



**ADVISORY BOARD FOR THE
PREPARATION OF A
MODEL LAW ON LEASING
First session
Rome, 17-18 October 2005**

UNIDROIT 2005
Study LIXA-Doc.2
Original: English
October 2005

SUMMARY REPORT

(prepared by the UNIDROIT Secretariat)

The first session of the Advisory Board for the preparation of a model law on leasing convened at the seat of UNIDROIT in Rome on 17 October 2005. The attending Advisory Board members were Mr Carsten Dageförde (Germany), Mr Ronald DeKoven (United Kingdom), Mr Robert Downey (Equipment Leasing Association of the United States of America), Ms Rachel Freeman (International Finance Corporation), Chief Mrs Tinuade Oyekunle (Nigeria), Mr Fritz Peter (Switzerland), Ms Yanping Shi (People's Republic of China) and Mr Murat Sultanov (International Finance Corporation). Those Board members unable to attend were Mr El Mokhtar Bey (France/Tunisia), Mr Rafael Castillo-Triana (Colombia) and Mr Nikolai Zinoviev (Russian Federation). Messrs Bey and Castillo-Triana, however, submitted written comments.

In opening the session, Mr Herbert Kronke, Secretary-General of UNIDROIT, indicated that, in the light of developing nations' urgent need for legislation on these matters, a model law produced by the Advisory Board might be presented to the Governing Council with the suggestion that it be approved for promulgation immediately, without the prior review by governmental experts that traditionally occurred for multilateral instruments.

The Advisory Board elected Chief Mrs Oyekunle Chairman. Following adoption of the agenda, the Advisory Board elected Mr DeKoven Reporter.

The main business of the session consisted in the Advisory Board's consideration of the issues to be covered by the proposed model law. The Advisory Board agreed that it should conform to the following guidelines:

- I. Spheres of application
 - A. Substantive
 1. Both financial and operating leases of goods should be covered.
 2. The definition of financial leases should include a requirement that the lessor not interfere in the selection of the goods to be leased.
 3. Real estate, software and consumer leases should not be covered.

4. Secondary leases should be covered.

B. Geographic: The proposed model law should apply when the leased goods or the lessor's centre of main interest is within the State or when the parties select the State's law.

II. The lessee

A. Lessee's role and concomitant duties

1. Financial leases should be subject to the "hell-or-high-water" rule.
2. In a financial lease the lessee's obligations should become irrevocable when the agreement is concluded.
3. The lessee should have a duty to maintain the leased goods.

B. Lessee's rights

1. The lessee may not assign or sublet its interest without the lessor's consent, which may not be withheld unreasonably.
2. In a financial lease the lessor should provide a warranty against any interference with the lessee's right of quiet enjoyment caused by the lessor's negligent or intentional acts.
3. The lessee in a financial lease should have the ability to enforce all rights against the supplier as though the lessee were a party to the sales contract.

III. The lessor

A. Lessor's rights

1. The general comment should recommend that lessors be either unregulated or only lightly regulated.
2. The lessor may assign his benefits under the lease or assign his full interest in the lease to another entity without notification to or consent from the lessee, unless such assignment impairs the lessee's rights, benefits or remedies under the lease.

B. Lessor's warranties and duties

1. In a financial lease, the supplier should be made aware that the goods were being obtained for the lessee's use.
2. The model law should contain a requirement that the lessor not interfere with and, if needed, provide assistance to a lessee's efforts to enforce its rights against the supplier.

3. In a financial lease, when the lessor does not interfere in the selection of the goods, the warranties of merchantability and fitness for a particular purpose are provided by the supplier, not the lessor.
4. In a financial lease the lessor's warranties should be limited to a warranty against any interference with the lessee's right of quiet enjoyment caused by the lessor's negligent or intentional acts.

IV. Parties' relationship to supplier

- A. The lessee must have a direct action against the supplier with respect to the goods.
- B. The supplier, not the lessor, should provide warranties of merchantability and fitness for a particular purpose.
- C. Suppliers that are affiliates of lessors should be treated as distinct entities under the proposed model law.

V. Parties' relationship to third parties

A. Creditors of the lessee

1. Since the lessor owns the goods, the lessee's creditors should have no rights in the goods.
2. The lessee's creditors cannot attach any leasehold interest belonging to the lessee without the consent of the lessor.
3. Where a State's law provides for a registry, parties must comply with its requirements; the proposed model law should not require creation of a registry.

B. Third parties harmed by the equipment

1. In a financial lease in which the lessor does not interfere with the selection of the goods the lessor should not be liable for harm caused by the goods or by use of the goods.
2. If the lessor does interfere in the selection of goods, the lessor may have greater liability.
3. This provision is subject to the limitations of Article 8(1) in States Parties to the UNIDROIT Convention on International Financial Leasing but it is senior to any other provision of internal law.

VI. Default and measure of damages

- A. The proposed model law should define those events that constitute default.
- B. Neither party should have a right to declare an anticipatory breach or to demand assurances of the other party's ability to perform.

- C. The lessor should have a statutory right to repossess the goods.
- D. The measure of damages should be consistent with Article 13 of the UNIDROIT Convention on International Financial Leasing.

VII. Freedom of contract

- A. The model law should endorse the parties' freedom of contract.
- B. The Advisory Board reserved determination of which provisions of the proposed model law should be mandatory.

VIII. Contract law

- A. Basic provisions of contract law should be included in the proposed model law.
- B. Article 2A (Leases) of the Uniform Commercial Code of the United States of America will provide a reference for those provisions, subject to the UNIDROIT Principles of International Commercial Contracts.

An English version of the first draft of the proposed model law will be circulated by 20 November 2005, with a French version to be circulated as soon as possible thereafter. The Advisory Board should provide written comments on the first draft to the Reporter in advance of the second session of the Advisory Board, due to be held on 6 and 7 February 2006.

A second draft will follow after the second session. The Advisory Board should provide written comments on the second draft to the Reporter in advance of the third and final session due to be held on 3 and 4 April 2006. The proposed model law will then be finalised and submitted to the UNIDROIT Governing Council with a recommendation that it be approved for immediate promulgation.

APPENDIX

SUMMARY REPORT ON THE FIRST SESSION OF THE ADVISORY BOARD:

COMMENTS BY MR EL MOKHTAR BEY, MEMBER OF THE ADVISORY BOARD

I.A.1. In general, the term "goods" would seem inappropriate in view of the exclusions listed in I.A.3. Would it not be better to use the term "equipment" or "equipment and plant"?

I.A.2. If the prohibition on the lessor's intervening in the selection "of the goods" is to constitute an element of the definition of financial leases, and thus to be determinative of its legal character, why contemplate such interventions in III.B.3 and V.B.1 and 2? Does this mean that the intention was to consider this element, whilst a definitional ingredient, not a matter of substance? Or is it simply a case of the Advisory Board not considering this characteristic as a definitional ingredient, which could follow from the use of the conditional "should" rather than "shall" (I.A.2)? If the latter is the case, this characteristic would involve the disposition of the relations of the parties and the consequences thereof on third parties.

II.A.3. For the lessor the ownership of the equipment serves as "security" (in the factual and not the legal sense, of course). His keeping the equipment in good condition - which is something more than simple maintenance - is essential. I would, therefore, suggest the addition of the words "to keep the leased goods in good condition and" before the words "to maintain", with the words "the leased goods" being replaced by "them".

II.B. *Quid* where the lessor has intervened in the selection of the lessee and the supplier has failed to deliver, is bankrupt, has disappeared ... ?

IV.C. Regarding the "treatment" of suppliers that are affiliates of lessors, permit me to remind you of the so-called "captive" affiliates, which are totally dependent on lessors!

V.A.3. I would suggest that the parties be obliged to comply with any method of public notice instituted by law and not only public notice taking the form of an entry in a "registry". Public notice for accounting purposes alone could suffice ... It seems logical to add *in fine* for this case "or define a method of giving public notice of financial leasing".

V.B.1. Does this Article also cover the strict liability of the lessor that would ordinarily flow from his position as owner of the thing leased (specific texts)?

V.B.2. I would suggest that the lessor be made liable in proportion to his interventions or that the judge be left to determine the importance of his interventions, which would imply the removal from the text of the indefinite and imprecise assessment of "greater liability", which refers implicitly but necessarily to a minimal liability.

VI.B. Does this text contemplate the contractual definition of default, that is the contractual causes of breach of the leasing agreement for default and the contractual terms for the implementation thereof? If so, the model law will open up a range of potential disputes bristling with difficulties, in particular where one party is in bad faith or a pettifogger, able to play on procedural time-limits and the congestion of the courts whilst continuing to use the equipment without any *quid pro quo* (rentals). Moreover, what is intended by "assurances"? Does this mean the perfectly classic personal and real guarantees granted for the due performance of the leasing agreement? If this is so, is there not a risk of going against the interests of lessors and excluding from leasing agreements, thus open only to the most completely reliable companies, those borderline lessees who are, however, very numerous in developing countries!

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