INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

**MEETING OF THOSE INVITED BY THE JOINT SESSION OF THE UNIDROIT GENERAL ASSEMBLY AND THE UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE FINALISATION AND ADOPTION OF A DRAFT MODEL LAW ON LEASING TO WORK IN CLOSE CO-OPERATION WITH THE UNIDROIT SECRETARIAT FOR THE PREPARATION OF AN OFFICIAL COMMENTARY ON THE UNIDROIT MODEL LAW ON LEASING**
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# FIRST DRAFT OF AN OFFICIAL COMMENTARY

***(prepared by Mr R.M. DeKoven, Reporter to the Joint Session)*:**

# COMMENTS

***(by the Chairmen of the Committee of governmental experts and the Governments of Canada, France and the United States of America, as members of the Drafting Committee of the Committee of governmental experts)***

## INTRODUCTION

A Resolution was passed by the Joint Session of the UNIDROIT General Assembly and the UNIDROIT Committee of governmental experts for the finalisation and adoption of a draft model law on leasing, held in Rome from 10 to 13 November 2008, calling upon the UNIDROIT Secretariat to prepare an Official Commentary on the UNIDROIT Model Law on Leasing adopted in Rome on 13 November 2008, in close co-operation with the Reporter to the Joint Session, the Secretary to the Joint Session, the Chairman of the Committee of governmental experts and members of the Drafting Committee of the Committee of governmental experts. Following and on the basis of the decision that this Official Commentary should concentrate essentially on the points specifically referred by the Committee of governmental experts and the Joint Session for clarification therein, a first draft of such an Official Commentary was prepared by Mr R.M. DeKoven, Reporter to the Joint Session, and circulated for comment among those others invited by the Joint Session to co-operate closely with the UNIDROIT Secretariat in the preparation of the Official Commentary.

As of 25 May 2009 the UNIDROIT Secretariat had received comments from Messrs N.J. Makhubele and I.S. Thindisa (South Africa), Chairmen of the Committee of governmental experts, and the Governments of Canada, France and the United States of America, as members of the Drafting Committee. These comments are reproduced hereunder. It is to be noted that the

comments of the Governments of Canada and the United States of America incorporate the text of the first draft Official Commentary - highlighted by the use of bold type - their proposed drafting changes being included in the relevant paragraph thereof and explanatory comments being appended thereunder.

## COMMENTS

### THE CHAIRMEN OF THE COMMITTEE OF GOVERNMENTAL EXPERTS

***Re: Article 1***

We agree with commentary in paragraphs 1 and 2 and regarding this Article as true and correct reflection of decisions of the Joint Session of the UNIDROIT General Assembly and the UNIDROIT Committee of governmental experts.

***Re: Article 2***

**Asset**

We agree with the commentary relating to the definition of the above term.

**Financial Lease**

Commentary 1 and 2 on the above term is supported.

**Lessor**

Commentary under this Article is supported.

***Re: Article 3***

The commentary under this Article is supported.

***Re: Article 4***

The commentary under this Article is supported.

***Re: Article 5***

The Commentary is a correct reflection of the purpose of this Article, which is the creation of a balance of the powers of the lessor and lessee.

***Re: Article 6***

Commentary 1 and 2 under this Article is supported.

***Re: Article 7***

The commentary under this Article is supported.

***Re: Article 9***

Commentary in paragraphs 1, 2 and 3 regarding this Article is supported.

***Re: Article 10***

The commentary under this Article is supported.

***Re: Article 11***

There is a need to explain this Article more clearly, given the strong mixed views expressed by States. We need to insert another paragraph which should read:

> 2. The Article provides, in case of financial lease, an exception where, after the lease has been entered into, an asset is not delivered, is partially delivered, is delivered late or fails to conform to the lease, and the lessee enforces its remedies under Article 14. The lessee may, subject to Article 18(1), treat the risk of loss as having remained with the supplier.

***Re: Article 12***

Commentary under this Article is supported.

***Re: Article 13***

Commentary under this Article is supported.

***Re: Article 14***

Commentary under this Article is supported.

***Re: Article 15***

Commentary under this Article is supported.

***Re: Article 16***

Commentary under this Article is supported.

***Re: Article 17***

Commentary under this Article is supported.

***Re: Article 18***

Commentary under this Article is supported.

***Re: Article 19***

Commentary under this Article is supported.

***Re: Article 20***

While we do not have a problem with the comprehensive commentary under this Article, States would have to consider this more closely since our recollection is that this Article was discussed extensively and that several States sought the harmonisation of the English- and French-language versions.

***Re: Article 21***

Commentary under this Article is supported.

***Re: Article 22***

Commentary under this Article is supported.

**GOVERNMENT OF CANADA**

***General comments***

Canada thanks UNIDROIT for preparing a first draft of the Official Commentary. As a general comment, the Commentary should be further developed with explanations, examples and reference to pertinent instruments such as the UNIDROIT *Principles of International Commercial Contracts* (hereinafter referred to as the *Principles*), the UNCITRAL *Legislative Guide on Secured Transactions* (hereinafter referred to as the *Secured Transactions Guide)* or the UNCITRAL *Convention on the Assignment of Receivables in International Trade* (hereinafter referred to as the *Assignment Convention*). Canada proposes hereinafter substantive changes and additions as a result of the discussions at the Joint Session held in November 2008.

In terms of format, a unique numbering of paragraphs may facilitate future reference and it may also be useful to add the text of the Articles to the Commentary.

***Re: Article 1***

> **1. Article 1 provides for the Law to "appl[y] to any lease of an asset" ~~so long as the asset or the lessee's centre of main interests is within the State adopting the Law or so long as the leasing agreement provides that the law of that State will govern the transaction.~~**

Comments

Delete paragraph 1 as it is repetitive of the first sentence of paragraph 2.

An example along the following lines would be helpful here:

For example, the choice of law rules of the enacting State may refer issues relating to the third party effectiveness of the lessor's title to the leased asset to the law of the State in which the asset is located. In the event a dispute between the lessor and a third party arises in a State which has adopted the Law and whose law has been selected by the parties to govern their transaction, the provisions of the Model Law would be displaced in favour of the law of the location of the leased asset.

In addition, rather than expressing such an example in narrative terms, it probably would be even more helpful to use a factual scenario.

**2. ~~The Law applies~~ (add directly at the end of paragraph 1) if the asset is within the enacting State, or the centre of main interests of the lessee is within the enacting State, or the parties agree that the enacting State's law governs the transaction. ~~There may be transactions that fall within the sphere of application of several States' laws. In such cases, traditional choice of law rules will determine which law applies.~~ However, ~~T~~this provision does not displace ~~traditional~~ the enacting State's choice of law rules. Consequently, the application of the Model Law may be displaced by the law of another State to the extent the enacting State's own choice of law rules would refer to the law of a different State on a particular issue.**

**3. The term "centre of main interests" derives from the UNCITRAL Model Law on Cross-Border Insolvency Art. 2(b) (UNCITRAL 1997) and European Union Council Regulation 1346/2000, Preamble § 13, 2000 O.J (L 160) 1, 2 (EU), and should be interpreted as it is under those laws.**

***Re: Article 2***

**Asset**

**1. The definition of asset is sufficiently broad to ~~include~~ bring a lease of intellectual property, including software, within the scope of application of Law. Whether particular intellectual property qualifies as an asset will be determined on a case-by-case basis.**

Comments

Should not some guidance be provided here – is the concept of leasing an I.P. asset meant to be the same as its licensing? Why do we specify that software is included but then say that the determination of what I.P.R.s qualify will be decided on a case-by-case basis? What criteria apply to determine inclusion or exclusion?

**Financial Lease**

**1. The Law defines "financial lease" to include an operating lease~~s~~, that is, a lease~~s~~ that does not amortise the entire investment of the lessor.**

Comments

Commentary should perhaps explain why operating leases are also included.

**2. A subsequent lease of an asset that has previously been leased may qualify as a financial lease if it satisfies the definition of financial lease. Sub-paragraph (b) requires that the asset be acquired in connection with a lease. This may include a previous lease. So long as the supplier has knowledge that the asset is being acquired in connection with a lease, there is a sufficient basis to extend the duties owed by the supplier to the lessee in Article 7.**

**Lessor**

**1. The definition of lessor is unqualified. Consequently, t~~T~~hat a lessor is affiliated with a supplier or is also a vendor of the asset does not affect the lessor's status under the definition of "lessor" or the lease's status under the definitions of "lease" or "financial lease". However, a~~A~~ lessor that is also a vendor of the asset may have other duties that arise from other law.**

***Re: Article 3***

**1. ~~Ar~~ticle 3(1)~~'s reference~~ provides that the Law does not apply to a lease~~s~~ that function~~s~~ as a security rights. Whether a lease functions as a security right is determined by the existing law of an enacting State and this incorporates existing State law regarding the definition of "security right". Article 3(1) ensures that, when a transaction creates a security right as defined in other law, this Law does not apply to any aspect of the transaction.**

Comments

This is a critical section and requires extensive commentary. We need to emphasise that security right is used here in a generic sense and would exclude any lease that is subject to the same set of regulations that would apply to real rights in a grantor's assets given to secure payment or performance of an obligation. The relationship between this provision and the Secured Transactions Guide needs to be elaborated. Essentially, if a State has already implemented a law similar to that contemplated by the Secured Transactions Guide, it would be pointless to enact the Model Law. Same if a State later enacts such a law – in that event, the Model Law would be implicitly repealed.

***Re: Article 4***

**1. Because a uniform leasing law can encourage development not only within individual States but also across a region, Article 4 instructs domestic courts to interpret the Law with due regard for the interpretations of other States and the Law's purpose.**

Comments

It may be helpful to explain that paragraph 1 of Article 4 is a long-standing provision in international instruments aimed at encouraging courts to consider the jurisprudence of other States where they share a common instrument so as to promote uniformity. However, since this is a model law, it should also be explained that paragraph 1 does not extend to State-specific modifications to the Model Law.

***Re: Article 5***

**1. Article 5 ensures that only those provisions that are essential for protecting the rights of the weaker party should be made mandatory.**

Comments

The commentary should elaborate on the provisions which are mandatory and explain why, either here, through a cross reference to the commentary on the relevant Articles. A reference to "the weaker party" without further elaboration may confuse readers. Also, it should be emphasised, as always, that freedom of contract cannot bind third parties – this latter aspect could be elaborated in the discussion on priority in Article 8.

***Re: Article 6***

**1. Article 6 provides for the enforceability of the leasing agreement and the parties' rights and remedies between the parties and against purchasers of the asset and against creditors.**

**2. Article 6 can be limited by other law, i.e. law governing insolvency or secured transactions.**

Comments

The reason that the *prima facie* third party effectiveness of the lessor and lessee's rights under Article 6 can be limited by other law is because Article 6 begins with the caveat "except as provided by this Law" and then Article 8 – dealing with priority - begins with the caveat "except as provided by the law of" the enacting State. This should be explained because it is by no means obvious (especially since Article 6 and Article 8 seem to say much the same thing except for the all-important differences in their opening caveats).

***Re: Article 7***

**1. Article 7 provides that the lessee is able to enforce the rights of the lessor under the supply agreement. This provision recognises that the underlying substantive transaction is one in which the lessee acquires an asset or the use and possession of an asset from the supplier and that the lessor is a mere financier.**

Comments

A more elaborate, paragraph-by-paragraph commentary is suggested along with a fuller explanation why the entitlement of the lessee to the benefit of the supply agreement is necessarily a mandatory rule. Factual examples would probably help to clarify.

***Re: Article 8***

**1. Article 8 provides rules for the treatment of creditors of the lessee and lessor with respect to the lease.**

Comments

The *prima facie* priority rule stated in Article 8 is a key provision, as is the exception for other law. A more fulsome explanation of the actual substance of the rules is needed along with an elaboration of the possible qualifications that other existing law of the State might impose. This, as alluded to in the commentary on Article 6, would include insolvency law. However, it would not

include secured transactions law where the lease is treated as a security right under other law as per Article 3. All this should be addressed.

***Re: Article 9***

**1. Article 9 limits the liability of the financial lessor for actions taken in the course of performing its duties as lessor and as owner.**

**2. Article 9, while limiting liability based on the lessor's capacity of lessor or of owner, does not exclude liability based on other grounds, i.e. fraudulent acts of the lessor.**

Comments

Give examples of the dividing line and its rationale.

**3. The rule provided in Article 9 differs from the rule provided in Article 8(1) of the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988), which bars liability of the lessor in its capacity as lessor but permits liability based on the lessor's capacity as owner.**

Comments

Explain the reason for the change, which is important, especially for States that are Parties to the Ottawa Convention.

***Re: Article 10***

**1. Recognising the financial lessor's role as a financier, Article 10 makes the parties' duties irrevocable and independent when the asset subject to the lease has been delivered to and accepted by the lessee.**

Comments

A fuller explanation of the rationale is needed. Also the high importance of the qualification found in Article 23(1)(c) needs to be highlighted.

***Re: Article 11***

Comments

**1. Article 11 gives the lessee the risk of loss, enabling the lessee to insure its interest in the asset and protect itself against any damage to the asset.**

The lessee bears the risk of loss only in the financial lease, not in an operating lease, and this distinction should be explained along with its rationale (i.e. the best person to bear the burden of insurance is the lessee in a financial lease and the lessor in an operating lease, because of who presumptively has an interest in the capital value in each case).

***Re: Article 12***

**1. Article 12 provides rules to govern the circumstance in which an asset is damaged without fault of the lessee or of the lessor.**

Comments

It is necessary to explain, first, that this Article deals with loss suffered prior to delivery (Article 13 is concerned with post-delivery loss), secondly, that the rules and consequences are different for financial and operating leases, and thirdly, why this distinction is made.

**2. Article 12 is subject to the freedom of contract provided in Article 5. When a lessee accepts a damaged asset with due compensation from the supplier for the loss in value, Article 12 does not prevent the lessee and the lessor from agreeing that such compensation is to be remitted to the lessor and applied to reduce the rentals owed.**

Comments

Is this necessary? Clearly, if the lessee proceeds with the lease, it is obligated to make the lease payments and this can be done in any manner it chooses.

***Re: Article 13***

**1. Article 13 seeks to identify the time at which acceptance occurs, as well as, in conjunction with Articles 10 and 14, certain consequences of acceptance. The lessee's acceptance of the asset may have consequences under other laws of an enacting State, such as the law of sales.**

Comments

The concept of acceptance and its legal consequences should be explained in detail along with the rationale for the difference in treatment between financial and operating leases.

**2. Article 13 is subject to the freedom of contract provided in Article 5. When a lessee is entitled to damages because the asset does not conform to the lease or the supply agreement, Article 13 does not prevent the lessee and the lessor from agreeing that such compensation is to be remitted to the lessor and applied to reduce the rentals owed.**

Comments

Again, is this necessary? Clearly, if the lessee proceeds with the lease it is obligated to make the lease payments and this can be done in any manner it chooses.

***Re: Article 14***

**1. Article 14 provides further rules regarding the parties' rights and duties when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the leasing agreement.**

Comments

The commentary here seems to be a place-holder for what will need to be a detailed explanation, ideally with examples, of the diverse remedies available in the diverse range of circumstances contemplated by Article 14. The reader needs to be walked through the various scenarios ideally with factual examples given of the different circumstances. And again, the reason for different approaches for operating and financial leases needs to be explained.

***Re: Article 15***

**1. To facilitate the growth of a leasing market, Article 15 provides for the transfer of the lessor's rights. Article 15 also provides for the transfer of the lessee's rights and the transfer of both parties' duties.**

Comments

How does transferability facilitate the growth of a leasing market? Presumably the reference here is to the ability of the lessor to use the lease payments as collateral for a loan in an assignment to raise capital. This should be explained.

However, there is an important difference between the transfer of rights (no consent being required) and duties (consent being required). This needs to be elaborated.

**2. The reference in Article 15(1)(a)(ii) to the lessee's ability to assert defences or rights arising from the incapacity of the lessee is to a transfer that is invalid owing to the lessee's lack of legal capacity to contract.**

Comments

The commentary should explain that this Article assumes that other law of the enacting State preserves the lessee's defences and rights of set-off and reference should be made to international instruments including the Secured Transactions Guide and the Assignment Convention confirming this principle. The Assignment Convention also preserves the incapacity defence. It also preserves fraud as a defence and the commentary should explain that the omission of a reference to fraud in the Model Law is not meant to say that it should not be available.

***Re: Article 16***

**1. Article 16 requires a lessor to warrant that the lessee's quiet possession will not be disturbed and makes clear that, if such warranty is broken, the lessee may bring an action for damages against the lessor.**

Comments

Explain the difference in the character of the obligation between operating and financial leases.

**2. The lessor's warranty of quiet possession does not interfere with any right of an owner or any other holder of an interest to take possession of the asset subject to the lease. Article 16 creates a remedy for a lessee whose quiet possession is disturbed by such an action.**

Comments

Explain that the remedy is limited to damages and why this is so.

***Re: Article 17***

**1. Article 17 requires the lessor or, in a financial lease, the supplier to warrant that the asset being leased meets certain minimum requirements for such an asset in the trade.**

Comments

Elaborate on the content of the obligation.

***Re: Article 18***

**1. Article 18 specifies the duty of care required of the lessee in respect of the asset.**

Comments

Elaborate on the content of the lessee's duty of care. Also explain that this Article also covers the lessee's duty to return the asset at the end of the lease.

***Re: Article 19***

**1. Article 19 provides a definition of default but permits the parties to agree otherwise.**

Comments

Emphasis perhaps should be in the other direction - parties are free to agree but this Article provides a default definition in the event they fail to do so. Ideally, commonplace contractual events of default should be given as examples.

***Re: Article 20***

**1. Article 20 requires the other party to send a notification of any default, enforcement or termination and provide an opportunity for such non-compliance to be cured.**

**2. Whether notice is adequate shall be governed by existing law of the State or, where there is no such law, by reference to such other authorities as are permitted by law. Article 1.10(1) of the UNIDROIT Principles of International Commercial Contracts provides that, where notice is required, it may be given by any means appropriate under the circumstances. Article 1.10(2)-(3) of those Principles provide that a notice is effective when it reaches the person to whom it is given, whether by being given to that person orally or delivered at that person's place of business or mailing address.**

**3. Whether the opportunity to cure is reasonable shall be governed by existing law of the State or, where there is no such law, by reference to such other authorities as are permitted by law. Under Article 7.1.4 of the UNIDROIT Principles of International Commercial Contracts, the right to cure is not precluded by notice of termination. The cure must be permitted when the cure is accompanied by notice, given without undue delay, from the defaulting party indicating the proposed manner and timing of the cure; the cure is appropriate in the circumstances; the aggrieved party has no legitimate interest in refusing cure; and the cure is effected promptly.**

***Re: Article 21***

**1. Article 21 provides a damages rule if the parties do not otherwise agree.**

Comments

Emphasis perhaps should be in the other direction - parties are free to agree but this Article provides a default definition in the event they fail to do so. Ideally, commonplace contractual events of default should be given as examples.

***Re: Article 22***

**1. Article 22 permits the parties to agree to a liquidated damages amount for any default, so long as the amount is reasonable.**

Comments

This is not being quite accurate. Article 22 says that a contractual agreement on damages is subject to reduction to a reasonable amount only if the agreed amount is grossly excessive in relation to the harm. This will be new for many systems - especially those in the Common law tradition - and needs to be highlighted.

***Re: Article 23***

**1. Article 23 permits a party to terminate the agreement, and discharge all the parties' future duties, only upon a fundamental default by the other party.**

Comments

There is a need to explain the difference in remedies available depending on whether fundamental default occurs before or after delivery and acceptance by the lessee. After delivery and acceptance, the only remedy is damages and since this will be a novel contract rule for most legal systems, this needs to be highlighted and explained in terms of rationale.

**2. Under Article 7.3.1 of the UNIDROIT Principles of International Commercial Contracts, whether a default amounts to a fundamental default shall be determined with regard to whether (a) the default substantially deprives the aggrieved party of what it was entitled to expect under the agreement unless the other party did not foresee and could not reasonably have foreseen such result; (b) strict compliance with the duty that has not**

**been performed is of essence under the agreement; (c) the default is intentional or reckless; (d) the default gives the aggrieved party reason to believe that it cannot rely on the other party's future performance; and (e) the defaulting party will suffer disproportionate loss as a result of the preparation or performance of the agreement is terminated.**

***Re: Article 24***

**1. Article 24 provides that the lessor has the right to take possession of the leased asset at the end of the lease.**

Comments

The Commentary should cross-refer to the lessee's duty in Article 18 to return the asset at the end of the lease.

**2. The means by which a lessor may take possession of an asset is left to be determined by other law of the State.**

Comments

Elaborate.

**3. The lessor's right to take possession of and dispose of the asset is subject to the parties' freedom of contract.**

Comments

Is this comment necessary?

**GOVERNMENT OF FRANCE**

***Re: Article 1***

It would assist the comprehension of the text if:

- paragraph 1 stated the *principle*: the Law "applies to any lease of an asset";

- paragraph 2 defined the alternative *conditions for its application*: "if … or … (knowing that, under Article 2(b) of the UNCITRAL Model Law on Cross-Border Insolvency, the) 'centre of main interests' is (…), a definition to which this text makes implicit reference";

- paragraph 3 recalled the *rules* of *conflicts of laws* (efficiency).

***Re: Article 2***

**Asset**

- The commentary on this definition should be developed further.

- Although use of the term “property” and “all property” covers the things over which subjective rights may exist, the examples given *suggest* a limitation on the *property*, which is *subject to a right in rem*.

- Does the definition cover a *fonds de commerce*, which is made up of the totality of the corporeal movable items (equipment, machinery and goods) and the incorporeal elements (the lease, the name, …) which a tradesman or a manufacturer arranges and uses with a view to building up a clientèle and which is characterised by the fact that it forms a distinct legal entity from the elements of which it is composed?

It is true that some of the corporeal items of which it is composed may be the subject of a financial lease - and this is the case with equipment - but is the same true also of some *incorporeal elements*?

For example, under French law, Article L.313-7, paragraph 2 of the Commercial Code authorises and regulates financial leases (crédit-bail) regarding the “right to the renewal of a lease” “for the rental of real property or premises for use in trade or manufacturing or by an artisan”.

Furthermore, paragraph 3 of the same Article authorises “the leasing of *fonds de commerce,* of the businesses of artisans or of one of their incorporeal elements, with a unilateral promise of sale via the payment of an agreed price taking account, at least in part, of the payments made by way of rental, to the exclusion of any lease to the former owner of the *fonds de commerce* or the artisan’s business” (via a sale and lease-back, termed “*cession-bail*” under French law).

May one consider that the *fonds de commerce*, an artisan’s business and one of their incorporeal elements may be the subject of a financial lease and are, therefore, covered by the term “asset”?

- Besides, any “asset” does not fall within the category of the types of property *eligible* for financial leasing. Certainly, some do *by their very nature,* such as an excavator or an oil tanker, or *by the purpose for which they are intended*, but others are excluded, such as pleasure boats as such. But what about *mixed assets*, which may be used both for professional and private purposes? The classic example of such an asset is a motor-car, which may be considered as part of the equipment of a business once, even though for tourism, it is used in the running of this business.

The cumulative distinctive criteria here are the *appropriation* of the asset for a trade, manufacturing or professional purpose or for the purpose of its use by an artisan and the *extent to which it is used* for this purpose.

- Furthermore, the asset which is materially the *subject of the financial lease* must also be - and this is an essential, qualifying requirement of financial leasing - materially the subject of the supply agreement (the same asset being materially subject to the two agreements).

- The asset is, therefore, *purchased* by the lessor - under the initial supply agreement - who is thus the owner, *with a view to* the financial lease (Article 2: the definition of financial lease; the definition of supplier; the definition of supply agreement).

It follows from this that the *manufacturer* of equipment which he has not acquired (under a preliminary purchase) but will manufacture cannot supply this equipment under a financial lease (financially).

However, once this condition of a preliminary purchase is realised, the transaction is valid regardless of whether the seller of the equipment knew who was to be the lessee. In other words, the lessor who has purchased an asset for leasing from the future lessee of the asset under a financial lease and the said lessee who has sold it to him for this purchase validly carry out a transaction of this type. This is what, in professional jargon, is known as "sale and lease-back" or, in French law, as "*cession-bail*", under which the lessee of the asset leased is none other than its seller and the lessor its acquirer, thus involving the existence of two successive agreements making up the financial leasing transaction: a sale contract (the preliminary purchase) and a lease, where appropriate with a financial purchase option (residual value).

The same is true of the transaction, for example, under French law, termed "*crédit-bail adossé*" ("*leasing adossé")* and thus "financial leasing *adossé*", under which the lessor, considering that the would-be lessee under a classic financial lease ("crédit-bail") is not capable of settling the rentals under the lease on time, invites the supplier/seller, who is keen on the realisation of the proposed investment, to take the equipment and lease it to him with the option of *sub-leasing* it to the original would-be lessee. He thus bears the financial risks of the transaction arising in particular with regard to the constituent requirement of financial leasing: the *preliminary purchase* of the asset to be leased.

Now - and this is what has, *inter alia*, justified the previous considerations - this requirement may be missing in the *software* field.

For, if the problem does not arise in respect of software which is *attached to the equipment* and is sold with it as a whole, forming the equipment leased, the difficulty arises in full when the *software* is *independent* of the item in connection with which it is to be used and may not be appropriated by the purchaser/lessor. Failing realisation of the condition of the preliminary purchase, a financial lease is impossible.

Moreover, it would be impossible even more so because the same difficulty precludes the inclusion of a *purchase option*, which in certain legal systems is an essential ingredient of financial leasing, in respect of software independent of the item in connection with which it is to be used, in favour of the lessee who cannot appropriate such software to himself, by removing it from the item in question.

**Financial lease**

- The definition of "*operating leases*" in the first draft Official Commentary is *restrictive* and fails to take account of a fundamental ingredient: "*the services*" which have made it a separate product of financial leasing, related rather, in the definitions of Article 2, to "lease".

- In fact, what is called in the professional jargon used in certain countries *"operating leasing"* is *defined* by two cumulative constituent ingredients, the second of which has become more important than the first:

  - the *amortisation of the capital* invested by the lessor and the *return* thereon in the purchase of the asset leased, over several leases of variable duration with differing rentals;
  - *and* the supply by the lessor of "*services*" which are both more and more numerous and sophisticated, creating competitivity between lessors, going even to the extent of the creation of specialised structures or the extension of the purpose and the activity of existing structures, for example the

recovery of equipment subject to dispute following the termination of the contracts.

- Given that the original selection of the equipment and of the supplier is not a characteristic feature of the transaction and that the financial imperative gives way to a "services" imperative (such as insurance, maintenance of the asset, supply of services relating to use of the asset - such as a driver -and the replacement of the asset by another more up-to-date and high-performance model), the *operating lease falls rather within the general category of lease,* apart from giving the term a very restrictive meaning.

- The first draft Official Commentary (Article 2, Financial lease, paragraph 2) takes the view that a subsequent lease of an asset that has previously been leased "may qualify as a financial lease if it satisfies the definition of financial lease". *Now* sub-paragraph (a) of the definition of financial lease *imposes* as a cumulative requirement that the *lessee makes the original selection of the asset and the supplier*, which is not the case in a new lease.

This seems all the more founded to our mind given that it is upon *the selection of the first lessee* that the supply agreement is made, as is provided by sub-paragraph (a) *in fine* and sub-paragraph (b), under which "… the supplier; *and* the lessor requires the asset in connection with a lease and the supplier has knowledge of that fact", as well as on the choice of the initial lessee who, consequently, by virtue of the financial nature of the transaction expressed in sub-paragraph (c) and the purpose for which the asset acquired in these conditions is to be used, can, notwithstanding the rule of privity of contract, invoke the duties of the supplier under Article 7.

Besides, this same Article clearly proves that the financial leasing transaction is mounted for *this initial lessee*. Is this not, for example, shown by Article 7(3), which provides that "the rights of the lessee … shall not be affected by a variation of any term of [the supply] agreement unless consented to by the lessee," or by Article 7(2), requiring the lessor to "assign its rights to enforce the supply agreement …" or again by Article 7(1), establishing the rule whereby the initial lessee for whom the transaction is mounted and of which he is the principal party is entitled to invoke the duties of the supplier.

In the light of this interpretation of Articles 2 (regarding financial lease) and 7, *any subsequent lease of an asset that has previously been leased, coming after a financial lease, may not be qualified as a financial lease* under Article 2.

*On the other hand*, the parties to an agreement may, by a clear expression of their will, make their agreement subject to the Model Law (Article 5).

Furthermore, this interpretation does not preclude the *sale of a used* (second-hand) *asset* by a supplier in the context of a financial leasing transaction.

**Lessor**

- A *lessor may not be at one and the same time "vendor" and "lessor" of the same asset,* which is thus no longer his property, unless he were to lease the asset from someone else!! The first draft Official Commentary calls for some clarification on this point. It is probably designed to cover the case of *captive companies* of suppliers that have a separate legal personality. In this case, even though the capital of the leasing company is held by the supplier of which it is a subsidiary (whence use of the term "captive"), the leased asset is sold by the supplier - the "parent company" - to the purchaser/lessor - its subsidiary - to be either simply leased or leased under a financial lease to such a lessee.

- The first draft Official Commentary might also cover the *sale and lease-back* transaction, in which the lessee of the asset is also the person who sells it to its purchaser/lessor. However, the purchaser/lessor acquires these two different capacities under *two successive contracts concerning the same asset*: a supply agreement between the future lessee/the supplier and the purchaser/the future lessor, followed by a financial lease between the latter and the former.

***Re: Article 3***

This Article concerns the disqualification of a financial lease and its re-qualification as a *security right*. It would be helpful if the first draft Official Commentary could be further developed, in particular concerning the criteria or rather the *definitional ingredients of the security right* in question, in particular in relation to a financial lease under which "the rentals or other funds payable under the lease take account … the amortisation of the whole … of the investment of the lessor" (Article 2, Definitions: Financial lease) and its profit margin, the remedies against the supplier are exercised by the lessee and *the ownership of the asset, which is kept by the lessor* until such time as the lessee exercises his purchase option at a price (the residual value of the asset) not corresponding to the economic value of the same asset, *performs an economic and not a legal function as security*.

***Re: Article 4***

The two paragraphs of this Article are short but clear. It would, nevertheless, be useful in the first draft Official Commentary on Article 4(2), which, whilst it does not raise any particular problem of interpretation *stricto jure*, deals with "*matters*" - and, therefore, *a priori*, *disputes* - not "expressly settled in it [and which] are to be settled in conformity with the *general principles* on which [the Model] Law is based", to specify and define these general principles. This also raises the question of what should happen regarding *those in no way "settled"* in the Model Law. Do the matters "not expressly settled in" the Model Law cover those collateral agreements, such as personal and *in rem* guarantees, insurance, the agreement of the supplier to repurchase the asset and the supplier's promise to assist in its remarketing? Article 4(2), to our mind, merits more ample commentary.

***Re: Article 5***

- This is a provision of *very great theoretical and practical importance*, in that it enables the parties to arrange their contractual relations in terms of their individual concerns while preserving the harmony of the Model Law and compliance with its mandatory provisions.

- In consideration of the fact that the principal protagonist in a financial leasing transaction is *the lessee,* who is the party who sets it in motion, for whom the equipment is purchased by the lessor who then leases it to him, either with a financial purchase option or without a purchase option but frequently in this case for a term corresponding to the economic life of the asset, against the payment of rentals, covering the amortisation of the capital invested by the lessor and his return on the transaction, Article 7 *places* the lessee in the legal situation in which he would have been *if the transaction had been a direct supply agreement.* This "rebalancing" - moreover desired by all the three parties in practice - is, therefore, imposed on them. This is what is stated in Article 7, which, on the one hand, in paragraphs 1, 2 and 3, creates a *direct link* between the lessee and the supplier, thus *derogating,* however imperfectly (paragraph 2)*, from the principle of privity of contract*, and, on the other, provides that the parties may not derogate from Articles 7(1), (2) and (3) (paragraph 4).

It is *not,* therefore, a "*provision essential for protecting the rights of the weaker party"* (first draft Official Commentary) but an *essential structural ingredient* of the financial leasing transaction, the absence of which would, therefore, change its nature consubstantially. *It is this which provides the basis for its mandatory nature.*

*On the other hand,* in certain everyday transactions, a lessee who signs pre-printed financial leasing agreements (standard contracts), which include liquidated damages that are manifestly excessive in relation to the lessor's real measure of loss, in effect finds himself in an unbalanced situation, a situation of *weakness* which justifies his protection by law. Thus, Article 5 makes Article 22(1) and (2) mandatory. It is necessary to remember, in this regard, that in major investments, it will be the lessor who will find himself in the weaker situation!

***Re: Article 6***

- It features in Chapter II ("Effects of a lease") which covers both leases and financial leases, as this is made clear by Articles 7 and 9. However, it *only* contemplates *"a lease".*

- It deals with the effects of a "lease" between the parties thereto and against *third parties*, that is those persons who are extraneous to such an agreement, "[e]xcept [however] as otherwise provided in this Law", which must necessarily refer to different provisions, which may be contrary thereto. It would be helpful if this were made clear, as is done in respect of Article 8.

- Article 6(a) lays down the rule of the *binding effect of the lease* between the parties thereto and Article 6(b) the rule of *the lease's enforceability against third parties:* acquirers of the leased asset once it has been sold by the lessor and creditors of the lessor and the lessee. From this it may be deduced that an acquirer of the asset may not be without notice of the lease to which it is subject and the creditor of the duties of its debtor: the lessor or lessee in a lease.

Does Article 6, to the extent that it is subject to other (contrary?) provisions of "this Law", exclude other legal exceptions? If so, what is the use of the aforementioned exception?

***Re: Article 7***

- This is *extremely important*, dealing as it does with the subject-matter of the most serious *disputes* (along with those cases concerned with arrears in rentals and damages for termination) that financial leasing companies have to deal with, concerning all *the "technical" aspects of the asset* (selection, negotiation of the price, alterations to be made thereto, time for, and place and conditions of delivery, guarantees (performance, duration)) in which the lessor, confining himself to his financial role, does not intend to interfere, however, granting the lessee the necessary legal capacity to act efficiently, at the legal level. It is this which justifies the relief from liability granted under financial leasing transactions and the direct right of action which they grant in favour of lessees, within the limit of the legal technique chosen for its implementation (for example, *mandat* or *stipulation pour autrui*). This Article is, therefore, concerned with all those cases relating to the existence of the asset, such as its characteristics, that is, *to be more precise,* performance of the supplier's duty of delivery and the warranties provided for under the supply agreement concluded between the acquirer - the financial leasing company - and said supplier/seller of the asset which the owner/lessor leases, under a financial lease, to the lessee under the conditions agreed between the lessee and the same supplier, who, when performing - as we have pointed out - his duty of delivery and his warranties, performs at the same time - as specified in the supply and financial leasing agreements - the (parallel and almost identical) duty of delivery and the warranties of the lessor vis-à-vis the lessee. Consequently - the lessee's remedies against the supplier having, moreover, been validly established in law - claims regarding the non-existence of

the asset, non-delivery and incomplete delivery of the asset and latent and hidden defects affecting the asset and making it unsuitable for the use for which it is intended are all dealt with by the lessee *directly* against the supplier, the lessee, however, continuing to remain liable to pay his rentals up until final settlement of the dispute, where necessary under the supervision of the judge.

- Article 7, derogating, however imperfectly (Article 7(2)), from the principle of privity of contract, thus creates, *by law*, the aforementioned *direct right of action*, in that the lessee may invoke the contractual duty of the supplier as though it were a party to the supply agreement, *knowing*:
  - that said supplier *has not to compensate* both the lessee and the lessor for the same loss. For example, where the lessee continues to pay his rentals regularly or has settled the entirety of these rentals, the lessor who has not sustained any loss through the supplier's default is not entitled to any compensation, which is not the case of the lessee (Article 7(1)).
  - that a lessor who *refuses to "assign* its rights to enforce the supply agreement [duty of delivery and warranties] to the lessee" is obliged to take upon himself the duties flowing thereunder. In reality, he would only be performing his own (parallel) duty of delivery and warranties as a lessor without any other consideration entailing his full responsibility in the event of default (Article 7(2)). Moreover, given its mandatory character, Article 7(2) cancels the effect of Article 14(1) on the lessee's right "to demand a conforming asset" from the defaulting supplier "and seek such other remedies as are provided by law".
  - that the lessee's *right to invoke the supplier's duties* is *intangible* so that no variation of the supply agreement "affect[ing] [his rights]" may be invoked against him if he has not consented to it; however, the agreement in question must have been "*approved by the lessee"*. What then would happen where the agreement was varied *without* his consent? In that case, it would seem to us that his rights would simply not be affected by such a variation so that Article 7(1) and (2) would be applied in full.
  - that the legislative *prerogatives* granted to the lessee *do not,* however, *extend* to "modification", "termination" [1] or "rescission" of the supply agreement, in both cases retroactively, "without the consent of the lessor" (Article 7(5)).
  - that Articles 7(1), (2) and (3) are mandatory (Article 7(4)). Article 7(5), on the other hand, may be varied by the parties.

***Re: Article 8*** (see above, *sub* Article 6)

***Re: Article 9***

- This Article is *very important* and raises *several questions:*
  - Does it lay down the principle of the owner/lessor's *relief* from liability or rather a *limitation* of his liability?
  - *Does it exclude* the owner/lessor's *strict liability* and subject to which conditions?
  - If so, *does it exclude this liability generally* and *absolutely or within the limits* and *subject to international Conventions*, for example, those dealing with *pollution*?

[1] *Note by the Secretariat:* the comments of the French Government suggest that the term corresponding in the French text to "termination" should be "résolution" rather than "résiliation".

- Where does this leave the liability of an owner/lessor in breach of his duties such as to justify him being relieved from his liability or seeing it limited?

***Re: Article 10***

A *purchase option*, the price for the exercising of which is financial (residual value) and the exercise of which is subordinated to due performance of the lease, may be a substantial ingredient of a financial lease. Termination of the financial lease must entail the termination of the promise to sell the leased asset given thereunder. What would be the effect of "irrevocability and independence" in such a case?

***Re: Article 11***

In a financial lease, the risk of loss of the asset is logically transferred to the lessee at the very moment when the lessor, not being party to the "technical" relationship between the lessee and the supplier, becomes the owner thereof. Article 11(1)(a) provides otherwise but the parties may decide differently, pursuant to Article 5.

***Re: Article 12***

- Under Article 12(1), the lessee is given the right to receive "*compensation …for … loss in value*" from the supplier of an asset that was damaged before delivery. The compensation referred to is intended to compensate the lessee for his own measure of loss and should be assessed in the light of his *loss of enjoyment* of the asset and *the extent* to which his enjoyment of the asset has been diminished: it is not intended to compensate the *owner/lessor's* measure of loss in terms of the value of the asset.

Moreover, the same text does not concern itself with *the fate of this compensation* as regards the lessor, who, as purchaser of the damaged asset, pays the purchase price, therefore, to the supplier, whereas, logically and in practice, the sum paid is offset by said purchase price or is deducted from the lessor's investment constituting the rental basis of the transaction, and thus, financially, proportionately to the rentals to be paid and, where appropriate, from the residual value.

- The *same remarks* may be made in respect of the assessment of the loss of the lessee in the lease: the diminution of enjoyment and not the loss in value of the asset leased (Article 12(2)).

- It will thus be for *the parties* to financial leases and leases to derogate from or vary the effect of those provisions (Article 5) which are incompatible with, or unsuitable for their actual concerns and the legal and economic certainty of their transactions.

***Re: Article 13***

- This Article has *considerable scope*, both in theory and in practice, given that it deals with *a fundamental part of the structure* of what is essentially a financial leasing transaction. In fact, in practice, with a view to safeguarding his investment, the purchaser/lessor only pays the price of the asset purchased for lease to the lessee, who has selected it freely, upon production of a *"certificate of receipt* (in the maritime, inland navigation and air fields) *of the equipment*" concerned, established jointly by the supplier and the lessee, acting both on his own account and as the agent of the purchaser/lessor, and certifying that the asset delivered is in conformity with that ordered and purchased and that, consequently, said purchaser/lessor may pay the purchase price

for it to the supplier, who, thereby, has validly performed his duty of delivery under his supply agreement with the purchaser/lessor, who at the same time and by the same means has performed his own duty of delivery vis-à-vis the lessee, who acknowledges this fact in the same certificate and, consequently, accepts the equipment.

Once he has received this key document, the purchaser/lessor who has, as mentioned, paid the agreed price to the supplier, will issue an *invoice* to the lessee calling upon him to settle his *first rental*. There is thus *concomitant settlement* (and, moreover, accounting of the transaction). The lessee is thus master of the situation.

Article 13(1) is thus *in line with the practice* most generally employed and, where defects - in particular latent or hidden defects - appear beyond the time allowed in the agreement for such purposes - the "reasonable opportunity" of the Model Law - the supplier will, in such a case, use the legal means placed at his disposal by the Model Law or agreed by the parties.

Agreements, moreover, provide for the case where *the asset is used* without a certificate being drawn up, with the asset in such a case, however, being judged to have been *implicitly accepted* (conditions regarding time, protests and reservations).

- Article 13(2) deals with the lessee's *measure of loss* by reason of the *non-conformity* of the asset under the two agreements in question. It involves the *same particular legal distinction* referred to in respect of Article 12(1), namely that the lessee's measure of loss is for the loss or diminution of enjoyment of the leased asset and not for the asset's loss in value by reason of its non-conformity linked to its inherent characteristics, which affects the lessor as owner and not the user of the asset (see above).

The parties may, therefore, arrange their relations differently under Article 5.

***Re: Article 14***

- See the comments on Article 7, above.

- *Delivery* of "an asset [which] *fails to conform* to the …" refers to the defects affecting an asset leased under either a lease or a financial lease.

- *Article 14(2)(c)*: "… the lessee is entitled to … recover any rentals …. , less a reasonable sum corresponding to any benefit the lessee has derived from the asset". The reasonableness referred to means that the sum in question must be the closest possible to the actual benefit derived, so as to avoid any abuses.

- Article 14 does not deal, as regards leases other than financial leases, with the liability of the lessee in its free choice of the asset and the supplier thereof which lies at the root of the situation calling for redress. Such free choice may exist in this type of agreement.

***Re: Article 15***

- Is this provision *concerned only with leases?*

*Article 15(1)(a)(i)*: "The rights of the lessor under the lease may …" are the *rentals owed*. What is being talked about here, therefore, is the classic assignment of debts. This provision does not, therefore, derogate from Article 7(2) (above).

- *Article 15(1)(a)(ii)*: "the lessee" not being able to raise any of its "defences or rights of set-off" does not cover the case of "those (defences or rights of set-off) arising from the *incapacity of the lessee*". Does this incapacity of the lessee refer to his incapacity to contract?

But, in that case, a lease *contract* concluded in these conditions would be *invalid*; and this invalidity means that it disappears retroactively with the result that, when applied to the problem raised, it has the effect that "the lessee['s] defences …" *no longer exist*, by virtue of the invalidity of this contract. And *Article 15(1)(a)(ii)* is, therefore, *stricto jure,* dealing with a question that does not arise! *Unless* behind the expression discussed there is another legal explanation.

If these remarks are founded, the paragraphs should, as a result, be reviewed.

- *Article 15(1)(b)*: it would be useful to define "*unreasonably withheld*", bringing it closer to the concept of "good cause" sometimes employed in contracts.

***Re: Article 16***

- *Article 16(1)(a)* provides that, 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*" - and this is the condition which generates this warranty - "such title, right or claim derives from (the alternatives listed) a negligent or intentional act or omission of the lessor", that is to say from that party's wrongful behaviour.

This restriction on the warranty *is explained* and justified by the fact that the selection of both the asset and the supplier is made freely by the lessee. The *lessor*, as a result, *is only bound by his own acts*: a negligent or intentional act or omission of his having caused the disturbance of the lessee's quiet possession referred to.

- *Article 16(2):* this provision explains that in leases other than a financial lease *there is not* such a restriction on the lessor's warranty, the lessor being bound by his common law warranty of quiet possession.

- It is for this same reason that Articles 16(1)(b) and (2) provide a *different* treatment for the lessor's warranty of quiet possession in respect of claims by way of infringement, depending on whether the technical "specifications" concerned have been furnished by the lessee (in the case of a financial lease) or whether they have been followed by the lessor in the performance of his common law warranty of quiet possession (a lease other than a financial lease). In the first case, the lessee naturally warrants to the lessor and the supplier that its quiet possession will not be disturbed by any claim of infringement; on the other hand, in the case of a lease covered by Article 16(2) this warranty will be given by the lessor.

- In the event of "*a fundamental default*" by the lessor in respect of the warranty of quiet possession under a financial lease, the lessee may terminate the lease (Article 23(1)(c)). In the cases referred to in Article 16(1)(a) and (2) the only remedy available to the lessee, to the exclusion of that given by Article 23(1)(c), will be an action for damages against the lessor for his negligent or intentional act or omission.

***Re: Article 17***

- Article 17(1) deals with the supplier's warranty of acceptability and fitness for purpose according to what "is accepted in the trade" and, in the case of a financial lease, "under the

description in the lease", being one of the protagonists and players in this type of transaction. In supplying this warranty, he covers the lessor's duty of delivery and warranty to the lessee, *even though* the provision does not state this expressly.

- Article 17(2) contemplates the lessor's ordinary warranty in a lease other than a financial lease, introducing, however, a reservation to take account of the extreme variety of the types of equipment that are leased, under the form of a condition: "if the lessor regularly deals in assets of that kind", that is usually.

***Re: Article 18*** (no comments)

***Re: Article 19***

- In order to obtain a proper understanding of the concept of "*default*" and that of "*fundamental* default", the latter of which is the only one given due legal effect - mere "default" not being given as much - Article 19(2) needs to be *read together* with Article 23.

- The mere default contemplated in Article 19(2) refers to the situation where one party to the agreement is in default regarding the performance of one of his duties. Such default *becomes "fundamental" where* it meets one of the requirements of Article 7.3.1 of the Principles. This is the case, for example, of "intentional or reckless non-performance", of "non-performance [that] substantially deprive[s] the aggrieved party of what it [i]s entitled to expect under the contract" - such as failure to pay the rentals, which ensure the lessor the amortisation of his investment and his profit margin under a financial lease - and non-performance of a duty "strict compliance with [which] is of essence under the contract". These three cases cover more or less all the disputes arising under the two types of lease covered by the Model Law.

- Furthermore, Article 5 authorises the parties to agree on what they consider to amount to "fundamental default".

***Re: Article 20***

- This Article concerns the *notice* given to a lessee in default, notifying him of the breach of his contract represented by the default - which at that point constitutes a fundamental default (Article 23) - in his performance of the duty concerned, the remedies that may be exercised against him and the termination of the contract that he risks in the event of non-performance. Such notice is to be given in the conditions and according to the procedure settled in the agreement (Article 5). Furthermore, *the validity of* such notice is subject under the Model Law to the aggrieved party giving the defaulting party "a *reasonable opportunity* to cure". This will usually consist in a *moratorium*, with the amounts due being split up and spread out over instalments, a review of the deadline for the payment of rentals and the cancellation of debts.

***Re: Article 21***

This Article presents the interest of *limiting* damages to the *real loss* sustained by the aggrieved party assessed in concrete form, in that they must "place the aggrieved party in the (economic) position in which it would have been had the agreement being performed in accordance with its terms".

***Re: Article 22***

- This Article deals with *liquidated damages*, which it defines and the validity and effectiveness of which it affirms (Article 22(1)).

- *However*, these liquidated damages "may be *reduced* to a *reasonable* amount *where* … ***grossly*** *excessive* in relation to the harm resulting from the default" (Article 22(2)). Such a reduction will *only be called for if* the liquidated damages are "*grossly* excessive" - and, therefore, not if they are only excessive - and, thus, constitute a sort of *excess within excess*. For it is in the nature of liquidated damages - fulfilling, as they do, a dual role, that of compensating the real loss sustained by the aggrieved party (*compensation*) and that of dissuading the debtor from breaching his agreement through the size of the penalty to be paid in the event of breach (*deterrent*) - to be excessive but, in no way, excessive to an exaggerated degree, and they are, in any case, subject to the control of the *judge*, who, where he finds them grossly excessive, will reduce them to a "reasonable amount … in relation to the harm resulting from the default" and *not to an accurate assessment thereof*, in view of the complicated nature of such an assessment.

Since this is a matter of legal salubrity, Article 22 is mandatory (Article 22(3)).

***Re: Article 23***

- Article 23(1)(a) provides that leases and financial leases may be terminated, "subject", though, to Article 23(1)(b) concerning financial leases; it does not, therefore, apply just to leases as such.

- Attention must be drawn to the consequences for the lessee of acceptance of the asset, whereby he is prohibited from terminating the "lease" within the financial leasing transaction (a structural ingredient of the financial lease) for fundamental default - as understood by Article 7.3.1 of the Principles (see above) – by the lessor and the supplier (Article 23(1)(b)).

- Article 23(1)(c) recalls that, a lease entailing the performance over time of the reciprocal services agreed upon, termination of the lease carries with it *cancellation for the future* of those services *not yet* performed, to the exclusion of those the performance of which is subject to termination of such agreement.

This is particularly true of the liquidated damages payable on such termination and the duty to return the asset previously leased to the owner thereof.

***Re: Article 24***

- This Article recalls the lessee's duty to return the asset (in the conditions agreed, under Article 5) to the lessor, who is still the owner thereof and who has the right freely to dispose of it, leaving aside the fact that, under a financial lease, the lessee will (frequently) have an option to purchase the asset, his exercise of such option being subject to the due performance of the lease and Article 10 concerning the irrevocability and independence of the duties of the lessor and said lessee not having the effect of cancelling this condition.

**GOVERNMENT OF THE UNITED STATES OF AMERICA**

***General comments***

The United States welcomes the adoption of the Model Law. It is an outstanding product that will bring significant benefits to developing countries and countries in transition. In many emerging economies the legal infrastructure for leasing is insufficient and as a result modern forms of leasing finance are virtually unavailable or available only at high cost. This of course sharply limits its use. The Model Law can bring about its benefits by incorporating contemporary leasing law into domestic law. This, in turn, will substantially boost the ability of end-users to have available much needed equipment and other goods at a reasonable cost. We are very pleased that a number of States have already adopted the elements of the Model Law in their national legislation and that many other States are considering doing so.

The United States wishes to thank the Secretariat and the Reporter for providing a first draft of the Official Commentary on the UNIDROIT Model Law on Leasing. We also appreciate the opportunity to submit the following comments.

***Re: Article 1* - Sphere of application**

Comment 2 on Article 1 should be clarified as follows:

> **The Law applies if the asset is within the enacting State, the centre of main interests of the lessee is within the enacting State, or the parties agree that the enacting State's law governs the transaction. There may be transactions that fall within the sphere of application of this Law as well as the law of another State. ~~of several States' laws~~ In such cases, the applicable law is determined by the private international law (conflicts of law) rules of the forum State. ~~Traditional choice of law will determine which law applies~~ This provision does not displace ~~traditional choice of~~ such private international law (conflicts of law) rules.**

***Re: Article 2* - Treatment of software in definitions of asset and lease**

Comment 1 on Article 2 (Asset) should be adjusted as follows:

Asset and Lease (intellectual property)

> **The definition of asset is sufficiently broad to include intellectual property, including software. Whether particular intellectual property qualifies as an asset will be determined on a case-by-case basis. Under the Law's definitions, in order to qualify as a lease, the transaction must be one in which the lessor "grants a right to possession and use of the asset . . . ." The Law does not define possession, thereby leaving the definition of that concept to local law. In States in which the term "possession" refers to actual physical possession of a tangible asset, "possession" cannot refer to intangible assets such as intellectual property. In that case, the Law would not apply to a transaction in which intellectual property is "leased." In States in which "possession" has a broader meaning, including concepts such as control or constructive possession of intangibles, the Law might apply to a lease of intangible assets.**

Comment

In its Submission in advance of the Joint Session and during that Session, the United States specifically requested that the Commentary include the additional language set forth above. At the Joint Session and Drafting Committee meetings there was agreement that whether intellectual property is covered by the Law turns on whether the concept of possession under other applicable law is broad enough to include intellectual property. There was also agreement in the Drafting Committee meetings that the Commentary would cover this point.

Background

"The question of whether the definition encompassed intangible property was also raised. One State noted that the issue might be resolved by reference to local law's interpretation of the term 'possession', inasmuch as local law might determine whether an intangible asset could be possessed. Some States agreed. Other States questioned whether the definition of 'asset' encompassed leases of software, films and other forms of intellectual property; it was noted that the definition of 'asset' was broad but the Joint Session did not modify the definition contained in the text." (*Summary report on the Joint Session* (Study LIXA - Doc. 16 at 3))

***Re: Article 2* – Financial lease**

Comments 1 and 2 under Financial lease should be rewritten as follows:

**1. The Law defines "financial lease" to include operating leases, that is leases that do not amortise the entire investment of the lessor.**

**2. The term "financial lease" ~~A subsequent lease of an asset that has previously been leased~~ may include a re-lease of the asset by the lessor at the end of the term of a financial lease. ~~qualify as a financial lease if it satisfies the definition of financial lease~~ The ability to re-lease the asset in a transaction that qualifies as a financial lease permits the lessor to lower the original lessee's rental payments and it similarly benefits the subsequent lessee. The requirements that the lessor acquire the asset in connection with a lease and that the supplier have knowledge of that fact are satisfied by the lessor's acquisition and the supplier's knowledge with regard to the original financial lease. ~~Sub-paragraph (b) requires that the asset be acquired in connection with a lease. This may include a previous lease.~~ So long as the supplier has the required knowledge with regard to the original lease ~~that the asset is being acquired in connection with a lease~~, there is a sufficient basis to extend to the lessee in the re-lease the duties owed by the supplier ~~to the lessee in~~ under Article 7. If the new lessee has notice at the time it enters into the lease that it is a re-lease after a financial lease or that the lessor generally engages in leases of the type that the Law refers to as financial leases, the transaction will constitute a financial lease.**

Background

"One State suggested that it be made clear that a re-lease of the same asset could qualify as a financial lease. One State questioned whether a definition of financial lease that broad would be appropriate, inasmuch as the draft model law also limited the lessor's liability in a financial lease. However, it was noted that the lessor's liability was not limited to the extent that such liability was based on any of its actions in its capacity of manufacturer or

supplier. Some States questioned whether permitting a re-lease of the same asset would eliminate the distinction between a financial lease and a lease other than a financial lease but others noted that the other requirements of a financial lease could still be met even with a re-lease. It was, therefore, agreed that the planned Commentary should reflect the fact that re-lease could qualify as a financial lease." *(Summary report on the Joint Session* (Study LIXA - Doc. 16 at 4))

***Re: Article 2* – Definition of Lessor**

Comment 1 under Lessor should be clarified as follows:

**1. A lessor may be any person who provides another person with the right to possess and use an asset under a lease without regard to any other factors. Accordingly, the fact that a lessor is a dealer that also sells assets of the type being leased does not affect the lessor's status under the definition of "lessor" or the lease's status under the definition of "lease". Similarly, in a financial lease the fact [t]hat ~~a~~ the lessor is closely affiliated with the ~~a~~ supplier ~~or is also a vendor of the asset~~ does not affect the lessor's status under the definition of "lessor" or the lease's status under the definition of "~~lease" or~~ "financial lease". As long as it is a separate entity, the lessor in a financial lease may be a wholly owned subsidiary of, or have a long-term contractual relationship with, the supplier. ~~A lessor that is also a vendor of the asset may have other duties that arise from other law.~~**

Background

"One State suggested that the preliminary draft model law should specifically address the issue of captive lessors and make it clear that a lessor did not lose its status as a lessor because it was also affiliated with a supplier. It was agreed that the future Commentary should make this clear. One State suggested that, when a lessor was also a vendor of a particular asset, supplying the asset from stock, the lessor might be entitled to certain protections offered by the financial lease but not other such protections. It was agreed that such issues should be dealt with not in the definition of supplier but rather in those Articles that afforded such protections." *(Summary report on the second session of the Committee of governmental experts* (Study LIXA - Doc. 13 at 4))

***Re: Article 3* – Exclusion of leases that create security rights**

The comments on Article 3 concerning security rights should be revised to state as follows:

**1. Article 3(1)'s reference to leases that function as security rights incorporates ~~existing~~ other State law in effect at the time the lease is entered into regarding the definition of "security right". Article 3(1) ensures that, when a transaction creates a security right as defined in other State law, this Law does not apply to any aspect of the transaction.**

2. "Security right" means a property right in a movable asset that is created by agreement and secures payment or other performance of an obligation, regardless of whether the parties have denominated the agreement as a lease agreement or the transaction creating the right as a lease."

3. It is hoped that States will adopt both the present Model Law and legislation based on the UNCITRAL Legislative Guide on Secured Transactions. In essence,

Article 3(1) makes clear that if a transaction is governed by legislation based on the UNCITRAL Guide, then the transaction falls outside the scope of this Model Law, and falls within the scope of the law governing security interests.

4. If a State that enacts the Model Law on Leasing also enacts the recommendations of the UNCITRAL Legislative Guide on Secured Transactions adopting a non-unitary approach to acquisition financing, the reference to an acquisition security in Article 3(1) should be replaced by a reference to the terms "acquisition security right, retention-of-title right and financial lease right".

Background

"To alleviate UNCITRAL's concern that the definition of financial lease could be interpreted to cover a lease that created a security right, such leases being expressly excluded from the sphere of application of the draft model law by Article 3(1), it was agreed that the planned Commentary should refer to Article 3(1)'s exclusion of leases that created security rights … A number of States recognised that the express reference in paragraph 1 to the Legislative Guide was anomalous and that a State would not be able to incorporate such a mere reference to the Legislative Guide in its implementing legislation. The observer of UNCITRAL proposed that, inasmuch as the principles of the Legislative Guide were also adopted by States implementing the future model law on leasing, the text could be amended to refer to 'other law' or something similar." (*Summary report on the Joint Session* (Study LIXA - Doc. 16 at 4-5))

"On the proposed definition of 'security right', which had been taken from the Legislative Guide, several States noted that implementing States would need to take special care to ensure that they had drawn the line between the financial lease and the security right appropriately in their existing legal systems. Accordingly, at the suggestion of the Secretary-General, it was agreed that the proposed definition be deleted from Article 2 and that guidance should be provided in the planned Commentary regarding the meaning of the term." (*idem* (in the context of the discussions within the Joint Session following the meeting of the Drafting Committee) (Study LIXA - Doc. 16 at 11))

"The UNIDROIT Secretariat's report on the history of Article 3(1) and the relationship between the preliminary draft model law and the Legislative Guide on Secured Transactions prepared by the United Nations Commission on International Trade Law (UNCITRAL) was followed by the recommendation, made jointly by the UNIDROIT and UNCITRAL Secretariats, that the reference in Article 3(1) to 'acquisition financing right' be replaced by 'acquisition security right', so as to correspond to the language contained in the UNCITRAL Legislative Guide. The Committee asked the Drafting Committee to implement this recommendation. The UNIDROIT Secretariat also conveyed a further recommendation from the UNCITRAL Secretariat that the future model law indicate, for instance in a footnote to Article 3(1), that, when States adopted both the future model law and legislation based on the recommendations of the UNCITRAL Legislative Guide adopting a non-unitary approach to acquisition financing, the reference in Article 3(1) to an acquisition security should be replaced by one to the terms 'acquisition security right, retention-of-title right and financial lease right'. The Committee endorsed this recommendation and decided that the most appropriate place to make this point clear was in the future Commentary; it was agreed that the language to be employed for this purpose should be as follows: 'If a State that enacts the Model Law on Commercial Leasing also enacts the recommendations of the UNCITRAL Legislative Guide on Secured Transactions adopting a non-unitary approach to acquisition financing, the reference to an acquisition security in Article 3(1) should be replaced by a reference to the terms acquisition security right, retention-of-title right and financial lease right'." (*Summary report on the second session of the Committee of governmental experts* (Study LIXA - Doc. 13, at 5))

" … it is hoped that States may choose to adopt both the present model law and legislation based on the UNCITRAL guide on secured transactions. Because the line between financing an acquisition using a lease and financing the transaction by means of a security interest is thin, it was important to clarify the scope of this law with respect to transactions that might appear to function as security interests. At its last session, the Committee agreed to adopt Article 3(1), which had been carefully prepared through a series of discussions between the UNIDROIT and UNCITRAL Secretariats. In essence, Article 3(1) makes clear that if a transaction is governed by legislation based on the UNCITRAL guide, then the transaction falls outside the scope of this model law on leases, and falls within the scope of the law governing security interests. This decision created important clarity for States that have laws based on both instruments." (The preliminary draft model law on commercial leasing as reviewed by the Committee of governmental experts at its first session: an introduction to its objectives and basic features (a half-day seminar addressed to the Governments and international Organisations invited to participate in the second session of the Committee of governmental experts) (Muscat, 6 April 2008): Sphere of application of model law by Brian Hauck in *Summary report on the second session of the Committee of governmental experts* (Study LIXA – Doc. 13 – Appendix VIII at 4))

***Re: Article 3* – Exclusion of large aircraft in absence of "opt-in"**

An additional comment should be added addressing the treatment of large aircraft as follows:

> 5. The Law provides that large aircraft equipment of the type covered by the Protocol to the *Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment*, adopted in Cape Town in 2001, (i.e. airframes, aircraft engines and helicopters of a certain size) are excluded from the sphere of application of the Law, unless the lessor, the lessee and the supplier otherwise agree in writing. The words "unless the lessor, the lessee and the supplier otherwise agree in writing" means "unless and to the extent" so that these three parties could agree on partial application. This exclusion removes a potential source of conflict between the Law and the Convention on International Interests in Mobile Equipment.

Background

"Under the Secretariat and the A.W.G.'s joint proposal, which was the outcome of those discussions, the idea was for paragraph 3 to be amended to exclude, subject to freedom of contract, leases of large aircraft equipment as that term was defined in the Aircraft Protocol and for a definition of such equipment to be added to Article 2 … . It was ultimately agreed that, in order to permit the future model law as broad a sphere of application as possible, to ensure that it did not interfere with the operation of the Cape Town Convention and the Aircraft Protocol in respect of large aircraft equipment, stakeholders in which had raised a particular concern, and also to ensure that the future model law not be an obstacle to operation of the Cape Town Convention in respect of other types of asset, paragraph 3 should be amended along the lines of the joint proposal … ." *(Summary report on the Joint Session* (Study LIXA - Doc. 16 at 6))

***Re: Article 5* – Freedom of contract**

Comment 1 under Article 5 should be revised to state as follows:

> **1. The Law recognises the principle of freedom of contract by providing generally that its provisions are subject to and may be varied by agreement between the lessor and lessee. There are two exceptions: Article 7**

**(concerning a lessee's right under the supply agreement) and Article 22 (concerning liquidated damages). Article 5 ensures that only those provisions that are essential for protecting the rights of the ~~weaker~~ parties ~~y~~ should be made mandatory,**

2. The principle of freedom of contract that generally underlies the Law is limited only as provided in Article 5. The fact that the Law or the Commentary refers to freedom of contract in the context of a specific provision does not create any implication regarding other provisions.

***Re: Article 6* – Effectiveness between the parties and as against third parties**

Comment 2 should be revised so that the Commentary reads as follows:

**1. Article 6 provides for the enforceability of the leasing agreement and the parties' rights and remedies between the parties and against purchasers of the asset and against creditors.**

~~**2. Article 6 can be limited by other law, i.e. law governing insolvency or secured transactions.**~~

**2. These rights and remedies may be subject to the effect of other law, e.g. insolvency law.**

***Re: Article 7* – Supply agreement**

We request that the comments be revised to add a new comment so that they read as follows:

**1. Article 7 provides that the lessee is able to enforce the rights of the lessor under the supply agreement. This provision recognises that the underlying substantive transaction is one in which the lessee acquires an asset or the use and possession of an asset from the supplier and that the lessor is a mere financier.**

2. Article 7(2) provides that, at the request of the lessee, the lessor is required to assign its rights to enforce the supply agreement to the lessee. If the lessor assigns its rights, it has no other responsibility to assist the lessee in enforcing the rights of the lessor under the supply agreement.

Background

"A number of States agreed that the lessor's transfer of documents or an assignment of its right to enforce the supply agreement would be adequate*."*(*Summary report on the Joint Session* (Study LIXA - Doc. 16 at 7))

"At the suggestion of an observer, it was agreed that paragraph 2 should be amended to make it clear that the lessor's duty to assign its rights under the supply agreement required only that the lessor assign its rights "to enforce" the supply agreement and that other rights that the lessor might have would not be affected". (*idem* (in the context of the discussions within the Joint Session following the meeting of the Drafting Committee) (Study LIXA – Doc. 16 at 10)).

***Re: Article 8* – Priority of liens**

Comment 2 should be added as follows:

**1. Article 8 provides rules for the treatment of creditors of the lessee and lessor with respect to the lease.**

2. A creditor of the lessor that obtains a lien or other right against an asset already subject to a lease, or against the lessor's rights under an existing lease, is subject to the rights and remedies of the parties under the lease.

***Re: Article 9* – Limitation of the liability of the lessor / owner**

Comments 1 – 3 under Article 9 should be revised to state as follows:

**1. Article 9 limits the liability of the financial lessor for actions taken in the course of performing its duties as lessor and as owner.**

**2. Article 9, while limiting liability based on the lessor's capacity as lessor or owner, does not exclude liability based on other grounds, i.e. fraudulent acts of the lessor, liability to the State or liability arising under the State's international obligations.**

**3. The rule provided in Article 9 differs from the rule provided in Article 8(1) of the UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988). That provision precludes~~, which bars~~ liability of the lessor in its capacity as lessor but is silent as to ~~permits~~ liability based on the lessor's capacity as owner. See Article 8(1)(c) of the Ottawa Convention. The rule in Article 9 recognises that, while the lessor in a financial lease is an owner of the asset, the lessor is essentially a conduit between the supplier and the lessee and is protected as provided in this Article because its role is limited to financing the leasing transaction.**

Background

"One State proposed that, because the lessor in a financial lease was a mere financier, the lessor should be relieved not only from liability based on its capacity of lessor but also liability based on its capacity of owner. Several States supported this proposed amendment, which was, therefore, agreed to. On the question as to whether such an exclusion of the lessor's liability should be subject to other law, it was generally agreed that it should override general liability as between the parties but that it should not override, for example, liability based on the lessor's fraudulent acts or fault, liability to the State or liability arising under the State's international obligations. The Drafting Committee was, accordingly, invited to review Article 9 in such a way as to ensure that liability based on the lessor's status as lessor and owner was excluded but that the lessor's liability on such other grounds was preserved and, in particular, to consider whether the language of Article 9 as drafted was sufficient to alleviate the last-mentioned concern and whether this concern could be addressed in the planned Commentary. It was also suggested that the planned Commentary should note that the exclusion of liability based on the lessor's capacity of owner differed from the rule provided in Article 8 of the UNIDROIT Convention on International Financial Leasing, opened to signature in Ottawa on 28 May 1988." (*Summary report on the Joint Session* (Study LIXA – Doc. 16 at 7))

"Although there was substantial agreement that a lessor should be liable for actions but not liable on the basis of its status of lessor or owner, there was disagreement as to whether the additional language proposed by the Drafting Committee – excluding liability based on the lessor's status of lessor or owner 'unless the lessor contributed to the death, personal injury or damage' – was appropriate. A number of States and one observer expressed the view that the principle was adequately expressed without that additional language and that any additional clarification could be supplied by the planned Commentary; other States, however, expressed the view that the supplying of such clarification in the planned Commentary was not sufficient. It was, therefore, ultimately agreed that Article 9 should be replaced in its entirety by the sentence 'In a financial lease, the lessor when acting in its capacity of lessor and as owner within the limits of the transaction, as documented under the supply agreement and the lease, shall not 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'. It was noted that this amendment would, moreover, necessitate a consequential modification of the definition in Article 2 of the term 'lease': the decision taken during the Joint Session to replace the term 'transaction' by 'agreement' would need to be reversed." *(idem* (in the context of the discussions within the Joint Session following the meeting of the Drafting Committee) (Study LIXA – Doc. 16 at 12))

***Re: Article 10* – Irrevocability and independence**

New comments 2 and 3 should be added so that the Commentary reads as follows:

**1. Recognising the financial lessor's role as a financier, Article 10 makes the parties' duties irrevocable and independent when the asset subject to the lease has been delivered to and accepted by the lessee.**

2. With regard to Article 10(2), notwithstanding the termination of the lease by the lessor in accordance with Article 23, the lessee may still owe the lessor duties, including maintenance and return as set forth in Article 18(2) of the Law. Typically, after the delivery and acceptance of an asset subject to a financial lease, the lessor has no continuing duties.

3. Although the lessee's executory obligations may be discharged upon the termination of the lease, the lessor's rights based on the lessee's default or performance prior to the termination survive the termination. See Article 23(2).

***Re: Article 12* – Damage to the asset**

Comment 1 should be clarified so that the overall Commentary reads as follows:

**1. Article 12 provides rules to govern the circumstance in which an asset is damaged without fault of the lessee or of the lessor. In such a circumstance, the lessee may demand inspection and either accept the asset with due compensation from the supplier for the loss in value or seek such other remedies as are provided by other law. But the lessee cannot terminate the lease once the item has been delivered and accepted, even if the equipment does not operate as a result of the damage. See Articles 10(1)(a), 14, and 23(1)(b) of this Law.**

**2. Article 12 is subject to the principle of freedom of contract. When a lessee accepts a damaged asset with due compensation from the supplier for the loss in value, Article 12 does not prevent the lessee and the lessor**

**from agreeing that such compensation is to be remitted to the lessor and applied to reduce the rentals owed.**

***Re: Article 15* – Transfer of rights and duties**

The Commentary should state as follows:

**1. To facilitate the growth of a leasing market, Article 15 of the Law, like other international instruments such as the United Nations Convention on the Assignment of Receivables in International Trade, provides for the transfer of the lessor's rights. A transfer may be for less than for all of the lessor's rights including for example, the creation of a security right in the lesssor's rights. The Article also explicitly permits parties to agree that the lessee will not assert against a transferee of the lessor's rights certain defences or rights of set-off that the lessee holds against the lessor. The reference in Article 15(1)(a)(ii) to the lessee's ability to assert defences or rights of set-off arising from the incapacity of the lessee is to a lease ~~transfer~~ that is invalid owing to the lessee's lack of legal capacity to contract.**

**2. Article 15 also provides for the transfer of the lessee's rights and the transfer of both parties' duties. The transfer is subject to the consent of the other party, which may not be unreasonably withheld.**

Background

"There was agreement that the brackets contained in sub-sub-paragraph 1(a)(ii) should be removed. At the request of one State, it was agreed that the reference to the lessee's incapacity should be explained in the planned Commentary as a reference to the lessee's lack of legal capacity." (*Summary report on the Joint Session* (Study LIXA - Doc. 16 at 9))

"A number of States agreed with the suggestion that the future model law, like other international instruments, should explicitly permit parties to agree that the lessee would not assert certain defences or rights of set-off against a transferee of the lessor, the Drafting Committee being invited by the Committee to review Article 15(1) in this connection." (*Summary report on the second session of the Committee of governmental experts* (Study LIXA - Doc. 13 at 7))

"In the course of the Committee's review of the proposal of the Drafting Committee, which was based on language taken from the 2001 United Nations Convention on the Assignment of Receivables in International Trade, it was agreed that the phrase 'other than those arising from the incapacity of the lessee' should be placed inside square brackets, as some States raised questions regarding the meaning of the term 'incapacity' in this context." (*idem* (in the context of the discussions within the Committee of governmental experts at its second session following the meeting of the Drafting Committee) (Study LIXA - Doc. 13 at 10-11))

***Re: Article 16* – Warranty of quiet possession**

The Commentary should include a new comment 3 so that the entire Commentary reads as follows:

**1. Under Article 16 ~~requires~~ a lessor ~~to~~ warrants that the lessee's quiet possession will not be disturbed. The Article ~~and~~ makes clear that, if such**

**warranty is broken, the lessee may bring an action for damages against the lessor.**

**2. The lessor's warranty of quiet possession does not interfere with any right of an owner or any other holder of an interest to take possession of the asset subject to the lease. Article 16 creates a remedy for a lessee whose quiet possession is disturbed by such an action.**

3. Article 16 is subject to the principle of freedom of contract.

Background

"One State argued that parties should be free to limit the lessor's warranty of quiet possession beyond the warranty contained in Article 16, noting the situation in which a lessor leased large volumes of assets and the parties agreed that a transfer of risk was important in those circumstances. It was, accordingly, agreed that Article 16 should be made subject to the principle of freedom of contract." (*Summary report on the Joint Session* (Study LIXA - Doc. 16 at *9*))

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

Comment 1 under Article 17 should be revised as follows**:**

**1. Under Article 17 ~~requires the~~ a lessor or, in a financial lease, the supplier ~~to~~ warrants that the asset being leased meets certain minimum requirements for such an asset in the trade.**

***Re: Article 18* – Duties of the lessee to maintain and return the asset**

Comment 1 under Article 18 should be modified as follows:

**1. Article 18(1)(a) specifies the duty of care required of the lessee in respect of the asset. Article 18(2) recognises that when a lease sets forth, as provided in Article 18(1)(b), 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 satisfies the requirements of the Law. However, the lease or technical instructions only apply to the extent they address an issue. To the extent something occurs that is not described in the lease or the instructions, the fact that there are no instructions does not insulate the lessee from complying with the provisions of Article 18(1)(a).**

***Re: Article 19* – Definition of default**

Comment 1 should be revised as follows:

**1. Article 19 provides a definition of default, but permits the parties to agree otherwise. Article 19 does not address whether a particular default is fundamental. "Fundamental default" is discussed in the Comments on Article 23.**

***Re: Article 21* – Damages**

Comment 1 should be revised to include a cross-reference to Article 22 as follows:

**1. Article 21 provides a damages rule if the parties do not otherwise agree. See Article 22 with respect to agreements liquidating damages.**

***Re: Article 22* – Liquidated damages**

Comment 1 under Article 22 should be revised as follows:

**1. Article 22(1) permits the parties to agree to a liquidated damages amount for any default. ~~so long as the amount is reasonable.~~ Article 22(2) provides that if the agreed amount is excessive in relation to the harm resulting from the default it may be reduced to a reasonable amount. Article 22(2) is not subject to the principle of freedom of contract.**

***Re: Article 23* – Termination**

The comments under Article 23 should be modified as follows:

**1. Article 23(1)(a) permits a party to terminate the agreement ~~and discharge all the parties' future duties, only~~ upon a fundamental default by the other party. A termination discharges all of the parties' future duties, but does not discharge any right based on prior default or performance.**

2. Article 23(1)(b) and (c) further provide that upon fundamental default in a financial lease after the asset subject to the lease has been delivered to and accepted by the lessee, the lessee may not terminate the lease but is entitled to such other remedies as are provided by the agreement of the parties and by law, unless the default is in respect of the warranty of quiet possession referred to in Article 16.

**3. Under Article 7.3.1 of the UNIDROIT Principles of International Commercial Contracts, whether a default amounts to a fundamental default shall be determined with regard to whether (a) the default substantially deprives the aggrieved party of what it was entitled to expect under the agreement unless the other party did not foresee and could not reasonably have foreseen such result; (b) strict compliance with the duty that has not been performed is of essence under the agreement; (c) the default is intentional or reckless; (d) the default gives the aggrieved party reason to believe that it cannot rely on the other party's future performance; and (e) the defaulting party will suffer disproportionate loss as a result of the preparation or performance of the agreement is terminated.**

4. Article 23 is subject to the principle of freedom of contract.