee in contract and tort and, on the other hand, the intention to confer immunity on the lessor, once again *qua* lessor, in respect of any liability for personal injury or damage to property that it might otherwise incur vis-à-vis third parties. The former class of immunity is now dealt with in *Article 7 (1)(a)* and the latter in *Article 7 (1)(b)*. As a result of the redrafting exercise performed on these two clauses, the draft Convention, where previously it spoke of "the lessor ... not ow[ing] the lessee ... any duty in contract or tort", now speaks of "the lessor ... not incur[ring] any liability to the lessee in respect of the equipment" and, where previously it spoke of "the lessor ... not ow[ing] ... third parties any duty in ... tort", now speaks of "the lessor ... not ... be[ing] liable to third parties for any personal injury or damage to property caused by the equipment."

25. - Another amendment made to *Article 7 (1)(a)* involved the addition of the words "or the leasing agreement" after the words "provided by this Convention". This addition was designed to avoid unduly tying the hands of the parties addressed by this provision.

26. - The provision, previously located in *Article 7 (1)(b)*, indicating that the lessor forfeited its aforementioned immunity from liability in contract and tort *qua* lessor where and to the extent that it had intervened in the choice of the supplier or the choice or specifications of the equipment was, as a result of the redrafting of *Article 7 (1)(a) and (b)* referred to in §24 *supra*, relocated in *Article 7 (1)(a)*.

27. - The replacement of the word "affect" by the word "govern" in *Article 7 (1)(c)* was designed to make it clear that the lessor's liability in any other capacity than as lessor is intended to fall outside the scope of the future Convention and that such questions as that of any liability of the lessor *qua* owner will accordingly fall to be settled in accordance with the applicable law.

28. - The third session of the committee witnessed a marked division of opinion among representatives regarding the extent to which the lessor should be responsible for any disturbances of the lessee's quiet possession. In the event it proved impossible to bridge this gap at the session. The committee accordingly decided to forward alternative versions of *Article 7 (2)* (Alternative II containing, it should be noted, an additional paragraph, *Article 7 (3)*) to the diplomatic Conference with a view to the matter being decided there. *Alternative I*, itself a combination of Alternatives I and II of *Article 7 (2)* as these emerged from the second session of governmental experts, imposed a broader liability on the lessor. Under this alternative, the lessor, first, warrants that the lessee's quiet possession will not be disturbed by a person having a superior title or right provided that that superior title or right does not result from the lessee's fault and regardless of whether or not the lessor is at fault. The lessor, under *Alternative I*, secondly, warrants that the lessee's quiet possession will not be disturbed by a person claiming a superior title or right, again provided that this claim is not derived from an act or omission of the lessee but only so long as the claim is a serious one. In determining whether a claim to a superior title or right is serious the committee adopted the criterion that the person asserting such a claim must be acting under the authority of the court, for instance under an interim order for return of the property to the claimant. The effect of this proviso would be that even where the claimant subsequently has its claim to the property struck down the lessor would still remain liable to the lessee for the resultant disturbance of its quiet possession. Under *Alternative II*, which represents the narrower version of the lessor's liability for disturbance of the lessee's quiet possession, the lessor is once again made responsible for disturbances caused either by a person having a superior title or right or by a person laying claim to such a superior title or right, but with the difference that this time the superior title or claim has to derive from an act or omission of the lessor, that is the lessor has to have been at fault in bringing about the disturbance. This second alternative is complemented by an additional paragraph the effect of which is to preserve any broader warranty of quiet possession by the lessor under the applicable law.

29. - The only change made to *Article 9 (1)* at the third session consisted in the deletion of the words "for its professional or business purposes" appearing at the end of this provision as it emerged from the second session. The reason for this change was that it was felt that it was already sufficiently clear from the new *Article 1 (3)* that the future Convention would only apply to transactions concluded for professional or business purposes, so that where the equipment was not being supplied for the lessee's professional or business purposes the provision in question would not be applicable.

30. - The word "vary" which appeared in square brackets in the text of *Article 9 (2)* as it emerged from the second session was deleted at the third session. As has been mentioned *supra* (at §18), the committee took the view that the question of whether the lessee should have the right to vary the supply agreement was one that should not be governed by the future Convention, being better left to be settled by the parties in their agreement or in accordance with the applicable law.

31. - The committee felt unable to introduce into the draft Convention a proposed additional paragraph to *Article 9*⁽³⁾ designed to avoid the risk of duplication of the supplier's liability in respect of the same loss or damage. Under this proposal, once the lessee had acquired rights of action against the supplier under *Article 9 (1)*, then these rights of action would no longer have been exercisable against the supplier by the lessor too. This problem had indeed already exercised the ingenuity of the Unidroit study group which had prepared the preliminary draft submitted to the committee of governmental experts. In that forum too, an attempt to require both lessor and lessee to be joined as parties to any proceedings against the supplier of the type now contemplated in *Article 9 (1)*⁽⁴⁾ had run into an insuperable difficulty, namely that such a solution would have been considered as unduly encroaching on domestic procedural law. The proposal made to the third session of governmental experts for a new paragraph to be added onto *Article 9* was also found to be unacceptable, on the ground that the interests of lessor and lessee were quite distinct. It was nevertheless agreed by the committee that the essence of this proposal should be reflected in the explanatory report, namely that it was understood that the supplier could not be liable to two parties for the same loss or damage.

32. - *Article 10 (1) and (2)* remained unchanged from the second session apart from one or two minor drafting improvements. *Article 10 (3)* is a new provision introduced at the third session. It is designed to deal with the problem, significant above all in the case of hidden defects which the lessee discovers only some time after the equipment has been in operation, of the point in time at which the lessee should lose its right to reject the equipment conferred under *Article 10 (1)*. There was an attempt by a number of representatives to fix this moment at the time when

(3) Cf. Proposals of the delegation of Korea to the second session of the committee of governmental experts (Study LIX - Doc. 32) at pp. 1-2.

(4) Cf. *Article 7 (3)* of the alternative revised versions of the tentative draft uniform rules on the *sui generis* form of leasing transaction laid before the Study Group on the leasing contract at its second session (Study LIX - Doc. 10).

the lessee intimates acceptance to the lessor or supplier, the universal practice in financial leasing transactions being for the lessor only to disburse the purchase price to the supplier after it has received notification from the lessee that the equipment has been delivered and is in good working order. This proposal met with considerable opposition, principally on the ground that the remedies granted to the lessee against the supplier under Article 9 would not by themselves give the lessee adequate redress in the event of hidden defects emerging only after the initial intimation of acceptance - for instance, the lessee's remedies against the supplier under Article 9 would be considerably limited as a result of Article 9 (2) and the prohibition contained therein on the lessee's terminating or rescinding the supply agreement - but also because of a reluctance to deprive the lessee of its right to reject equipment that it had been supplied with under a standard form of contract. In the event the committee agreed that the lessee should lose its right to reject under Article 10 where it would have lost this right if it had been buying the equipment. It was felt that it was right that if, as a buyer, the lessee would have been treated as against the supplier as having decided to retain the goods, it should also be so treated as against the lessor.

33. - The new *Article 10 (4)* was based on Alternative I of Article 10 (3) as this emerged from the second session, its language being revised so as to bring it more into line with that of the previous paragraphs of Article 10. However, this redrafting was without any affect on the substance of the provision. The reason why the committee basically favoured Alternative I over Alternative II of the 1986 version of Article 10 (3) resided in what it saw as the pointlessness of giving the lessee a general right to withhold payment of its rentals: either the lessee retained the equipment and asserted its rights against the supplier for non-conformity or it rejected the equipment and recovered any rentals or other sums it had paid to the lessor. The only circumstances in which the committee was willing to recognise a temporary (the temporary nature of this right being brought out by the employment of the word "meanwhile" in the fourth line of Article 10 (4)) right for the lessee to withhold payment of its rentals were during that limited period of time when, after having been supplied with a piece of non-conforming equipment, the lessee required a short period of time in which to make up its mind whether to exercise its right to reject or not.

34. - Apart from some minor drafting improvements to the French text of *Article 11* and the correction of an inaccurate cross-reference that has crept into the text of *Article 11 (2)* at the second session - the cross-reference to paragraph 4 of that article should have been to paragraph 5 - the text of Article 11 remained unchanged at the third session. It was, however, agreed that space should be found in the

explanatory report to illustrate the committee's thinking on the matter of the compensation to which the lessor is entitled following its termination of the leasing agreement under Article 11 (2). This illustration was felt to be particularly apposite in view of the prohibition in Article 11 (4) on the lessor's enforcement of any acceleration clause that might appear in the leasing agreement where it has already terminated that agreement. This prohibition was based on the fact that in order to sue for rentals presupposes that there was a current leasing agreement. At the same time, however, the compensation to which the lessor is entitled under Article 11 (2)(b) following its termination of the leasing agreement is intended to be assessed in such a way as to take account of the lessor's loss of future rentals. The committee felt that this was already sufficiently clearly indicated by the present text of Article 11 (2)(b).

35. - The only changes made to Article 12 at the third session were in the nature of drafting improvements. It was agreed that prior to the diplomatic Conference an effort should be made by the French-speaking representatives to resolve the infelicities in the French text of Article 12 (1) to which they had drawn attention. At the closing session of the committee the chairman of the drafting committee who, as deputy chairman of the committee of governmental experts, was in the chair for the committee's final reading of the text indicated that these infelicities in the French text should be resolved in such a way as to bring the French text into line with the English text of this provision which accurately reflected what the committee had sought to achieve in this provision, notably to allow the lessor to deal in any manner it chooses with its real rights in the equipment and its contractual rights under the leasing agreement.

36. - Article 13 is a new provision introduced at the third session designed to make it clear that the future Convention is intended to apply to sub-leasing transactions. An alternative formula, involving an amendment to the sphere of application provisions, was rejected as making those provisions over cumbersome, although it was recognised that the rightful place of this new provision might well finally be the sphere of application provisions of the future Convention. The effect of Article 13 (1) is that, in the case of a financial sub-leasing transaction, the sub-lessor is to be treated as the lessor for the purposes of the future Convention, the sub-lessee as the relevant lessee and the supplier from whom the lessor acquired the equipment as the relevant supplier. Where there is a series of transactions involving the same equipment, Article 13 (2) provides that the last financial lessor is to be treated as the lessor for the purposes of the future Convention and the party who supplied the first financial lessor as the relevant supplier.

37. - *Article 14 (1)*, left inside square brackets at the second session, remained so at the conclusion of the third session, on the understanding that the issues it raised could only be decided on the basis of a full examination conducted at the diplomatic Conference.

38. - The general intention in *Article 14 (2)* is to allow the parties the maximum freedom of contract possible in their relations with each other. It was accordingly found easier to reformulate this clause at the third session in such a way as, rather than listing a relatively long list of all the provisions that the parties could contract out of, to list only those provisions which were intended to be mandatory. It is not, however, intended to allow the parties to derogate from the sphere of application provisions of the future Convention. There was general agreement within the committee that there were, moreover, two other provisions which could not be left subject to the parties' freedom of contract: these provisions were *Article 11 (3)* and *(4)*. Certain representatives took the view that the lessee's right to quiet possession was of the essence of a financial lease and that the provisions of *Article 7 (2)* should therefore also be made mandatory. While this was a minority view and the point was made that the lessee's right to quiet possession was invariably excluded in all financial leasing transactions, it was nevertheless decided to insert a reference to *Article 7 (2)* in *Article 14 (2)* inside square brackets, thus leaving the matter to be decided at the diplomatic Conference.

39. - The only change made to *Article 15* at the third session was to remove the square brackets within which the words "its object and purpose as set forth in the Preamble, to" had been introduced into the text of the then *Article 14 (1)* at the second session. It was agreed that the explanatory report should draw attention to the fact that the term "international trade" specifically encompasses international investments.

40. - The third session of the committee of governmental experts saw the participation for the first time in the committee's work of a representative of the World Bank. He illustrated the likely coverage of leasing arrangements under the 1985 Convention Establishing the Multilateral Investment Guarantee Agency and the Draft Operational Regulations adopted by the preparatory committee of the signatory States of the Convention, to which reference has already been made elsewhere in this report (cf. *supra* at note 2). MIGA's mission, as expounded in *Article 2* of the aforementioned Convention, is "to encourage the flow of investments for productive purposes among member countries, and in particular to developing member countries" and, to this end, it is authorised to "issue guarantees, including coinsurance and reinsurance, against non-commercial risks in respect of investments in a member country which flow from other member countries" (*Article 2 (a)*) and to "carry out appropriate complementary

activities to promote the flow of investments to and among developing member countries". The non-commercial risks that will be covered by MIGA include risks resulting from currency transfers (Article 11 (a)(i)), expropriation and similar measures (Article 11 (a)(ii)), breach of contract (Article 11 (a)(iii)), and war and civil disturbance (Article 11 (a)(iv)). The question put to the committee of governmental experts by the representative of the World Bank was whether MIGA's coverage could potentially extend to that type of international financial leasing transaction addressed by the Unidroit draft Convention. As has already been shown, to qualify for MIGA coverage a transaction has to be an investment as distinguished from a straightforward trade transaction. The concept of a MIGA-covered investment is broad and flexible. Article 12 (a) provides that "eligible investments shall include equity interests ... and such forms of direct investment as may be determined by the Board" of MIGA.

The aforementioned Draft Operational Regulations adopted by the preparatory committee of the signatory States of the MIGA Convention contained certain recommendations to MIGA's Board the effect of which would be to allow for coverage of leasing arrangements on the following conditions being met: first, that the lease is an operating lease; secondly, that the lease is for a term of at least three years and, finally, that the lessor provides capital goods on terms whereunder the rentals are "substantially dependent on the production, revenues or profits from the investment project." The requirement that the transaction be an operating lease was more a question of terminology than of substance, the underlying intention being to distinguish an eligible investment from what is nothing more than an export credit substitute.

The committee took note with interest of the concept of leasing transactions with variable rentals proposed for coverage under the MIGA Convention. The possibility was raised of the inclusion in the draft Convention of a provision designed to ensure that its application extend to transactions in which the rentals payable under the leasing agreement are dependent on, and therefore variable according to the returns generated by the lessee's use of the equipment, subject to such modifications as the parties to such transactions may agree upon in the light of the particular characteristics of these transactions. However, the committee considered itself unauthorised to introduce such a provision into the draft Convention at such a late stage in its proceedings, all the more so given that Governments had been given no advance notice that there would be discussion at the session of the issues involved such as might have enabled their representatives to take a position thereon at the session. There was, nevertheless, a general feeling that the matter merited careful consideration by Governments with a view to the preparation of their position at the diplomatic Conference. The committee finally recorded its appreciation of the participation by the World Bank's representative in its deliberations.

DRAFT AGENDA

1. Adoption of the draft agenda.
2. Continuation of consideration of the preliminary draft uniform rules on international financial leasing (Appendix to Study LIX - Doc. 33), notably in the light of:
 - (a) draft final provisions capable of embodiment in a draft Convention to be built around the preliminary draft uniform rules on international financial leasing as these emerged from the first session of governmental experts (drawn up by the Unidroit Secretariat) (Study LIX - Doc. 27), a paper laid before the committee at its second session but which was not considered on that occasion owing to lack of time;
 - (b) committee of governmental experts for the preparation of a draft Convention on international financial leasing (second session, 14-18 April 1986): summary report prepared by the Unidroit Secretariat (Study LIX - Doc. 33);
 - (c) 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 (Study LIX - Doc. 34);
 - (d) comments by the Government of the Federal Republic of Germany on the text of the preliminary draft uniform rules on international financial leasing as this emerged from the second session of governmental experts (Study LIX - Doc. 35).
3. Future work.
4. Any other business.

Draft Convention on international financial leasing

as adopted by a Unidroit committee of governmental experts
at its third session held in Rome from 27 to 30 April 1987

PREAMBLE

THE STATES PARTIES TO THIS CONVENTION,

RECOGNIZING the importance of removing certain legal impediments to the international financial leasing of equipment, while maintaining a fair balance of interests between the different parties to the transaction,

AWARE of the need to make international financial leasing more available to developing countries,

CONSCIOUS of the fact that the rules of law governing the traditional contract of hire need to be adapted to the distinctive triangular relationships created by the financial leasing transaction,

RECOGNIZING therefore the desirability of formulating certain uniform rules relating primarily to the civil and commercial law aspects of international financial leasing,

HAVE AGREED as follows:

CHAPTER I - SPHERE OF APPLICATION

Article 1

1.- This Convention governs a financial leasing transaction as defined in paragraph 2 of this article in which one party (the lessor)

(a) on the specifications of, and on terms approved by, another party (the lessee), enters into an agreement (the supply agreement) with a third party (the supplier) under which the lessor acquires plant, capital goods or other equipment (the equipment) and

(b) enters into an agreement (the leasing agreement) granting to the lessee the right to use the equipment in return for the payment of rentals.

2. - The financial leasing transaction referred to in the previous paragraph is a transaction which includes the following characteristics:

(a) the lessee specifies the equipment and selects the supplier without relying primarily on the skill and judgment of the lessor;

(b) the equipment is acquired by the lessor in connection with a leasing agreement which, to the knowledge of the supplier, either has been made or is to be made between the lessor and the lessee; and

(c) the rentals payable under the leasing agreement are calculated so as to take into account in particular the amortisation of the whole or a substantial part of the cost of the equipment.

3. - This Convention does not apply to a transaction in which the equipment is to be used primarily for the lessee's personal, family or household purposes.

Article 2

1.- This Convention applies when the lessor and the lessee have their places of business in different States and when:

(a) those States and the State in which the supplier has its place of business are Contracting States; or

(b) both the supply agreement and the leasing agreement are governed by the law of a Contracting State.

2.- For the purposes of this article, if a party to the supply agreement or the leasing agreement has more than one place of business, the place of business is that which has the closest relationship to that agreement and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of that agreement.

Article 3

This Convention applies whether or not the lessee has or subsequently acquires the option to buy the equipment or to hold it on lease for a further period, and whether or not for a nominal price or rental.

CHAPTER II - RIGHTS AND DUTIES OF THE PARTIES

Article 4

The supply agreement may not be varied without the consent of the lessee.

Article 5

1.- The lessor's real rights in the equipment shall be valid against the lessee's trustee in bankruptcy and creditors, including creditors who have obtained an attachment or execution.

2.- Where by the applicable law the lessor's real rights in the equipment are valid against a person referred to in the previous paragraph only on compliance with rules as to public notice, those rights shall be valid against that person only where they are valid according to such rules.

3.- For the purposes of the previous paragraph the applicable law is:

(a) [In the case of ships, aircraft, vehicles or other equipment subject to registration pursuant to the law of a State, the law of the State of registration];

(b) in the case of all other [mobile] equipment [normally used in more than one State], the law of the State where the lessee has its principal place of business; and

(c) in the case of all other equipment, the law of the State where the equipment is situated at the time when the person referred to in paragraph 1 is entitled to invoke the rules referred to in paragraph 2.

4.- This article shall not affect the rights of any creditor having a lien on or a security interest in the equipment.

* It was agreed by the committee of governmental experts that the provisions of Article 5(3)(a) should be examined in advance of the diplomatic Conference by a working group of technical experts to be convened by Unidroit in order to see whether the solution proposed by the committee would be workable in practice.

Article 6

Any question whether or not the equipment has become a fixture to or incorporated in land, and if so the effect on the rights inter se of the lessor and a person having real rights in the land shall be determined by the law of the State where the land is situated.

Article 7

1.- (a) Except as otherwise provided by this Convention or the leasing agreement, the lessor shall not incur any liability to the lessee in respect of the equipment save to the extent that it has intervened in the selection of the supplier or the specifications of the equipment.

(b) The lessor shall not, in its capacity of lessor, be liable to third parties for any personal injury or damage to property caused by the equipment.

(c) The above provisions shall not govern any liability of the lessor in any other capacity, for example as owner.

Alternative I

2.- The lessor warrants that the lessee's quiet possession will not be disturbed by a person who has a superior title or right, or who claims a superior title or right and acts under the authority of the court, where such title, right or claim is not derived from any act or omission of the lessee.]

Alternative II

2.- The lessor warrants that the lessee's quiet possession will not be disturbed by a person who has a superior title or right, or who claims a superior title or right and acts under the authority of the court, where such title, right or claim is derived from an act or omission of the lessor.

3.- The previous paragraph does not affect any broader warranty of quiet possession by the lessor under the applicable law.]

Article 8

1.- The lessee shall take proper care of the equipment, use it in a manner consistent with that of a normal user and keep it in the condition in which it was delivered, subject to fair wear and tear.

2.- When the leasing agreement comes to an end the lessee, unless exercising its right to buy the equipment or to hold the equipment on lease for a further period, shall return the equipment to the lessor in the condition specified in the previous paragraph.

Article 9

1. - The duties of the supplier under the supply agreement shall also be owed to the lessee as if it were a party to that agreement and as if the equipment were to be supplied directly to the lessee.

2.- Nothing in this article shall entitle the lessee to terminate or rescind the supply agreement.

Article 10

1.- The lessee shall have the right, as against the lessor, to reject the equipment:

(a) if the equipment fails to conform to the terms of the supply agreement; or

(b) if the supplier fails to tender delivery within a reasonable time after the delivery date stipulated in the leasing agreement or, if none, that stipulated in the supply agreement or, in the absence of any stipulation as to date, within a reasonable time after the making of the leasing agreement.

2.- The right to reject non-conforming equipment shall be exercised by notice to be given to the lessor within a reasonable time after the lessee has discovered the non-conformity or ought to have discovered it. Rejection for non-conformity of the equipment under the supply agreement shall not preclude a fresh tender of the same equipment or a tender of other equipment in conformity with that agreement if made within a reasonable time after notice to reject.

3. - The lessee shall lose its right to reject the equipment where, if the equipment had been supplied to it as buyer, it would have lost the right to reject.

4.- Where the lessee has rejected the equipment in accordance with this article and the supplier has failed to make a fresh tender of the same equipment or a tender of other equipment in accordance with paragraph 2 of this article, the lessee shall be entitled to terminate the leasing agreement, meanwhile having the right to withhold rentals payable thereunder, and to recover any rentals and other sums paid in advance. Nevertheless, the lessee shall be obliged to pay the lessor a reasonable sum for the benefit the lessee has derived from the equipment.

5.- The lessee shall have no other claim against the lessor for non-delivery, delay in delivery or delivery of non-conforming equipment except to the extent to which this results from the act or omission of the lessor.

Article 11

1.- In the event of default by the lessee, the lessor may recover accrued unpaid rentals, together with interest.

2.- Where the lessee's default is substantial, then subject to paragraph 5 of this article the lessor may also terminate the leasing agreement and after such termination may:

(a) recover possession of the equipment; and

(b) recover such compensation as will place the lessor in the position in which it would have been had the lessee performed the leasing agreement in accordance with its terms, except in so far as the lessor has failed to take all reasonable steps to mitigate its loss.

3.- The leasing agreement may provide for the manner in which the compensation referred to in paragraph 2 (b) of this article is to be computed and such provision shall be enforceable between the parties unless such compensation is disproportionate to the compensation provided for under paragraph 2 (b).

4.- Where the lessor has terminated the leasing agreement it shall not be entitled to enforce a term of the leasing agreement accelerating payment of the rentals.

5.- The lessor shall only be entitled to terminate the leasing agreement or accelerate payment of the rentals if it has by notice given the lessee a reasonable opportunity of remedying the default so far as the same may be remedied.

Article 12

1.- The lessor may transfer or otherwise deal with all or any of its rights in the equipment or under the leasing agreement. Such a transfer shall not relieve the lessor of any of its duties under the leasing agreement or alter either the nature of the leasing agreement or its legal treatment as provided in this Convention.

2.- The lessee may transfer the right to the use of the equipment or any other rights under the leasing agreement only with the consent of the lessor and subject to the rights of third parties.

Article 13

1.- This Convention applies in relation to a financial sub-leasing transaction as if the sub-lessor were the lessor, the sub-lessee were the lessee and the supplier from whom the lessor acquired the equipment were the supplier.

2. - In the case of a series of transactions involving the same equipment which includes more than one financial leasing transaction, this Convention applies as if the last financial lessor were the lessor and as if the supplier from whom the first financial lessor acquired the equipment were the supplier.

CHAPTER III - GENERAL PROVISIONS

Article 14

[1.- This Convention shall not apply where it is excluded either by the terms of the supply agreement or by the terms of the leasing agreement.

2.-] The parties may, in their relations with each other, derogate from or vary this Convention except for the provisions of Article[s 7(2),] 11(3) and (4).

Article 15

1.- In the interpretation of this Convention, regard is to be had to its object and purpose as set forth in the Preamble, to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

2.- Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based and in conformity with the law applicable by virtue of the rules of private international law.