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PREPARATION OF A
MODEL LAW ON LEASING**

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PRELIMINARY DRAFT MODEL LAW ON LEASING

*(prepared by Mr R.M. DeKoven, Reporter, on the basis of the guidelines provided
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MODEL LAW ON LEASING

CHAPTER I: GENERAL PROVISIONS

Article 1 Sphere of application

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

Source: Uniform Commercial Code of the United States of America (hereinafter referred to as "U.C.C.") § 2A-102 (2003), supplemented to specify the Law's geographic sphere of application

Article 2 Definitions

In this Law:

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

Sources: European Union Council Regulation 1346/2000, Preamble § 13, 2000 O.J. (L 160) 1, 2, supplemented with language from UNCITRAL Model Law on Cross-Border Insolvency Art. 16.3, 30 May 1997

Default is defined in Article 22.

Equipment means all personal property that is movable or that is a fixture, including future equipment, specially manufactured equipment, and the unborn young of animals. The term does not include information, money, investment securities, or software except to the extent that the software is so embedded in equipment as to become part of the equipment, but no equipment shall cease to be equipment for the sole reason that it becomes attached or fixed to real estate.

Source: U.C.C. § 2A-103(1)(n) (2003), modified to exclude software

Financial lease means a lease that includes the following characteristics:

- (a) the lessee specifies the equipment without relying primarily on the skill and judgment of the lessor;
- (b) the lessor acquires the equipment or the right to possess and use the equipment in connection with the lease or a previous lease, and the supplier is so notified;
- (c) the rentals or other funds payable under the leasing agreement are calculated so as to take into account the amortisation of the whole or a substantial part of the cost of the equipment; and
- (d) before the leasing agreement becomes effective, the lessee either
 - (i) receives an accurate and complete statement designating the promises, warranties, disclaimers of warranties, and limitations on remedies, including those of a third party, such as the manufacturer of equipment, provided to the lessor by the supplier in connection with the supply agreement, or
 - (ii) is informed that the lessee is entitled to all the promises and warranties provided in the supply agreement, is informed that the lessee may communicate with the supplier to receive an accurate and complete statement of those promises and warranties, and is informed of the supplier's identity unless the lessee selected the supplier.

Sources: (a) UNIDROIT Convention on International Financial Leasing Art. 1(2)(a), 28 May 1988; (b) UNIDROIT Convention on International Financial Leasing Art. 1(2)(b), 28 May 1988, modified to provide coverage for equipment obtained in connection with a previous leasing arrangement; (c) UNIDROIT Convention on International Financial Leasing Art. 1(2)(c), 28 May 1988, modified to remove language requiring "particular" reference to calculation and to modify reference to rentals; (d) U.C.C. § 2A-103(1)(l)(iii)(C) & (D) (2003), modified to streamline requirements and conform in style to this draft

Lease means a transaction in which a person grants a right to possession or control of equipment to another person for use in trade or business for a term in return for rentals or other funds payable. Unless the context indicates otherwise, the term includes a sub-lease.

Sources: Convention on International Interests in Mobile Equipment Art. 1(q), 16 Nov. 2001, modified to omit reference to "with or without an option to purchase," to modify reference to rentals, and to limit definition to equipment used in trade or business and to include limitation on term

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

Source: U.C.C. § 2A-103(1)(t) (2003)

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

Source: U.C.C. § 2A-103(1)(v)

Supplier means a person from whom a lessor buys or leases equipment to be leased under a financial lease.

Source: U.C.C. § 2A-103(ff) (2003)

Article 3 Freedom of contract

Except as otherwise provided in this Law and the law of [this State], the lessor and the lessee are free to determine the content of and create a leasing agreement.

Source: Art. 1.1 UNIDROIT Principles 2004, modified to conform in style to this draft

CHAPTER II: FORMATION AND DOCUMENTATION OF LEASING AGREEMENT

Article 4 Formation

A leasing agreement may be created by the acceptance of an offer or by conduct of the parties that is sufficient to show agreement.

Sources: Art. 2.1.1 UNIDROIT Principles 2004, modified to replace "concluded" with "created"

Article 5 Interpretation

A leasing agreement shall be interpreted according to the common intention of the parties. If such intention cannot be established, the leasing agreement shall be interpreted according to the meaning that reasonable persons of the same kind as the parties to the leasing agreement would give to it in the same circumstances.

Sources: Art. 4.1 UNIDROIT Principles 2004

Article 6 Documentation

1. A leasing agreement is not enforceable against a party unless there is a record, signed by that party or that party's agent, sufficient to indicate that a leasing agreement has been made.

2. A record is not insufficient because it omits or incorrectly states a provision that is important for a determination of the parties' rights and duties.

3. When a record omits or incorrectly states such a provision, a provision that is appropriate in the circumstances shall be supplied. In determining what provision to supply, factors to consider should include the intention of the parties, good faith, fair dealing and reasonableness.

Sources: (1) U.C.C. § 2A-201(1)(b) (2003), modified to streamline language and to eliminate explicit requirement of description of equipment and lease term; (2) U.C.C. § 2A-201(3) (2003), modified to incorporate test from Art. 4.8(1) UNIDROIT Principles 2004; (3) Art. 4.8(1)-(2) UNIDROIT Principles 2004, modified to remove explicit reference to nature and purpose of contract

Article 7 Modification

A leasing agreement that contains a clause requiring modification or termination to be in a particular form may not be otherwise modified or terminated. A party may be precluded by its conduct from asserting such a clause to the extent that the other party has reasonably acted in reliance on that conduct.

Source: Art. 2.1.18 UNIDROIT Principles 2004, modified to conform in style to this draft and to remove limitation to leasing agreements "in writing" in the light of Article 6, which requires all leasing agreements to be in writing

CHAPTER III: EFFECT OF LEASING AGREEMENT

Article 8 Enforceability

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

Source: U.C.C. § 2A-301 (2003), modified to include reference to insolvency administrator

Article 9 Transfer

1. The lessor's rights and duties under the leasing agreement may be transferred except when a transfer would impair the lessee's rights in the equipment.

2. The lessee's rights and duties under the leasing agreement may be transferred only (a) with the consent of the lessor, which may not be unreasonably withheld, and (b) subject to the rights of third parties. The lessor and third parties may give their consent in advance.

3. A transfer that is prohibited is otherwise effective if made to one who did not know and reasonably should not have known that the transfer was prohibited.

Sources: (1) original draft; (2) UNIDROIT Convention on International Financial Leasing Art. 14(2), 28 May 1988, modified

to recognise that consent may not be unreasonably withheld, modified to eliminate explicit reference to right to use the equipment, and modified with language from Art. 9.3.4 UNIDROIT Principles 2004 regarding the permissibility of providing consent in advance; (3) U.C.C. § 2A-303(2) (2003), modified to remove limitation to transfers that are default events under the leasing agreement and to incorporate requirement of transferee's lack of knowledge

Article 10 Lessee under financial lease as beneficiary of supply agreement

1. (a) The benefit of a supplier's promises to the lessor under the supply agreement and of all warranties, whether express or implied, including those of any third party provided in connection with or as part of the supply agreement, extends to the lessee to the extent of the lessee's interest under a financial lease related to the supply agreement.

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

(c) Where the absence of privity of contract between the lessee and supplier creates a deficiency in the lessee's efforts to enforce the supplier's promises or warranties against the supplier, the lessor shall be bound to take commercially reasonable steps to assist the lessee. If the lessor does not take such steps, the lessor is deemed to have assumed such promises and warranties.

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

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

Sources: (1)(a) U.C.C. § 2A-209(1) (2003), modified to conform in style to this draft and to remove explicit reference to warranties and defenses; (1)(b) U.C.C. § 2A-209(2) (2003), modified to conform in style to this draft; (1)(c) original draft; (2) UNIDROIT Convention on International Financial Leasing Art. 11, 28 May 1988, modified to reflect that Article 2 defines financial lease to require the lessee be made aware of key information regarding the supply agreement, and supplemented by U.C.C. § 2A-209(3) (2003), modified to conform in style to this draft and to remove explicit reference to lessor's duties under the leasing agreement; (3) UNIDROIT Convention on International Financial Leasing Art. 10(2), 28 May 1988, modified to explicitly include modifications

Article 11 Priority of liens

1. Except as provided in paragraph 3, a creditor of the lessee and the holder of any interest in land or personal property to which the equipment becomes affixed take subject to the leasing agreement and cannot attach any interest belonging to the lessee.
2. Except as provided in paragraph 3 or otherwise provided by the law of [this State], a creditor of the lessor takes subject to the leasing agreement.
3. If a person in the ordinary course of its business furnishes services or materials with respect to equipment subject to a leasing agreement, a lien upon that equipment in the possession of that person for the materials or services takes priority over any interest of the lessor or lessee unless the law governing that lien provides otherwise.

Sources: (1) U.C.C. §2A-307(1) (2003), modified to include treatment of equipment that becomes a fixture and to bar attachment of lessee's interest; (2) U.C.C. § 2A-307(2) (2003), modified to remove exception for liens attached before lease became enforceable and to eliminate provision regarding security interest held by lessor's creditor; (3) U.C.C. § 2A-306 (2003)

Article 12 Other laws

A leasing agreement subject to this Law is also subject to any law of [this State] requiring registration of a leasing agreement. Failure to comply with such law has only the effect specified therein.

Source: U.C.C. § 2A-104(1) & (3) (2003), modified to conform in style to this draft

Article 13 Liability for death, personal injury, or property damage caused to third parties

In a financial lease, the lessor shall not, in its capacity of lessor, be liable to the lessee or third parties for death, personal injury, or damage to property caused by the equipment or the use of the equipment, unless the lessor was involved in selecting the supplier or the equipment, in which case the lessor shall be liable to the extent of that involvement.

Source: UNIDROIT Convention on International Financial Leasing Art. 8(1)(b), 28 May 1988, modified to include liability to lessee and supplemented to reflect that while the lessee's selection of equipment in a financial lease will not "primarily" rely on the lessor's expertise, the lessor may play some role in selection

CHAPTER IV: PERFORMANCE OF LEASING AGREEMENT

Article 14 Risk of loss

1. Except in a financial lease, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a financial lease, risk of loss passes to the lessee.

2. If risk of loss is to pass to the lessee and the time of passage is not stated, the risk of loss passes to the lessee upon the lessee's acceptance of the equipment.

3. If the lessee revokes acceptance of the equipment in accordance with this Law or the leasing agreement, the lessee, to the extent of any deficiency in its insurance coverage, may treat the risk of loss as having remained with the lessor or, in a financial lease, the supplier, from the beginning.

Sources: (1) U.C.C. § 2A-219(1) (2003); (2) U.C.C. § 2A-219(2) (2003), modified to reflect some Advisory Board members' suggestion that risk of loss pass upon acceptance; (3) U.C.C. § 2A-220(1)(b) (2003), modified to permit lessee to treat risk of loss as remaining with supplier in a financial lease, which is appropriate given that under Article 16 the lessee's duty to lessor becomes irrevocable upon creation of the leasing agreement

Article 15 Damage to equipment

Except in a financial lease, when equipment subject to a leasing agreement is damaged without fault of the lessee or lessor before the equipment is delivered to the lessee,

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

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

Source: U.C.C. § 2A-221 (2003), modified to eliminate reference to identification and to reflect that under Article 16, in a financial lease the lessee's duties to the lessor become irrevocable before any damage under this Article could occur

Article 16 Irrevocability

1. In a financial lease, the lessee's duties to the lessor become irrevocable and independent when the leasing agreement and supply agreement have been created.

2. In a lease other than a financial lease, the parties may agree to make the lessee's duties to the lessor irrevocable and independent at any time.

Source: (1) U.C.C. § 2A-407(1) (2003), modified to reflect that consumer leases are not covered by Model Law and to make irrevocability dependent on creation, not acceptance; (2) original draft

Article 17 Acceptance

1. Acceptance of equipment occurs when the lessee (a) signifies to the lessor or supplier that the equipment is conforming, (b) fails to reject the equipment after a reasonable opportunity to inspect it, or (c) uses the equipment in a manner inconsistent with the lessor's or supplier's rights.

2. Once a lessee has accepted equipment, the lessee may still be entitled to damages for any non-conformity, but the lessee may reject the equipment under Article 27 only if the non-conformity substantially impairs the value of the equipment and either (a) the lessee accepted the equipment without knowledge of the non-conformity, owing to the difficulty of discovering it, or (b) the lessee's acceptance was induced by the lessor's or supplier's assurances.

Sources: (1) U.C.C. § 2A-515(1) (2003), modified to streamline language; (2) U.C.C. § 2A-517(1) (2003), modified to remove limitations on revocation in financial leases and to remove option of revocation based on expectation of cure unless that expectation was induced by assurances

Article 18 Warranty of quiet possession

1. (a) In a financial lease, the lessor warrants that the lessee's quiet possession will not be disturbed by a person who has a superior title or right, or who claims a superior title or right and acts under the authority of a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor.

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

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

Source: (1)(a) UNIDROIT Convention on International Financial Leasing Art. 8(2), 28 May 1988, modified to limit warranty to acts derived from lessor's negligent or intentional act or omission; (1)(b) U.C.C. § 2A-211(3) (2003); (2) UNIDROIT Convention on International Financial Leasing Art. 8(2), 28 May 1988, modified to apply to non-financial leases and to include claims of infringement

Article 19 Warranty of merchantability

1. Except in a financial lease, a warranty that the equipment will be merchantable is implied in a leasing agreement if the lessor is a merchant with respect to equipment of that kind.

2. In a financial lease, a warranty that the equipment will be merchantable is implied in a supply agreement if the supplier is a merchant with respect to equipment of that kind.

3. Equipment to be merchantable must be at least such as (i) is accepted in the trade under the description in the leasing agreement; and (ii) is fit for the ordinary purposes for which equipment of that description is used.

Sources: (1) U.C.C. § 2A-212(1) (2003); (2) U.C.C. § 2A-212(1) (2003), modified to cover supplier; (3) U.C.C. § 2A-212(2) (2003), modified to streamline requirements for merchantability

Article 20 Warranty of fitness for a particular purpose

1. Except in a financial lease, if the lessor at the time the leasing agreement is created has reason to know of the particular purpose for which the equipment is required and that the lessee is relying on the lessor's skill or judgment to select or furnish suitable equipment, there is in the leasing agreement an implied warranty that the equipment will be fit for that purpose.

2. In a financial lease, if the supplier at the time the supply agreement is created has reason to know of the particular purpose for which the equipment is required and that the lessee is relying on the supplier's skill or judgment to select or furnish suitable equipment, there is in the supply agreement an implied warranty that the equipment will be fit for that purpose.

Sources: (1) U.C.C. § 2A-213 (2003); (2) U.C.C. § 2A-213 (2003), modified to cover supplier

Article 21 Lessee's duty to maintain the equipment

1. The lessee shall take proper care of the equipment, use the equipment reasonably in the light of the manner in which such equipment is ordinarily used and in the light of any additional understanding the parties have regarding the particular purpose for which the equipment will be used, and keep the equipment in the condition in which it was delivered, subject to fair wear and tear and to any modification of the equipment agreed by the parties.

2. When the leasing agreement comes to an end the lessee, unless exercising a right to buy the equipment or to hold the equipment on lease for a further period, shall return the equipment to the lessor in the condition specified in paragraph 1.

Sources: (1) UNIDROIT Convention on International Financial Leasing Art. 9(1), 28 May 1988, modified to incorporate standards of "ordinary use" and parties' expectations; (2) UNIDROIT Convention on International Financial Leasing Art. 9(2), 28 May 1988

CHAPTER V: DEFAULT

Article 22 Definition of default

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

2. In the absence of agreement, default for the purpose of this Chapter occurs when one party substantially deprives the other party of what it is entitled to expect under the leasing agreement and this Law.

Sources: (1) Convention on International Interests in Mobile Equipment Art. 11(1), 16 Nov. 2001; (2) Convention on International Interests in Mobile Equipment Art. 11(2), 16 Nov. 2001, modified to include expectations under the Law

Article 23 Notice

Except as otherwise provided in this Law or the leasing agreement, the lessor or lessee in default is not entitled to notice of default or notice of enforcement.

Source: U.C.C. § 2A-502 (2003), modified to conform in style to this draft

Article 24 Damages

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

Source: UNIDROIT Convention on International Financial Leasing Art. 13(2)(b), 28 May 1988, modified to apply to either aggrieved party and to make clear that damages may be combined with other remedies

Article 25 Liquidated damages

A leasing agreement that provides for the manner in which damages are to be computed is enforceable between the parties unless it would result in damages substantially in excess of those provided for under Article 24. The parties may not derogate from or vary the effect of the provisions of this Article.

Source: UNIDROIT Convention on International Financial Leasing Art. 13(3), 28 May 1988

Article 26 Termination

1. Notwithstanding Article 16, a leasing agreement may be terminated by operation of this Law, by agreement of the parties, or by an aggrieved party upon the lessee's or lessor's default.
2. On termination, all duties under the leasing agreement that are executory on both sides are discharged but any right based on prior default or performance survives.
3. The right of a party to terminate the leasing agreement is exercised by notice to the other party.

Sources: (1) original draft; (2) U.C.C. § 2A-505(2) (2003), modified to conform in style to this draft; (3) Art. 7.3.2(1) UNIDROIT Principles 2004

Article 27 Rejection of non-conforming delivery

1. (a) When the equipment is not delivered or is delivered late or fails to conform to the leasing agreement, the lessee has the right to accept the equipment, to reject the equipment

in whole or in part, or, in a lease other than a financial lease, and subject to paragraph 1 of this Article, Article 22 and Article 26(1), to terminate the leasing agreement.

(b) Rejection of equipment or termination of the leasing agreement under the preceding sub-paragraph must be within a reasonable time after the non-conforming delivery.

2. (a) When a lessee rejects equipment in accordance with this Law or the leasing agreement while the lessee's duties are revocable, the lessee is entitled to withhold rentals until the non-conforming delivery has been remedied.

(b) When a lessee terminates a leasing agreement in accordance with the preceding paragraph or the leasing agreement while the lessee's duties are revocable, the lessee is entitled to recover any rentals and other funds paid in advance, less a reasonable sum for any benefit the lessee has derived from the equipment.

(c) When a lessee, in accordance with this Law or the leasing agreement, rejects equipment in its possession, the lessee has a duty to hold the equipment with reasonable care for a time sufficient to permit the lessor or supplier to remove it.

3. If the lessee rejects equipment or revokes acceptance of equipment in accordance with this Law or the leasing agreement and the time for performance has not expired, the lessor or, in a financial lease, the supplier, has the right to remedy its failure within the agreed time.

Sources: (1)(a) UNIDROIT Convention on International Financial Leasing Art. 12(1), 28 May 1988, modified to add explicit right to reject the equipment "in part," and to limit the right to terminate to non-financial leases and to condition that right on the occurrence of a default; (1)(b) U.C.C. § 2A-509(2) (2003), modified to cover termination; (2)(a) UNIDROIT Convention on International Financial Leasing Art. 12(3), 28 May 1988, modified to make lessee's power to withhold rentals dependent on the lessee's duties being revocable; (2)(b) UNIDROIT Convention on International Financial Leasing Art. 12(4), 28 May 1988, modified to limit remedy to terminations while the lessee's duties are revocable; (2)(c) U.C.C. § 2A-509(3)(b) (2003); (3) UNIDROIT Convention on International Financial Leasing Art. 12(1)(b), 28 May 1988, modified with language from U.C.C. § 2A-513(1) to require that cure come within the agreed time

Article 28 Lessor's right to the equipment

1. Subject to the rights of a transferee under Article 9(3), upon termination of the leasing agreement by the lessor, the lessor has the right to take possession of the equipment. The lessor may proceed without judicial process if it can be done without breach of the peace.

2. Upon termination of the leasing agreement by the lessor, the lessor has the right to dispose of the equipment in its possession.

Source: (1) U.C.C. § 2A-525(2) (2003), modified to make right to repossession dependent on termination rather than default, and U.C.C. § 2A-525(3) (2003); (2) original draft

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