



**UNIDROIT COMMITTEE OF GOVERNMENTAL  
EXPERTS FOR THE PREPARATION OF A DRAFT  
MODEL LAW ON LEASING  
First session  
Johannesburg, 7/10 May 2007**

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## **SUMMARY REPORT**

(prepared by the UNIDROIT Secretariat)

### **I. INTRODUCTION**

The first session of the UNIDROIT Committee of governmental experts for the preparation of a draft model law on leasing (hereinafter referred to as the *Committee*), set up to review the preliminary draft model law on leasing established by a UNIDROIT Advisory Board at its third session, held in Rome from 3 to 5 April 2006, as authorised for transmission to Governments by the UNIDROIT Governing Council at its 85<sup>th</sup> session, held in Rome from 8 to 10 May 2006 (C.G.E. Leasing/1/W.P.2) (the text of which is reproduced in Appendix I to this summary report and which is hereinafter referred to as the *preliminary draft model law*), was held, with the gracious approval of the Government of South Africa, in Sandton, Johannesburg from 7 to 10 May 2007.

Given the special vocation of the proposed model law - to assist developing countries and countries with economies in transition to a market economy, not countries primarily represented amongst UNIDROIT's membership - also non-member States which were either developing countries or countries with economies in transition were invited to participate in the work of the Committee. 24 States and four international Organisations were represented at the session (see *List of participants* reproduced in Appendix II to this summary report).

The session began at 9.30 a.m. with a half-day seminar entitled *The preliminary draft model law on leasing established by a UNIDROIT Advisory Board as authorised for transmission to Governments for finalisation by the UNIDROIT Governing Council: an introduction to its objectives and basic features* (see the seminar programme reproduced in Appendix III to this summary report). This seminar was designed, on the one hand, to permit members of the Advisory Board to introduce the preliminary draft model law and, on the other, to permit the representatives of Governments and Organisations attending the session to raise any questions. The seminar was chaired by Mr J.H. de Lange, Deputy Minister of Justice and Constitutional Development of South Africa. The text of the opening address given by Mr de Lange, that of the addresses by Mr M.J. Stanford (Deputy Secretary-General of UNIDROIT) and Ms R. Freeman (Deputy General Manager and Sector Operations Manager, Financial Markets, PrivateEnterprisePartnership Africa, International Finance Corporation) on the practical need for, and the potential uses of the proposed model law, that of the address by Mr Stanford on the work accomplished to date on preparation of the proposed model law, that of the address by Mr R.M. DeKoven (Associate Member, 3/4 South

Square, London, Of Counsel to Jenner & Block LLP and a UNIDROIT correspondent) on the overall conceptual approach followed in the drafting of the proposed model law, that of Mr B. Hauck (Associate, Jenner & Block LLP, Chicago) on the sphere of application of the proposed model law, that of the paper prepared by Mr El Mokhtar Bey (former Chairman of the Legal Affairs Committee of the European Federation of Leasing Company Associations (Leaseurope) and a UNIDROIT correspondent) on the rights and duties of the parties under the proposed model law, that of Chief Mrs T. Oyekunle (Legal Practitioner in Lagos, Honorary Vice-President of the International Council for Commercial Arbitration and a UNIDROIT correspondent) on the viewpoint of Africa regarding the relevance of the proposed model law for developing and transition economies, that of Ms A. Normantovich (Deputy Chief Counsel of Europlan in Moscow) on the viewpoint of transition economies in the same regard, that of Mr M. Sultanov (Legal Adviser to the PrivateEnterprisePartnership for the Middle East and North Africa of the International Finance Corporation) on the viewpoint of Middle East economies and that of Mr Stanford on the process for finalisation and adoption of the proposed model law are reproduced in Appendices IV to XIV to this summary report.

The session of the Committee proper was opened by Mr Stanford at 2.40 p.m. on 7 May 2007. Upon a proposal by the Government of Latvia, seconded by the Governments of India and Rwanda, Mr I.S. Thindisa (South Africa) was appointed Chairman of the Committee.

Mr DeKoven, who had been Reporter to the UNIDROIT Advisory Board, was Reporter to the Committee. In this capacity, he was invited by the Chairman to lead the Committee through the preliminary draft model law, Article by Article. Mr Hauck, who had been Secretary to the UNIDROIT Advisory Board, was Secretary to the Committee.

## **II. BUSINESS OF THE COMMITTEE**

The Committee was seised of the following papers:

- Draft agenda (C.G.E. Leasing/1/W.P. 1);
- Preliminary draft model law on leasing (as established by the UNIDROIT Advisory Board for the preparation of a model law on leasing at its third session (Rome, 3-5 April 2006) and modified in accordance with the instructions of the UNIDROIT Governing Council at its 85<sup>th</sup> session (Rome, 8-10 May 2006)) (C.G.E. Leasing/1/W.P. 2);
- Preliminary draft model law on leasing established by a UNIDROIT Advisory Board as authorised for transmission to Governments, for finalisation, by the UNIDROIT Governing Council: introductory note (C.G.E. Leasing/1/W.P. 3);
- Preliminary draft model law on leasing established by a UNIDROIT Advisory Board as authorised for transmission to Governments, for finalisation, by the UNIDROIT Governing Council: comments submitted by Governments and Organisations (C.G.E. Leasing/1/W.P. 4); and
- Joint proposal for clarifying the relationship between the preliminary draft model law on leasing and the draft UNCITRAL legislative guide on secured transactions (submitted by the UNIDROIT Secretariat and the Secretariat of the United Nations Commission on International Trade Law (UNCITRAL)) (C.G.E. Leasing/1/W.P. 5).

Upon a proposal by the Government of South Africa, seconded by the Government of Oman, the Committee adopted the agenda, the text of which is reproduced in Appendix XV to this summary report.

The organisation of the Committee's work was introduced by Mr Stanford, on the basis of the draft order of business (C.G.E. Leasing/1/O/B 1). It was decided that during the session the Committee should review the preliminary draft model law Article by Article, on first reading, in such a way as to permit a drafting committee to implement any amendments decided upon by the Committee during this review and to enable the Committee itself to review the work thus accomplished by the Drafting Committee.

The Drafting Committee was established in the following composition: Oman, Rwanda, Tanzania and the United States of America. The Reporter was invited to participate in the Drafting Committee's work on an *ex officio* basis.

### **III. REVIEW OF THE PROVISIONS OF THE PRELIMINARY DRAFT MODEL LAW BY THE COMMITTEE ON FIRST READING**

*Re: Title of, and preamble*

It was agreed that the Committee would only review the title of, and the preamble to the preliminary draft model law at such time as it had completed its first reading.

*Re: Article 1 - Sphere of application*

After clarification regarding the scope of the preliminary draft model law and the fact that nothing in the preliminary draft model law's sphere of application provisions prevented the parties from opting out of all the terms of the preliminary draft model law, simply by choosing the law of another State to govern their transaction, the Committee adopted Article 1 as drafted.

*Re: Article 2 - Definitions*

(a) "Asset"

Questions were raised regarding whether the provisions of Article 2 defining an "asset" meant that the preliminary draft model law was intended to cover leases of intellectual property and software, agricultural produce and real property. First, it was agreed that, because intellectual property was more commonly licensed than leased and because leases of intellectual property involved unique issues, it would not be appropriate for the preliminary draft model law to make any specific mention of intellectual property. Secondly, it was agreed that the definition of "asset" should be revised to make it explicit that the term included agricultural produce and, unless a lease of real property were governed by another law of the State applicable to real property (as indicated in Article 3), land.

Several Governments having commented on the preliminary draft model law's exclusion of consumer leases, the Committee, whilst acknowledging the importance of consumer leases, agreed with the position advocated by several delegations that the preliminary draft model law ought to focus on commercial leases. It was agreed that the definition of "asset" should be clarified to indicate that the relevant question was whether the asset was used in the trade or business of the *lessee*, not the trade or business of the *lessor*.

On a point raised by some Governments, it was agreed that the second sentence of the definition of "asset" should be broken up into two sentences, with a view to making it clearer.

With these clarifications and amendments, the Committee adopted the definition of "asset" as drafted in Article 2.

(b) "Centre of main interests"

It having been pointed out that the provisions of Article 2 defining "centre of main interests" were drawn from the UNCITRAL Model Law on Cross-Border Insolvency, the Committee adopted this definition as drafted.

(c) "Financial lease"

At the suggestion of some Governments, discussion of the provisions of Article 2 defining "financial lease" was taken together with that of Article 3, inasmuch as the joint proposal of the UNIDROIT and UNCITRAL Secretariats regarding Article 3 (C.G.E. Leasing/1/W.P. 5) could affect the decision that the Committee might wish to take regarding the definition of "financial lease". In the event, following consideration of Article 3, the Committee adopted this definition as drafted.

(d) "Lease", "lessee", "lessor" and "person"

The provisions of Article 2 defining "lease," "lessee", "lessor" and "person" were adopted as drafted, although one Government noted that States preparing Spanish-language versions of the future model law would wish to take care in looking at the word "possession", which in legal systems like his could inappropriately imply ownership.

(e) "Supplier"

One Government urged that the preliminary draft model law provide a definition of the term "vendor-supplier", in order that it could also cover operating leases but this suggestion did not gain support.

One Government pointed out that, because the definition of "financial lease" given in Article 2 contemplated that a financial lessor need not own the asset but could have leased it, the provisions of Article 2 defining "supplier" should reflect the fact that a supplier might in fact have provided the lessor only with the right to possession and use of the asset. With this clarification, the Committee adopted the definition of "supplier" as drafted in Article 2.

(f) "Supply agreement"

The provisions of Article 2 defining "supply agreement" were adopted as drafted, on the understanding that they be brought into line with the amendment agreed to the definition of "supplier".

*Re: Article 3 - Other laws*

Discussion of this Article centred around the joint proposal of the UNIDROIT and UNCITRAL Secretariats for clarification of the relationship between the preliminary draft model law and the draft UNCITRAL legislative guide on secured transactions (hereinafter referred to as the *draft UNCITRAL guide*) (C.G.E. Leasing/1/W.P. 5) (the text of which is reproduced in Appendix XVI to this summary report). It was noted that the amendment to Article 3 proposed thereunder, combined with the proposed enactment note, was designed to ensure that the preliminary draft model law and the draft UNCITRAL guide would work together harmoniously and was the result of critical efforts by the two Secretariats, which testified both to its importance for the continuing

work of the two Organisations and to its usefulness to those States that implemented laws based on these two instruments.

One Government, whilst endorsing the joint proposal, suggested that the text of the preliminary draft model law should not only refer to certain definitions contained in the draft UNCITRAL guide but, as a matter of drafting, should explicitly incorporate those definitions. An observer supported this addition to the joint proposal of the two Secretariats. He noted that these definitions were the product of six years of work by member States of UNCITRAL and, while not final, were unlikely to change.

After reviewing the aforementioned definitions (the text of which is reproduced in Appendix XVII to this summary report), one Government expressed concern at the idea of States adopting only the proposed model law on leasing thereby implementing definitions contained in the proposed UNCITRAL guide, which might, moreover, conflict with the understanding of leasing in most Asian States. Another Government also expressed concern at endorsing definitions in a draft guide that was not yet finalised, since a State might thus find itself bound by definitions that it had never considered.

Several Governments encouraged the Committee to endorse the Secretariats' joint proposal, notwithstanding these concerns. One Government noted that the proposed revision to Article 3(1) sought simply to ensure that the two instruments worked harmoniously together, which could be accomplished only by incorporating such express deference. Another Government further noted that States would not implement the proposed new Article 3(1) in such express terms but would necessarily revise it at the implementation stage, the proposed new text having the virtue of signalling the need for such revisions. Yet another Government stressed the importance of the instruments' working harmoniously together. Still another Government agreed that the reference to the draft UNCITRAL guide would not impair the proposed model law's usefulness.

In these circumstances, the proposed new text of Article 3 as set out in the Secretariats' joint proposal was adopted. It was noted that appropriate channels would exist for States to communicate any concerns about the UNCITRAL definitions.

*Re: Article 4 - Interpretation of this Law*

The Committee adopted Article 4 as drafted.

*Re: Article 5 - Freedom of contract*

The Committee decided that it would, in general, make more sense to consider Article 5, and in particular which provisions of the preliminary draft model law should be mandatory, after a complete reading of all the Articles of the preliminary draft model law.

*Re: Article 6 - Enforceability*

Some Governments noted that Article 6 did not protect *bona fide* purchasers for value, in the way that would be common in most countries. However, in the light of comments by another Government and another participant, regarding the lessor's ownership of the asset, and by an observer and another participant, regarding the proposed model law's special purpose of encouraging investment in States in which lessors had previously hesitated to operate, the Committee decided to maintain the preliminary draft model law's silence regarding *bona fide* purchasers for value.

One Government having also noted that, by appearing to make the leasing agreement effective against third parties, Article 6 conflicted with traditional concepts of the relativity of contracts, the Committee agreed that this Article be redrafted so as to make it clear that the parties' rights and remedies, not the agreement, were effective against third parties.

*Re: Article 7 - Lessee under financial lease as beneficiary of the supply agreement*

(a) Article 7(1)(a) and (b)

One Government questioned whether it was necessary to limit Article 7(1)(a) and (b) to financial leases, inasmuch as operating leases often contemplated a similar relationship between the lessee and the supplier. However, it was noted that the relationship between the lessor and the supplier in an operating lease was typically governed by the law of sales and that operating leasing agreements could create the appropriate relationship between lessees and suppliers.

Article 7(1)(a) and (b) were adopted as drafted.

(b) Article 7(1)(c)

It was noted that the purpose of Article 7(1)(c), in the light of the protection which the proposed model law granted to the financial lessor, was to ensure that the lessee be able to enforce its rights against the supplier. The suggestion by some Governments that the reference to "privity" be removed found favour. Certain questions raised by some other Governments were clarified. One Government questioned whether the phrase "commercially reasonable steps" was sufficiently clear.

Subject to the decision to delete the reference to "privity", Article 7(1)(c) was adopted as drafted.

(c) Article 7(1)(d)

It was noted that the reference to "parties" in this provision was intended to refer to the parties to both agreements.

It being further noted that not only all Article 7(1) but also Article 7(2) was intended to be mandatory (see *sub* Article 7(2)), the Committee agreed that the text of Article 7(1)(d) should be subsumed in a new Article 7(3), providing that the provisions of both paragraphs were mandatory.

(d) Article 7(2)

As mentioned above (see *sub* Article 7(1)(d)), the Committee endorsed one Government's suggestion that Article 7(2) be made mandatory, to prevent a supplier and lessor from inappropriately affecting a lessee's rights. It also endorsed the suggestion by another Government that the first sentence be redrafted to make it clear that the phrase "previously approved by the lessee" applied to the word "term" and not to the word "variation".

Subject to these amendments, the Committee adopted Article 7(2) as drafted.

(e) Article 7(3)

Article 7(3) was adopted as drafted.

*Re: Article 8 - Priority of liens*

(a) Article 8(1)

One Government's suggestion that Article 8(1) be redrafted found favour, as a number of proposals for drafting amendments emerged. In particular, one Government proposed that, in line with the decision taken regarding Article 6, Article 8(1) be redrafted to emphasise that third parties take their interest subject to the parties' rights and remedies, not to the leasing agreement itself. Two other Governments indicated that Article 8(1)'s reference to "interest belonging to the lessee" gave rise to confusion. Another Government emphasised the importance of Article 8(1)'s treatment of third parties' interests.

Subject to the aforementioned amendments, the Committee adopted Article 8(1) as drafted.

(b) Article 8(2)

It was agreed that the same amendments proposed in respect of Article 6 and Article 8(1) regarding the effect of the agreement should be made in Article 8(2).

Subject to these amendments, the Committee adopted Article 8(2) as drafted.

*Re: Article 9 - Liability for death, personal injury or property damage caused to third parties*

Some Governments and one observer questioned whether Article 9, in relieving the lessor from certain kinds of liability in a financial lease, left the lessee with sufficient remedies. However, after explanation by other Governments, it was agreed that Article 9 did not prejudice the lessee's and third parties' ability to obtain remedies created by the model law, in particular under Article 7, nor their ability to obtain remedies created under other laws, including remedies against the lessor in its capacity other than as lessor.

One Government noted that, if the proposed model law were revised to treat operating leases as a distinct category, as it had suggested, this provision should be amended to cover both financial and operating leases.

Another Government noted further that, whereas the heading of Article 9 referred to liability, the provision itself operated as a limitation on liability.

Subject to this amendment, the Committee adopted Article 9 as drafted.

*Re: Article 10 - Irrevocability*

(a) Article 10(1)

Regarding Article 10(1)'s treatment of irrevocability in a financial lease, some Governments and one observer suggested that, in order to prevent a lessee from being bound by an agreement where the asset was never delivered, the financial lessee's duties should not become irrevocable until the time when the asset was delivered or accepted, as opposed to the time when the leasing agreement was entered into. The Committee invited the Drafting Committee to consider this suggestion.

Given certain Governments' discomfort with the lessee's duties becoming irrevocable and the leasing industry's declared need for such a provision, one observer proposed that the Committee consider whether both parties' - and not just the lessee's - duties should be made irrevocable and whether Article 10 should be clarified so that irrevocability was only a waiver of the party's right to terminate the agreement but was not a waiver of other remedies.

After one Government had indicated that making the parties' duties reciprocal would provide important balance to the proposed model law and another Government had indicated that its leasing industry would accept irrevocability being made reciprocal, the Committee decided that Article 10(1) should be amended to make both the lessee's and the lessor's duties reciprocal.

Subject to this amendment, the Committee adopted Article 10(1) as drafted.

(b) Article 10(2)

Article 10(2) was adopted as drafted.

*Re: Article 11 - Risk of loss*

(a) Article 11(1)

In response to a question from some Governments as to whether the risk of loss in Article 11(1) should pass to the lessee later than the time provided for under the preliminary draft model law (namely, the time when the leasing agreement was entered into), one Government explained that the time provided for the passing of such risk made clear both that the lessee was able to insure its interest at an earlier time and that the lessor should not bear the risk of the asset becoming obsolete.

With this explanation, Article 11(1) was adopted as drafted.

(b) Article 11(2)

In response to a question from one Government regarding which party would bear the risk of loss in an operating lease, one Government explained that Article 11 simply provided default rules and another pointed out that the issue would invariably be dealt with by the parties' agreement.

With this explanation, Article 11(2) was thus adopted as drafted.

(c) Article 11(3)

In response to a question from one Government as to why the risk of loss in a financial lease remained with the supplier rather than the lessor, it was explained that the lessor in a financial lease was a mere financier, another Government adding that Article 11(3) sent the parties the appropriate signal regarding the role of the lessor.

Some Governments having pointed out that that part of Article 11(3) dealing with non-financial leases was rendered unnecessary by Article 11(2), Article 11(3) was remitted to the Drafting Committee for consideration.

*Re: Article 12 - Damage to the asset*

## (a) Article 12(1)

One Government expressed concern that Article 12(1) did not adequately capture the lessor's need for asset security in an asset-based financing transaction, noting that, while providing remedies for the lessee, it did nothing to remedy the diminished value of the lessor's interest. It was, however, explained that the lessor would be able to obtain such security by contract.

In response to a question from one Government as to the meaning of the words "but without further right against the supplier", it was explained that a lessee who obtained compensation from the supplier for the loss in the asset's value would have no other remedies but that a lessee could elect to seek other remedies instead of that particular remedy.

Article 12(1) was thus adopted as drafted.

## (b) Article 12(2)

One Government expressed concern that Article 12(2) did not make special provision for the treatment of operating leases. It was explained, however, that the parties to an operating leasing agreement could obtain the benefits of a financial leasing agreement by contract and that the lack of statutory recognition would not impair the parties' ability to enter into such arrangements.

Article 12(2) was adopted as drafted.

*Re: Article 13 - Acceptance*

## (a) Article 13(1)

One Government observed that, under the preliminary draft model law, the risk of loss passed to the lessee before the lessee had accepted the asset. It was noted that this early passing of the risk of loss benefitted the lessee, who could thus insure its interest in the asset at an earlier stage.

Article 13(1) was adopted as drafted.

## (b) Article 13(2)

One Government noted that Article 13(2) and Article 12 both provided remedies to a lessee in a financial lease. Another observed that Article 13(2) governed assets damaged before delivery, whereas Article 12 governed the lessee's remedies after accepting the asset.

Two Governments observed that, when read in combination with Article 7, Article 13(2)(a) created a set of statutory remedies against the supplier.

One Government noted that Article 13(2) would need to be amended if the preliminary draft model law were revised to cover operating leases.

Article 13(2) was adopted as drafted.

*Re: Article 14 – Rejection*

Following clarification of an issue identified by one Government, the Committee adopted Article 14 as drafted.

*Re: Article 15 - Transfer*

(a) Article 15(1)

While noting that Article 15(1) gave the lessor the appropriate freedom to transfer its rights, one Government expressed doubts as to whether the lessor should be able to transfer its duties without the lessee's consent. Another Government agreed, noting further that the paragraph's current inquiry into whether a transfer "would impair the lessee's rights in the asset" was unclear. The Committee agreed that Article 15(1) should be revised to limit the lessor's power to transfer its duties without the lessee's consent, which was not to be unreasonably withheld.

As thus amended, Article 15(1) was adopted.

(b) Article 15(2)

Article 15(2) was adopted as drafted.

(c) Article 15(3)

One Government questioned the purpose of Article 15(3)'s reference to third parties, wondering whether such parties could ever be identified to consent to transfers in advance. It was explained that in a securitisation investors would often be required to consent in advance to such transfers.

With this explanation, Article 15(3) was adopted as drafted.

*Re: Article 16 - Warranty of quiet possession*

(a) Article 16(1)

One Government having questioned how, under Article 16(1), a lessor could warrant quiet possession against a claim raised under the authority of a court, which could be read to imply that the lessee would be entitled to recover possession of the asset despite a court order recognising title in a third party, other Governments noted that the provision would not entitle the lessee to recover the asset itself in the face of a contrary court order but would rather entitle the lessee to damages from the lessor. The Secretariat moreover noted this provision's origin in the 1988 UNIDROIT Convention on International Financial Leasing.

The Committee, accordingly, decided that the Drafting Committee should consider whether the text could be clarified in such a way as to create a right to damages but not a right to disobey a court order.

(b) Article 16(2)

One Government noted an identical concern regarding Article 16(2) to that which it had raised under Article 16(1).

The Committee agreed that this be dealt with by the Drafting Committee in the same manner as had been decided in the context of Article 16(1).

*Re: Article 17 - Warranty of acceptability and fitness*

(a) Article 17(1)

One Government questioned how, as provided in Article 17(1), a warranty could be implied in the financial leasing contract in this manner. Some Governments agreed that the provision's phrasing should be reconsidered.

Subject to such reformulation, Article 17(1) was adopted.

(b) Article 17(2)

After one Government suggested that Article 17(2) should require the lessor to warrant acceptability and fitness regardless of whether the lessor regularly dealt in such assets and questioned whether Article 17(2)'s reference to one who "regularly deals in assets of that kind" should be expanded to refer specifically to, for example, manufacturers and dealer/agents, other Governments indicated that Article 17(2) struck the appropriate balance as drafted.

Article 17(2) was thus adopted as drafted.

*Re: Article 18 - Lessee's duties to maintain and return the asset*

The Committee adopted Article 18 as drafted.

*Re: Article 19 - Definition of default*

(a) Article 19(1)

One Government questioned why Article 19(1) required the parties to define the term "default" in writing and another drew attention to the general trend, both in domestic law and in international instruments, away from requiring such agreements to be in writing. It was agreed that the requirement of writing should be removed.

With this amendment, Article 19(1) was adopted.

(b) Article 19(2)

It was noted that the statutory definition of "default" provided in Article 19(2) was probably unnecessary, in that parties would invariably define the term in their agreement, but that Article 19(2) provided a definition for instances when the parties failed to agree.

Article 19(2) was thus adopted as drafted.

*Re: Article 20 - Notice*

One Government asked for a clarification regarding the distinction between the term "default" and the term "fundamental default" as employed in the preliminary draft model law. Another Government suggested deleting the reference to notice of fundamental default in

Article 20. While that suggestion was accepted, it was agreed that further discussion of "fundamental default" be reserved until such time as the term reappeared in the text.

With this amendment, Article 20 was adopted.

*Re: Article 21 - Damages*

In response to an inquiry from one Government, it was noted that the question as to whether Article 21's reference to damages included moral or emotional damages would be left to other domestic law.

The Committee adopted Article 21 as drafted.

*Re: Article 22 - Liquidated damages*

Article 22 was adopted as drafted.

*Re: Article 23 - Termination*

(a) Article 23(1)(a)

In the context of further consideration of the term "fundamental default" as employed in Article 23(1)(a), it was observed that the term had been introduced after the UNIDROIT Governing Council had expressed concern, when considering the text of the preliminary draft model law established by the Advisory Board, at its 85<sup>th</sup> session, that, without some similar concept, the preliminary draft model law would permit a party to terminate an agreement upon only the slightest default. After further discussion regarding the term's lack of clarity, the Committee concluded that the term "fundamental" was insufficient and invited the Drafting Committee to revise the preliminary draft model law accordingly.

Subject to this amendment, Article 23(1)(a) was adopted.

(b) Article 23(1)(b)

It was agreed that the Drafting Committee should also find a suitable replacement for the term "fundamental default" as employed in Article 23(1)(b).

Some Governments questioned whether the lessee had adequate protection in the event of a fundamental default by the lessor. However, it was observed that the provision was of unique importance for lessors and would not in practice hinder lessees' rights.

Subject to the aforementioned amendment, Article 23(1)(b) was adopted.

(c) Article 23(2)

Article 23(2) was adopted as drafted.

*Re: Article 24 - Possession and disposition*

(a) Article 24(1)

In response to an enquiry by one Government, it was clarified that Article 24(1) would not displace existing insolvency laws.

Article 24(1) was thus adopted as drafted.

(b) Article 24(2)

After suggestions by one Government that Article 24(2) give the lessee a lien on the asset and by another that it entitle the lessor to receive rentals until the asset was returned, yet another noted that the proposed model law should not resolve such issues in a one-size-fits-all manner. Rather, it should leave the resolution of such matters to the courts to apply as circumstances required.

One Government questioned whether the preliminary draft model law should be clarified to deal expressly with options to purchase or subsequent leases. However, it was agreed that such issues should be left to the parties' agreement.

Article 24(2) was thus adopted as drafted.

**IV. REVIEW BY THE COMMITTEE OF THE AMENDMENTS TO THE PRELIMINARY DRAFT MODEL LAW EFFECTED BY THE DRAFTING COMMITTEE FOLLOWING ITS FIRST READING**

Following completion of the Committee's first reading of the preliminary draft model law, the Drafting Committee met to implement the amendments agreed upon during that reading. The preliminary draft model law as thus amended (the text of which is reproduced in Appendix XVIII to this summary report) was reviewed by the Committee on the last day of its session.

The Reporter and the Chairman introduced the amendments made, in particular noting that the Drafting Committee had proposed amendments to the headings of certain Articles, in line with the suggestion made by the Chairman.

The Committee endorsed the text of the preliminary draft model law as reviewed by the Drafting Committee, with the following exceptions:

*Re: Article 2 - Definition of "financial lease"*

One Government expressed concern that the changes made to Article 3(1), in line with the joint proposal of the Secretariats of UNIDROIT and UNCITRAL, might have carved out a portion of the transactions covered by the current definition of "financial lease", in particular in the light of the third clause of Article 2. It was agreed that this was an issue that should be raised at the following session of the Committee, when it could receive more thorough discussion.

*Re: Article 7 - Lessee under financial lease as beneficiary of supply agreement*

One Government suggested that Article 7(4) should be made mandatory, so as to put lessees and lessors on an equal footing. Again, it was agreed that this was a matter that should be raised at the following session of the Committee for further discussion.

*Re: Article 8 - Priority of liens*

One Government wondered whether it was necessary to refer in Article 8 to the parties' "rights and remedies" or whether would not be sufficient simply to refer to their "rights". Another Government wondered whether Article 8(2) was redundant in the light of Article 6(2). It was agreed that these too were matters that should be flagged for consideration at the following session of the Committee.

*Re: Article 10 - Irrevocability*

(a) Article 10(1)(a)

Several Governments expressed concern at the amendment made to Article 10(1)(a), namely that making the parties' duties irrevocable at the time when the asset was accepted rather than the time when the parties signed the agreement. One Government noted that lessors needed to book their transaction immediately, not at the time when the asset was delivered. Other Governments also expressed agreement that the original language "the leasing agreement has been entered into" should be reinstated. It was so decided.

(b) Article 10(2)

Some Governments also expressed concern regarding Article 10(2), under which a duty that was irrevocable and independent was to be performed regardless of whether other parties performed their own duties. It was agreed, though, that this again was a matter that should be flagged for consideration at the following session of the Committee.

*Re: Article 12 - Damage to the asset*

It was agreed that, in the light of the Committee's decision to reinstate "acceptance", under Article 10(1)(a), as the point in time at which duties became irrevocable, the language making Article 12 "subject to Article 10" should also be reinstated.

*Re: Article 16 - Warranty of quiet possession*

Some Governments expressed concern at Article 16(3)'s limitation on the lessee's right to terminate the agreement where the lessor did not perform its duties. It was agreed that this was another matter that should be flagged for consideration at the following session of the Committee.

*Re: Article 17 - Warranty of acceptability and fitness for purpose*

One Government suggested that there might have been confusion regarding whether the Drafting Committee intended to make Article 17 mandatory and suggested that the new Article 17(3) should be deleted. Other members of the Drafting Committee agreed. The proposed new Article 17(3) was, accordingly, deleted.

*Re: Article 20 - Notices*

One Government called for clarification of the term "enforcement" in the context of Article 20. It was agreed that this was another matter that should be flagged for consideration at the following session of the Committee.

*Re: Article 23 - Termination*

(a) Article 23(1)(a)

It was noted that, in response to the Committee's request that the Drafting Committee consider an appropriate replacement for the concept of "fundamental default", the Drafting Committee had come up with the concept of "substantial default". It was further noted that this solution would keep the preliminary draft model law in line with the Governing Council's recommendation and was consistent with other international texts. It was agreed that some concept along the lines of "substantial default" was necessary. The Committee, however, agreed that the term "substantial" should be placed in square brackets to flag the need for it to receive further attention at its following session.

(b) Article 23(1)(b)

One Government suggested that, the Committee having amended Article 10 to make the financial lessor's duties irrevocable and independent, it should also amend Article 23(1)(b) to prohibit the lessor from terminating the lease upon another party's default or substantial default. Another Government agreed that Article 23(1)(b) should be amended to cover both parties. Yet another Government questioned why the lessee in a financial lease should be barred from terminating the agreement where the financial lessor did not perform its duties.

The Committee decided to amend Article 23(1)(b) so as to make it apply to both parties but also to place that provision in square brackets to flag the need for it to receive further attention at its following session.

## **V. REVIEW BY THE COMMITTEE OF THE TITLE OF, AND PREAMBLE TO THE PRELIMINARY DRAFT MODEL LAW**

The Committee having completed its review of the text of the preliminary draft model law as reviewed by the Drafting Committee, it proceeded to an examination of the title of, and preamble to the preliminary draft model law.

One Government suggested that the title be amended to refer specifically to "commercial" leasing, in order to clarify the preliminary draft model law's essential purpose. It was pointed out that a law governing commercial leasing would still assist the smallest of the small- and medium-sized enterprises, as long as their purpose was commercial. The Committee, accordingly, endorsed this proposed amendment, with it being noted that the term "commercial" would also need to be added in those places in the preamble where the model law on leasing was referred to.

One Government suggested removing the reference in the preamble to "international" trade in capital goods, because the preliminary draft model law was intended to cover both international and domestic leasing transactions. This proposal was adopted.

It was also agreed to delete the reference to the number and date of the session of the UNIDROIT General Assembly to which the preliminary draft model law was due to be submitted for adoption, appearing at the head of the preamble, as being otiose.

The text of the preliminary draft model law with the title thereof and the preamble thereto as reviewed by the Committee during the session is reproduced in Appendix XIX to this summary report, in marked-up form, and in Appendix XX, in clean form.

## **VI. FUTURE WORK**

Mr Stanford indicated that a second session of the Committee would be held at a venue that was yet to be determined but that would seek to take into account, like the first session, the regions of the world for which the preliminary draft model law was primarily designed. He expressed the hope that the draft model law to emerge from that session could then be put to the UNIDROIT General Assembly for adoption in Spring 2008.

He indicated that a summary report on the session, incorporating the amended text of the preliminary draft model law as reviewed by the Committee during that session, and an invitation to formulate comments on this amended text would be sent out in due course.

Finally, he expressed UNIDROIT's keen appreciation to all participants for their hard work and its particular appreciation to the Government of South Africa and the International Finance Corporation for their invaluable support in making it possible for the session to be held in South Africa.

**PRELIMINARY DRAFT MODEL LAW ON LEASING**

*(as established by the UNIDROIT Advisory Board for the preparation of a model law on leasing at its third session (Rome, 3-5 April 2006) and modified in accordance with the instructions of the UNIDROIT Governing Council at its 85<sup>th</sup> session (Rome, 8-10 May 2006))*

**[PREAMBLE**

*THE GENERAL ASSEMBLY OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW (UNIDROIT), meeting at its 60th session in Rome on 30 November 2006,*

*Recognising* that leasing provides developing countries and countries in transition in particular with an important source of capital for the development of infrastructure and small- and medium-sized enterprises;

*Aware* that, while many States already possess leasing legislation and a well-developed leasing industry, many other States, and in particular those States with developing economies and economies in transition, require a legal framework that will foster the swift growth of a nascent or non-existent leasing industry;

*Convinced* accordingly as to the usefulness of proposing a model law on leasing for consideration by national legislators, which may adapt it to meet their specific needs;

*Committed* to the purpose of harmonising legal regulations of leasing on a global basis in order to facilitate international trade in capital goods;

*Finding* that the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) has not only removed certain legal impediments to the international financial leasing of equipment while maintaining a fair balance of interests between the different parties to the transaction for States Parties thereto, but has also frequently served as a model for States drafting their first leasing laws;

*Considering* the legal regimen enshrined in the aforementioned Convention as a useful starting point for the development of a comprehensive model law governing such transactions;

*Being of the view* that in the preparation of such a model law priority must be given to the establishment of rules governing the civil and commercial law aspects of leasing,

*Mindful* of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law as opposed to the specific area of that law reserved to leasing,

*HAS APPROVED THE FOLLOWING TEXT OF THE UNIDROIT MODEL LAW ON LEASING:]\**

## CHAPTER I: GENERAL PROVISIONS

### Article 1 Sphere of application

This Law applies to any lease of an asset, if the asset is within [the State], the lessee's centre of main interests is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

### Article 2 Definitions

In this Law:

**Asset** means all property used in trade or business, including plant, capital goods, equipment, future assets, specially manufactured assets and living and unborn animals. The term does not include money or investment securities but no asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in land.

**Centre of main interests** means the place where a person conducts the administration of its interests on a regular basis. In the absence of proof to the contrary, the person's registered office, or habitual residence in the case of an individual, is presumed to be the centre of the person's main interests.

**Financial lease** means a lease, with or without an option to purchase, that includes the following characteristics:

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) the rentals or other funds payable under the leasing agreement take into account the amortisation of the whole or a substantial part of the lessor's investment.

**Lease** means a transaction in which a person grants a right to possession and use of an asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

**Lessee** means a person who acquires the right to possession and use of an asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessee.

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\* The preamble to the preliminary draft Model Law as reproduced herein was prepared by the UNIDROIT Secretariat, in line with the decision taken by the Advisory Board at its second session. It is designed simply to demonstrate the fundamental objectives of the preliminary draft Model Law and is in no way intended to prejudge the decision on this issue to be taken by Governments.

**Lessor** means a person who grants the right to possession and use of an asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessor.

**Person** means any legal, private or public entity or an individual.

**Supplier** means a person from whom a lessor acquires an asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires an asset for lease.

### **Article 3 Other laws**

A leasing agreement subject to this Law is also subject to any law of [this State] applicable to real property or public notice with respect to a leasing agreement or an asset subject to a leasing agreement. Failure to comply with such law has only the effect specified therein.

### **Article 4 Interpretation of this Law**

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.
2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

### **Article 5 Freedom of contract**

Except as provided in Articles 7(1), 16(1)(a), 16(2) and 22(3) and the law of [this State], the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a leasing agreement.

## **CHAPTER II: EFFECT OF LEASING AGREEMENT**

### **Article 6 Enforceability**

Except as otherwise provided in this Law, a leasing agreement is effective and enforceable according to its terms between the parties, against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

### **Article 7 Lessee under financial lease as beneficiary of supply agreement**

1. (a) In a financial lease, the duties of the supplier under the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

(b) The extension of the supplier's duties to the lessee under the preceding subparagraph does not modify the rights and duties of the parties to the supply agreement, whether arising therefrom or otherwise, or impose any duty or liability under the supply agreement on the lessee.

(c) Where the absence of privity of contract between the lessee and supplier prevents the lessee from enforcing the supplier's duties under the supply agreement, the lessor shall be bound to take commercially reasonable steps to assist the lessee. If the lessor does not take such steps, the lessor is deemed to have assumed such duties.

(d) The parties may not derogate from or vary the effect of the provisions of this paragraph.

2. The lessee's rights under this Article shall not be affected by a variation of any term of the supply agreement previously approved by the lessee unless the lessee consented to that variation. If the lessee did not consent to such variation, then the lessor is deemed to have assumed the duties of the supplier to the lessor that were so varied to the extent of the variation.

3. Nothing in this Article shall entitle the lessee to modify, terminate or rescind the supply agreement without the consent of the lessor.

#### **Article 8 Priority of liens**

1. A creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the leasing agreement and cannot attach any interest belonging to the lessee.

2. Except as otherwise provided by the law of [this State], a creditor of the lessor takes subject to the leasing agreement.

#### **Article 9 Liability for death, personal injury or property damage caused to third parties**

In a financial lease, the lessor shall not, in its capacity of lessor, be liable to the lessee or third parties for death, personal injury or damage to property caused by the asset or the use of the asset.

### **CHAPTER III: PERFORMANCE**

#### **Article 10 Irrevocability**

1. (a) In a financial lease, the lessee's duties to the lessor become irrevocable and independent when the leasing agreement has been entered into.

(b) In a lease other than a financial lease, the parties may agree to make any of the lessee's duties to the lessor irrevocable and independent by specifically identifying each duty that is irrevocable and independent.

2. A duty that is irrevocable and independent must be performed, regardless of any other party's performance or non-performance, unless the party to whom the duty is owed terminates the leasing agreement or otherwise explicitly agrees.

#### **Article 11 Risk of loss**

1. In a financial lease, risk of loss passes to the lessee. If the time of passage is not stated, the risk of loss passes to the lessee when the leasing agreement has been entered into.

2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

3. When an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, then the lessee, subject to Article 18(1), may treat the risk of loss as having remained with the lessor or, in a financial lease, the supplier from the beginning.

#### **Article 12 Damage to the asset**

1. In a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and at the lessee's option either accept the asset with due compensation from the supplier for the loss in value but without further right against the supplier or, subject to Article 10, seek such other remedies as are provided by law.

2. In a lease other than a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,

(a) if the loss is total, the leasing agreement is terminated; and

(b) if the loss is partial, the lessee may demand inspection and at the lessee's option either treat the leasing agreement as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

#### **Article 13 Acceptance**

1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.

2. (a) Once a lessee in a financial lease has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement.

(b) Once a lessee in a lease other than a financial lease has accepted an asset, the lessee is entitled to damages from the lessor if the asset does not conform to the leasing agreement.

#### **Article 14 Rejection**

1. In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

2. (a) In a lease other than a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the leasing agreement. Rejection or termination must be within a reasonable time after the non-conforming delivery.

(b) In a lease other than a financial lease, once a lessee has accepted the asset, the lessee may reject the asset under the preceding sub-paragraph only if the non-conformity substantially impairs the value of the asset and either

(i) the lessee accepted the asset without knowledge of the non-conformity, owing to the difficulty of discovering it, or

(ii) the lessee's acceptance was induced by the lessor's assurances.

(c) In a lease other than a financial lease, when the lessee rejects an asset in accordance with this Law or the leasing agreement, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied and to recover any rentals and other funds paid in advance, less a reasonable sum corresponding to any benefit the lessee has derived from the asset.

3. If the lessee rejects an asset in accordance with this Article and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

#### **Article 15 Transfer**

1. The lessor's rights under the leasing agreement may be transferred without the consent of the lessee. The lessor's duties under the leasing agreement may be transferred without the consent of the lessee except when a transfer would impair the lessee's rights in the asset.

2. The lessee's rights and duties under the leasing agreement may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

3. The lessee, lessor and third parties may consent to such transfers in advance.

### **Article 16 Warranty of quiet possession**

1. (a) In a financial lease, 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 a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor. The parties may not derogate from or vary the effect of the provisions of this sub-paragraph.

(b) In a financial lease, a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications.

2. In a lease other than a financial lease, the lessor warrants that the lessee's quiet possession will not be disturbed by a person who has a superior title or right, who claims a superior title or right and acts under the authority of a court or who makes a claim by way of infringement. The parties may not derogate from or vary the effect of the provisions of this paragraph.

### **Article 17 Warranty of acceptability and fitness**

1. In a financial lease, a warranty that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used is implied in the supply agreement and is enforceable only against the supplier.

2. In a lease other than a financial lease, a warranty that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used is implied in a leasing agreement if the lessor regularly deals in assets of that kind.

### **Article 18 Lessee's duties to maintain and return the asset**

1. (a) The lessee shall take proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.

(b) When a leasing agreement sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the asset's use, the lessee's compliance with such agreement or instructions shall satisfy the requirements of the preceding sub-paragraph.

2. When the leasing agreement comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the asset to the lessor in the condition specified in the preceding paragraph.

## **CHAPTER IV: DEFAULT**

### **Article 19 Definition of default**

1. The parties may at any time agree in writing as to the events that constitute a default or otherwise give rise to the rights and remedies specified in this Chapter.
2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the leasing agreement or this Law.

### **Article 20 Notice**

Except as otherwise provided in the leasing agreement, an aggrieved party shall give a defaulting party notice of default, notice of fundamental default, notice of enforcement, notice of termination and a reasonable opportunity to cure.

### **Article 21 Damages**

Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the leasing agreement, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

### **Article 22 Liquidated damages**

1. When the leasing agreement provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.
2. Such sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.
3. The parties may not derogate from or vary the effect of the provisions of this Article.

### **Article 23 Termination**

1. (a) Subject to sub-paragraph (b), a leasing agreement may be terminated by operation of law, by operation of Article 12, by agreement of the parties or by an aggrieved party upon fundamental default by the lessee or lessor.

(b) The lessee in a financial lease may not terminate the leasing agreement upon another party's fundamental default but is entitled to such other remedies as are provided by the agreement of the parties and by law.

2. Subject to Article 10, on termination all duties under the leasing agreement that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

**Article 24 Possession and disposition**

1. After the leasing agreement comes to an end or is terminated, the lessor has the right to recover possession of the asset.
2. After the leasing agreement comes to an end or is terminated, the lessor has the right to dispose of the asset.

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Mr Fritz PETER, Correspondent; Member of the Advisory Board



**INTERNATIONAL INSTITUTE FOR THE UNIFICATION  
OF PRIVATE LAW**

**IN CO-OPERATION WITH THE GOVERNMENT OF SOUTH AFRICA**

***THE PRELIMINARY DRAFT MODEL LAW ON LEASING ESTABLISHED BY  
A UNIDROIT ADVISORY BOARD AS AUTHORISED FOR TRANSMISSION  
TO GOVERNMENTS FOR FINALISATION BY THE UNIDROIT  
GOVERNING COUNCIL: AN INTRODUCTION TO ITS OBJECTIVES AND  
BASIC FEATURES***

**A half-day seminar addressed to the Governments and international  
Organisations invited to participate in the process of finalising the  
preliminary draft model law**

**(Johannesburg, 7 May 2007)**

Conscious of the particular aptitude of leasing to provide much-needed finance for the needs, in terms of equipment and infrastructure, of developing countries, in particular in Africa, and countries engaged in the transition to a market economy, the International Institute for the Unification of Private Law (UNIDROIT) has under preparation a model law on leasing designed to facilitate greater access to lease finance by such countries. The preliminary draft model law on leasing established by a UNIDROIT Advisory Board (which brought together legal and business expertise from North Africa and Arabic-speaking countries, sub-Saharan Africa, the Asia-Pacific region, the countries of the Former Soviet Union, Europe, Latin America and North America) has now been authorised by the UNIDROIT Governing Council for transmission to Governments, for finalisation. In the belief that those Governments and international Organisations attending the first session of the UNIDROIT Committee of governmental experts called to commence this process of finalisation in Johannesburg from 7 to 10 May 2007 will find it helpful to have an introduction to both the objectives and the basic features of the preliminary draft model law as intended by its authors, UNIDROIT has judged it opportune to organise a half-day seminar at the very beginning of this first session designed, on the one hand, to permit members of the Advisory Board to introduce the preliminary draft model law and, on the other, to permit the representatives of Governments and Organisations attending the session to raise any questions that they may have in this regard. The Governments and Organisations intending to participate in the session are, accordingly, urged to seize this invaluable opportunity to familiarise themselves with the preliminary draft.

## PROGRAMME

9.30 a.m. Welcome from Seminar Chairman – *Johnny de Lange, Deputy Minister of Justice and Constitutional Development of South Africa*

*BACKGROUND TO PREPARATION OF MODEL LAW AND PROGRESS TO DATE*

9.40 a.m. Practical need for, and potential uses of model law - *Martin Stanford, Deputy Secretary-General, UNIDROIT / Rachel Freeman, Deputy General Manager and Sector Operations Manager, Financial Markets, PrivateEnterprisePartnership Africa, International Finance Corporation; Member of Advisory Board*

10 a.m. Work accomplished to date on preparation of model law - *Martin Stanford*

*BASIC FEATURES OF MODEL LAW*

10.10 a.m. Overall conceptual approach followed in drafting of model law - *Ronald DeKoven, Associate Member, 3/4 South Square, London; Of Counsel, Jenner & Block LLP; UNIDROIT Correspondent; Reporter to Advisory Board*

10.30 a.m. Sphere of application of model law - *Brian Hauck, Associate, Jenner & Block LLP, Chicago; Secretary to Advisory Board*

10.50 a.m. Rights and duties of parties under model law - *El Mokhtar Bey, former Chairman, Legal Affairs Committee, European Federation of Leasing Company Associations (Leaseurope); UNIDROIT Correspondent; Member of Advisory Board (to be read in his absence)*

11.10 a.m. *Morning refreshments*

*ASSESSMENT OF RELEVANCE OF MODEL LAW FOR DEVELOPING AND TRANSITION ECONOMIES*

11.40 a.m. The viewpoint of Africa - *Tinuade Oyekunle, Legal Practitioner, Lagos; Honorary Vice-President, International Council for Commercial Arbitration; UNIDROIT Correspondent; Chairman of Advisory Board*

11.50 a.m. The viewpoint of transition economies - *Anna Normantovich, Deputy Chief Counsel, Europlan, Moscow (to be read in her absence)*

12 p.m. The viewpoint of Middle East economies - *Murat Sultanov, Legal Adviser, PrivateEnterprisePartnership Middle East and North Africa, International Finance Corporation; Member of Advisory Board*

*PROCESS AND SUBSTANCE MOVING FORWARD*

12.10 p.m. The process for finalisation and adoption of the model law - *Martin Stanford*

12.15 p.m. Open forum discussion: question-and-answer session  
*Moderator: Ronald DeKoven*

1 p.m. Closing remarks - *Johnny de Lange /Martin Stanford*



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FINALISATION BY THE UNIDROIT GOVERNING COUNCIL: AN INTRODUCTION TO ITS  
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**A half-day seminar addressed to the Governments and international Organisations  
invited to participate in the process of finalising the preliminary draft model law**

**(Johannesburg, 7 May 2007)**

*Welcome from the Chairman of the seminar:*

Johnny de Lange  
Deputy Minister of Justice and Constitutional Development of South Africa

Good morning, first to the Deputy Secretary-General of the International Institute for the Unification of Private Law, Mr Martin Stanford. I say welcome, as well, to the member of the UNIDROIT Governing Council, Professor Henry Gabriel, the representatives of international Organisations, heads of delegation and all experts attending on behalf of Governments.

Ladies and gentlemen, first, it is an honour for me to welcome you to South Africa on behalf of the South African Government. I trust you have travelled very well and in particular that your stay in this country is going to be memorable. Please remember it should not all just be work; I would hope that you will at least find time for a little play while here, as we have lovely amenities and I see that the sun is shining. But please work hard in the process as well. Let me apologise for our slightly late start. It is my fault: I flew in on a flight from Cape Town this morning in good time, as I thought, only to get stuck in all kinds of traffic jam. I do apologise.

Secondly, I also apologise on behalf of my Minister, Ms Bridget Mabandla, the Minister of Justice and Constitutional Development. She was actually invited to chair this seminar but she is unfortunately engaged elsewhere and I am standing in for her. It is a very big honour for me to do so.

Thirdly, I also take this opportunity above all to convey our sincere appreciation to Mr Martin Stanford and all his team, who organised this conference and made it a reality. I have been told this morning that this is the first time ever that a session of a UNIDROIT Committee of governmental experts has taken place outside Rome. And it is, of course, a great honour for us to be the first country to be chosen to host such a session. Therefore, I want to thank you for all the hard work that you put in with the substantial work in drafting the documents and organising and arranging this meeting.

Let me just briefly say - those of you who follow issues in Africa will, of course, already know this - that we in Africa have adopted what is called NEPAD. It is our version of a renaissance which Europe had a few centuries ago. Under NEPAD we have set the goal of making the 21<sup>st</sup> century in Africa the African Century. And that it is a very large objective that we have set ourselves but that is what we have done. To do so, of course, we shall in the coming years have drastically to change developing practices and patterns in Africa and for that we shall need many mechanisms. It is very important for us that we are able to network, meet and discuss with countries that are much more developed than ours in Africa and to discuss that which has worked in your countries. You have obviously gone through many of these processes where you had to go through the all development processes to get to the level of sophistication and development where you are now. Although there are positive signs in Africa we are just at the beginning of achieving that African renaissance and the African century that we seek. Obviously, to do so development and particularly growth is very vital. And, therefore, the development, the promotion of mechanisms - and in particular legal mechanisms - which will make it possible for us in Africa to be able to make use of mechanisms like leasing and make investors in other countries willing to invest their money comfortable in entering into such agreements is something that, speaking also on behalf of all countries from the developing world, we are very grateful to the Institute for: we are grateful to it for having established an Advisory Board to draft a preliminary draft model law on leasing for consideration at this meeting and, as I understand, for adoption at a subsequent meeting.

It is very evident from discussions and interactions so far that developing countries and countries engaged in the transition to a market economy are ever more needful of model legal rules governing the financing of various goods but also equipment at every level of value in order to develop their economic infrastructure. In this regard, the preliminary draft model law on leasing that will be the subject of in-depth discussion over the next three and a half days is considered to be a most efficient way of developing basic leasing laws in developing countries and countries in transition. And, therefore, I wish you very well in all your deliberations and I ask that we look at this model law very carefully, particularly in the context of developing countries, so that it can become a mechanism through which we can pursue those goals we have in NEPAD and particularly so as to make this an African century.

The organisers have decided that this morning will be used specifically to explain to us what has happened so far, so that when you go on to the rest of the conference you are up to date with what has gone on before to-day. And, therefore, we shall have four sessions this morning. The first one will deal with the background to the preparation of the model law and progress to date; we shall have two speakers. Then in the second session we shall deal with the basic features of the model law; there we shall have also three speakers. Then we shall have a very important part of the morning's proceedings: morning refreshments. During that break I would ask the South African delegation to meet me briefly: there is an issue we need to discuss. The third session will consist in an assessment of the relevance of the model law from the perspective of developing countries and economies in transition; there we shall have three speakers. The last session will focus on the process and substance moving forward; there again Mr Stanford will deal with the matter. After all that, we shall have a question and answer session. Questions should not, therefore, be raised after each presentation: you are invited to hold your horses until the end. Following that session, we shall have some brief closing remarks.



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*Practical need for, and potential uses of model law*

by Martin Stanford  
Deputy Secretary-General, UNIDROIT

## **INTRODUCTION**

Thanks are due to the Government of South Africa, and in particular to the Department of Justice and Constitutional Development, for graciously approving the holding of this session here.

This is the first time that a UNIDROIT Committee of governmental experts has been held outside Rome and South Africa, as a leading member State of UNIDROIT, had to be one of the ideal countries in which to hold the first round of intergovernmental negotiations in respect of a project particularly designed for use by developing countries and countries in transition to a market economy.

We are, therefore, extremely grateful to the Government of South Africa for its kind hospitality and support.

We are especially grateful to Adv. de Lange, the Deputy Minister of Justice and Constitutional Development, for kindly finding the time in his busy timetable to come and chair this seminar.

Whilst on the subject of thanks, no expression of our gratitude could do adequate justice to the extraordinary commitment and generosity of the International Finance Corporation in providing the material support necessary for organising this session of governmental experts so far from Rome.

We are especially grateful to Ms Rachel Freeman, Deputy General Manager and Sector Operations Manager, Financial Markets, PrivateEnterprisePartnershipAfrica, for her and her team's thorough preparation of the session here in Johannesburg.

Thanks finally to all of you for coming from near and far to be with us here to-day.

### **NEED FOR PROPOSED MODEL LAW**

Ms Freeman will be introducing you to the especial usefulness of the future model law in the context of the I.F.C.'s programmes in developing countries and transition economies designed, through the development of leasing industries, to assist the development of the private sector in these countries.

Generally, leasing has shown itself to be a particularly creative and flexible vehicle for economic growth all over the world. This was particularly noticeable in the industrialised world in the aftermath of World War II, when its 100% financing was crucial to the effort to get the world economy moving again. But it showed its particular credentials as an engine of national and individual economic growth for transition economies in the post-Soviet world.

The 100% financing it provides, for instance, permitted one country to develop a whole plastics industry without any upfront financing from the Government. The factory obtained the necessary technical know-how from a Western company that recouped its investment through the exclusive right to sell a portion of the products of the factory over a given period of time. The financier who provided the funding recovered its investment through the sale of these products. After a certain time the country in question found that it had acquired a new industry capable of generating new wealth, all this without any money being advanced upfront by the Government of that country.

Our enquiries showed that there are still whole parts of the world where the message of leasing and its potential as an engine of growth have still not got through. There are whole areas of the economy that are crying out for lease investment; for example, we heard from the World Bank that there is a very serious shortfall in infrastructure financing in Africa that leasing would be particularly well suited to help with.

A legislative framework alone is clearly not going to create a leasing industry in one of these countries. But the establishment of a modern legal framework for leasing is going to be absolutely necessary if foreign investors are going to feel sufficiently protected in order to invest in such countries.

By providing a uniform framework like the proposed model law we are aiming not only to provide the necessary legal certainty for foreign investors to invest in a new country via leasing but also to avoid having to reinvent the wheel anew each time a country sets out to develop its leasing industry.

There are, moreover, countries, like the People's Republic of China which are currently in the process of developing their leasing law and the proposed model law provides a perfect model for such countries to take in developing their own municipal legislation.



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*Practical need for, and potential uses of model law*

by Ms Rachel Freeman

Deputy General Manager and Sector Operations Manager, Financial Markets,  
PrivateEnterprisePartnership Africa, International Finance Corporation;  
Member of Advisory Board

I would like to thank the Deputy Minister of Justice of South Africa, who has generously offered his support and his team support for this event, as well as UNIDROIT which, as the institution that has been working on leasing legislation for decades, has really been a tremendous partner for the International Finance Corporation (I.F.C.) as we have been working, most recently, throughout Africa and the Middle East to develop the best enabling environment for leasing possible.

The I.F.C. is part of the World Bank Group. We are concerned to be the private sector arm. This means that what we do is work to create sustainable private sector development in our member countries, which are the majority of developing countries in the world. We provide both advisory services to Governments and to private institutions as well as investments to private sector companies, designed to make a difference in bringing about development or having an impact in the countries in which they work.

We think leasing is important. Three years ago I made a new commitment to sub-Saharan Africa: at that point in time our investments in Africa were about U.S. \$ 200,000,000 a year. They were mainly with large corporations working in Africa. We recognised that we were not doing enough in this continent and made a commitment to change our operations. This included bringing more people to work in Africa as well as a huge recruitment programme to bring people from Africa into IFC to work in Africa. And I am proud to say that, three years later, we are going to be financing over a billion dollars of investments in Africa. And our investments have changed from supporting foreign companies to working mainly with local sponsors; local financial institutions. Of this we are very proud and we are promoting development that is significantly different from that which we had before.

In the next months we are going to be approving the first investment in several years in both Liberia and Sierra Leone with two micro financial institutions that we are already setting up, who will also be looking at leasing. We also brought our global expertise in leasing to work in Africa, where we have set up our first step programmes. We are working on legislation, capacity building, awareness and investment in Tanzania, Ghana, Rwanda and Madagascar. We have just recently seen some of the fruits of this work in Tanzania, where we have provided, through our local bank, a million dollars to our local micro leasing firm. This firm focusses mainly on helping women in business acquire equipment. The leases are not huge but for the companies that they have they make a significant difference. We have programmed that our million dollar loan to this company will result over the next five years in three thousand micro leases to women in business in Tanzania. This is the type of development impact that we see with leasing. And we are now moving out to many more countries here.

The reason that we joined forces with UNIDROIT to create this model law for leasing is because we saw that if we work in first Tanzania and then in Ghana, Rwanda, Madagascar, country by country, it will take us decades to reach the forty-eight countries of Africa in which we have a presence right now. This is why we needed to come up with a better approach, which was more efficient to get into more countries faster and where you have a much more systemic programmed approach to leasing. And when we heard about the work of the model law that UNIDROIT was coming up with, we realised this is one way that we could develop legislation that had the best tenets and used global best practices to be used for many countries at the same time. This is what good best practice leasing legislation should contain. We do not see this law as something that you just can take and then adopt in every Parliament: it needs to be customised to look at the existing legislation in each country. What we do see in this law is that it has the appropriate tenets that all legislation on leasing should address and this is why we have been working so closely with UNIDROIT to bring this legislation to many countries in Africa.

Over the next several months we are planning to launch a major leasing initiative throughout francophone West Africa and this would be a combination of the advisory work that we do and investment products that we would be providing to leasing institutions. And with this we see the model law as very important, as it would be part of the package that we would be providing to the countries that we work with. For the first time we will also be working in Lusophone Africa, with a leasing programme coming up soon in Mozambique.

Our programmes that we do in Africa are based upon a global partnership that we have with the Swiss Government. The State Secretariat for Economic Affairs of Switzerland (Seco) has partnered with I.F.C. to work on leasing technical assistance work, first in Central Asia and Latin America and now in Africa and we are grateful for this partnership and have also benefitted from Swiss best practices in leasing, both on the legislative side and in how the leasing companies work. I encourage everyone here to get to know Mr Fritz Peter, who is the person who founded all leasing in Switzerland and who has been a member of the UNIDROIT Advisory Board.

What we hope to hear from everyone is their views and how they think that they can use this legislation going forward. We see it as an incredible step to have legislation that any country can refer to and think "oh, here is what is important for us to include in our legislation".

And I would like to thank the Government of Tanzania, which has sponsored four people to come to this session and which is one of the first countries we are working with in Africa on leasing. You will later be hearing from the I.F.C. about what we are doing in the Middle East, which is the other major new area where we are working on leasing. I would also encourage you to meet our teams we have brought here, the teams from Ghana, Rwanda and Tanzania, to interact with all the different delegates, to explain how we are working and also benefit from the global expertise that

many of you have brought to the table here. And I believe most of you have met the team that has organised this session: this is also representative of the programme we have and we have four assistants here from South Africa, Ghana, Tanzania and Rwanda, who are available for any questions you may have about this event. They can also share their experiences in the countries in which they are working so that we can make this a truly global community on leasing.

I would again like to thank UNIDROIT and the Government of South Africa for making this possible and look forward to working with all of you to really create the best leasing legislation possible for sub-Saharan Africa.



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*Work accomplished to date on preparation of model law*

by Martin Stanford  
Deputy Secretary-General, UNIDROIT

**PRELIMINARY ENQUIRIES**

The UNIDROIT Secretariat started out by verifying the need for, and feasibility of a model law on leasing for developing and transition economies among some of the key economic stakeholders, in particular the World Bank, the International Finance Corporation (I.F.C.), the Equipment Leasing Association of America (E.L.A.) and the European Federation of Leasing Company Associations (Leaseurope). These preliminary enquiries confirmed both the need for, and the feasibility of such a model law, in particular with a view to meeting the serious infrastructure financing shortages experienced in African countries.

**DECISION BY UNIDROIT TO PREPARE MODEL LAW**

In the light of the preliminary enquiries made by the UNIDROIT Secretariat, the UNIDROIT Governing Council (at its 84<sup>th</sup> session, held in Rome from 18 to 20 April 2005) recommended, and the UNIDROIT General Assembly (at its 59<sup>th</sup> session, held in Rome on 1 December 2005) decided upon the inclusion of the preparation of a model law on leasing in the Work Programme of UNIDROIT, albeit on the understanding that it should not impact on UNIDROIT's Budget.

A project, once included in the UNIDROIT Work Programme, typically follows a three-stage process. The first stage consists in the preparation of a first draft by an independent body of experts, the second, depending on the reaction of the UNIDROIT Governing Council to this first draft, in its transmission to Governments for finalisation by a Committee of governmental experts and the third in the adoption of the draft instrument emerging from this intergovernmental consultation process by a diplomatic Conference, in the case of an international Convention, or by the General Assembly of UNIDROIT member States, in the case of a model law.

In this case, the first stage has been completed. A preliminary draft model law has been prepared by an Advisory Board made up of representatives of the world's major economic and legal systems, including key economic stakeholders such as the I.F.C. and the E.L.A. The Board included amongst its members representatives of North Africa and the Middle East, sub-Saharan Africa, Asia and the Pacific region, the Former Soviet Union countries, Europe, North America and Latin America. All those serving on the Board, including the Chairman, Chief Mrs Tinuade Oyekunle (Nigeria) and the Reporter, Mr Ronald DeKoven (United Kingdom), were acknowledged experts in the field of leasing. Three sessions of the Board were held in Rome, in October 2005, February 2006 and April 2006 respectively. A preliminary draft model law on leasing was established at the conclusion of the third session, in equally authentic English- and French-language versions.

The second stage of this project commenced with the consideration by the UNIDROIT Governing Council, in May 2006, of the preliminary draft established by the Advisory Board and, subject to a number of amendments, its authorisation of the preliminary draft's transmission to Governments for finalisation. The preliminary draft was duly transmitted for comment, in July 2006, to all member Governments and the interested international Organisations and professional associations, as well as non-member Governments with developing and transition economies. A considerable body of comments came in from the Governments of Austria, Bolivia, Bulgaria, Cameroon, the People's Republic of China, Germany, Japan, Latvia, Mongolia, Morocco, the Russian Federation, Tunisia, the United Kingdom and the United States of America as well as from the International Civil Aviation Organization, the E.L.A., Leaseurope, the International Chamber of Commerce and the Latin American Leasing Federation (Felalease). In January 2007 the Government of South Africa informed the UNIDROIT Secretariat that it would be happy to see the session held on its territory and, accordingly, with its co-operation.

The fact that the project was designed specifically to assist developing countries and countries in transition was seen as justifying the moving of the venue of the Committee of governmental experts, at least for the first session, from the typical Rome venue to a place closer to the intended beneficiaries of the future model law. Sessions of UNIDROIT Committees of governmental experts in Rome tend almost invariably to be followed for developing countries and countries in transition by representatives of those countries' Embassies in Rome, which means that those countries in effect are deprived of full and proper participation in the negotiations, their negotiating brief being restricted to those issues on which specific instructions have been issued by their Governments.

This first session of governmental experts thus offers the representatives of developing countries and countries in transition a unique opportunity to determine the basic shape of the model law, in a way calculated to respond to their own genuine needs rather than needs imputed to them by others.



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*Basic features of model law: overall conceptual approach followed in drafting of model law*

by Ronald DeKoven

Associate Member, 3/4 South Square, London; Of Counsel, Jenner & Block LLP, Chicago;  
UNIDROIT Correspondent; Reporter to Advisory Board

The topic that has been chosen for me is the conceptual approach followed in the drafting of this preliminary draft model law, in particular the role of a legal framework. I must confess that I feel comfortable in addressing the topic, because I had the pleasure of drafting the first two versions of the preliminary draft model law only after very specific instructions from the Advisory Board.

The function of a law of this nature, I believe, is to create a legal framework that has sufficient certainty that it will be successful in attracting capital. That may not be intuitively obvious to you but I intend later in my comments to give you a few examples of what has happened in various parts of the world after a State has enacted a leasing law. The rationale behind the creation of a statute like this is that a type of transaction, leasing in particular, cannot exist in a vacuum: it is not enough that two parties get together and decide that one will be the lessor and the other will be the lessee. In order for the benefits of leasing to be created for both parties, the State needs to create a legal framework that sets forth certain parameters for the transaction and essentially ensure, in the event there is later a difference between the parties, that the benefit of the bargain will be maintained. And that is really what underlies all the work that we are going to be doing over the next few days.

Among the bargaining points that a lessor will be focussed on is that, if the lessee is in default, the lessor's expectation is that he or she will be able to get the leased asset back, in other words, that he or she will be able to repossess the asset without the support of the State, that can

lead to various serious problems. With the insurance provided by this type of provision, you end up with a lower risk premium and, put in probably a more effective way, the lessee will pay less money under the leasing transaction. So this is not just a point that is relevant to the lessor: it is relevant to the lessee because it provides for less expensive capital. Another point that is critical to the lessor is that the lessee be prohibited from placing a lien on the leased asset, because the fundamental tenet of leasing is that the leased asset belongs to the lessor and, therefore, it would be inappropriate for the lessee to be able to put a lien on his or her property; again we need the support of the State in order to ensure that. Those are just two points that we shall cover when we discuss the preliminary draft model law.

Now, I said to you before that I believe that a State that enacts a law with respect to leasing actually creates the opportunity for the creation of significant capital. As I said, that might not be intuitively obvious. To support this observation, I shall call on my own experience: I was asked in the early 1980's to be the Reporter for what became Article 2A of the Uniform Commercial Code in the United States. By that point in time I had been practising law for some twelve or fourteen years and had been asked, from time to time, to document a leasing transaction. As you know, in the United States we have a federal Government which creates its own laws but we also have a number of States and they create their own laws. Every time I was asked to document a leasing transaction I had to decide first which State's law would apply to the transaction, which in the abstract is very, very hard to do. Secondly, after I made that decision, I had to research the law of that State to see whether there was any law on that point, in particular to see whether there would be any restrictions on what my client would be doing. Needless to say, that took time and that made the transaction expensive. Not surprisingly, there was really not much of a leasing industry in the United States up until the mid-1980's: the rather extraordinary leasing industry that people talk about to-day in the United States was created in the last twenty-five years. Before that, it was virtually non-existent.

What happened? I submit to you that the creation of a uniform law that applied in each of the States of the United States, once it was enacted, provided a framework that attracted that capital, so that, after 1985, if a lawyer was instructed by a leasing company to create a leasing transaction, that lawyer did not have to do extensive research, because very quickly after initial promulgation of the uniform law the States in the United States began enacting that law. Now there were identical enactments, there were some local law changes but they were fairly modest. So it made it very efficient for the providers of capital to start leasing throughout the United States. I must confess to you - it is my hope - that in particular African States will follow that lead with respect to this model law and if, each State can resist the impulse to make too many changes when they effect the enactment, Africa can have the same benefits that were created in the United States. It will make it easier for European, Russian, Chinese, Japanese and American leasing companies to export their capital to Africa, because it will reduce the cost for them, the number of lawyers that they will have to hire and the amount of time that will be involved in each leasing transaction (because time too is highly relevant to a capital provider). There are other examples of countries where the creation of a leasing law essentially developed a rather extraordinary economy. Serbia enacted a leasing law in 2003 and within six months of the enactment of that law transactions worth 57 million Euros were put in place. That is astonishing, at least to my way of thinking. Turkey enacted a leasing law in 1985 and that resulted in a burgeoning leasing economy in Turkey. Most recently the International Finance Corporation compared the development of Korean leasing to the development of leasing in Thailand: in the Republic of Korea a leasing law was enacted in 1973, as a result of which in the twenty-five year period following that the Republic of Korea grew to the point where it is now the fifth largest leasing market in the world, whereas in Thailand, because the reforms were late in the making, it was not until the early 1990's that, as a result of the enactment of those reforms, leasing tripled within a year.

The point here is that there is a direct correlation, I submit, between the enactment of a leasing law and the development of a market economy for leasing in a country. I do not think it is enough that a law is enacted. I think there are a couple of key components that we must keep in mind as we go through this process and actually I would summarise it with one sentence which I am borrowing from a great architect "less is more". The current draft of the preliminary draft model law is nine pages long. There is a reason for that: when you add in complexity you create the opportunity for greater dispute, you put a larger burden on the judiciary, you put a larger burden on the lawyers in advising. So I hope you will accept the saying that less is more.

In terms of creating a framework, we began, of course, with the UNIDROIT Convention on International Financial Leasing which was completed in 1988. What Martin taught me was that, after the promulgation of the Convention, a number of States actually adopted the Convention and, with little modification, treated it as if it were a local or State law. That was flattering to UNIDROIT but it was not appropriate because it was not drafted for that purpose. Martin pointed out that there was a gap here: we have the Convention, which a number of State have ratified, but there is no correlative local law or model law. So, in drafting the preliminary draft model law, we were guided by the drafting principles reflected in the UNIDROIT Convention but, of course, we were not restricted by them. Secondly, we thought that the preliminary draft model law would be of some use to the I.F.C.'s project for using leasing as a means of developing the private sector. Finally - and this is a point that Ms Freeman made in her comments - it is important to recognise that the model law cannot be enacted without change: in each State it is going to be critical to examine the existing legal framework and, as a result of that examination, I have no doubt that modifications will be made to the model law.

In terms of the goals that we set for ourselves, again you heard from several speakers that our principal focus was Africa. That is not to say that other countries will not be interested in the law or will not consider enacting it, in whole or in part. But Africa was our principal focus and the Advisory Board I think took that commitment to heart. When we first started out, we talked about the type of transaction we should have in mind as we went through the drafting process. And my first proposal was the lease of a donkey, because I thought it was very important that the law should be drafted in such a way as to support subsistence economies, as they make their transition to developed economies. Now, I have never seen a lease of a donkey but that was the transaction that we had in mind. I was honoured to be invited to speak at the World Leasing Convention in Dubai, where the representative from the African Leasing Association (Afrolease) was taking to us about leasing in Africa. His comments included a reference to the leasing of beehives in Rwanda. As a result, we no longer talk about the lease of a donkey but talk rather about the lease of a beehive, which is an even more compelling example, because, when you think about it, the amount of capital involved in creating a beehive is truly minimal and because it is not a figment of my imagination but a fundamental truth, that really grips you when you think about it.

That is not to say that this preliminary draft model law will not also support grander transactions. Before my time in London I practiced in New York and put together a number of large leasing transactions. I believe that the preliminary draft model law will support those as well.

Before this meeting, as I said to you before, we spoke in Dubai at the World Leasing Convention and we were then invited by Afrolease to speak in Ghana and finally by the IFC to speak in Washington, D.C. At all of those meetings very important feedback was given to all of us from the Advisory Board.

The other important point in the drafting of this preliminary draft model law was to draft it in a way that it could be useful in different types of legal system. Among other things, it was important that the it be compliant. It is also important that the draft be handled in a way that it

can be enacted in francophone countries. This is not just a common law product. Now, during the course of the next several days, I have no doubt that some of you will make comments that will require a loosening of various tensions within the draft but please keep in mind that, as a model, it needs to be useful for all of us - not just one of us - and that in order to achieve that objective it is important to be flexible. In order to be useful, the law has to respect the sovereignty of the State that is going to enact it. So, you will find, for example, that we do not deal with regulatory aspects. There are a number of stories that you will hear from those policing industry about the problems they have had in various States. This law is not structured to grapple with those problems - for instance, the question as to whether or not a lessor must be a bank. Those are political issues and the preliminary draft model law does not deal with them.

There are a couple of points that we expect there will be differences on and the preliminary draft model law has been drafted so that it can be fairly easily revised to achieve the goal. For example, some of you thought that it was absolutely brilliant that we included real estate in the preliminary draft model model law, whereas others among you thought it was a very bad idea. Well, if you are in a State that does not want to include real estate leasing, the modifications that have to be made to pull that out are very simple.

Secondly, some of you thought that it was granted that we had the entire panoply of leasing transactions governed, whilst others among you thought that a very bad idea and that it should be limited to financial leases. Again, if you are in a State that wants thus to restrict coverage, the changes in the draft that have to be made are modest. So, I submit that it should not be difficult to modify the future model law to make it work in a given State.

The last point that you will see reflected in the preliminary draft model law is the notion that the parties have freedom of contract. We think that this is an important principle and in the few areas where freedom of contract has been impinged upon by the draft we think that there is a good reason but there are very few of these provisions.

Basically, we think it is important, now that the work of the Advisory Board is done to listen to all of you and to make revisions to the draft that are consistent with the input that we receive from you. The most important point though is that we handle this process with the efficiency with which it has been handled so far; it is our hope that the entire process may be completed in 2007 so that I.F.C. and the others can begin the promulgation process in 2008, because there are a number of States that are sadly in need of additional capital, which we think will be provided by this law once it is completed.



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**(Johannesburg, 7 May 2007)**

*Basic features of model law:*

*Sphere of application of model law*

by Mr Brian Hauck

Associate, Jenner & Bloch LLP, Chicago; Secretary to Advisory Board

## **I. Introduction**

As the others have explained, the model law on leasing was drafted with the goal of reducing transaction costs by making it possible to standardize leasing legislation across borders and regions, encouraging investment in emerging and transitioning economies, and in particular, of assisting the small- and medium-sized enterprises that are especially important in driving that growth. In order to achieve those ends, as Mr. DeKoven explained, the preliminary draft takes a flexible, wide-open approach. It permits the industry to grow in many different directions, depending on where the opportunities emerge. And as a result, while the Advisory Board took care that its product would be acceptable in the world's various legal systems, it did so with a view that its product also facilitate a wide variety of transactions.

## **II. Types of issues covered**

### **A. Civil rights and duties**

It is important to note at the outset that, consistent with UNIDROIT's focus on *private law* issues, the preliminary draft model law focuses on the rights and duties of the parties. In a few minutes we will hear more about those rights and duties. But in discussing what the model law covers, it may be helpful to identify what the model law does not include. But it is worth noting that the Advisory Board made a considered decision not to deal with issues of taxation, accounting, or supervision in this document. This is not to say those issues are not important. To the contrary,

they are critical to the growth of the industry. But the Advisory Board concluded that they were outside the model law's scope, for a couple of reasons.

#### **B. No tax, accounting, and supervision**

First, the Advisory Board determined that rules regarding taxation and accounting were secondary to the rules that govern the rights and duties of the parties to a leasing transaction. Until that civil framework were set, it would be impossible to create an appropriate framework for treating the transaction's taxation and accounting effects. In other words, you cannot decide how to *book* a transaction before you have decided what that transaction *means*.

And with regard to taxation, specifically, every State will have unique taxation concerns relating to its overall economic goals. Taxation is a particularly *public* concern. While it might be possible to lay out certain principles that should guide legislators seeking to encourage leasing, and indeed the I.F.C. has done so,<sup>1</sup> drafting a model law on taxation would be difficult at best and, more likely, presumptuous and counter-productive. Tax legislation should be drafted only after careful study of a State's policies and laws.

The issue of supervision is slightly different. States take various approaches to supervising leasing companies. Some States require that because lessors in financial leases provide credit, the lessors must be licensed and regulated by the central bank in the same manner as traditional banks. Other States take an approach of "light regulation", under which lessors may be subject to minimum capital requirements, be required to submit annual reports to the central bank, and have directors or managers with certain credentials. In still other States, which include the most successful leasing economies, lessors are unsupervised altogether.

The Advisory Board rejected a proposal that would have required lessors to be licensed financial institutions. So the model law is silent with respect to supervision. But States may take note that there was a strong sentiment on the Advisory Board that supervision would be counter-productive.

### **III. Features of the transaction covered**

So that is what the preliminary draft model law does not cover. What, then, does it cover?

#### **A. Lease**

First of all, most basically, Article 1 states that the model law

applies to any lease of an asset, if the asset is within [the State], the lessee's centre of main interests is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

#### **B. Commercial leases**

Most importantly, the model law only applies to commercial leases. It does not apply to consumer leases. This is clear in Article 2's definition of the "assets" that the model law covers. The model law covers only leases of assets that are "used in trade or business." This limitation is important. It means, first, that the model law focuses on the transactions that are most critical to economic development. And second, it means the law need not have the kinds of consumer

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<sup>1</sup> See, e.g., Matthew Fletcher et al., *Leasing in Development: Lessons from Emerging Economies* (International Finance Corp. 2005).

protections that one might expect in a law governing consumer leases. The parties to the commercial lease will be business entities, for whom consumer protections would be inappropriate and would discourage transactions that the parties would willingly enter.

### C. Types of assets

The model law provides a full definition of the term "asset" in Article 2:

**Asset** means all property used in trade or business, including plant, capital goods, equipment, future assets, specially manufactured assets and living and unborn animals. The term does not include money or investment securities but no asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in land.

The definition is expansive, encompassing "all property" used in trade or business. As Mr DeKoven described, this broad reach is appropriate, because it is impossible to predict what kinds of assets a particular economy may find appropriate for leasing.

Some States have noted that this definition means that the model law covers leases of real property. The Advisory Board considered this issue in some depth. It decided that because leases of real property can be of great economic significance, the model law should not *exclude* them from coverage. That said, laws governing real property will often reflect unique local and historical concerns, and it would be inappropriate to intrude on such issues with a model law. Thus, under Article 3, the model law defers to any existing law governing real property. But if there is no law in place, the model law will at least permit the transaction.

One State also noted that the model law does not specifically mention whether it covers leases of software, which are of growing importance. This is consistent with other international instruments, such as the Vienna Convention on Contracts for the International Sale of Goods ("CISG"). By not mentioning software explicitly, the model law recognizes that sometimes, software is an "asset" like other physical assets. But sometimes, software is much more like a "service," designed and maintained for a particular user. Just as under the Vienna Convention, courts applying the model law will decide on a case-by-case basis whether particular software qualifies as an "asset" or a "service." Thus, the model law's silence on this issue has important advantages.

### D. Domestic and international

Thus the scope of the model law with respect to assets. The model law also has a geographic scope. Under Article 1, the model law applies when a transaction meets any one of three criteria: leases in which "the asset is within [the State], the lessee's centre of main interests is within [the State] or the leasing agreement provides that [the State's] law governs the transaction."

Recall that the 1988 Ottawa Convention covers only cross-border leases, in which the lessor and lessee are based in different States. The model law's geographic reach is much wider. It applies both to purely domestic leases *and* to cross-border leases, as long as either the asset or the lessee's centre of main interests are located in the State, or if the parties choose the State's law to govern. This reach will thus both encourage foreign investment, like the Ottawa Convention, *and* encourage the growth of a domestic leasing industry. So the law's geographic reach, like its reach in other ways, is wide.

## IV. Defining the Lease

### A. Universe of leases

Of course, the most important question of scope is that of the definition of lease. The model law covers two kinds of transactions. Recall that the Ottawa Convention covered only financial leases. There is no doubt that generally speaking, the financial lease is the most powerful engine of growth. But again, as Mr DeKoven explained, the Advisory Board did not want to “channel” the industry into any particular kind of transaction. The model law thus covers both financial leases and non-financial leases.

There are several ways that one could understand the categories of “financial lease” and the “lease other than financial lease.” The model law treats them both as leases. It first defines the whole universe of leases, which includes both the traditional lease and, importantly, the financial lease within that single category of “lease.” Then, the model law breaks that universe into two, with the financial lease, on the one hand, and the lease other than a financial lease, on the other. The model law treats all of them as leases. They are two subsets of a single set.

The Advisory Board recognized that not every legal system conceived of the financial lease in this way, as a type of lease. But the Board concluded that defining the financial lease as a kind of lease had certain advantages for the purposes of a model law. First, it meant that a single piece of legislation could cover more kinds of transaction. Second, treating the financial lease as a type of lease would promote the law’s usefulness in certain places. Where certain systems do not permit the creation of credit instruments and the charging of interest, treating the financial lease as a lease, instead of as a credit device, to the extent possible may help the model law - and leasing - gain acceptance and thus encourage economic growth.

How, then, does the model law defines these categories?

**B. Definition of “lease”: “a transaction in which a person grants a right to possession and use of an asset to another person for a specific term in return for rentals.” Includes a sub-lease.**

First, the law defines the universe of the “lease.”

**Lease** means a transaction in which a person grants a right to possession and use of an asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

As we’ll learn shortly, when Professor Bey’s paper is delivered, the model law then establishes a number of rules that govern all leases, or everything that falls in this category. Unless a particular provision states otherwise, any provision in the model law that refers to a “lease” applies to all kinds of leases: both the financial lease and the lease other than the financial lease.

**C. Definition of “financial lease”: “a lease, with or without an option to purchase, that includes the following characteristics”**

Having defined this broad universe of the “lease,” the model law then carves out one subset of leases that it calls the “financial lease.” It defines the financial lease in Article 2.

1. the lessee specifies the asset and selects the supplier

2. the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact

3. the rentals or other funds payable under the leasing agreement take into account the amortisation of the whole or a substantial part of the lessor's investment

Again, Professor Bey's paper will explain these provisions in more detail. In short, however, the financial lease is treated as a kind of transaction in which the lessor acts less as a manager of assets, and more as a financier to finance the transaction between the lessee and the supplier. The model law then establishes certain rules for handling the financial lease, as apart from other leases, which Professor Bey's paper will explain. Broadly speaking, the model law identifies certain rules that apply to all kinds of leases, certain rules that apply only to financial leases, and certain rules that apply only to leases other than financial leases.

In describing the kind of transaction that the model law covers, it is important to note that the UNIDROIT and UNCITRAL Secretariats will be submitting for your consideration here a proposal that clarifies the relationship between the present model law on leasing and the UNCITRAL draft legislative guide on secured transactions. As you are no doubt aware, there is only a thin line between financing an acquisition using a lease and financing the transaction by means of a security interest. Some transactions in the form of leases may function as security interests. Accordingly, the Secretariats will propose here that a provision be added to this model law that states explicitly that the model law does not apply to any lease that qualifies as a security right or acquisition financing right under the UNCITRAL draft legislative guide. And correspondingly, the UNCITRAL Secretariat agreed that the draft legislative guide would cover only those financial leases that function as security or acquisition financing rights. So where a State has enacted laws based on both of these important instruments, it will know that its laws are working in harmony.

## **V. Conclusion**

As you can see, then, the model law has a wide reach. It will govern financial leases and non-financial leases of all kinds of assets of a commercial nature, whether the transaction is entirely domestic or has a cross-border element. The law should thus be of significant value in ensuring investors that a wide variety of transactions will be given effect. I will leave it to Professor Bey's paper now to explain the precise effect on those transactions that the law will have.



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**(Johannesburg, 7 May 2007)**

*Rights and duties of parties under model law*

by El Mokhtar Bey

former Chairman, Legal Affairs Committee, European Federation of Leasing Company Associations  
(Leaseurope); UNIDROIT Correspondent; Member of UNIDROIT Advisory Board

**I.**

The preliminary draft model law submitted for your assessment deals with two types of leasing, those leases responding to certain relative criteria, such as the asset leased, and financial leasing, called, for example, in France and in certain African countries "crédit-bail".

A leasing agreement and financial leasing are considered, as expressly specified, as regards leasing, by the definition given in Article 2, and as regards financial leasing, by that in Article 2, as "a transaction" and accordingly involve multiple contracting parties and contracts that are, however, all united by the final purpose, i.e. its performance – performance of the transaction in question – to the satisfaction of all parties and hence, to that of all those involved.

**II.**

Which, then, in this preliminary draft model law, are the rights and duties of the parties to, first, a leasing agreement – which is the term we shall use in this report (II-1) – and, second, to a financial lease (II-2)? Which are these rights and duties (1A) and which are the sanctions for breach thereof (1B)?

## II-1 THE RIGHTS AND DUTIES OF THE PARTIES TO A LEASING AGREEMENT

### 1A. Which are these rights and duties?

Pursuant to Article 2, a lease is a "transaction in which a person grants a right to possession and use of an asset to another person for a specific term in return for rentals". It is, therefore, a bilateral contract, concluded between the *lessor* "who grants the [aforementioned] right to possession and use", and the *lessee*, "who acquires the right to possession and use" in return for payment.

It flows from this definition that both lessor and lessee have a duty and a right, each of which is reciprocal: the duty, for the lessor, to grant to the lessee the right to possession and use of the leased asset in return for the right to the regular payment of the agreed rentals, which is the duty of the lessee.

#### A-a. Duties of the lessor and, therefore, rights of the lessee

In order for the lessee to enjoy the right thus granted (the right to use the leased asset in return for the payment of fixed rentals), the lessor must perform its duty to deliver the asset in question to the lessee. This duty is implicit in the text. It flows from Article 11(2) and (3) on the "risk of loss", Article 12(2) on "damage to the asset", and above all from Articles 13, on acceptance of the asset, and 14, on rejection of the asset for the reasons set forth in that Article.

Accordingly, as provided for in Article 11, the "risk of loss is retained by the lessor and does not pass to the lessee."

It follows from a combined reading of Articles 11(3) and 14 that, if the asset is delivered late, is delivered only in part or fails to conform – non-conformity – to the parties' agreement, the risk of loss is retained by the lessor if the lessee:

- does not accept the asset as it is, the tender of which is then to be considered as not being a conforming tender (Article 14(2)(a)),
- or accepts the asset as it is, initiates proceedings to terminate the leasing agreement and – if required to do so under the contract – complies with its duty to maintain the asset (Article 18(1)(a) and (b)).

All this means that the asset delivered must conform to the specifications of the lease if the lessee is to be able to use it normally and, as a consequence, to make regular, full payment of the rentals.

However, the leased asset may, upon its delivery to the lessee, be found to have sustained damage without fault of the lessor. In that case, the lessee, under Article 12(2), has the option of:

- either "treat[ing] the leasing agreement as terminated" – by reason of the mere fact of the damage – if the loss is total; although the preliminary draft does not specify what is meant by total loss (Article 12(2)(a)), this will generally mean damage such as to render the asset wholly unfit for the purpose for which it was intended;
- or, if the loss is partial, "treat[ing] the leasing agreement as terminated" upon inspection; although the preliminary draft does not specify the degree of loss, it would be logical to assume, in line with the theory of abuse of right – as known in civil law systems, for

example – that substantial loss is required (Article 12(2)(b)) and not total loss as contemplated by Article 12(2)(a).

This assessment also follows from Article 12(1), which gives the lessee the option of accepting the asset as it is but with a reduction in the rentals payable for the balance of the lease term to reflect the loss in value of the asset rather than the extent to which the lessee's enjoyment of the asset has thereby been reduced.

As a rule, pursuant to Article 13(2)(b), the lessee, even where it has accepted the asset as it is, is entitled to claim damages from the lessor if the asset does not conform to the leasing agreement; given that, under Article 13(1), acceptance occurs when the lessee signals to the lessor or supplier – and, therefore, expressly – that the asset conforms to the agreement, fails to reject it or uses it – and, therefore, tacitly accepts it – after a reasonable opportunity to inspect it.

In order to ensure the lessee's full and quiet possession of the leased asset, Article 17(2) provides that a warranty that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is normally intended to be used is implied in the leasing agreement if the lessor regularly deals in assets of that kind. This is the warranty of acceptability and fitness of the leased asset.

The lessor also warrants, under Article 16 (Warranty of quiet possession), 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 a court, or who makes a claim by way of infringement.

This is a mandatory provision and the parties may not derogate from it or vary its effects.

- The lessee is entitled to transfer its rights and duties, but only - in accordance with Article 15(2) - with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

A-b. Duties of the lessee and, therefore, rights of the lessor

- The lessee has several duties. It must pay – as laid down in Article 2 (Definition), – rentals for a specific term, in accordance, of course, with the deadlines and other terms of the contract, although the preliminary draft does not specifically state this.
- The lessee must, pursuant to Article 18(1)(a), take proper care of the asset, which is the property of the lessor, and use it reasonably in the light of the manner in which such assets are ordinarily used and keep it in the condition in which it was delivered, subject to fair wear and tear.
- When the manufacturer or supplier of the asset issues technical instructions for the asset's use and maintenance, under Article 18(1)(b), the lessee's compliance with such instructions satisfies its duty of proper care and maintenance, if such is the intent of the parties.
- Finally, the lessee has the duty to return the asset to the lessor when the leasing agreement comes to an end or is terminated (Article 24), in the condition in which it was delivered. Since the lessee is not entitled to buy the asset, an option that may only be exercised in the case of a financial lease, it cannot acquire it by exercising such an option. The lessee may nevertheless buy the asset, in accordance with municipal law, once the

leasing agreement expires or it may hold it on lease for a further period, in accordance with Article 18(2).

One or other of the contracting parties may breach the terms of the leasing agreement. The preliminary draft model law contemplates this situation, which it refers to as "default".

*1B. What then is the sanction for "default" by one of the parties to the leasing agreement under the preliminary draft model law?*

B-a. Termination of the leasing agreement

- Pursuant to Article 19(1), the parties may, at any time, agree as to the events that shall constitute default. In the absence of such agreement, Article 19(2) provides that default "occurs when one of the parties fails to perform a duty arising under the leasing agreement or this Law." However, the sanction of termination only applies to such default as is termed "fundamental" in Article 23(1)(a), which does not however provide a definition for that term.
- In that case, the leasing agreement is terminated by operation of law, by agreement of the parties or by an aggrieved party upon fundamental default by the other, in accordance with Article 23(1)(a).

In this last case, in accordance with Article 20, except as otherwise provided in the leasing agreement, the aggrieved party must give the defaulting party notice of the reason for such termination as well as a reasonable opportunity to cure its default.

B-b. Damages

- Once the agreement is terminated, the defaulting contracting party must compensate the aggrieved party for the damage it has caused. The aggrieved party is, accordingly, entitled to such damages as will, in accordance with Article 21, place it "in the position in which it would have been had the agreement been performed in accordance with its terms.

However, the parties may also make provision in their contract for compensation – liquidated damages – but the amount stipulated must not be not just excessive but not "grossly excessive", in relation to the harm resulting from the default. Article 22(2) does not, however, provide any specific guidance as to when such a sum is to be adjudged not merely excessive but grossly excessive.

In this case, the sum agreed may be reduced to a reasonable amount, which may, however, still be excessive for the purpose of attaining the coercive and dissuasive objective of the relevant clause. In order to prevent abuse, the parties may not derogate from the provisions of Article 22 (Article 22(3)).

Such are the rights and duties of the parties to a leasing agreement and the sanctions for breach of the same.

## **II-2. THE RIGHTS AND DUTIES OF THE PARTIES TO A FINANCIAL LEASING TRANSACTION**

What are the rights and duties of the parties to a financial leasing transaction, in which the lease serves a financial purpose, an idea eloquently rendered by the French "crédit-bail" or "crédit par le bail"?

First of all, however, what is financial leasing?

2A. *The definition of financial leasing and a description of its structure*

A-a. Constitutive ingredients:

- Article 2 describes a financial lease as a lease, with or without an option to purchase, that presents the following cumulative characteristics:
  - (a) the lessee specifies the asset to be leased and selects the supplier;
  - (b) the lessor acquires the asset, in principle on terms freely agreed with the supplier, although this is not specified in the text; and
  - (c) “the rentals and other funds payable under the leasing agreement” – not specified in the text – “take into account the amortisation of the whole or a substantial part of the lessor’s investment”, i.e. the capital it has invested in the transaction, which includes the purchase price of the asset and related costs such as the cost of transport and insurance, customs duties, ..., the cost of alterations, which, taken together, form the rental base on the basis of which the rentals are calculated but which do not affect the rentals’ legal nature.

Accordingly, the rental is not merely the counterpart of the right to possession and use of the asset leased under a financial lease, determining their *legal character*, but also, indeed chiefly, part of the amortisation corresponding to the lessor’s investment and profit margin, determining their *financial character*.

The combination of these two elements explains the special nature and originality of this type of leasing which find a logical and balanced expression in the preliminary draft, which reflects, *inter alia*, the multiplicity of the parties and contractual relationships involved, which we shall now look at, from the perspective of the rights and duties of the parties to such transactions.

A-b. Structure(s)

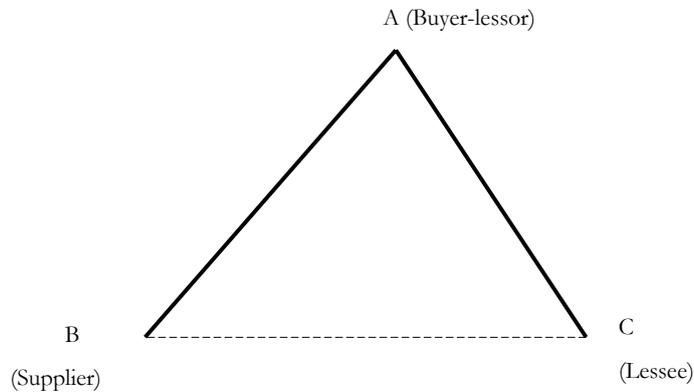
- Pursuant to Article 2 of the preliminary draft, the lessor acquires the asset, selected by the lessee, from a supplier designated by it, or the right to possession and use of the asset in question under a lease; in both cases, in order to lease the asset to the lessee, the financial leasing transaction consists *either* in a contract of sale – called the supply agreement – and a leasing agreement for the same asset, then bought and leased to the lessee – a simple leasing agreement with an option to purchase the leased asset which turns into an actual sale once the lessee expresses its intention to buy on the agreed terms – *or* a simple leasing agreement and a sub-lease for the same asset or a leasing agreement with an option to purchase the asset and a sub-lease for the same asset with the purchase option from the leasing agreement transferred to the sub-lessee.

Since such a transfer amounts to the transfer of a possible future right which is not allowed in some legal systems or a purely discretionary condition which is invalid under some legal systems, this transaction comes down to either a simple lease and a simple sub-lease or a lease with a purchase option and a simple sub-lease, except if we consider that Article 15 authorises the transfer in question (in that it refers to the rights and duties of the parties “under the leasing agreement”, which specifically grants this option).

There are six possible scenarios in respect of financial leasing.

In the first scenario, the transaction involves, on the one hand, the supplier and the buyer- lessor, bound by a contract of sale for the asset to be leased, and on the other hand, the lessor and the lessee, bound by a leasing agreement for the asset in question (see Diagram No. 1).

Diagram No. 1



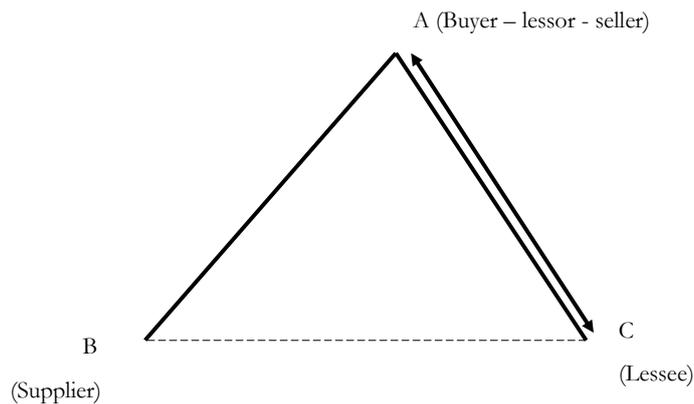
AB= supply agreement (the initial sale)

AC= simple leasing agreement

BC= legal relationship created by the intent of parties A and B in view of the financial nature of the transaction (Art. 7(1)(a) and (c)).

In the second scenario, the lease relationship AC is supplemented by the lessee enjoying an option to purchase the asset. Where the lessee exercises the option, a sale of the asset originally purchased and leased takes place on the terms, in particular the financial terms, agreed (see Diagram No. 2).

Diagram No. 2



AB= supply agreement (the initial sale))

AC= - leasing agreement with a purchase option

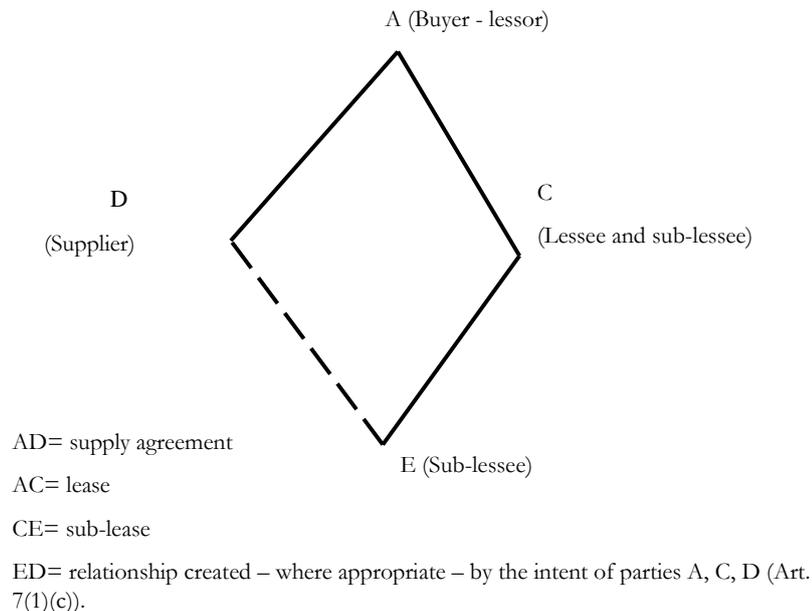
- contract of sale following the lessees exercising of the purchase option

BC= legal relationship created by the intent of parties A and B in view of the financial nature of the transaction (Art.. 7(1)(a) and (c)).

Since the lessor's fundamental purpose is to amortise, either in full or in part, the capital invested in buying the asset and to make a profit by collecting rentals for the term of the lease, on the one hand, and since the user of the purchased asset – the person who requested the financing by way of leasing – who is the beneficiary of an option to purchase the asset in question, is the lessee who selected the asset and the supplier of that asset in accordance with its own technical, economic, commercial and financial specifications, and approved the supply agreement as provided in Article 7(2), the lessee must, where necessary, be entitled to rely on the supply agreement against the supplier as if it were a party to that agreement.

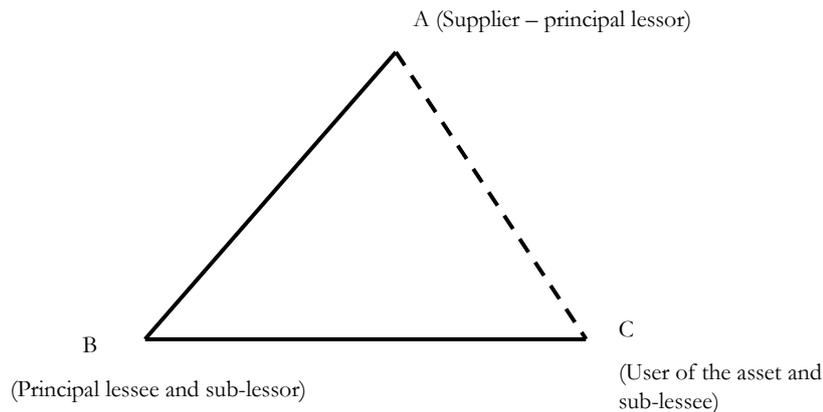
The combination of Article 2, whose definition of financial lease includes sub-lease in the lease, and Article 7(1)(c) which provides that "[w]here the absence of privity of contract between the lessee and supplier prevents the lessee from enforcing the supplier's duties under the supply agreement, the lessor shall be bound ...", suggests a third scenario in which the relationships in Diagram No. 1 are supplemented by a sub-leasing relationship – binding the sub-lessee to the lessee – which is typical of what in the technical jargon of some countries is known as *leasing adossé*, in which the lessee – the principal lessee – is, economically speaking, a guarantor, whereas the sub-lessee is the real user, who will not normally have been approved by the lessor, usually on grounds of financial risk. Here, it is clearly the sub-lessee's right to rely on the supply agreement against the supplier as though it were a party to that agreement (see Diagram No. 3).

Diagram No. 3



In a fourth scenario, the supplier – perhaps the manufacturer of the asset – is the lessor of the asset granted under a simple lease to the lessee, which might be a subsidiary – a captive – and in effect the sub-lessor (see Diagram No. 4). The difference from Diagram No. 1 resides in the position of the lessor and the sub-lessor.

Diagram No. 4



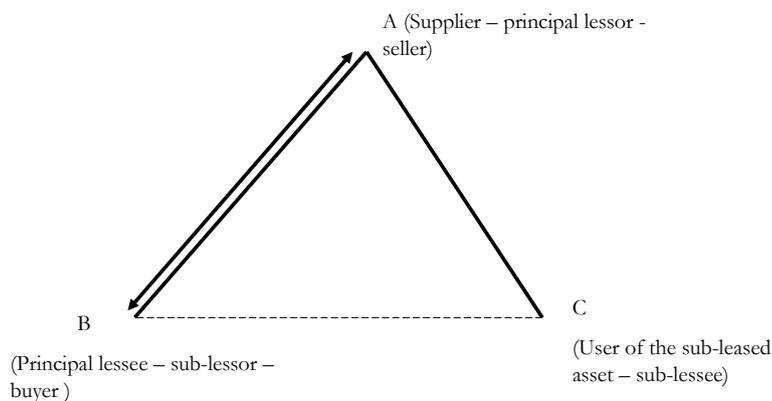
AB= principal lease

BC= sub-lease

AC= choice of asset and establishment of the terms of the transaction; legal relationship created by the intent of parties A and B in favour of C

In this same transaction, the principal lessee may have a purchase option, which does not apply to the sub-lessee (see Diagram No. 5).

Diagram No. 5



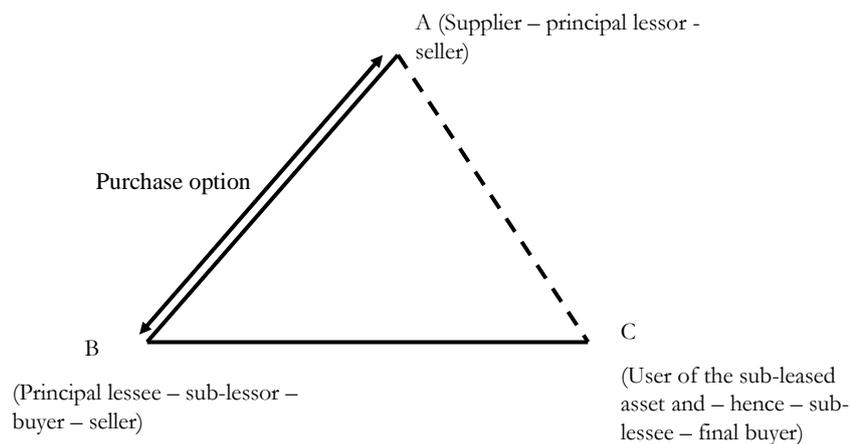
- In these two cases, the sub-lessee being the user of the asset, it is the sub-lessee that chooses the asset and the supplier. The leasing company does not buy the asset but leases it. It, therefore, has the capacity of lessee in relation to the supplier, which is then its lessor, and lessor or, rather, sub-lessor in relation to its own lessee or sub-lessee.

By the same token, the sub-rentals are made up of the principal rentals, increased in such a way as to provide remuneration for the sub-lessor. In addition, since the sub-lessor is not the owner of the asset, it cannot grant the sub-lessee an option to purchase the asset. This

means that the term of the lease and that of the sub-lease must be identical and cover the economic life of the asset, the usefulness of which diminishes with time. Article 2 of the preliminary draft does not deal with these consequences.

However, the sub-lessor, who is the lessee in the principal leasing relationship, may have a purchase option which it would then transfer to its own lessee – the sub-lessee (see Diagram No. 6).

Diagram No. 6



AB= principal lease with purchase option and subsequent contract of sale

BC= sub-lease with the same purchase option and subsequent contract of sale

AC= choice of asset and establishment of the terms of the transaction

In some legal systems, it would nevertheless be impossible to transfer the purchase option – considered as a possible future right or a purely discretionary clause – although Article 15 authorises the parties to transfer their rights and duties in compliance with the terms of that Article, “under the leasing agreement”, which precisely stipulates such a purchase option.

Which, then, are the rights and duties arising from such a financial leasing transaction in which the relationships between the parties are structured as described above?

## 2B. *Rights and duties of the parties*

The rights and duties of the parties are subject, on the one hand, to the normal municipal law of a State, as expressly provided for in Articles 3, 5, 8(2), 12(1) and 23(1)(a) and (b), applicable to real property and public notice (as provided by Article 3), rules which are, however, compatible with the mandatory provisions of the preliminary draft model law, and, on the other hand, to the text that forms the subject of this analysis.

The rights and duties in question concern:

- the creation of a direct right of action between the lessee or the sub-lessee and the supplier (Ba);
- the lessor’s relief from liability (Bb);
- the transfer of risks to the lessee (Bc);
- the lessee’s right of action for breaches the lessor’s duty to deliver (Bd);

- warranties (Be);
- other duties (by reference) (Bf).

#### B-a Direct right of action between lessee and supplier

The preliminary draft model law regulates the relationship between the parties in the light of the financial nature of the transaction, which is the predominant factor in the determination of its legal nature and which explains the derogations, not to the principle of the relativity of contracts but to the ordinary municipal law governing leasing, which it makes. These derogations are justified by the prerogatives and initiatives of the principal actor, the lessee, for whose benefit the transaction is made, the fundamental purpose of the supplier being to sell the asset and that of the lessor being to amortise and make a profit on its investment over the term of the lease, through the rentals – amortisation and profit margin – agreed, subject, however, to the substantive features of the agreement.

- As a result, Article 7(1)(a) creates a direct right of action between the lessee and the supplier which enables the former to rely on the duties arising out of the supply agreement – notwithstanding the fact that, legally speaking, it is a third party to that agreement – “as if the lessee were a party to that agreement”, on the understanding that the supplier cannot be held liable vis-à-vis both the lessee and the buyer-lessor for the same damage and that, pursuant to Article 7(1)(b), this extension of the supplier’s duties to the lessee does not modify the rights and duties of the parties to the supply agreement, or impose any duty or liability under the supply agreement on the lessee.
- This direct right of action is not, however, mandatory, since, pursuant to Article 7(1)(c), “[w]here the absence of privity” – described as contractual and hence as expressing the intent of the parties and complying with the relativity of contracts – between the lessee and supplier “the lessor shall be bound to take commercially reasonable steps to assist the lessee. If the lessor does not take such steps, the lessor is deemed to have assumed such duties.”

These provisions of Article 7(1)(a), (b) and (c) may not be derogated from (Article 7(1)(d)).

- Where the supply agreement grants rights to the lessee and once the latter has approved that agreement, the agreement may not be modified in any way without the lessee’s consent. If the agreement is modified, the lessor is deemed to have assumed the duties of the supplier as so varied and to the extent of such variation (Article 7(2)).
- Ever observant of the principle of the relativity of contracts, Article 7(3) does not authorise the lessee to modify, terminate or rescind the supply agreement without the lessor’s consent.

#### B-b. Lessor’s relief from liability

- Since the lessor neither chooses the asset nor selects the supplier and since it clearly does not use the asset, Article 9 relieves the lessor, in its capacity of lessor, from liability vis-à-vis the lessee for death, personal injury or damage to property caused by the asset or the use of the asset. This relief from liability of the lessor extends to any liability that the lessor might incur to third parties in its capacity of lessor/owner – which covers the case of strict liability – or in any other capacity.

#### B-c Transfer of risks to the lessee

Since the financial role in the transaction is reserved to the lessor and responsibility for the technical aspects – relating to the asset – is reserved to the lessee, together with the initiatives and prerogatives that are, as a result, the lessee's, the risk of loss of the asset passes to its user, the lessee, on the date agreed or, if no time for the passing of risk is stated, when the leasing agreement has been entered into (Article 11(1)). However, the lessee may, if the asset is not delivered, is partially delivered, is delivered late or fails to conform to the terms of leasing agreement, claim that the risk of loss has remained with the supplier from the beginning, provided that it has taken proper care of the asset and used it reasonably in compliance with such instructions from the manufacturer or supplier as may exist and with the terms of the leasing agreement (Article 18(1)(a) and (b)).

#### B-d Lessee's direct right of action for breach of the lessor's duty to deliver

In the event of damage to the asset before it is delivered, without fault on the part of any of the contracting parties, the lessee may demand inspection and accept the asset with due compensation from the supplier, not for its diminished usefulness but for its loss in value, but without any further right against the supplier, or seek such other remedies as are provided by municipal law, in compliance with its duties to the lessor, which Article 10(1)(a) declares to be irrevocable and independent when once the leasing agreement has been entered into (Article 14(1)).

If the asset is not delivered, delivered only in part, delivered late or fails to conform to the financial leasing agreement, the lessee has the right, pursuant to Article 14(1), to demand a conforming tender from the supplier or seek such other remedies as are provided by law, on the understanding that, pursuant to Article 14(3), if the lessee rejects the asset, the lessor or supplier has the right to cure its non-performance within the time stipulated for delivery.

#### B-e. Warranties

- Once the lessee has chosen the asset to be leased and selected the supplier, the lessor, pursuant to Article 16(1)(a), which is mandatory, 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 a court, however only where such title, right or claim derives from a negligent or intentional act or omission of the lessor.
- By the same token, a lessee who provides specifications to the lessor or the supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications (Article 16(1)(b)).
- Moreover, Article 17(1) provides that a warranty that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used is implied in the supply agreement and is enforceable only against the supplier.

#### B-f. Other duties (by reference)

With respect to the duty to maintain and return the asset (Article 18), the definition of default (Article 19), notice (Article 20), damages and liquidated damages (Articles 21 and 22), termination (Article 23), the lessor's recovery of possession and its right to dispose of the asset (Article 24), we would refer you to our comments on the leasing agreement.

It should however be borne in mind that:

- the lessee does not return the asset if it exercises an option to purchase the asset or if it leases it for a further term (Article 2);
- damages and liquidated damages designed to compensate the lessor for the loss that it sustains through the lessee's default must basically be limited to the financial loss sustained, on the understanding that the leased asset is returned upon termination of the lease;
- the lessee may not terminate the leasing agreement upon the lessor's or supplier's default but is entitled to such other remedies as are provided by the agreement of the parties and by law (Article 23(1)(b));

Finally, it should be pointed out that Article 5, which enshrines the principle of freedom of contract subject to the substantive rules that it enumerates, authorises the parties to adapt the model law to the specific features and objectives of a given transaction.

### III.

Such are the rights and duties of the parties and leading players in the complex area of leasing as proposed under the preliminary draft model law, which the parties are free to supplement and adapt in accordance with municipal law and subject to the mandatory rules that it lays down.



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IN CO-OPERATION WITH THE GOVERNMENT OF SOUTH AFRICA

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ADVISORY BOARD AS AUTHORISED FOR TRANSMISSION TO GOVERNMENTS FOR  
FINALISATION BY THE UNIDROIT GOVERNING COUNCIL: AN INTRODUCTION TO ITS  
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invited to participate in the process of finalising the preliminary draft model law**

**(Johannesburg, 7 May 2007)**

*Assessment of relevance of the model law for developing and transition economies:*

*The viewpoint of Africa*

by Chief Mrs Tinuade Oyekunle  
Legal Practitioner, Lagos;  
Honorary Vice-President, International Council for Commercial Arbitration;  
UNIDROIT Correspondent; Chairman of the Advisory Board

It has become very important for States with developing economies or those States in transition to address their positions vis-à-vis their leasing interactions with Entrepreneurs from developed economies who have the capabilities to provide them with equipments on terms in order to enhance their economic and social developments in the interest of their people.

This need has become so urgent considering the fact that these States are parties to the UNIDROIT Convention on International Financial Leasing, (hereinafter referred to as the UNIDROIT Convention,) which opened for signature in Ottawa on 28<sup>th</sup> May, 1988. The UNIDROIT Convention regulates cross border leases and is said to supersede national legislation in all countries that have signed up to the Convention for example Nigeria signed the Convention on 28<sup>th</sup> May, 1988 and ratified it on 25<sup>th</sup> October, 1994. The Convention entered into force for other developing economies at various dates (e.g. on 1<sup>st</sup> December, 1996 for Hungary, on 1<sup>st</sup> October 1997 for Panama on 1<sup>st</sup> March, 1998 for Latvia, on 1<sup>st</sup> January 1999 for the Russian Federation, on 1<sup>st</sup> March 1999 for Belarus and on 1<sup>st</sup>

February, 2001 for Uzbekistan.) Unfortunately most of these States have not implemented the provisions of the Convention into their laws and make them proactive. This inaction has adverse effect on the financial and infrastructural developments in these countries. Studies have revealed macro economic volatility and weak financial systems as two of the major reasons behind poor investment performance. In 2001 survey conducted by the World Bank's Regional Programme on Enterprise Development observed high levels of uncertainty and lack of confidence expressed by managers who are in charge of enterprises. Lack of favourable future forecast were due mainly to inadequate access to finance and poor infrastructure. Enterprises requiring funds to progress either relied mainly on bank loans with its high interest rates and very severe conditionalities or are tied to purchase agreements which are more or less based on the philosophy of hire purchase agreements with its stringent terms. Enterprises that could not comply with the notorious conditions of the loan agreements and high interest rates had to rely on internally generated funds both for working capital and investment of their projects. This system distorts the ability of firms to manage their working capital, stalling their capacity to increase sales and operate at full steam. It sometimes leads to total collapse of the enterprises which were set up with good intentions to succeed. The shortage of finance particularly had severe impact on improvement of technology, lower costs and expand output. The high costs of borrowing money and the limited availability of credit by Banks was a major factor in raising the costs of doing business and competitiveness with other sectors. Most African Countries faced with this dilemma of depletion of finance cannot compete with other countries, for example, of Asia and the countries have become retrogressive commercially and consequently economically.

These recurring revelations which handicap business led to studies conducted by the World Bank Group on MSME diagnostic and mapping exercise in parallel with the Regional Programme on Enterprise Development – A study on Nigeria in 2002, the foreign Investment Advisory services study – “Joining the Race for Non – Oil Foreign Investment” (2000); These studies and roundtable discussions have revealed many inadequacies in the systems namely –

- a. **Poor access to finance** for example it was found that about 85 percent of all Nigerian manufacturing firms have access only to short-term credit, mainly from costly overdrafts, often carrying more than 30 percent interest rate charges and 150 percent collateral restricted access and that there was shortage of liquidity in the banking system. An attempt has been recently made to address this inadequacy by the consolidation of Banks and the increase in the Bank share capital by the Central Bank of Nigeria. This lack of access to finance challenges not only the economic development but also the dignity and integrity of the people. For instance, in a country like Nigeria, well qualified Nigerians who have acquired advanced knowledge in their professions, are handicapped by lack of access to finance to purchase the best equipments to perform the contracts to the satisfaction of their clients.
- b. **Lack of access to business development services** which include training, consultancy, advisory services, marketing assistance, information, technological development and transfer and business linkage promotion.
- c. **Investment climate** indicate astronomical transaction costs in doing business due to lack of predictability and transparency. In addition to lack of confidence in the judicial process in dealing with commercial issues, procedures covering business registration, licensing, inspections and tax administrations are uncertain and cumbersome.
- d. **Weak infrastructure** particularly the power sector was identified as one of the most important factors contrasting private sector growth similar to the effort being made in other developing countries and transition economies.

The Nigeria Government development strategy is articulated in the year 2000 as follows: -

1. Strengthening the fledging democracy, improving security and safeguarding political and social stability including promoting transparency, anti – corruption measures and the rule of law.
2. Pursuing structural reforms that redefine and reduce the role of government within the economy and promote private sector.
3. Rehabilitating and improving physical infrastructure to facilitate economic activity and access by the poor.
4. Investing in education, health and other social services to lay a solid foundation for longer – term growth but also to build the capacity to fight immediate threats to the country’s well being such as malaria and the emerging HIV/AIDS epidemic

Many of these strategies are gradually being met by Government not only of Nigeria but of many developing and transitional economies. The focus of these Governments is to pursue a more private sector led market development approach for invigorating the MSME project.

The most important part of these considerations make it necessary to develop national leasing laws in these countries which will conform with uniform standards of best practice acceptable internationally.

The adoption of a well drafted model law on leasing is very commendable and it is one of the important factors which will enhance economic development. The Conference of representatives of Governments which follow this Seminar is a golden opportunity for all to spell out very clearly the Rights and duties of the parties to a Leasing Agreement – so that such interrelationships among parties will be clearly reflected when redrafting old national laws on leasing or on the preparation of new leasing laws where there are non – existing laws on the subject.

It is also hoped that while considering the effectiveness of the draft Articles participants will take into consideration the joint proposal of UNIDROIT and UNCITRAL Secretariats on the proposed New Article 3 dealing with other laws (creating a security right or an acquisition financing right as defined in the UNCITRAL Legislative Guide on Secured Transactions

### **Conclusion**

Finally I am convinced that the adoption of a model law on leasing is an important example of uniform law for the economic development of developing and transition economies and it is the roadmap to achieving some of the objectives of NEPAD in making the 21<sup>st</sup> Century an African Renaissance. I wish the conference successful and fruitful deliberations.



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*The viewpoint of transition economies*

by Anna Normantovich  
Deputy Chief Counsel, Europlan, Moscow;  
Member of UNIDROIT Advisory Board

Although economic changes are not necessarily followed with legislative reforms, most countries with economies in transition have to deal with reviewing national legislation, if not replacing it in order to provide a legal framework for a new economic reality.

Post-Soviet countries took first steps towards a free market in the absence of an adequate, market-friendly legislation. A mixture of new legal acts and old laws inherited from the Soviet era resulted in a legislative chaos that could hardly facilitate the development of market-based relations.

With new laws adopted to replace old ones, a relatively stable legislation has been gradually formed. Comprised of numerous laws, it is mainly based on codified legal acts as well as some special laws developed to deal with particular legal issues.

Those acts and laws both provide regulatory environment for lease transactions. By now, some post-Soviet countries have adopted a set of rules to regulate leasing activity. Considering the aforesaid, the rules can be defined as follows:

- Basic provisions incorporated into codified legal acts;
- Special rules provided by laws on leasing matters.

In particular, this scheme works for the Russian Federation, Ukraine, Moldova, Georgia, Tajikistan, Uzbekistan, Kazakhstan and Kirgizstan.

Even though the legislation on leasing has been developed to some extent, it is still being modified to meet the needs of the growing market. For instance, Moldova has recently replaced an old law on leasing with a new one.

At the same time, the harmonisation of legal regulation should be considered along with the necessity of making changes in laws.

In this regard, the preliminary draft model law on leasing prepared by UNIDROIT (hereinafter referred to as the *model law*) may be of interest for the following reasons:

**1. A range of issues covered by the model law is limited by freedom of contract**

At the time the legislation on leasing was adopted, post-Soviet countries did not have much experience in dealing with free-market issues. Though the demand for leasing as a source of financing was high, only a few companies had been operating in the market for a number of years.

Thus, the existing legislation on leasing can hardly be characterised as having been based on a long-term business practice. Drawbacks and gaps will become even clearer, as more practical experience is gained.

One of the main drawbacks appears to be an excessive regulation, when the legislation interferes in determining conditions which should solely depend on the agreement of the parties to the contract.

It is quite explicable, though, that the lack of experience sometimes leads to overregulation. Since there is no clear idea of what issues need to be covered by law, legislators tend to address as many issues as possible.

For instance, Russian law interferes in the commercial relationship between the lessor and the lessee by having established some provisions on the economic foundations of leasing. It elicits quite a negative attitude from market participants, as questions of the structure of the lease payments and the issues related to the purchasing of the leased asset at the end of the leasing term should be left to the discretion of the parties.

Unlike the legislation developed in Russia, the model law does not provide any special rules on what the lease payments should be comprised of, how the lessee should purchase the leased asset at the expiry of contract, whether anything else except the lease payments should be included in the total amount of the leasing contract etc. It is only mentioned there that the rentals or other funds payable under the leasing contract take into account the amortisation of the whole or a substantial part of the lessor's investment.

Needless to say, leasing activity cannot be facilitated without the parties being provided with the freedom to determine the content of their contract. The model law is, in this regard, more favourable to participants in leasing transactions than Russian laws on the issue.

**2. The rules provided by the UNIDROIT Convention on international financial leasing have been considered**

Once having acceded to the UNIDROIT Convention on international financial leasing, some post-Soviet countries do not entirely implement its provisions while national legislation on leasing is being developed.

For instance, Russia has always been criticised for having adopted rules which significantly deviate from the provisions of the Convention.

A definition of leasing incorporated into Russian legislation is seen as being vague and uncertain. To be precise, there are several definitions addressing the issue, and none is designated as prevailing.

The model law provides two definitions - "lease" and "financial leasing" - though making a distinction between them. The definition of "financial leasing" is similar to the one introduced by the Convention, while the meaning of "lease" is limited to a transaction in which a person grants a right to the possession and use of an asset to another person for a specific term in return for rentals.

The latter is known to Russian legislation, as there are general provisions on leases included in the Civil Code of Russia, while the so-called "finance lease (leasing)" is provided with a special set of rules.

Nevertheless, confusion arises since it is not clear whether the term "financial lease (leasing)" is supposed to mean the same thing as "financial leasing".

In order to avoid misunderstanding, a definition of "financial leasing" as provided by the Convention needs to be incorporated into Russian legislation.

### **3. The model law does not interfere in the regulation of issues which should be addressed by legislation other than civil legislation**

Among the issues which are usually discussed with regard to the need for clarification is the question of the undisputed repossession of the leased asset.

Russian law on leasing empowers the lessor to do this, though a detailed procedure has not been established yet.

The model law treats this subject carefully by introducing a provision according to which the lessor has the right to recover possession of the leased asset after the leasing contract comes to an end or is terminated.

Though a little vague, this Article can, when examined carefully, be found similar to what is provided under Russian law.

By providing that the contract may be terminated by an aggrieved party upon fundamental default by another party, the lessor is empowered to require the termination in cases where the lessee fails to perform a duty arising under the contract or the respective law.

After the contract is terminated, the lessor may start the procedure for gaining repossession of the leased asset.

It seems reasonable that the model law does not provide any special rules dealing with the aforementioned procedure. This issue should hardly be regulated by the provisions of civil law, as it is mainly a task for the law of procedure.

Thus, even though an important issue, the procedure of the undisputed repossession of the leased asset is left outside the scope of the model law. It would be advisable if national legislators considered doing the same when reviewing laws on leasing.

The model law also does not address economic issues such as taxation, currency control and customs regulation, as they should be specified by legislation relevant to those matters.

Considering the aforesaid, the model law will have a positive impact on the process of improving the legal basis of financial leasing activity in post-Soviet countries. It may also serve as a guiding line for eliminating inconsistency between the UNIDROIT Convention on international financial leasing and national legislation that has been already adopted.



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*The process for finalisation and adoption of the model law*

by Martin Stanford  
Deputy Secretary-General, UNIDROIT

The results of this first session will be communicated to Governments and Organisations as soon as possible after the end of the session and then a second session will be convened to proceed to a second reading of the preliminary draft model law.

We believe that at least two full readings of the preliminary draft model law established by the Advisory Board as authorised for transmission to Governments by the UNIDROIT Governing Council are necessary to ensure that a draft capable of achieving consensus among Governments can then be laid before the General Assembly of member States, meeting in extraordinary session and reinforced by those non-member States participating in the intergovernmental process, for adoption as a model law.

We would hope to be in a position to call this second session of governmental experts later in the year, towards November 2007, and then submit the resultant draft model law to our General Assembly for adoption towards early Summer 2008.

The model law, once adopted, would be offered to States for consideration for implementation as national law.



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*Assessment of relevance of model law for developing and transition economies:*

*The viewpoint of Middle East economies*

by Murat Sultanov  
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**UNIDROIT Draft Model Law on  
Leasing: *Middle East and Northern  
Africa perspective***

**Johannesburg,  
May 7, 2007**

### **IFC Leasing Development Program in the MNEA region**

- IFC promotes leasing in the Middle East and Northern Africa region through technical assistance program;
- The goal of the Program is to improve access to finance for firms, especially SME's, by creating and enlarging leasing markets in select MENA countries;
- The Program currently operates in the Hashemite Kingdom of Jordan, Republic of Yemen and Afghanistan with potential expansion of its operations into Egypt.



## IFC Leasing Development Program in the MNEA region

Leasing Program is engaged in various activities to develop leasing such as:

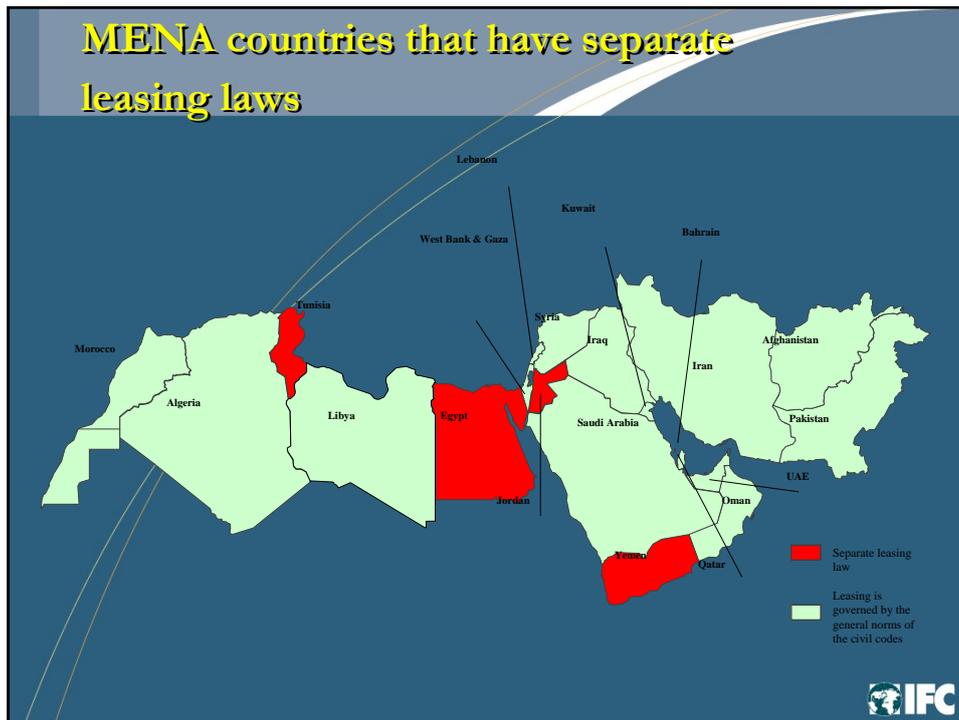
- awareness raising among various program stakeholders,
- capacity building for lessors;
- and legislative reform to create progressive legal environment for leasing (including civil, tax and accounting frameworks)



## Leasing in MENA

- Leasing exists in at least 15 of the 20 countries of the region.
- It is largely under-developed except for Pakistan, Morocco, Tunisia and Egypt;
- Leasing in MENA is mainly regulated under the general rules of civil legislation.





### Legal environment for leasing in MENA

- Presence of the separate leasing law is not an ultimate prerequisite for the leasing sector to grow but can become a significant factor for its development;
- Even in those countries which have leasing laws, there is a need to improve them (for example Egypt and Jordan);

IFC

## IFC MENA Leasing Program legal work

- Yemen:
  - ✓ The Law on Leasing was adopted by the Parliament and signed by the President in April 2007.
- Jordan:
  - ✓ The amendments into the Temporary Law on Leasing were agreed within the government's Steering Committee and the new Draft Law was presented to the Cabinet of Ministers.
- Afghanistan:
  - ✓ The Draft Law on leasing is under development and will soon be presented to the Government.



## UNIDROIT Model Law on Leasing

- IFC recommendations are based on the Model Law;
- UNIDROIT reputation helps building an argument for a specific change in the regulation;
- Model Law gives incentives to the MENA governments to critically reassess the provisions of the current legislation that governs leasing transactions and adopt changes;



**AGENDA**

1. The preliminary draft model law on leasing established by a UNIDROIT Advisory Board as authorised for transmission to Governments for finalisation by the UNIDROIT Governing Council: an introduction to its objectives and basic features (a half-day seminar addressed to the Governments and international Organisations invited to participate in the process of finalising the preliminary draft model law) (Johannesburg, 7 May 2007)
2. Opening of the session
3. Election of the Chairman
4. Adoption of the agenda
5. Organisation of work
6. Consideration of the preliminary draft model law on leasing established by a UNIDROIT Advisory Board as authorised for transmission to Governments for finalisation by the UNIDROIT Governing Council (C.G.E. Leasing/1/W.P. 2), in particular in the light of the introductory note thereon prepared by the UNIDROIT Secretariat (C.G.E. Leasing/1/W.P. 3) and the comments thereon submitted by Governments and Organisations (C.G.E. Leasing/1/W.P. 4)
7. Future work
8. Any other business.

**JOINT PROPOSAL FOR CLARIFYING THE RELATIONSHIP BETWEEN THE PRELIMINARY  
DRAFT MODEL LAW ON LEASING AND THE DRAFT UNCITRAL LEGISLATIVE GUIDE ON  
SECURED TRANSACTIONS**

(submitted by the UNIDROIT Secretariat and the Secretariat of the United Nations Commission on International Trade Law (UNCITRAL))

**I. BACKGROUND**

With a view to allaying the concerns expressed by the Secretariat of the United Nations Commission on International Trade Law (UNCITRAL), both to the UNIDROIT Advisory Board for the preparation of a model law on leasing, at its third session, held in Rome from 3 to 5 April 2006, and to the UNIDROIT Governing Council, at its 85<sup>th</sup> session, held in Rome from 8 to 10 May 2006, regarding the relationship between the preliminary draft model law on leasing (hereinafter referred to as the *preliminary draft model law*), on the one hand, and the draft UNCITRAL legislative guide on secured transactions (hereinafter referred to as the *draft legislative guide*), on the other, the UNIDROIT Secretariat and the UNCITRAL Secretariat agreed to prepare a joint proposal for the clarification of this relationship, for consideration by the UNIDROIT Committee of governmental experts for the preparation of a draft model law on leasing. It was agreed that this joint proposal should take the form of a suggested amendment to Article 3 of the preliminary draft model law established by the UNIDROIT Advisory Board at its third session as authorised for transmission to Governments for finalisation by the UNIDROIT Governing Council at its 85<sup>th</sup> session (C.G.E./Leasing/1/W.P. 2) and, given that it is the intention for the future model law to be accompanied by enactment notes, a suggested enactment note for Article 3 regarding the future model law's relationship to secured transaction laws.

The preparation of this joint proposal was the subject of a co-ordination meeting between the UNIDROIT and UNCITRAL Secretariats held in Rome on 18 September 2006. A draft proposal prepared by the UNIDROIT Secretariat provided the starting-point for these discussions.

At that meeting it was agreed, first, that the texts of the preliminary draft model law and the draft legislative guide could be brought more closely into line if Article 3 of the preliminary draft model law were clarified in such a way as to provide that a leasing agreement that creates a security right is to be treated as a security right and, accordingly, not under the future model law, on the one hand, and if the definition of "acquisition security right" in the draft legislative guide were reviewed in such a way as to reflect the fact that not all "financial leases" create security rights, on the other, secondly, that the term "security right" would not be defined in the preliminary draft model law, which would rather defer to the draft legislative guide on this point, thirdly, that such deference should apply to a law governing security rights whether that law existed at the time when the future model law was enacted or it was adopted subsequently, fourthly, that the inclusion in the preliminary draft model law of a choice of law rule in this regard was not necessary in view of the choice of law rule already appearing in the draft legislative guide and, fifthly, that the proposed enactment note to Article 3 of the preliminary draft model law should be expanded in such a way as to illustrate how and why there are States where the law governing secured transactions is applied to certain types of leasing transaction.

It was, accordingly, decided that the UNIDROIT Secretariat should prepare a revised proposal for consideration by the UNCITRAL Secretariat. On the basis of this revised proposal, the UNIDROIT and UNCITRAL Secretariats have finalised a joint proposal, the effect of which is, on the one hand, to define "acquisition financing right" in the draft legislative guide in such a way as to include only those leases that are the functional equivalent of a "security right" and, on the other, to provide that the preliminary draft model law does not apply to a leasing agreement that creates a security right or an acquisition financing right, as defined in the draft legislative guide. The UNIDROIT and UNCITRAL Secretariats have the honour to submit this joint proposal to Governments and Organisations for consideration by the future UNIDROIT Committee of governmental experts for the preparation of a draft model law on leasing at its first session. The terms of this joint proposal are set out hereunder, with the additions to the text involved in the suggested amendments to Article 3 of the preliminary draft model law being highlighted by the use of underlining.

\* \* \*

**Joint proposal**  
**for a new Article 3 of the preliminary draft model law and the enactment note thereto**

*submitted by the UNIDROIT and UNCITRAL Secretariats*

***Proposed new Article 3    Other laws***

1.    This law does not apply to a leasing agreement that creates a security right or an acquisition financing right, as defined in the UNCITRAL Legislative Guide on Secured Transactions.
  
2.    A leasing agreement subject to this Law is also subject to any law of [this State] applicable to real property or public notice with respect to a leasing agreement or an asset subject to a leasing agreement. Failure to comply with such law has only the effect specified therein.

***Proposed enactment note***

This Law should not be implemented in lieu of a law that applies to security rights and acquisition financing rights but in conjunction with such law. Indeed, this Law defers to such laws and, specifically, it is designed to work harmoniously with the recommendations of the UNCITRAL Legislative Guide on Secured Transactions. Accordingly, when applicable law treats a leasing agreement as creating a security right or an acquisition financing right, the leasing agreement is subject to that other law; similarly, the UNCITRAL Legislative Guide on Secured Transactions' choice of law provision made it unnecessary to include one in Article 3. The proposed new Article 3(1) provides for deference to the applicable law on security rights and acquisition financing rights whether that applicable law is effective at the time of the Model Law's enactment or is adopted subsequently.

Article 3's reference to leasing agreements that create security rights or acquisition financing rights reflects that there are States in which transactions in the form of a lease but economically equivalent to a secured financing are treated as creating security rights or acquisition financing rights. In those States, in a transaction in the form of a lease that is economically equivalent to a title retention or conditional sale (as when the lessee automatically becomes owner of the goods upon full payment of the rentals) the lessor's interest is treated as a security right that secures the lessee's obligation to pay the outstanding amount of the purchase price.

**New Article 3 of the preliminary draft model law on leasing**

Relevant definitions of the draft UNCITRAL legislative guide on secured transactions

**"Security right"** means a consensual property right in movable property and attachments that secures payment or other performance of one or more obligations, regardless of whether the parties have denominated it as a security right. In the context of a unitary approach, the term includes both acquisition security rights and non-acquisition security rights, but in the context of a non-unitary approach it does not include an acquisition financing right. With respect to receivables, security right also means the right of the assignee (see the definition of "assignment" and other definitions below relating to assignments of receivables);

**"Acquisition financing right"**, a term used only in the context of the non-unitary approach to acquisition financing rights, means any of the following rights:

- (i) A retention-of-title right;
- (ii) The right of a lessor under a financial lease;
- (iii) The retained ownership and related rights arising under any arrangement that enables a person to acquire possession or use of goods and whereby pursuant to the arrangement title to those goods does not vest irrevocably in the person possessing or using the goods until or under the condition that the price is paid; and
- (iv) A right under any arrangement by which a creditor who has provided credit to enable a person to acquire possession or use of goods, reserves the right to become the irrevocable owner of the goods in satisfaction of the repayment obligation;

**"Financial lease"** means a lease, at the end of the term of which:

- (i) The lessee automatically becomes the owner of tangible property other than negotiable instruments or negotiable documents subject to the lease;
- (ii) The lessee may acquire the assets subject to the lease by paying no more than a nominal price; or
- (iii) The tangible property subject to the lease have no more than a nominal residual value.

The term includes a hire-purchase agreement.

**PRELIMINARY DRAFT MODEL LAW ON LEASING**

*(as reviewed by the Drafting Committee in accordance with the instructions of the Committee of governmental experts at its first session (Johannesburg, 7-10 May 2007))*<sup>\*</sup>

**[PREAMBLE**

*THE GENERAL ASSEMBLY OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW (UNIDROIT), meeting at its 60th session in Rome on 30 November 2006,*

*Recognising* that leasing provides developing countries and countries in transition in particular with an important source of capital for the development of infrastructure and small- and medium-sized enterprises;

*Aware* that, while many States already possess leasing legislation and a well-developed leasing industry, many other States, and in particular those States with developing economies and economies in transition, require a legal framework that will foster the swift growth of a nascent or non-existent leasing industry;

*Convinced* accordingly as to the usefulness of proposing a model law on leasing for consideration by national legislators, which may adapt it to meet their specific needs;

*Committed* to the purpose of harmonising legal regulations of leasing on a global basis in order to facilitate international trade in capital goods;

*Finding* that the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) has not only removed certain legal impediments to the international financial leasing of equipment while maintaining a fair balance of interests between the different parties to the transaction for States Parties thereto, but has also frequently served as a model for States drafting their first leasing laws;

*Considering* the legal regimen enshrined in the aforementioned Convention as a useful starting point for the development of a comprehensive model law governing such transactions;

*Being of the view* that in the preparation of such a model law priority must be given to the establishment of rules governing the civil and commercial law aspects of leasing,

*Mindful* of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law as opposed to the specific area of that law reserved to leasing,

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<sup>\*</sup> [Those amendments to the text of the preliminary draft model law as submitted to the first session of the Committee made by the Drafting Committee during that session are indicated, in the case of additions to the text, by the use of underlining and, in the case of deletions, by the use of crossing out.](#)

HAS APPROVED THE FOLLOWING TEXT OF THE UNIDROIT MODEL LAW ON LEASING:]\*\*\*

## CHAPTER I: GENERAL PROVISIONS

### Article 1 Sphere of application

This Law applies to any lease of an asset, if the asset is within [the State], the ~~lessee's~~ centre of main interests of the lessee is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

### Article 2 Definitions

In this Law:

**Asset** means all property used in the trade or business of the lessee, including plant, land, capital goods, equipment, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. ~~but a~~ No asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in land.

**Centre of main interests** means the place where a person conducts the administration of its interests on a regular basis. In the absence of proof to the contrary, the ~~person's~~ registered office of the person, or habitual residence in the case of an individual, is presumed to be the centre of ~~the person's~~ main interests of the person.

**Financial lease** means a lease, with or without an option to purchase, that includes the following characteristics:

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) the rentals or other funds payable under the leasing agreement take into account the amortisation of the whole or a substantial part of the ~~lessor's~~ investment of the lessor.

**Lease** means a transaction in which a person grants a right to possession and use of ~~the~~ an asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

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\*\* The preamble to the preliminary draft Model Law as reproduced herein was prepared by the UNIDROIT Secretariat, in line with the decision taken by the Advisory Board at its second session. It is designed simply to demonstrate the fundamental objectives of the preliminary draft Model Law and is in no way intended to prejudice the decision on this issue to be taken by Governments.

**Lessee** means a person who acquires the right to possession and use of thean asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessee.

**Lessor** means a person who grants the right to possession and use of thean asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessor.

**Person** means any legal, private or public entity or an individual.

**Supplier** means a person from whom a lessor acquires thean asset or the right to possession and use of the asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires thean asset or the right to possession and use of the asset for lease.

### **Article 3 Other laws**

1. This law does not apply to a leasing agreement that creates a security right or an acquisition financing right, as defined in the UNCITRAL Legislative Guide on Secured Transactions.

2. A leasing agreement subject to this Law is also subject to any law of [this State] applicable to real property or public notice with respect to a leasing agreement or an asset subject to a leasing agreement. ~~Failure to comply with such law has only the effect specified therein.~~

### **Article 4 Interpretation of this Law**

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

### **Article 5 Freedom of contract**

Except as provided in Articles 7(~~3+~~), 16(1)(a), 16(2) [, 17(3)] and 22(3) and the law of [this State], the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a leasing agreement.

## CHAPTER II: EFFECTS OF LEASING AGREEMENT

### Article 6 Enforceability

Except as otherwise provided in this Law:

(a) a leasing agreement is effective and enforceable according to its terms between the parties; and

(b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

### Article 7 Lessee under financial lease as beneficiary of supply agreement

1. (a) In a financial lease, the duties of the supplier under the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

(b) The extension of the ~~supplier's~~ duties of the supplier to the lessee under the preceding sub-paragraph does not modify the rights and duties of the parties to the supply agreement, whether arising therefrom or otherwise, or impose any duty or liability under the supply agreement on the lessee.

(c) Where the absence of privity of a contract between the lessee and supplier prevents the lessee from enforcing the ~~supplier's~~ duties of the supplier under the supply agreement, the lessor shall be bound to take commercially reasonable steps to assist the lessee. If the lessor does not take such steps, the lessor is deemed to have assumed ~~the~~ such duties of the supplier.

~~(d) The parties may not derogate from or vary the effect of the provisions of this paragraph.~~

2. The ~~lessee's~~ rights of the lessee under this Article shall not be affected by a variation of any term of the supply agreement that was previously approved by the lessee, unless the lessee consented to that variation. If the lessee did not consent to such variation, ~~then~~ the lessor is deemed to have assumed the duties of the supplier to the lessor that were so varied to the extent of the variation.

3. The parties may not derogate from or vary the effect of the provisions of paragraphs 1 and 2.

~~4.~~ Nothing in this Article shall entitle the lessee to modify, terminate or rescind the supply agreement without the consent of the lessor.

### Article 8 Priority of liens

1. A creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the [rights and remedies of the parties to the leasing agreement](#) and cannot attach any interest [arising under the leasing agreement belonging to the lessee](#).
2. Except as otherwise provided by the law of [this State], a creditor of the lessor takes subject to the [rights and remedies of the parties to the](#) leasing agreement.

### Article 9 [Limitation of Liability of the lessor for death, personal injury or property damage caused to third parties](#)

In a financial lease, the lessor shall not, in its capacity of lessor, be liable to the lessee or third parties for death, personal injury or damage to property caused by the asset or the use of the asset.

## CHAPTER III: PERFORMANCE

### Article 10 Irrevocability

1. (a) In a financial lease, the ~~lessee's~~ [duties of the parties to the lessor](#) become irrevocable and independent when [the leasing agreement has been entered into \[ the asset has been accepted by the lessee \]](#).
- (b) In a lease other than a financial lease, the parties may agree to make any of their ~~ir lessee's~~ [duties to the lessor](#) irrevocable and independent by specifically identifying each duty that is irrevocable and independent.
2. A duty that is irrevocable and independent must be performed, regardless of ~~any other party's~~ [the performance or non-performance of any other party](#), unless the party to whom the duty is owed terminates the leasing agreement or otherwise explicitly agrees.

### Article 11 Risk of loss

1. [\(a\)](#) In a financial lease, risk of loss passes to the lessee. If the time of passage is not stated, the risk of loss passes to the lessee when the leasing agreement has been entered into.  
[\(b\) In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, the lessee, subject to paragraph 1 of Article 18, may treat the risk of loss as having remained with the supplier from the beginning.](#)
2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

~~3. When an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, then the lessee, subject to Article 18(1), may treat the risk of loss as having remained with the lessor or, in a financial lease, the supplier from the beginning.~~

#### **Article 12 Damage to the asset**

1. In a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and at the ~~lessee's~~ option of the lessee either accept the asset with due compensation from the supplier for the loss in value but without further right against the supplier or, ~~subject to Article 10,~~ seek such other remedies as are provided by law.

2. In a lease other than a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,

(a) if the loss is total, the leasing agreement is terminated; and

(b) if the loss is partial, the lessee may demand inspection and at the ~~lessee's~~ option of the lessee either treat the leasing agreement as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

#### **Article 13 Acceptance**

1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.

2. (a) Once a lessee in a financial lease has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement.

(b) Once a lessee in a lease other than a financial lease has accepted an asset, the lessee is entitled to damages from the lessor if the asset does not conform to the leasing agreement.

#### **Article 14 RemediesRejection**

1. In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

2. (a) In a lease other than a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the leasing agreement. Rejection or termination must be within a reasonable time after the non-conforming delivery.

(b) In a lease other than a financial lease, once a lessee has accepted the asset, the lessee may reject the asset under the preceding sub-paragraph only if the non-conformity substantially impairs the value of the asset and either

(i) the lessee accepted the asset without knowledge of the non-conformity, owing to the difficulty of discovering it, or

(ii) the ~~lessee's~~ acceptance by the lessee was induced by the ~~lessor's~~ assurances of the lessor.

(c) In a lease other than a financial lease, when the lessee rejects an asset in accordance with this Law or the leasing agreement, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied and to recover any rentals and other funds paid in advance, less a reasonable sum corresponding to any benefit the lessee has derived from the asset.

3. If the lessee rejects an asset in accordance with this Article and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

#### **Article 15** Transfer of rights and duties

1. The ~~lessor's~~ rights of the lessor under the leasing agreement may be transferred without the consent of the lessee. The ~~lessor's~~ duties of the lessor under the leasing agreement may be transferred only with ~~without~~ the consent of the lessee, which may not be unreasonably withheld except when a transfer would impair the lessee's rights in the asset.

2. The ~~lessee's~~ rights and duties of the lessee under the leasing agreement may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

3. The lessee, lessor and third parties may consent to such transfers in advance.

#### **Article 16** Warranty of quiet possession

1. (a) In a financial lease, the lessor warrants that the ~~lessee's~~ quiet possession of the lessee 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 a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor. The parties may not derogate from or vary the effect of the provisions of this sub-paragraph.

(b) In a financial lease, a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications.

2. In a lease other than a financial lease, the lessor warrants that the ~~lessee's~~ quiet possession of the lessee will not be disturbed by a person who has a superior title or right, who claims a superior title or right and acts under the authority of a court or who makes a claim by way of infringement. The parties may not derogate from or vary the effect of the provisions of this paragraph.

3. The sole remedy for a disturbance of the quiet possession of the lessee under subparagraph (a) of paragraph 1 and under paragraph 2 is an action for damages against the lessor.

#### **Article 17 Warranty of acceptability and fitness for purpose**

1. In a financial lease, the supplier a warranty sy that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used is implied in the supply agreement and the warranty is enforceable only against the supplier.

2. In a lease other than a financial lease, the lessor a warranty sy that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used is implied in a leasing agreement if the lessor regularly deals in assets of that kind.

3. The parties may not derogate from or vary the effect of the provisions of this Article.

#### **Article 18 ~~Lessee's d~~Duties of the lessee to maintain and return the asset**

1. (a) The lessee shall take proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.

(b) When a leasing agreement sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the asset's use of the asset, the lessee's compliance by the lessee with such agreement or instructions shall satisfy the requirements of the preceding sub-paragraph.

2. When the leasing agreement comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the asset to the lessor in the condition specified in the preceding paragraph.

### **CHAPTER IV: DEFAULT**

#### **Article 19 Definition of default**

1. The parties may at any time agree in writing as to the events that constitute a default or otherwise give rise to the rights and remedies specified in this Chapter.

2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the leasing agreement or this Law.

## Article 20 Notices

~~Except as otherwise provided in the leasing agreement, a~~An aggrieved party shall give a defaulting party notice of default, ~~notice of fundamental default~~, notice of enforcement, notice of termination and a reasonable opportunity to cure.

## Article 21 Damages

Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the leasing agreement, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

## Article 22 Liquidated damages

1. When the leasing agreement provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.
2. Such sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.
3. The parties may not derogate from or vary the effect of the provisions of this Article.

## Article 23 Termination

1. (a) Subject to sub-paragraph (b), a leasing agreement may be terminated by operation of law, by operation of Article 12, by agreement of the parties or by an aggrieved party upon ~~fundamental~~ [substantial] default by the lessee or lessor.

(b) The [lessee] in a financial lease may not terminate the leasing agreement upon ~~another party's fundamental~~ [substantial] default by another party but is entitled to such other remedies as are provided by the agreement of the parties and by law.

2. Subject to Article 10, on termination all duties under the leasing agreement that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

## Article 24 Possession and disposition

~~1.~~ After the leasing agreement comes to an end or is terminated, the lessor has the right to ~~recover~~ take possession of the asset and the right to dispose of the asset.

~~2.~~ ~~After the leasing agreement comes to an end or is terminated, the lessor has the right to dispose of the asset.~~

PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING

*(as reviewed by the Committee of governmental experts during its first session  
(Johannesburg, 7-10 May 2007))* \*

[PREAMBLE

THE GENERAL ASSEMBLY OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW (UNIDROIT), ~~meeting at its 60th session in Rome on 30 November 2006,~~

*Recognising* that leasing provides developing countries and countries in transition in particular with an important source of capital for the development of infrastructure and small- and medium-sized enterprises;

*Aware* that, while many States already possess leasing legislation and a well-developed leasing industry, many other States, and in particular those States with developing economies and economies in transition, require a legal framework that will foster the swift growth of a nascent or non-existent leasing industry;

*Convinced* accordingly as to the usefulness of proposing a model law on commercial leasing for consideration by national legislators, which may adapt it to meet their specific needs;

*Committed* to the purpose of harmonising legal regulations of leasing on a global basis in order to facilitate ~~international~~ trade in capital goods;

*Finding* that the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) has not only removed certain legal impediments to the international financial leasing of equipment while maintaining a fair balance of interests between the different parties to the transaction for States Parties thereto, but has also frequently served as a model for States drafting their first leasing laws;

*Considering* the legal regimen enshrined in the aforementioned Convention as a useful starting point for the development of a comprehensive model law governing such transactions;

*Being of the view* that in the preparation of such a model law priority must be given to the establishment of rules governing the civil and commercial law aspects of commercial leasing,

*Mindful* of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law as opposed to the specific area of that law reserved to leasing,

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\* Those amendments to the text of the preliminary draft model law as submitted to the first session of the Committee agreed upon by the Committee during that session are indicated, in the case of additions to the text, by the use of underlining and, in the case of deletions, by the use of crossing out.

HAS APPROVED THE FOLLOWING TEXT OF THE UNIDROIT MODEL LAW ON COMMERCIAL LEASING:]\*

## CHAPTER I: GENERAL PROVISIONS

### Article 1 Sphere of application

This Law applies to any lease of an asset, if the asset is within [the State], the ~~lessee's~~ centre of main interests of the lessee is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

### Article 2 Definitions

In this Law:

**Asset** means all property used in the trade or business of the lessee, including plant, land, capital goods, equipment, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. ~~but a~~ No asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in land.

**Centre of main interests** means the place where a person conducts the administration of its interests on a regular basis. In the absence of proof to the contrary, the ~~person's~~ registered office of the person, or habitual residence in the case of an individual, is presumed to be the centre of ~~the person's~~ main interests of the person.

**Financial lease** means a lease, with or without an option to purchase, that includes the following characteristics:

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) the rentals or other funds payable under the leasing agreement take into account the amortisation of the whole or a substantial part of the ~~lessor's~~ investment of the lessor.

**Lease** means a transaction in which a person grants a right to possession and use of ~~the~~ an asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

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\* ~~The preamble to the preliminary draft Model Law as reproduced herein was prepared by the UNIDROIT Secretariat, in line with the decision taken by the Advisory Board at its second session. It is designed simply to demonstrate the fundamental objectives of the preliminary draft Model Law and is in no way intended to prejudge the decision on this issue to be taken by Governments.~~

**Lessee** means a person who acquires the right to possession and use of thean asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessee.

**Lessor** means a person who grants the right to possession and use of thean asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessor.

**Person** means any legal, private or public entity or an individual.

**Supplier** means a person from whom a lessor acquires thean asset or the right to possession and use of the asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires thean asset or the right to possession and use of the asset for lease.

### Article 3 Other laws

1. This law does not apply to a leasing agreement that creates a security right or an acquisition financing right, as defined in the UNCITRAL Legislative Guide on Secured Transactions.

2. A leasing agreement subject to this Law is also subject to any law of [this State] applicable to real property or public notice with respect to a leasing agreement or an asset subject to a leasing agreement. ~~Failure to comply with such law has only the effect specified therein.~~

### Article 4 Interpretation of this Law

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.
2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

### Article 5 Freedom of contract

Except as provided in Articles 7(~~31~~), 16(1)(a), 16(2) and 22(3) and the law of [this State], the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a leasing agreement.

## CHAPTER II: EFFECTS OF LEASING AGREEMENT

### Article 6 Enforceability

Except as otherwise provided in this Law:

(a) a leasing agreement is effective and enforceable according to its terms between the parties and

(b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

### Article 7 Lessee under financial lease as beneficiary of supply agreement

1. (a) In a financial lease, the duties of the supplier under the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

(b) The extension of the ~~supplier's~~ duties of the supplier to the lessee under the preceding sub-paragraph does not modify the rights and duties of the parties to the supply agreement, whether arising therefrom or otherwise, or impose any duty or liability under the supply agreement on the lessee.

(c) Where the absence of privity of a contract between the lessee and supplier prevents the lessee from enforcing the ~~supplier's~~ duties of the supplier under the supply agreement, the lessor shall be bound to take commercially reasonable steps to assist the lessee. If the lessor does not take such steps, the lessor is deemed to have assumed ~~thesuch~~ duties of the supplier.

~~(d) The parties may not derogate from or vary the effect of the provisions of this paragraph.~~

2. The ~~lessee's~~ rights of the lessee under this Article shall not be affected by a variation of any term of the supply agreement that was previously approved by the lessee, unless the lessee consented to that variation. If the lessee did not consent to such variation, ~~then~~ the lessor is deemed to have assumed the duties of the supplier to the lessor that were so varied to the extent of the variation.

3. The parties may not derogate from or vary the effect of the provisions of paragraphs 1 and 2.

43. Nothing in this Article shall entitle the lessee to modify, terminate or rescind the supply agreement without the consent of the lessor.

### Article 8 Priority of liens

1. A creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the [rights and remedies of the parties to the leasing agreement](#) and cannot attach any interest [arising under the leasing agreement](#)~~belonging to the lessee~~.
2. Except as otherwise provided by the law of [this State], a creditor of the lessor takes subject to the [rights and remedies of the parties to the](#) leasing agreement.

### Article 9 [Limitation of Liability of the lessor for death, personal injury or property damage caused to third parties](#)

In a financial lease, the lessor shall not, in its capacity of lessor, be liable to the lessee or third parties for death, personal injury or damage to property caused by the asset or the use of the asset.

## CHAPTER III: PERFORMANCE

### Article 10 Irrevocability

1. (a) In a financial lease, the ~~lessee's~~ [duties of the parties to the lessor](#) become irrevocable and independent when the leasing agreement has been entered into.  
(b) In a lease other than a financial lease, the parties may agree to make any of ~~their lessee's~~ [duties to the lessor](#) irrevocable and independent by specifically identifying each duty that is irrevocable and independent.
2. A duty that is irrevocable and independent must be performed, regardless of ~~any other party's~~ [the performance or non-performance of any other party](#), unless the party to whom the duty is owed terminates the leasing agreement or otherwise explicitly agrees.

### Article 11 Risk of loss

1. [\(a\)](#) In a financial lease, risk of loss passes to the lessee. If the time of passage is not stated, the risk of loss passes to the lessee when the leasing agreement has been entered into.  
[\(b\)](#) [In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, the lessee, subject to paragraph 1 of Article 18, may treat the risk of loss as having remained with the supplier from the beginning.](#)
2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

~~3. When an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, then the lessee, subject to Article 18(1), may treat the risk of loss as having remained with the lessor or, in a financial lease, the supplier from the beginning.~~

#### **Article 12 Damage to the asset**

1. In a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and at the ~~lessee's~~ option of the lessee either accept the asset with due compensation from the supplier for the loss in value but without further right against the supplier or, subject to Article 10, seek such other remedies as are provided by law.

2. In a lease other than a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,

(a) if the loss is total, the leasing agreement is terminated; and

(b) if the loss is partial, the lessee may demand inspection and at the ~~lessee's~~ option of the lessee either treat the leasing agreement as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

#### **Article 13 Acceptance**

1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.

2. (a) Once a lessee in a financial lease has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement.

(b) Once a lessee in a lease other than a financial lease has accepted an asset, the lessee is entitled to damages from the lessor if the asset does not conform to the leasing agreement.

#### **Article 14 RemediesRejection**

1. In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

2. (a) In a lease other than a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the leasing agreement. Rejection or termination must be within a reasonable time after the non-conforming delivery.

(b) In a lease other than a financial lease, once a lessee has accepted the asset, the lessee may reject the asset under the preceding sub-paragraph only if the non-conformity substantially impairs the value of the asset and either

(i) the lessee accepted the asset without knowledge of the non-conformity, owing to the difficulty of discovering it, or

(ii) the ~~lessee's~~ acceptance by the lessee was induced by the ~~lessor's~~ assurances of the lessor.

(c) In a lease other than a financial lease, when the lessee rejects an asset in accordance with this Law or the leasing agreement, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied and to recover any rentals and other funds paid in advance, less a reasonable sum corresponding to any benefit the lessee has derived from the asset.

3. If the lessee rejects an asset in accordance with this Article and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

#### **Article 15** Transfer of rights and duties

1. The ~~lessor's~~ rights of the lessor under the leasing agreement may be transferred without the consent of the lessee. The ~~lessor's~~ duties of the lessor under the leasing agreement may be transferred ~~only with~~ without the consent of the lessee, which may not be unreasonably withheld except when a transfer would impair the lessee's rights in the asset.

2. The ~~lessee's~~ rights and duties of the lessee under the leasing agreement may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

3. The lessee, lessor and third parties may consent to such transfers in advance.

#### **Article 16** Warranty of quiet possession

1. (a) In a financial lease, the lessor warrants that the ~~lessee's~~ quiet possession of the lessee 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 a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor. The parties may not derogate from or vary the effect of the provisions of this sub-paragraph.

(b) In a financial lease, a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications.

2. In a lease other than a financial lease, the lessor warrants that the ~~lessee's~~ quiet possession of the lessee will not be disturbed by a person who has a superior title or right, who claims a superior title or right and acts under the authority of a court or who makes a claim by way of infringement. The parties may not derogate from or vary the effect of the provisions of this paragraph.

3. The sole remedy for a disturbance of the quiet possession of the lessee under subparagraph (a) of paragraph 1 and under paragraph 2 is an action for damages against the lessor.

#### **Article 17 Warranty of acceptability and fitness for purpose**

1. In a financial lease, the supplier a warranty sy that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used is implied in the supply agreement and the warranty is enforceable only against the supplier.

2. In a lease other than a financial lease, the lessor a warranty sy that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used is implied in a leasing agreement if the lessor regularly deals in assets of that kind.

#### **Article 18 ~~Lessee's d~~Duties of the lessee to maintain and return the asset**

1. (a) The lessee shall take proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.

(b) When a leasing agreement sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the asset's use of the asset, the lessee's compliance by the lessee with such agreement or instructions shall satisfy the requirements of the preceding sub-paragraph.

2. When the leasing agreement comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the asset to the lessor in the condition specified in the preceding paragraph.

### **CHAPTER IV: DEFAULT**

#### **Article 19 Definition of default**

1. The parties may at any time agree in writing as to the events that constitute a default or otherwise give rise to the rights and remedies specified in this Chapter.

2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the leasing agreement or this Law.

#### **Article 20 Notices**

Except as otherwise provided in the leasing agreement, a An aggrieved party shall give a defaulting party notice of default, notice of fundamental default, notice of enforcement, notice of termination and a reasonable opportunity to cure.

### Article 21 Damages

Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the leasing agreement, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

### Article 22 Liquidated damages

1. When the leasing agreement provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.
2. Such sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.
3. The parties may not derogate from or vary the effect of the provisions of this Article.

### Article 23 Termination

1. (a) Subject to sub-paragraph (b), a leasing agreement may be terminated by operation of law, by operation of Article 12, by agreement of the parties or by an aggrieved party upon ~~fundamental~~ [substantial] default by the lessee or lessor.

(b) ~~[The [lessee] in~~ Neither party to a financial lease may ~~not~~ terminate the leasing agreement upon ~~another party's fundamental~~ [substantial] default by another party but either party is entitled to such other remedies as are provided by the agreement of the parties and by law.]

2. Subject to Article 10, on termination all duties under the leasing agreement that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

### Article 24 Possession and disposition

~~1.~~ After the leasing agreement comes to an end or is terminated, the lessor has the right to ~~recover~~ take possession of the asset and the right to dispose of the asset.

~~2. — After the leasing agreement comes to an end or is terminated, the lessor has the right to dispose of the asset.~~

**PRELIMINARY DRAFT MODEL LAW ON COMMERCIAL LEASING**

*(as reviewed by the Committee of governmental experts during its first session  
(Johannesburg, 7-10 May 2007))*

**[PREAMBLE**

*THE GENERAL ASSEMBLY OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF  
PRIVATE LAW (UNIDROIT),*

*Recognising* that leasing provides developing countries and countries in transition in particular with an important source of capital for the development of infrastructure and small- and medium-sized enterprises;

*Aware* that, while many States already possess leasing legislation and a well-developed leasing industry, many other States, and in particular those States with developing economies and economies in transition, require a legal framework that will foster the swift growth of a nascent or non-existent leasing industry;

*Convinced* accordingly as to the usefulness of proposing a model law on commercial leasing for consideration by national legislators, which may adapt it to meet their specific needs;

*Committed* to the purpose of harmonising legal regulations of leasing on a global basis in order to facilitate trade in capital goods;

*Finding* that the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988) has not only removed certain legal impediments to the international financial leasing of equipment while maintaining a fair balance of interests between the different parties to the transaction for States Parties thereto, but has also frequently served as a model for States drafting their first leasing laws;

*Considering* the legal regimen enshrined in the aforementioned Convention as a useful starting point for the development of a comprehensive model law governing such transactions;

*Being of the view* that in the preparation of such a model law priority must be given to the establishment of rules governing the civil and commercial law aspects of commercial leasing,

*Mindful* of the proven usefulness of the UNIDROIT Principles of International Commercial Contracts as a model for legislators in the general context of contract law as opposed to the specific area of that law reserved to leasing,

*HAS APPROVED THE FOLLOWING TEXT OF THE UNIDROIT MODEL LAW ON COMMERCIAL  
LEASING:]*

## CHAPTER I: GENERAL PROVISIONS

### Article 1 Sphere of application

This Law applies to any lease of an asset, if the asset is within [the State], the centre of main interests of the lessee is within [the State] or the leasing agreement provides that [the State's] law governs the transaction.

### Article 2 Definitions

In this Law:

**Asset** means all property used in the trade or business of the lessee, including plant, land, capital goods, equipment, future assets, specially manufactured assets, plants and living and unborn animals. The term does not include money or investment securities. No asset shall cease to be an asset for the sole reason that the asset has become a fixture to or incorporated in land.

**Centre of main interests** means the place where a person conducts the administration of its interests on a regular basis. In the absence of proof to the contrary, the registered office of the person, or habitual residence in the case of an individual, is presumed to be the centre of main interests of the person.

**Financial lease** means a lease, with or without an option to purchase, that includes the following characteristics:

- (a) the lessee specifies the asset and selects the supplier;
- (b) the lessor acquires the asset or the right to possession and use of the asset in connection with a lease and the supplier has knowledge of that fact; and
- (c) the rentals or other funds payable under the leasing agreement take into account the amortisation of the whole or a substantial part of the investment of the lessor.

**Lease** means a transaction in which a person grants a right to possession and use of the asset to another person for a specific term in return for rentals. Unless the context indicates otherwise, the term includes a sub-lease.

**Lessee** means a person who acquires the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessee.

**Lessor** means a person who grants the right to possession and use of the asset under a lease. Unless the context indicates otherwise, the term includes a sub-lessor.

**Person** means any legal, private or public entity or an individual.

**Supplier** means a person from whom a lessor acquires the asset or the right to possession and use of the asset for lease under a financial lease.

**Supply agreement** means an agreement under which a lessor acquires the asset or the right to possession and use of the asset for lease.

### **Article 3 Other laws**

1. This law does not apply to a leasing agreement that creates a security right or an acquisition financing right, as defined in the UNCITRAL Legislative Guide on Secured Transactions.
2. A leasing agreement subject to this Law is also subject to any law of [this State] applicable to real property or public notice with respect to a leasing agreement or an asset subject to a leasing agreement.

### **Article 4 Interpretation of this Law**

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.
2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

### **Article 5 Freedom of contract**

Except as provided in Articles 7(3), 16(1)(a), 16(2) and 22(3) and the law of [this State], the lessor and the lessee may derogate from or vary the effect of this Law and are free to determine the content of a leasing agreement.

## **CHAPTER II: EFFECTS OF LEASING AGREEMENT**

### **Article 6 Enforceability**

Except as otherwise provided in this Law:

- (a) a leasing agreement is effective and enforceable according to its terms between the parties; and
- (b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

### **Article 7 Lessee under financial lease as beneficiary of supply agreement**

1. (a) In a financial lease, the duties of the supplier under the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement and as if the asset were to be supplied directly to the lessee. The supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

(b) The extension of the duties of the supplier to the lessee under the preceding subparagraph does not modify the rights and duties of the parties to the supply agreement, whether arising therefrom or otherwise, or impose any duty or liability under the supply agreement on the lessee.

(c) Where the absence of a contract between the lessee and supplier prevents the lessee from enforcing the duties of the supplier under the supply agreement, the lessor shall be bound to take commercially reasonable steps to assist the lessee. If the lessor does not take such steps, the lessor is deemed to have assumed the duties of the supplier.

2. The rights of the lessee under this Article shall not be affected by a variation of any term of the supply agreement that was previously approved by the lessee, unless the lessee consented to that variation. If the lessee did not consent to such variation, the lessor is deemed to have assumed the duties of the supplier to the lessor that were so varied to the extent of the variation.

3. The parties may not derogate from or vary the effect of the provisions of paragraphs 1 and 2.

4. Nothing in this Article shall entitle the lessee to modify, terminate or rescind the supply agreement without the consent of the lessor.

#### **Article 8 Priority of liens**

1. A creditor of the lessee and the holder of any interest in land or personal property to which the asset becomes affixed take subject to the rights and remedies of the parties to the leasing agreement and cannot attach any interest arising under the leasing agreement.

2. Except as otherwise provided by the law of [this State], a creditor of the lessor takes subject to the rights and remedies of the parties to the leasing agreement.

#### **Article 9 Limitation of liability of the lessor**

In a financial lease, the lessor shall not, in its capacity of lessor, be liable to the lessee or third parties for death, personal injury or damage to property caused by the asset or the use of the asset.

### **CHAPTER III: PERFORMANCE**

#### **Article 10 Irrevocability**

1. (a) In a financial lease, the duties of the parties become irrevocable and independent when the leasing agreement has been entered into.

(b) In a lease other than a financial lease, the parties may agree to make any of their duties irrevocable and independent by specifically identifying each duty that is irrevocable and independent.

2. A duty that is irrevocable and independent must be performed, regardless of the performance or non-performance of any other party, unless the party to whom the duty is owed terminates the leasing agreement or otherwise explicitly agrees.

#### **Article 11 Risk of loss**

1. (a) In a financial lease, risk of loss passes to the lessee. If the time of passage is not stated, the risk of loss passes to the lessee when the leasing agreement has been entered into.

(b) In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement and the lessee invokes its remedies under Article 14, the lessee, subject to paragraph 1 of Article 18, may treat the risk of loss as having remained with the supplier from the beginning.

2. In a lease other than a financial lease, risk of loss is retained by the lessor and does not pass to the lessee.

#### **Article 12 Damage to the asset**

1. In a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and at the option of the lessee either accept the asset with due compensation from the supplier for the loss in value but without further right against the supplier or, subject to Article 10, seek such other remedies as are provided by law.

2. In a lease other than a financial lease, when an asset subject to a leasing agreement is damaged without fault of the lessee or lessor before the asset is delivered to the lessee,

(a) if the loss is total, the leasing agreement is terminated; and

(b) if the loss is partial, the lessee may demand inspection and at the option of the lessee either treat the leasing agreement as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

#### **Article 13 Acceptance**

1. Acceptance of an asset occurs when the lessee signifies to the lessor or supplier that the asset conforms to the agreement, fails to reject the asset after a reasonable opportunity to inspect it or uses the asset.

2. (a) Once a lessee in a financial lease has accepted an asset, the lessee is entitled to damages from the supplier if the asset does not conform to the supply agreement.

(b) Once a lessee in a lease other than a financial lease has accepted an asset, the lessee is entitled to damages from the lessor if the asset does not conform to the leasing agreement.

#### **Article 14 Remedies**

1. In a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

2. (a) In a lease other than a financial lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the asset, to reject the asset or, subject to this paragraph and Article 23, to terminate the leasing agreement. Rejection or termination must be within a reasonable time after the non-conforming delivery.

(b) In a lease other than a financial lease, once a lessee has accepted the asset, the lessee may reject the asset under the preceding sub-paragraph only if the non-conformity substantially impairs the value of the asset and either

(i) the lessee accepted the asset without knowledge of the non-conformity, owing to the difficulty of discovering it, or

(ii) the acceptance by the lessee was induced by the assurances of the lessor.

(c) In a lease other than a financial lease, when the lessee rejects an asset in accordance with this Law or the leasing agreement, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied and to recover any rentals and other funds paid in advance, less a reasonable sum corresponding to any benefit the lessee has derived from the asset.

3. If the lessee rejects an asset in accordance with this Article and the time for performance has not expired, the lessor or supplier has the right to remedy its failure within the agreed time.

#### **Article 15 Transfer of rights and duties**

1. The rights of the lessor under the leasing agreement may be transferred without the consent of the lessee. The duties of the lessor under the leasing agreement may be transferred only with the consent of the lessee, which may not be unreasonably withheld.

2. The rights and duties of the lessee under the leasing agreement may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

3. The lessee, lessor and third parties may consent to such transfers in advance.

#### **Article 16 Warranty of quiet possession**

1. (a) In a financial lease, the lessor warrants that the quiet possession of the lessee 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 a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor. The parties may not derogate from or vary the effect of the provisions of this sub-paragraph.

(b) In a financial lease, a lessee that furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim of infringement or the like that arises out of compliance with the specifications.

2. In a lease other than a financial lease, the lessor warrants that the quiet possession of the lessee will not be disturbed by a person who has a superior title or right, who claims a superior title or right and acts under the authority of a court or who makes a claim by way of infringement. The parties may not derogate from or vary the effect of the provisions of this paragraph.

3. The sole remedy for a disturbance of the quiet possession of the lessee under subparagraph (a) of paragraph 1 and under paragraph 2 is an action for damages against the lessor.

#### **Article 17 Warranty of acceptability and fitness for purpose**

1. In a financial lease, the supplier warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used and the warranty is enforceable only against the supplier.

2. In a lease other than a financial lease, the lessor warrants that the asset will be at least such as is accepted in the trade under the description in the leasing agreement and is fit for the ordinary purposes for which an asset of that description is used if the lessor regularly deals in assets of that kind.

#### **Article 18 Duties of the lessee to maintain and return the asset**

1. (a) The lessee shall take proper care of the asset, use the asset reasonably in the light of the manner in which such assets are ordinarily used and keep the asset in the condition in which it was delivered, subject to fair wear and tear.

(b) When a leasing agreement sets forth a duty to maintain the asset or the manufacturer or supplier of the asset issues technical instructions for the use of the asset, the compliance by the lessee with such agreement or instructions shall satisfy the requirements of the preceding sub-paragraph.

2. When the leasing agreement comes to an end or is terminated, the lessee, unless exercising a right to buy the asset or to hold the asset on lease for a further period, shall return the asset to the lessor in the condition specified in the preceding paragraph.

### **CHAPTER IV: DEFAULT**

#### **Article 19 Definition of default**

1. The parties may at any time agree as to the events that constitute a default or otherwise give rise to the rights and remedies specified in this Chapter.

2. In the absence of agreement, default for the purposes of this Law occurs when one party fails to perform a duty arising under the leasing agreement or this Law.

#### **Article 20 Notices**

An aggrieved party shall give a defaulting party notice of default, notice of enforcement, notice of termination and a reasonable opportunity to cure.

#### **Article 21 Damages**

Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by this Law or the leasing agreement, place the aggrieved party in the position in which it would have been had the agreement been performed in accordance with its terms.

#### **Article 22 Liquidated damages**

1. When the leasing agreement provides that a defaulting party is to pay to the aggrieved party a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.
2. Such sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.
3. The parties may not derogate from or vary the effect of the provisions of this Article.

#### **Article 23 Termination**

1. (a) Subject to sub-paragraph (b), a leasing agreement may be terminated by operation of law, by operation of Article 12, by agreement of the parties or by an aggrieved party upon [substantial] default by the lessee or lessor.

(b) [Neither party to a financial lease may terminate the leasing agreement upon [substantial] default by another party but either party is entitled to such other remedies as are provided by the agreement of the parties and by law.]

2. Subject to Article 10, on termination all duties under the leasing agreement that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

#### **Article 24 Possession and disposition**

After the leasing agreement comes to an end or is terminated, the lessor has the right to take possession of the asset and the right to dispose of the asset.