

# FINANCIAL LEASING UNDER THE UNIDROIT CONVENTION AND THE UNIFORM COMMERCIAL CODE: A COMPARATIVE ANALYSIS

David A. Levy\*

## I. INTRODUCTION

International equipment leasing has emerged as an important means of economic development in the global marketplace,<sup>1</sup> particularly where capital intensive acquisitions such as aircraft, ships, or machinery are involved.<sup>2</sup> Heretofore, financial developments have outpaced the evolution of sound legal theories<sup>3</sup> which are adapted to the *sui generis* form of the financial lease.<sup>4</sup>

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\* David A. Levy is a graduate of the School of Law at Southern Methodist University and is a member of the Pennsylvania Bar. He is the editor of the GULF WAR CLAIMS REPORTER and has written on the subject of Bulgarian legal development. Mr. Levy is the Kronstein Visiting Research Fellow at the International Law Institute and has previously worked in the area of commercial and trade law harmonization with the Office of the Assistant Legal Adviser for Private International Law, U.S. Department of State.

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1. Lawrence M. Taylor, Jr., *International Leasing*, in 2 EQUIPMENT LEASING-LEVERAGED LEASING 1223, 1223 (Bruce E. Fritch et al. eds., 3d ed. 1988). See also Ian Shrank, *Cross-Border Leasing*, in HOT ISSUES IN EQUIPMENT LEASING 1, 1 (A.B.A. Section of Business Law ed., 1994). For an excellent discussion of the advantages and disadvantages of financial leasing in the context of economic development, see Jack L. Upper, *Asset Financing: Capital Equipment Leasing* (Economic Development Institute Seminar Paper 29, 1984). For a discussion of the impact of leasing in Europe, Latin America, and Asia, see Taylor, *supra*, at 1226-30. See also *Draft Convention on International Financial Leasing with Explanatory Report*, UNIDROIT Study LIX, at 20-22, Doc. 48 (1987) [hereinafter Secretariat Report].

2. Taylor, *supra* note 1, at 1225.

3. *Id.* at 1238. "[I]n many . . . jurisdictions around the world, leasing may have been introduced as a financial product by foreigners before local laws and regulations had been promulgated to deal with any of the[ ] conceptual issues." *Id.*

4. A financial leasing transaction involves three parties: (a) the lessee, who selects the equipment from the supplier and pays rent to the lessor for the right to use the equipment; (b) the supplier, who provides the equipment specified by the lessee and who is paid for the equipment by the lessor in the supply agreement; and (c) the lessor, whose basic function is that of a financier—to purchase the equipment specified by the lessee from the supplier under the supply agreement, and to enter into a leasing agreement with the lessee granting the lessee the right to use the equipment in exchange for payment. Peter Breslauer, *Finance Lease, Hell or High Water Clause, and Third Party Beneficiary Theory in Article 2A of the Uniform*

National laws vary considerably<sup>5</sup>—or are nonexistent—thus giving rise to commercial uncertainty and hindering the utilization of financial leasing as a vehicle for international economic development.<sup>6</sup>

Recognizing the need for certainty in international trade, the International Institute for the Unification of Private Law (UNIDROIT) began work in 1974 on a set of Draft Rules designed to govern "the civil and commercial aspects"<sup>7</sup> of international financial leasing. The effort culminated in a multilateral convention. Both the UNIDROIT Convention on International Financial Leasing and its companion instrument, the UNIDROIT Convention on International Factoring,<sup>8</sup> were the end result of a diplomatic conference of fifty-five participating States,<sup>9</sup> four observer States,<sup>10</sup> and seven intergovernmental

*Commercial Code*, 77 CORNELL L. REV. 318, 319-20 (1992). See also U.C.C. § 2A-103(1)(g) (1990); UNIDROIT Convention on International Financial Leasing, May 28, 1988, art. 1, 27 I.L.M. 931 (1988) [hereinafter Leasing Convention].

5. States that have statutes directly affecting financial leasing include Belgium, Brazil, Canada, France, Spain, and those jurisdictions in the United States that have enacted Article 2A of the U.C.C. Ronald Cuming, *Legal Regulation of International Financial Leasing: The 1988 Ottawa Convention*, 7 ARIZ. J. INT'L & COMP. L. 39, 41 n.5 (1989). Although the Convention is designed to govern international leases, many states which lack a modern leasing law may model their domestic laws upon the Convention. Martin Stanford, *Striking a Fair Balance*, ASSET FIN. & LEASING DIG., Nov. 1988, at 5. In the absence of a modern law governing leasing, such as U.C.C. Article 2A, many legal systems have been forced to conceptually view a single leasing transaction as being two separate contracts: a supply contract between the supplier and lessor, and a bailment contract between the lessor and lessee. Walter E. May, Note, *International Equipment Leasing: The UNIDROIT Draft Convention*, 22 COLUM. J. TRANSNAT'L L. 333, 338 (1984). Bifurcating the financial leasing transaction ignores the interrelationship of the dual contracts—the leasing agreement and the supply agreement—thereby creating commercial uncertainty between the respective parties. *Id.*

6. Financial leasing serves as a vehicle for international development by (1) providing access to foreign capital; (2) permitting the leased equipment to be acquired earlier than if purchased outright, thereby paying for itself through increased productivity; and (3) by expanding the market for both the supplier and lessor/financier. Taylor, *supra* note 1, at 1232-34.

7. The Convention is intended to govern only the "civil and commercial aspects of international leasing" while leaving accounting and taxation issues to applicable domestic law. Stanford, *supra* note 5, at 5; Leasing Convention, *supra* note 4, pmb1.

8. UNIDROIT Convention on International Factoring, May 28, 1988, 27 I.L.M. 943 (1988).

9. UNIDROIT listed the 55 states that participated in the Ottawa Diplomatic Conference as being:

"the People's Democratic Republic of Algeria; the People's Republic of Angola; Antigua and Barbuda; Australia; the Republic of Austria; the Kingdom of Belgium; the Federative Republic of Brazil; the People's Republic of Bulgaria; the Republic of Burundi; the Republic of Cameroon; Canada; the Republic of Chile; the People's Republic of China; the Republic of Colombia; the Republic of Cuba; the Czechoslovak Socialist Republic; the Kingdom of Denmark; the Dominican

organizations<sup>11</sup> hosted by the Canadian government in Ottawa in May, 1988.<sup>12</sup> The United States signed<sup>13</sup> the UNIDROIT Convention on International Financial Leasing on December 28, 1990.<sup>14</sup> The Convention requires ratification or accession by three States,<sup>15</sup> and, as of this writing, has yet to become effective.<sup>16</sup>

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Republic; the Arab Republic of Egypt; the Republic of El Salvador; the Republic of Finland; the Republic of France; the Federal Republic of Germany; the Republic of Ghana; the Hellenic Republic; the Republic of Guinea; the Hungarian People's Republic; the Republic of India; Ireland; the Italian Republic; Japan; the Republic of Korea; the Lebanese Republic; the United Mexican States; the Kingdom of Morocco; the Kingdom of the Netherlands; the Federal Republic of Nigeria; the Kingdom of Norway; the Republic of the Philippines; the Polish People's Republic; the Portuguese Republic; the Republic of Senegal; the Kingdom of Spain; the Democratic Republic of the Sudan; the Kingdom of Sweden; the Swiss Confederation; the Kingdom of Thailand; the Republic of Turkey; the Union of Soviet Socialist Republics; the United Kingdom of Great Britain and Northern Ireland; the United Republic of Tanzania; the United States of America; the Republic of Venezuela; the Socialist Federal Republic of Yugoslavia; and the Republic of Zaire."

UNIDROIT Final Act of the Diplomatic Conference for the Adoption of the Draft UNIDROIT Conventions on International Factoring and International Financial Leasing, May 28, 1988, at 1, 27 I.L.M. 927 (1988).

10. The four States which sent observers to the Conference were Malaysia, the Republic of Peru, the Republic of Uganda, and the Eastern Republic of Uruguay. *Id.*

11. The seven intergovernmental organizations represented by observers to the Conference were the Commission of the European Union, the Council of Europe, the Hague Conference on Private International Law, the Organization of American States, the United Nations Commission on International Trade Law (UNCITRAL), the United Nations Conference on Trade and Development (UNCTAD), and the World Bank. *Id.* at 2.

12. Peter H. Pfund, *International Unification of Private Law: A Report on U.S. Participation—1987-88*, 22 INT'L LAW. 1157, 1163 (1988).

13. Under United States treaty practice, the act of signing a treaty does not give that instrument the binding force of law; rather it is deemed to "represent political approval and at least a moral obligation to seek ratification." A signed treaty must then be submitted by the executive branch to the Senate for its advice and consent pursuant to Article 2, Section 2 of the United States Constitution. RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 312 cmts. d, j (1986).

14. *Recent Actions Regarding Treaties to Which the United States is a Party*, 30 I.L.M. 573 (1991).

15. Leasing Convention, *supra* note 4, art. 16(1).

16. Letter from Valerie Hughes, Senior Counsel, Constitutional and International Law, Department of Justice, Canada, to David A. Levy, Legal Extern, State Department, Office of the Legal Adviser, Private International Law (Feb. 18, 1994) (on file with the State Department). The two countries which have ratified the Leasing Convention are France and Italy, with France having made the declaration permitted under Article 20. Letter from Valerie

First, this paper examines the UNIDROIT Convention on International Financial Leasing (Leasing Convention) from an American commercial law perspective by comparing it with Article 2A of the Uniform Commercial Code (U.C.C.),<sup>17</sup> which is a modern national law governing domestic commercial leasing.<sup>18</sup> The Convention embodies principles which are familiar to U.C.C.

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Hughes, Senior Counsel, Constitutional and International Law, Department of Justice, Canada, to David A. Levy (Sept. 1, 1994) (on file with the State Department) [hereinafter Letter from Hughes]. See discussion of Article 20, *infra* note 51.

17. For a useful overview of Article 2A, see generally Amelia H. Boss, *The History of Article 2A: A Lesson for Practitioner and Scholar Alike*, 39 ALA. L. REV. 575 (1988); Edwin E. Huddleson, III, *Old Wine in New Bottles: U.C.C. Article 2A—Leases*, 39 ALA. L. REV. 615 (1988). For an excellent discussion of issues concerning equipment leases generally, see Fritch et al., *supra* note 1.

18. As of this writing, Article 2A has been enacted in 42 American jurisdictions: Alabama, ALA. CODE §§ 7-2A-101 to -532 (1993); Alaska, ALASKA STAT. §§ 45.12.101 to .532 (1993); Arizona, ARIZ. REV. STAT. ANN. §§ 47-2A101 to -2A532 (Supp. 1994); Arkansas, ARK. CODE ANN. §§ 4-2A-101 to -532 (Michie Supp. 1993); California, CAL. COM. CODE §§ 10101 to 10532 (West Supp. 1994); Colorado, COLO. REV. STAT. §§ 4-2.5-101 to -533 (1992); Delaware, DEL. CODE ANN. tit. 6, §§ 2A-101 to -532 (1993); the District of Columbia, D.C. CODE ANN. §§ 28:2A-101 to -532 (Supp. 1994); Florida, FLA. STAT. ANN. ch. 680.1011 to .532 (Harrison Supp. 1992); Georgia, GA. CODE ANN. §§ 11-2A-101 to -532 (Michie Supp. 1994); Hawaii, HAW. REV. STAT. §§ 490:2A-101 to -532 (Supp. 1992); Idaho, IDAHO CODE §§ 28-12-101 to -532 (Supp. 1994); Illinois, ILL. ANN. STAT. ch. 810, paras. 5/2A-101 to -532 (Smith-Hurd 1993); Indiana, IND. CODE ANN. §§ 26-1-2.1-101 to -532 (Burns 1992); Kansas, KAN. STAT. ANN. §§ 84-2a-101 to -532 (Supp. 1993); Kentucky, KY. REV. STAT. ANN. §§ 355.2A-101 to -532 (Baldwin 1994); Maine, ME. REV. STAT. ANN. tit. 11, §§ 2-1101 to -1532 (West Supp. 1994); Maryland, MD. CODE ANN., COM. LAW I §§ 2A-101 to -532 (Supp. 1994); Michigan, MICH. COMP. LAWS ANN. §§ 440.2801 to .2982 (West 1994); Minnesota, MINN. STAT. ANN. §§ 336.2A-101 to -531 (West Supp. 1994); Missouri, MO. ANN. STAT. §§ 400.2A-101 to -532 (Vernon Supp. 1993); Montana, MONT. CODE ANN. §§ 30-2A-101 to -532 (1991); Nebraska, NEB. REV. STAT. §§ 2A-101 to -532 (1994); Nevada, NEV. REV. STAT. §§ 104A.2101 to .2532 (1993); New Hampshire, N.H. REV. STAT. ANN. §§ 382-A:2A-101 to -532 (1994); New Mexico, N.M. STAT. ANN. §§ 55-2A-101 to -532 (Michie Supp. 1993); New York, N.Y. U.C.C. LAW §§ 2-A-101 to -532 (McKinney Supp. 1995) (effective June 30, 1995); North Carolina, N.C. GEN. STAT. §§ 25-2A-101 to -532 (Supp. 1994); North Dakota, N.D. CENT. CODE §§ 41-02.1-01 to -80 (Supp. 1993); Ohio, OHIO REV. CODE ANN. §§ 1310.01 to .78 (Anderson 1993); Oklahoma, OKLA. STAT. ANN. tit. 12A, §§ 2A-101 to -532 (West Supp. 1995); Oregon, OR. REV. STAT. §§ 72A.1010 to .5310 (1993); Pennsylvania, 13 PA. CONS. STAT. ANN. §§ 2A101 to 532 (Supp. 1994); Rhode Island, R.I. GEN. LAWS §§ 6A-2.1-101 to -532 (1992); South Dakota, S.D. CODIFIED LAWS ANN. §§ 57A-2A-101 to -531 (Supp. 1994); Tennessee, TENN. CODE ANN. §§ 47-2A-101 to -532 (Supp. 1994); Texas, TEX. BUS. & COM. CODE ANN. §§ 2A.101 to .532 (West 1994); Utah, UTAH CODE ANN. §§ 70A-2a-101 to -532 (Supp. 1994); Virginia, VA. CODE ANN. §§ 8.2A-101 to -531 (Michie Supp. 1994); Washington, WASH. REV. CODE ANN. §§ 62A.2A-101 to -532 (West Supp. 1994); Wisconsin, WIS. STAT. ANN. §§ 411.101 to .532 (West Supp. 1993); and Wyoming, WYO. STAT. §§ 34.1-2.A-101 to -532 (1994).

practitioners, including the obligation of good faith,<sup>19</sup> "expectation-type" damages,<sup>20</sup> and the right of the parties to freely contract, subject to certain mandatory protections.<sup>21</sup> Second, this paper contends that the United States should ratify the Leasing Convention in order to protect the interests of American lessors who wish to enter into international leasing transactions secure in the enforceability of their contracts.<sup>22</sup>

### A. *The History of UNIDROIT*

The International Institute for the Unification of Private Law (UNIDROIT) was founded in 1926 by the League of Nations for the purpose of "exam[in]g ways of harmonizing and co-ordinating the private law of States and groups of States, and to prepare gradually for the adoption by the various States of uniform legislation in the field of private law."<sup>23</sup> UNIDROIT's offices are in Rome, and it is today an autonomous international organization.<sup>24</sup> The United States joined UNIDROIT in 1964<sup>25</sup> in recognition of the need to participate more actively in international law unification.<sup>26</sup>

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19. Compare Leasing Convention, *supra* note 4, art. 6 (setting forth the need to interpret the convention with regard to "observance of good faith in international trade") with U.C.C. § 1-203 ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.").

20. Leasing Convention, *supra* note 4, art. 13(2)(b); U.C.C. § 1-106.

21. Leasing Convention, *supra* note 4, art. 5. The comment to U.C.C. § 2A-101 emphasizes this point by stating that the codification of leases in Article 2A "was greatly influenced by the fundamental tenet of the common law as it developed with respect to leases of goods: freedom of the parties to contract. . . . to vary the effect of the provisions . . . subject to certain limitations . . ." U.C.C. § 2A-101 cmt. (1987). See also U.C.C. §§ 2A-103(4), 1-102(3).

22. The full text of the Leasing Convention has been provided as an appendix to this article for ease of reference.

23. Statute of the International Institute for the Unification of Private Law, done at Rome Mar. 15, 1940, art. 1, 15 U.S.T. 2494, 2504, T.I.A.S. 5743 (entered into force July 15, 1955; for the U.S., Mar. 13, 1964). Amendments: June 15-16, 1965, 19 U.S.T. 7802, T.I.A.S. No. 6611; Dec. 18, 1967, 20 U.S.T. 2529, T.I.A.S. No. 6716; Feb. 18, 1968, 30 U.S.T. 5663, T.I.A.S. No. 9519.

24. May, *supra* note 5, at 334 n.7.

25. Peter H. Pfund & George Taft, *Congress' Role in the International Unification of Private Law*, 16 GA. J. INT'L & COMP. L. 671, 673 (1986). See also 22 U.S.C. § 269(g) (1988) (authorizing membership and participation in Hague Conference and UNIDROIT).

26. Peter H. Pfund, *United States Participation in Transnational Lawmaking*, in LEX MERCATORIA AND ARBITRATION: A DISCUSSION OF THE NEW LAW MERCHANT 167, 177 (Thomas E. Carbonneau ed., 1990).

## B. *Financial Leasing Defined*

Financial leasing represents a "distinctive triangular relationship"<sup>27</sup> requiring three discrete parties:<sup>28</sup> (1) a lessor who advances funds for the purchase of the equipment which constitutes the subject of the leasing transaction, (2) a lessee who selects the equipment and pays a rental fee for the right to use it, and (3) a supplier who sells the equipment to the lessor.<sup>29</sup> Financial leasing also links two separate, albeit interrelated, contracts: a leasing agreement between the lessor and lessee, and a supply agreement between the supplier and lessor.<sup>30</sup>

Article 1 of the Leasing Convention sets forth the basic financial leasing transaction to which it applies and defines the relationship of the parties. Paragraph (1) states that the lessor is provided with equipment specifications by the lessee, and then, using those specifications, enters into a "supply agreement" to obtain the equipment from the supplier. The equipment may be "plant, capital goods, or other equipment," according to the lessee's specifications,<sup>31</sup> and the lessee has the right to approve the terms of the supply agreement entered into "so far as they concern its interests."<sup>32</sup> This

27. The Leasing Convention explicitly recognizes the "distinctive triangular relationship" created by the financial leasing transaction. Leasing Convention, *supra* note 4, pmb1. *See also* U.C.C. § 2A-103 cmt. g ("A finance lease is the product of a three party transaction.").

28. Note that the Leasing Convention by its terms is inapplicable to a simple bilateral lease, for example, where the supplier and the lessor are one and the same. Leasing Convention, *supra* note 4, art. 1(1)(a). The rationale for providing special protection for the lessor in a finance lease whose function is that of a financier does not exist where the lessor plays the more active role of the supplier. Secretariat Report, *supra* note 1, at 32. Consistently throughout the Convention, the more the lessor deviates from the role of financier, the greater is the assumed liability. *See, e.g.*, Leasing Convention, *supra* note 4, art. 8(1) (lessor's liability increased where "lessee has suffered loss as the result of its reliance on the lessor's skill and judgment and of the lessor's intervention in the selection of the supplier or the specifications of the equipment.").

29. "The reality of financial leasing is indeed that the technical specifications of the equipment, the terms of payment and delivery are worked out directly between the lessee and the supplier, with delivery being made directly by the supplier to the lessee." Secretariat Report, *supra* note 1, at 35.

30. Breslauer, *supra* note 4, at 319-20.

31. Leasing Convention, *supra* note 4, art. 1(1)(a). Moreover, the law of the Convention continues to apply between those parties even where the equipment "has become a fixture to or incorporated in land." *Id.* art. 4(1). Aircraft and other movables are expressly included. *Id.* art. 7(3).

32. *Id.* art. 1(1)(a). This right of approval becomes important as the Convention provides that the lessee effectively becomes the beneficiary of the supplier's warranties "as if it were a party to [the supply agreement] and as if the equipment were . . . supplied directly to the lessee." *Id.* art. 10(1). *Accord* U.C.C. § 2A-209(1).

definition of financial leasing under the Convention is consistent with the conception of a "finance lease" under U.C.C. Section 2A-103(g).<sup>33</sup>

Article 1, paragraph (2) of the Convention sets forth three criteria that must be met in order for the Convention to apply. First, the lessee must specify the equipment and select the supplier "without relying *primarily* on the skill and judgment of the lessor."<sup>34</sup> Second, the lessor must acquire the equipment in connection with the leasing agreement, and the supplier must know that the leasing agreement has been, or will be, entered into between the lessor and the lessee.<sup>35</sup> Third, rentals under the leasing agreement must "take into

33. Comment (g) to U.C.C. Section 2A-103 states:

A finance lease is the product of a three party transaction. The supplier manufactures or supplies the goods pursuant to the lessee's specification, perhaps even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor (as buyer or prime lessee) or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and lessee then enter into a lease or sublease of the goods. Due to the limited function usually performed by the lessor, the lessee looks almost entirely to the supplier for representations, covenants and warranties.

*Id.* Note that under the U.C.C., in order to qualify as a finance lease, a transaction must first satisfy the definition of a "lease" under 2A-103(1)(j): "a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale and return, or retention or creation of a security interest is not a lease." U.C.C. § 2A-103(g) cmt. g.

34. Leasing Convention, *supra* note 4, art. 1(2)(a) (emphasis added). While the use of the term "primarily" suggests that the lessor may take steps to protect its investment by recommending a particular type of equipment or a dependable supplier, the lessor who does more than simply finance the transaction creates a greater potential for liability both to the lessee and to third parties. Secretariat Report, *supra* note 1, at 39. Article 8(1)(a) states that the lessor shall not incur any liability to the lessee in respect of the equipment save to the extent that the lessee has suffered loss as the result of its reliance on the lessor's skill and judgment *and of the lessor's intervention in the selection of the supplier or the specifications of the equipment.*

Leasing Convention, *supra* note 4, art 8(1)(a) (emphasis added). The U.C.C. similarly states that in a finance lease in which the lessor does more than simply supply funds, "express warranties, covenants, and the common law will protect the lessee." U.C.C. § 2A-103 cmt. g. However, the Code explicitly provides that there is no implied warranty of fitness for a particular purpose in a finance lease. U.C.C. § 2A-213.

35. Leasing Convention, *supra* note 4, art. 1(2)(b). Prof. Ronald Cuming, the chief spokesperson for the Canadian delegation at the Ottawa Diplomatic Conference, points out that while the supplier must be aware that the equipment is being acquired in order to lease to the lessee, there is no requirement that the supplier be aware that the Convention will govern the leasing transaction. Because a primary goal of the Convention is to shift liability from the lessor to the supplier, suppliers who deal with foreign lessors risk facing additional potential

account in particular the amortisation of the whole or a substantial part of the equipment."<sup>36</sup> Paragraph (3) states that the Convention is applicable whether or not the lessee has the right to purchase the equipment or extend the lease period, and "whether or not for a nominal price or rental."<sup>37</sup>

### C. *International Commercial Leases*

The Leasing Convention was drafted to apply to international leases necessitating, at a minimum, that the parties to the leasing agreement,<sup>38</sup> the lessor and lessee, have their places of business in different Contracting States.<sup>39</sup> The supplier, the third essential party to the international financial lease, may have its place of business in the same Contracting State as the lessor or the lessee, or in a third-party State, provided that both the supply and leasing agreements are governed by the law of a Contracting State,<sup>40</sup> either through affirmative choice of law, or by virtue of conflicts rules.

If all three parties choose to do so, they may elect to exclude the Convention *in toto*.<sup>41</sup> However, the Convention permits the parties "in their relations with each other" to vary the effect of any of the Convention's

liability without being aware of the consequences. Cuming, *supra* note 5, at 54. *See also* Leasing Convention, *supra* note 4, art. 10.

36. Leasing Convention, *supra* note 4, art. 1(2)(c). Because under the Code, a finance lease must *a fortiori* qualify as a lease, U.C.C. § 2A-103(j), whether the obligations under the lease exceed the economic life of the leased goods is an important factor in U.C.C. Section 1-201(37) for determining whether a given transaction is a true lease or a "disguised" security interest governed by Article 9. This is a fact-specific determination that focuses on the economics of the transaction in question. U.C.C. § 1-201(37) & cmt. 37. This is not merely an exercise in semantics. If the transaction is determined to be a security interest disguised as a lease, the lessor will be required to file a financing statement to perfect its rights in the equipment as against the competing claims of third parties. U.C.C. § 2A-101 cmt. *See also* Edwin E. Huddleson III, *New Developments: Article 2A Leases of Goods*, in *COMMERCIAL LAW ANNUAL* 115, 117-23 (Louis F. & Patrick Del Duca eds., 1993) [hereinafter *New Developments*].

37. Leasing Convention, *supra* note 4, art. 1(3). Note that under U.C.C. Section 1-201(37), a purchase option of the leased equipment for nominal consideration is a factor which identifies a transaction as creating a security interest, rather than a true lease.

38. The drafters of the Leasing Convention focused on the leasing agreement to establish the international character of the lease because it represents the "fundamental legal relationship contained within the complex financial leasing transaction. . . ." Secretariat Report, *supra* note 1, at 42.

39. The Convention defines "place of business" as being that which has the "closest relationship to the relevant agreement and its performance." Leasing Convention, *supra* note 4, art. 3(2).

40. *Id.* art. 3(1).

41. *Id.* art. 5(1).



provisions.<sup>42</sup> The only exceptions to this permission are in Article 8(3) (lessor's warranty of quiet possession—intentional or grossly negligent acts of the lessor); Article 13(3)(b) (lessor's damages in the event of default by lessee); and Article 13(4) (acceleration of rentals due). The Leasing Convention thus follows the traditional principle of freedom of contract subject to limited mandatory provisions, which is generally consistent with Section 1-102(3) of the Uniform Commercial Code.<sup>43</sup>

Consumer leasing transactions are explicitly excluded from the Convention,<sup>44</sup> which also is inapplicable to leases purely of real estate.<sup>45</sup> Martin Stanford, Senior Research Adviser of UNIDROIT, observes that these limitations are a result of the different concerns underlying consumer and commercial laws, the limited instances of consumer leasing at the international level, and the impracticality of intertwining real and chattel property concepts into a single, uniform international law.<sup>46</sup>

42. *Id.* art. 5(2).

43. U.C.C. Section 1-102(3) states as a general principle that:

The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

*See also* U.C.C. § 2A-101 cmt., *supra* note 21.

44. The Convention does not apply to equipment which is leased "primarily for the lessee's personal, family, or household purposes." Leasing Convention, *supra* note 4, art. 1(4). By contrast, a financial lease under U.C.C. Section 2A-103(g)(iii) may be either a commercial or consumer transaction. The rationale for insulating a financial lessor against tort liability to third parties is weaker when consumer transactions are involved. The Code leaves consumer protection in leasing transactions primarily up to other law. U.C.C. § 2A-104(1)(c) & cmt. 4.

45. *See* Leasing Convention, *supra* note 4, art. 4(2):

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

The effect of this provision is that while the Convention was never intended to apply to real estate, it may potentially be applicable depending on the interpretation of the term "plant" in national courts. Secretariat Report, *supra* note 1, at 37. Section 2A-309(2) of the Code avoids this distinction by stating that "no lease exists under this Article of ordinary building materials incorporated into an improvement on land."

46. Stanford, *supra* note 5, at 5.

## II. LESSOR-LESSEE RELATIONSHIP

The leasing agreement, which gives rise to the lessor-lessee relationship, represents the core transaction in financial leasing. The treatment of the lessor and lessee under the Convention is substantially in accord with the rights and remedies of the respective parties set forth in the Uniform Commercial Code.

Financial leasing is a hybrid transaction; the concerns of the lessee parallel those of a buyer in a sales transaction, while the lessor's are those of a financier, rather than a seller of goods. The lessee wants to be able to use the equipment that it selects free from the competing claims of third parties, such as the seller's creditors, and with essentially the same warranty protection it would have if it had purchased the equipment from the supplier directly.

The lessor, on the other hand, wants to be guaranteed the right to receive payment from the lessee without the concern of liability (particularly products liability) exposure to third parties. This concern is due to the fact that the lessee selects the equipment regardless of its operational fitness.<sup>47</sup> Because of its limited involvement with the selection and acquisition of the equipment, the lessor seeks to maintain the supplier's warranty responsibility. Equally important, the lessor seeks assurance of the maintenance of its rights in the leased equipment in the event of the lessee's insolvency. The Convention addresses and clarifies each of these concerns.

### A. Lessor's Warranty of Quiet Possession

Both the Leasing Convention<sup>48</sup> and the Uniform Commercial Code<sup>49</sup> provide a lessor's warranty of quiet possession. Article 8(2) of the Leasing Convention states that "[t]he lessor warrants that the lessee's quiet possession will not be disturbed [unless such disturbance is] derived from an act or

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47. The drafters of the Convention, in recognition of this point, stated in the Secretariat Report:

[I]t would be morally indefensible for a lessee that has had ample opportunity to check on the technical suitability of the equipment required by it prior to delivery to be able to blame the lessor for its own bad choice when the equipment on delivery proves to be unsuited to its requirements.

Secretariat Report, *supra* note 1, at 38.

48. Leasing Convention, *supra* note 4, art. 8(2)-(4).

49. U.C.C. § 2A-211(1). "There is in a lease contract a warranty that for the lease term no person holds a claim to or interest in the goods that arose from an act or omission of the lessor . . . which will interfere with the lessee's enjoyment of the leasehold interest." Note that unlike the broader warranty stated in Article 8 of the Leasing Convention, the lessor under U.C.C. Section 2A-211(1) only warrants against conflicting claims that arise from the lessor's own acts or omissions.

omission of the lessee." Consequently, the lessor is deemed liable for any conflicting claims on the leased equipment brought by third parties, except those caused by the lessee.

The liability of the lessor for breaches of the warranty of quiet possession may, however, be contractually limited, subject to two exceptions: the mandatory provisions under paragraphs (3) and (4). Paragraph (3) states that the lessor cannot contract away responsibility for grossly negligent or intentional acts that give rise to superior claims in the equipment. Paragraph (4) provides that if a broader warranty of quiet possession is mandatory under the law governing the contract as determined by conflicts of law rules, attempts at disclaimer are ineffective.<sup>50</sup>

The rationale behind requiring a broad warranty of quiet possession, while perhaps understandable in domestic consumer transactions, makes little sense in the context of international commercial leasing. Effectively, the lessor is required to act as a title insurer, and presumably passes the cost of the risk to the lessee. This overlooks the fact that it is the lessee that selects both the leased equipment and the supplier, and arguably is in a better position to evaluate the reliability of title to the leased equipment. The well-advised lessor consequently will seek: (1) to narrow the scope of the warranty contractually, as is common practice in financial leasing, (2) to press the supplier and the lessee to exclude the Convention entirely,<sup>51</sup> or (3) to avoid the transaction altogether.<sup>52</sup>

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50. Leasing Convention, *supra* note 4, art. 8(2)-(4). In addition, the same concerns are addressed in Article 20 which states that "[a] Contracting State may . . . substitute its domestic law for Article 8(3) if its domestic law does not permit the lessor to exclude its liability for its default or negligence." This right to substitute domestic law was designed to accommodate French law, among others, which considers a warranty of quiet possession to be a fundamental feature of a leasing contract. Cuming, *supra* note 5, at 59. France, in fact, made the declaration under Article 20 in ratifying the convention. Letter from Hughes, *supra* note 16. Nevertheless, the domestic law declaration of Article 20 does defeat the purpose of "formulating certain *uniform* rules . . . of international financial leasing." Leasing Convention, *supra* note 4, pmb1. (emphasis added). The harmonization of commercial laws requires a degree of willingness to adapt domestic laws in order to achieve international commercial certainty. *See, e.g., The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9 (1972) (noting that "[w]e cannot have trade and commerce in world markets . . . exclusively on our terms, governed by our laws . . .").

51. Leasing Convention, *supra* note 4, art. 5. *See also supra* text accompanying note 41.

52. For a through analysis of the lessor's warranty of quiet possession, see Charles W. Mooney, Jr., *Filing Requirements for Personal Property Leases: A Comment and Response to Professor Ziegel*, 16 CANADIAN BUS. L.J. 419, 432-36 (1990). Professor Mooney was a member of the U.S. delegation that participated in the drafting of the Leasing Convention.

### B. *Improper Tenders—Nonconformity or Delivery Problems*

Both the Leasing Convention and the Uniform Commercial Code outline the respective rights and duties of the lessor and the lessee when the leased equipment either fails to conform to the supply agreement or where the equipment is not delivered as agreed. Although fundamentally similar, their approaches differ in several important respects.

Article 12 of the Leasing Convention represents the sole set of remedies available to the lessee for claims against the lessor regarding the performance of the leased equipment<sup>53</sup> or its delivery under the Convention.<sup>54</sup> This is consistent with the theory of the finance lease that it is the *supplier* to which the lessee should look for claims arising out of the equipment.<sup>55</sup>

Article 12 of the Convention provides that when the equipment is not delivered, is delivered late, or otherwise fails to conform to the specifications contained in the supply agreement, the lessee has a right as against the lessor to reject the nonconforming tender<sup>56</sup> or to terminate the leasing agreement,<sup>57</sup> subject to a corresponding right of the lessor to cure the defective tender.<sup>58</sup> These rights must be exercised or lost, as if the lessee had bought the equipment directly from the lessor on the same terms as those whom the lessor bought the equipment from the supplier under the supply agreement.<sup>59</sup> When the

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53. This is distinguished from claims under Article 8 for breaches of the lessor's warranty of quiet possession or the lessor's interference with the selection of the equipment or the supplier. Leasing Convention, *supra* note 4, art. 8.

54. *Id.* art. 12(5). Note that where the defective tender or delivery is through the fault of the lessor—for example, by failure to pay the supplier—the lessee may potentially recover additional sums as damages. Secretariat Report, *supra* note 1, at 69.

55. Leasing Convention, *supra* note 4, arts. 10, 12(6). *Accord* U.C.C. § 2A-209(1). In fact, the U.C.C. places so much importance on this fundamental finance lease concept that comment (1) to Section 2A-209(1) states that "[a]s a matter of policy, the operation of this provision may not be excluded, modified or limited . . . ."

56. Leasing Convention, *supra* note 4, art. 12(1)(a). *Accord* U.C.C. § 2A-509(1) (restating "perfect tender" rule of U.C.C. § 2-601 in the context of a lease).

57. Leasing Convention, *supra* note 4, art. 12(1)(a). *Accord* U.C.C. §§ 2A-508(1)(a), 2A-501(1), 2A-505(1).

58. Leasing Convention, *supra* note 4, art. 12(1)(b). *Compare* U.C.C. § 2A-513 (limiting the lessor's right of cure under the U.C.C. to instances where time for performance has not expired, U.C.C. § 2A-513(1), or in the case of substituted deliveries, U.C.C. § 2A-513(2)).

59. Leasing Convention, *supra* note 4, art. 12(1). Article 12(2) of the Leasing Convention reiterates that "[a] right conferred by [art. 12(1)] shall be exercisable in the same manner and shall be lost in the same circumstances as if the lessee had agreed to buy the equipment from the lessor under the same terms as those of the supply agreement." Thus, Article 12 effectively states a choice of law rule rather than an independent, substantive rule of law. *See* Cumings, *supra* note 5, at 57. By making specific rights and remedies of the lessee and lessor dependent on the domestic sales law of the supply contract, Article 12 fails to state the outcome where

lessee exercises the right to terminate the leasing agreement, it is entitled under the Convention to a restitution of rentals and other sums paid in advance, less an offset for beneficial use.<sup>60</sup>

For example, if the lessor purchases the equipment from the supplier under a supply agreement subject to U.S. sales law, Article 2 of the Uniform Commercial Code would govern, and the lessor as buyer can reject a less than perfect tender<sup>61</sup> or revoke its initial acceptance only in very limited circumstances.<sup>62</sup> The supplier as seller will have the right to cure only if the time for its performance has not yet passed,<sup>63</sup> or if it has tendered the nonconforming goods in the reasonable belief that they are acceptable.<sup>64</sup>

If the supply contract is governed by the Vienna Convention on the International Sale of Goods (CISG), following the contractual time for delivery, the lessor as buyer can reject the equipment and declare the contract avoided "if the failure by the seller to perform any of his obligations under the contract or [the CISG] amounts to a fundamental breach of contract."<sup>65</sup> If the contract

there is no comparable right, such as the right to cure defective tenders provided under the applicable law. Given the generally recognized freedom of commercial parties to choose the substantive law applicable to their contract, this interperative anomaly will probably remain more of a theoretical, rather than a practical consideration. *Id.* at 57-58.

60. Leasing Convention, *supra* note 4, art. 12(4). *Accord* U.C.C. § 2A-508(1)(b) (allowing the lessee to rightfully reject or revoke acceptance of goods and recover amounts paid "as is just under the circumstances").

61. U.C.C. § 2-601 (allowing buyer to reject "if the goods or the tender of delivery fail in any respect to conform to the contract . . . .")

62. Revocation of acceptance under Section 2-608 of the U.C.C. requires a higher degree of nonconformity than the "perfect tender" rule of Section 2-601. For a buyer to be able to revoke its initial acceptance of goods, the nonconformity of the goods must "substantially impair[] its value" to the buyer, U.C.C. § 2-608(1), and where the initial acceptance was either based on the "reasonable assumption" that the nonconformity would be cured by the seller, U.C.C. § 2-608(1)(a); or that the defect was difficult to discover or that acceptance was based on the seller's assurances, U.C.C. § 2-608(1)(b). Even if the buyer has colorable grounds for revocation of acceptance, it must do so within a reasonable period of time and must notify the seller, U.C.C. § 2-608(2). *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 8-3 (2d ed. 1980).

63. U.C.C. § 2-508(1).

64. U.C.C. § 2-508(2).

65. United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, art. 49(1)(a), U.N. Doc. A/CONF.97/18, 19 I.L.M. 668 (1980) [hereinafter CISG] (entered into force Jan. 1, 1988; for the U.S., Jan. 1, 1988). Article 25 of the CISG defines a "fundamental" breach as that which "results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result." *See* Fritz Enderlein, *Rights and Obligations of the Seller Under the UN Convention on Contracts for the International Sale of Goods, in*

is not declared avoided, the supplier as seller has the right to cure "without unreasonable delay and without causing the buyer unreasonable inconvenience . . . ."66

Rather than invoking the law of sales to provide rights for the lessee against the lessor, as opposed to the supplier, for equipment or deliveries which are not in conformity with the contract (and thereby ignoring the limited role of the financial lessor), the Uniform Commercial Code takes a functional approach in restricting the remedies available to the lessee which reflects actual commercial practice in financial leasing. Section 2A-509(1) states a "perfect tender" rule, which permits the lessee to reject prior to acceptance equipment that fails to conform to the supply agreement in any way. Acceptance, which cuts off the right to reject the leased goods,<sup>67</sup> occurs after the lessee has inspected the goods and either indicates that they are conforming, accepts them despite non-conformity,<sup>68</sup> or otherwise fails to make an effective rejection.<sup>69</sup>

In a finance lease under the Code, once the lessee has accepted the goods, the right of revocation of acceptance is limited to instances where the lessee had no knowledge of the nonconformity and the lessor induced the lessee to take the nonconforming goods through additional promises or assurances. In addition, the nonconformity must be serious enough that it substantially impairs the value of the goods to the lessee.<sup>70</sup> This rather high standard for rejection is deemed equitable because in a financial lease, the lessee has a direct claim against the supplier for defects in the equipment.<sup>71</sup> Moreover,

INTERNATIONAL SALE OF GOODS: DUBROVNIK LECTURES 133, 187, 193-96 (Petar Šarčević & Paul Volken eds., 1986).

66. CISG, *supra* note 65, art. 48(1). Even if the seller cures, the buyer nevertheless retains the right to claim damages arising out of the breach. *Id.* Note that if the buyer declares the contract avoided under Article 49 of the CISG, the seller loses the right to cure under Article 48(1). Enderlein, *supra* note 65, at 193.

67. U.C.C. § 2A-516(2).

68. In fact, in a finance lease, if the lessee has accepted equipment with knowledge of the nonconformity, acceptance cannot be revoked because of it. *Id.*

69. U.C.C. § 2A-515.

70. U.C.C. § 2A-517(1)(b). *See also* U.C.C. § 2A-516 cmt. 1. As with the Convention, a financial lessor that chooses to do more than merely provide funds increases its potential for liability. *See, e.g.,* Leasing Convention, *supra* note 4, art. 8(1)(a), art. 12(5).

71. U.C.C. § 2A-516(2) cmt. 1. Comment 10 to Section 2A-508 states that: Absent supplemental principles of law and equity to the contrary, in the case of most finance leases, following the lessee's acceptance of the goods, the lessee will have no rights or remedies against the lessor, because the lessor's obligations to the lessee are minimal. Since the lessee will look to the supplier for performance, this is appropriate.

(Internal citations omitted.) *See also* U.C.C. § 2A-209(1); Leasing Convention, *supra* note 4, art. 10(1).

the right of the lessor to cure a defective tender arises only prior to the expiration of the time for the lessor's performance,<sup>72</sup> or if the lessor or supplier tenders nonconforming goods that they have reasonable grounds to believe are acceptable.<sup>73</sup>

A fundamental difference in the U.C.C. and the Leasing Convention concerns the right of the lessee to withhold payments until the lessor cures a nonconforming tender. Under the Convention, the lessee is permitted to withhold payments until the lessor cures the defective tender or the lessee has lost the right to reject the equipment.<sup>74</sup>

Unlike the Leasing Convention, the Code does not permit the lessee to withhold rental payments in the event of a nonconforming performance by the lessor or supplier. Section 2A-407 of the Code restates the traditional "hell or high water" leasing clause by providing that in a commercial finance lease, the lessee's obligation to pay under the terms of the rental contract "becomes irrevocable and independent" upon the lessee's acceptance of the goods.<sup>75</sup> The U.C.C. emphasizes that "due to the function of the lessor" in financial leasing, the lessee should be required to pay the lessor notwithstanding the nonconforming tender because the lessee looks to the supplier to honor the equipment warranties.<sup>76</sup> Moreover, the Code places such emphasis on this principle that if a lease qualifies as a finance lease under Section 2A-103(1)(g), then the "hell or high water" clause of Section 2A-407 becomes a self-executing statutory provision of the lease, without the need to consciously include it in the draft.<sup>77</sup> This obligation to pay "come hell or high water" is subject only to the obligation of good faith and the ability of the lessee to revoke acceptance.<sup>78</sup>

Article 12 of the Leasing Convention, while constituting a choice of law reference rather than a "uniform rule[ ] relating [to] international financial

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72. U.C.C. § 2A-513(1).

73. U.C.C. § 2A-513(2).

74. Leasing Convention, *supra* note 4, art. 12(3). Note that the drafting of Article 12 is somewhat less than ideal. Paragraphs (1) and (2) explicitly invoke domestic sales law in determining the right of the lessee to reject the equipment or terminate the leasing agreement and the right of the lessor to cure the nonconforming tender, while paragraphs (3) and (4) make no such reference. Query if this would permit the withholding of payment in circumstances where it would not be allowed under the applicable sales law.

75. See Breslauer, *supra* note 4, at 326-27.

76. U.C.C. § 2A-407 cmt. 1. Comment 3 to U.C.C. § 2A-209 makes clear that in a commercial financial lease, the "hell or high water" clause of U.C.C. § 2A-407 is the price that the lessee pays to gain the benefits of the supplier's promises to the lessor under the supply agreement.

77. U.C.C. § 2A-407 cmt. 1. Breslauer, *supra* note 4, at 327.

78. U.C.C. § 2A-407 cmt. 1.

leasing,<sup>79</sup> represents a non-mandatory provision which may be varied contractually<sup>80</sup> and therefore is unlikely to alter actual commercial leasing practices. The financial lessor does not want the lessee to raise claims against it arising out of the equipment after it has already paid the supplier. Consequently, as a matter of sound business practice, the lessor will require the lessee to verify in writing prior to the payment of the supplier that it received and accepted the equipment, that the equipment is conforming as specified, and that the lessee agrees to be bound by its normally absolute obligation to pay under the leasing agreement.<sup>81</sup>

### C. *Lessor's Remedies if Lessee is in Breach*

The rights and remedies available to the lessor upon default by the lessee under the Leasing Convention and the Uniform Commercial Code are largely in accord.<sup>82</sup>

#### 1. *"Expectation Damages"*

The theory of damages under both the Leasing Convention and the U.C.C. is that the party who is injured by the other party's failure to perform its obligations has the right to receive monetary compensation, effectively gaining the benefit of its bargain. Section 1-106 of the U.C.C. states that the purpose of damages is to put the aggrieved party in "as good a position as if the other party had fully performed . . . ."<sup>83</sup>

Article 13(1) of the Leasing Convention states the basic rule that where the lessee is in default, whether or not such default would be considered "substantial" under the terms of the contract,<sup>84</sup> the lessor is entitled to accrued

79. Leasing Convention, *supra* note 4, pmb1. *See also supra* note 59 and accompanying text.

80. Leasing Convention, *supra* note 4, art. 5(2).

81. Charles W. Mooney, Jr., Report on UNIDROIT Convention on International Financial Leasing 7 (1990) (manuscript on file with the State Department). *See also* Cuming, *supra* note 5, at 58.

82. Compare Leasing Convention, *supra* note 4, art. 13 (lessor's remedies under the Convention) with U.C.C. § 2A-523 (index of lessor's remedies under the Code).

83. U.C.C. § 1-106.

84. The drafters of the Leasing Convention felt that because the "essential factor" in determining what constitutes a "substantial default" in a given transaction is the creditworthiness of the lessee, establishing the threshold at which a default would be deemed "substantial" was best left to the parties in their agreement. *See* Secretariat Report, *supra* note 1, at 70.



unpaid rentals, together with interest and damages upon default by the lessee.<sup>85</sup> Similarly, Section 2A-523(3)(b) of the Code provides that where the lessee's default does not "substantially impair the value of the lease contract," the lessor may recover for its loss arising from the lessee's default "as determined in any reasonable manner."<sup>86</sup>

Unlike the U.C.C., Article 13 of the Leasing Convention requires the election of remedies by the lessor in the event of substantial default by the lessee.<sup>87</sup> If the lessee's fault is indeed "substantial," the lessee must first be given notice of the default and a reasonable opportunity to remedy it,<sup>88</sup> unless such notice would be futile.<sup>89</sup> Cure by the defaulting lessee returns the parties to *status quo ante*.

Where notice has been given and the lessee's default is not remedied, the lessor has the option to terminate the lease, repossess the equipment,<sup>90</sup> and recover "expectation-type" damages.<sup>91</sup> In the alternative, Article 13(2) of the Leasing Convention permits a lessor to elect to keep the leasing agreement in force, leave the lessee in possession of the equipment, and accelerate payments of future rentals if permitted under the leasing agreement.<sup>92</sup> However, as a practical matter, a lessee who is in substantial default because it cannot make rental payments as they come due in the ordinary course of business will not likely be able to pay accelerated future rentals in order to retain possession of the equipment for the original term of the leasing agreement.<sup>93</sup>

The comparable Code provision, Section 2A-529(1), permits the lessor to recover accelerated rentals, discounted to present value as of the date of judgment, plus incidental expenses, less expenses saved where a lessee is in substantial default and the goods are "not repossessed by or tendered to the

85. Leasing Convention, *supra* note 4, art. 13(1).

86. U.C.C. § 2A-523(2), (3)(b).

87. *Cf.* U.C.C. § 2A-523 cmt. 4 ("This Article rejects any general doctrine of election of remedy.")

88. Leasing Convention, *supra* note 4, art. 13(5). In contrast, U.C.C. Section 2A-502 states that a "lessee in default . . . is not entitled to notice of default or notice of enforcement . . . ."

89. For example, notice and an opportunity to remedy a substantial default would be futile where the lessee is bankrupt. Secretariat Report, *supra* note 1, at 71.

90. Leasing Convention, *supra* note 4, art. 13(2)(a). *Accord* U.C.C. §§ 2A-523, -525(2).

91. Article 13(2)(b) of the Leasing Convention provides that the lessor may "recover such damages as will place the lessor in the position in which it would have been had the lessee performed the leasing agreement in accordance with its terms." Leasing Convention, *supra* note 4, art. 13(2)(b).

92. *Id.* art. 13(2).

93. Cuming, *supra* note 5, at 62.

lessor."<sup>94</sup> Under the Uniform Commercial Code, a clause permitting the lessor to accelerate payments "at will" is enforceable if the lessor has a good faith belief that the prospect of payment is "impaired."<sup>95</sup> Good faith is presumed, and the lessee has the burden of demonstrating that a commercial lessor is not acting in good faith.<sup>96</sup> Note that damages available to the lessor under the Convention, whether the default by the lessee is substantial or not, are subject to a duty of mitigation by the lessor.<sup>97</sup>

## 2. *Liquidated Damages Clauses Enforceable*

One of the key objectives of the Leasing Convention was to ensure the enforceability of liquidated damages clauses.<sup>98</sup> Article 13(3) of the Leasing Convention permits the parties to determine damages in advance through an enforceable liquidated damages clause subject to the mandatory rule that such damages cannot be substantially in excess of the amount that would have been due the lessor if the lease had been fully performed.<sup>99</sup> Similarly, Section 2A-504(1) of the Uniform Commercial Code provides that damages may be liquidated "only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default . . . ."

Article 13(5), one of the few mandatory provisions of the Convention, states that the lessor may not accelerate future rentals after termination of the leasing agreement; however, the same result may be achieved contractually by an enforceable liquidated damages clause that "take[s] into account" the value of future rentals.<sup>100</sup>

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94. U.C.C. § 2A-529(1). The other instances where a lessor has the statutory right to accelerate rentals under Section 2A-529(1) include where conforming goods have been lost or damaged within a commercially reasonable time after the risk of loss passed to the lessee, or where the goods were identified to the contract and the lessor is unable to dispose of them at a reasonable price after reasonable effort, or where circumstances reasonably indicate such effort will be unavailing. See also *New Developments, supra* note 36, at 134.

95. U.C.C. § 2A-109(1).

96. U.C.C. § 2A-109(2) & cmt.

97. Article 13(6) of the Leasing Convention states that "[t]he lessor shall not be entitled to recover damages to the extent that it failed to take all reasonable steps to mitigate its loss." Leasing Convention, *supra* note 4, art. 13(6).

98. R.M. Goode, *Conclusion of the Leasing and Factoring Conventions-I*, J. BUS. L. 347, 349 (1988) (U.K.). Professor Goode served as Deputy Chairperson of the United Kingdom's Committee to the Leasing Convention and was Chairperson of the Drafting Committee.

99. Leasing Convention, *supra* note 4, art. 13(3)(b).

100. *Id.* art. 13(4).

D. *Subleases—Rights of Assignment—Transfers of Interests*

Both the Leasing Convention and Section 2A of the U.C.C. provide for subleases, assignments, and transfers of interest. Article 2 of the Leasing Convention states that the Convention continues to apply to subleases and that the original supplier and supply agreement maintain the same relationship with the sublessee as they had *vis a vis* the original lessee. Similarly, the Code defines the term "lease" to include subleases.<sup>101</sup>

Article 14 of the Leasing Convention sets forth the rights of the parties to transfer or assign their interests under the leasing agreement. Paragraph (1) provides that the lessor may transfer "or otherwise deal with" its rights in the equipment or its rights under the leasing agreement. Significantly, paragraph (1) makes clear that such a transfer "shall not relieve the lessor of any of its duties" under the leasing agreement, nor will the transfer itself remove the leasing agreement from the application of the Leasing Convention. Therefore, a transferring lessor remains liable to the lessee for its promises under the leasing agreement, and if the lessor transfers its interest in the leasing agreement to a party whose principal place of business is not in a Contracting State,<sup>102</sup> the Convention continues to govern the leasing agreement as if the transferee's place of business was within a Contracting State.<sup>103</sup>

Under Section 2A-303(3) of the U.C.C., the lessor may transfer its duties under the lease to a transferee who effectively assumes a duty to perform the obligations of the lessor.<sup>104</sup> Consistent with the Leasing Convention, such a transfer of the lessor's interest does not relieve the lessor of its contractual obligations to the lessee absent agreement of the parties.<sup>105</sup>

Article 14(2) of the Leasing Convention states that the lessee may only transfer the right to use the equipment or any other rights under the leasing agreement with the consent of the lessor and subject to the rights of third parties. Similarly, lessor consent is required under the Code. Section 2A-303 of the U.C.C. provides that the transfer by the lessee of the right to possession or use of the equipment may be deemed contractually to constitute an event

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101. U.C.C. § 2A-103(1)(j).

102. Leasing Convention, *supra* note 4, art. 3(1). *See also supra* text accompanying note 39.

103. The second sentence in Article 12 was intended by the drafters to prevent the use of transfers by the lessor of its interests under the leasing agreement in order to either defeat the applicability of the Convention or to "internationalize" a purely domestic leasing transaction, thereby supplanting domestic law with the Convention. Secretariat Report, *supra* note 1, at 75.

104. U.C.C. § 2A-303(3) & cmt. 1.

105. U.C.C. § 2A-303(7).

of default<sup>106</sup> giving the lessor the range of rights and remedies set forth in Section 2A-501. Of course, the lessor may permit such assignment, provided that both it and any interested third parties have given prior consent.<sup>107</sup>

### E. Lessee's Standards for Use of the Leased Equipment

Article 9 of the Leasing Convention requires the lessee to take proper care of the leased equipment, "use it in a reasonable manner," and maintain the equipment in its original, as-delivered condition "subject to fair wear and tear."<sup>108</sup> Any modification must be agreed to by the parties.<sup>109</sup> Under Section 2A-219(1) of the U.C.C., the lessee in a finance lease bears the risk of loss arising out of the equipment.

## III. SUPPLIER—LESSEE RELATIONSHIP

Essential to the tripartite relationship in a financial leasing transaction is the concept that it is the supplier who provides the equipment. Therefore, the supplier is the proper party to whom the lessee should look for problems arising out of the equipment,<sup>110</sup> despite the absence of contractual privity. Both the Leasing Convention and the U.C.C. formalize this relationship.

Article 10(1) of the Leasing Convention provides that the supplier owes the same duty to the lessee as it does to the lessor under the supply agreement, "as if [the lessee] were a party to that agreement and as if the equipment were to be supplied directly to the lessee."<sup>111</sup> It also protects the supplier by providing that the supplier is not exposed to liability to both the lessor and

106. Note that if the leasing agreement does not specifically provide that a transfer of the lessee's interest constitutes an event of default—but only bars such transfer—the lessor must prove and is limited to the recovery of actual damages. U.C.C. § 2A-303(5)(b). In rare occasions where the transfer would materially increase risk, the court could issue an injunction. *Id.* & cmt. 9; *New Developments, supra* note 36, at 138.

107. Taylor, *supra* note 1, at 1260.

108. Leasing Convention, *supra* note 4, art. 9(1). Paragraph (2) states that the equipment is to be returned to the lessor by the lessee in the same condition described in paragraph (1). *Id.* art. 9(2). The drafters of the Convention elected to define a uniform obligation of the lessee to keep the leased equipment in good working order. Secretariat Report, *supra* note 1, at 61. While this is not an explicit risk of loss provision as stated in § 2A-219(1), it has much the same practical effect by creating a minimum standard for acceptable use of the equipment by the lessee. Note that the parties are free to include a more specific risk of loss provision in their leasing agreement.

109. Leasing Convention, *supra* note 4, art. 9(1).

110. Stanford, *supra* note 5, at 5.

111. Leasing Convention, *supra* note 4, art. 10(1).

the lessee "in respect of the same damage."<sup>112</sup> Paragraph (1) should promote legal predictability in leasing transactions involving jurisdictions that might otherwise be reluctant to enforce the assignment of rights arising under the supply agreement by the lessor to the lessee.<sup>113</sup> This is consistent with the policy stated in U.C.C. Section 2A-209 to treat the lessee in a finance lease as the beneficiary of the promises to the lessor in the supply agreement.<sup>114</sup> Article 10, paragraph (2) of the Leasing Convention further protects the lessor's interest by providing that the lessee may not "terminate or rescind the supply agreement without the consent of the lessor," notwithstanding the relationship of the lessee and supplier recognized by paragraph (1).<sup>115</sup>

Both the Leasing Convention and the U.C.C. provide comparable protection for the lessee. Article 11 of the Leasing Convention states that the consent of the lessee is required if any variation in the terms of the supply agreement previously approved by the lessee are to effect the lessee's rights. Under Section 2A-209(3) of the Code, modifications of the terms of the supply agreement are ineffective if the supplier has received notice prior to the attempted modification that the lessee has entered into a finance lease related to the supply agreement. However, if the supplier has not learned of the lease, the modification is nevertheless effective, and the lessor is deemed to have assumed any obligations of the supplier benefitting the lessee arising in the original supply agreement which were subsequently modified or rescinded.

#### IV. LESSOR—THIRD PARTY RELATIONSHIPS

##### A. *Lessee's Judgment Creditors and Trustees in Bankruptcy*

A major concern of a lessor in international commerce is the protection of its rights in the equipment in the event of the insolvency of the lessee.<sup>116</sup>

112. *Id.*

113. Mooney, *supra* note 81, at 6-7.

114. Section 2A-209(1) of the U.C.C. states:

The benefits of a supplier's promises to the lessor under the supply contract and of all warranties, whether express or implied, including those of any third party provided in connection with or as part of the supply contract, extends to the lessee . . . under a finance lease related to the supply contract, but is subject to the terms of the warranty and of the supply contract and all the defenses or claims arising therefrom.

Further this concept is so central to the theory of the finance lease under the Code that "[a]s a matter of policy, the operation of [2A-209(1)] may not be excluded, modified or limited . . ." U.C.C. § 2A-209 cmt. 1.

115. Leasing Convention, *supra* note 4, art. 10(2). *Accord* U.C.C. § 2A-407(2).

116. Stanford, *supra* note 5, at 5-6.

Article 7 of the Leasing Convention therefore deals with the lessor's "real rights"<sup>117</sup> in the leased equipment as against the lessee's creditors and trustees in bankruptcy.<sup>118</sup>

Paragraph (1) provides that the lessor's "real rights" in the equipment are protected against the lessee's creditors and trustees in bankruptcy, providing for compliance with notice requirements, if any.<sup>119</sup> By negative implication, where there are no rules regarding public notice under the applicable law, the lessor's real rights are automatically protected against this class of claimants.<sup>120</sup> The Leasing Convention purposefully does not attempt to affect the priority of liens or security interests, excepting attachment or execution creditors;<sup>121</sup> nor does it affect the priority of any creditor having the "right of arrest, detention or disposition" of ships or aircraft under applicable international law.<sup>122</sup>

Protection for the lessor as owner is consistent with the general rule of Section 2A-307(1) of the U.C.C. that "except [for statutory liens], a creditor of the lessee takes subject to the lease contract." This provision of the Convention should be particularly beneficial to financial lessors where the equipment will be located in Contracting States that have not fully developed a system of laws for personal property security and where a determination of the lessor's property rights would be ambiguous at best.<sup>123</sup>

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117. The Convention uses the term "real rights" rather than "title" in reference to the leased equipment because the Convention also covers sub-leasing transactions (art. 2) under which the lessor will not necessarily be the owner of the equipment. *Id.*

118. The Secretariat Report, discussing an earlier, substantially similar version of the current Article 7, stated that the draft was only intended to address "those conflicts between the lessor and third party creditors of the lessee arising in the limited context of the [lessee's] bankruptcy. It does not attempt to deal with conflicts between the lessor and those third parties acquiring the leased asset in good faith from the lessee." Secretariat Report, *supra* note 1, at 51.

119. Generally, the applicable law which determines notice requirements will be the law where the equipment is situated (art. 7(3)(d)), although special rules are provided for registered ships (para. (3)(a)), aircraft (para. (3)(b)), and other mobile equipment including aircraft engines (para. (3)(c)). Leasing Convention, *supra* note 4, art. 7(3)(a)-(d). In addition, paragraph (4) subordinates the public notice rules of the Convention to "any other treaty under which the lessor's real rights in the equipment are required to be recognised." *Id.* art. 7(4).

120. Secretariat Report, *supra* note 1, at 49.

121. Leasing Convention, *supra* note 4, art. 7(5)(a). This choice reflects the difficulty of reconciling domestic laws concerning liens and security interests. Mooney, *supra* note 81, at 3. For example, U.C.C. § 1-201(12) defines a "creditor" broadly to include: "a general creditor, a secured creditor, a lien creditor, and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor's or assignee's estate." U.C.C. § 1-201(12) (1990).

122. Leasing Convention, *supra* note 4, art. 7(5)(b).

123. Mooney, *supra* note 81, at 3.

### B. *Lessor/Persons having Interest in Land*

Although the Leasing Convention is not designed to govern real estate leasing, the definition of "equipment" may extend to situations where the equipment "has become a fixture to or incorporated in land."<sup>124</sup> Article 4 of the Convention states the general rule that the Convention continues to apply whether or not the equipment has become a fixture to the land as determined by the law of the State where the land is situated. It is state law that determines the rights of the lessor and a person having real rights in the land.<sup>125</sup>

Section 2A-309 of the U.C.C. provides that, as a general rule, the perfected interest of a lessor of fixtures has priority over the conflicting interests of the owner or encumbrancer of the real estate.<sup>126</sup> This interest is perfected by filing a fixture filing statement.<sup>127</sup> However, the lessor's interest is subordinate to a construction mortgage.<sup>128</sup> The Code leaves unenumerated examples to be determined according to priority rules established by real estate law.<sup>129</sup>

### C. *Lessor's Liability to Third Parties in Tort*

A major benefit to the international equipment lessor provided by the Leasing Convention is a general immunity from liability arising out of the equipment.<sup>130</sup> Article 8(1)(b) states the broad policy of the Convention to protect lessors *qua* lessors from tort liability to third parties. This policy reflects the fact that in a financial lease it is the *lessee*, not the *lessor*, that assumes responsibility for the selection, quality, or use of the equipment which is the subject of the lease.

American courts have reached similar holdings as a matter of public policy. For example, the Pennsylvania Supreme Court in *Nath v. National Equipment Leasing Corp.*<sup>131</sup> stated:

We agree . . . that the finance lease is *sui generis* and that the policy considerations justifying an extension of the concept of strict liability

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124. Leasing Convention, *supra* note 4, art. 4. See also *supra* discussion accompanying note 45.

125. Leasing Convention, *supra* note 4, art. 4(2).

126. U.C.C. § 2A-309(4), (5).

127. *Id.* § 2A-309(9).

128. *Id.* § 2A-309(6).

129. *Id.* § 2A-309(7).

130. Stanford, *supra* note 5.

131. 497 Pa. 126, 439 A.2d 633 (1981).

to the true lease are not present when the lessor is not "marketing" or "supplying" the product, but is, in fact, merely a secured party, or financier, whose collateral is the "product."<sup>132</sup>

Similarly, the Seventh Circuit in *Abco Metals Corp. v. Equico Lessors, Inc.*<sup>133</sup> held that strict liability was inapplicable to a lessor that had no control over the production or use of a defective product.

Article 8, paragraph (1)(c) of the Leasing Convention states a limited exception to this policy, providing liability for the lessor acting in any other capacity, such as owner. This provision was included in order to avoid conflict with international conventions that base liability on ownership.<sup>134</sup>

## V. CONCLUSION

The UNIDROIT Convention on International Financial Leasing represents an important legal development for parties considering transborder leasing transactions. It has the potential to promote legal certainty by clarifying the positions of each party to the "distinctive triangular relationship" that is financial leasing. It shifts responsibility from the lessor to the supplier, restricts the lessor's liability to third parties, protects the rights of the lessor against the lessee's creditors, and provides for the enforceability of liquidated damages clauses. Moreover, it accomplishes these goals in a manner that is consonant with Article 2A of the Uniform Commercial Code and which will be familiar to American practitioners. The interests of American lessors and their legal counsel will be greatly advanced by United States ratification of the Leasing Convention, which should be facilitated as soon as possible.

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132. *Id.* at 130, 439 A.2d at 635.

133. 721 F.2d 583, 585 (7th Cir. 1983).

134. *See, e.g.*, International Convention on Civil Liability for Oil Pollution Damages, done at Brussels, Nov. 29, 1969, *as amended* by Protocol of 1984, May 25, 1984, 23 I.L.M. 177 (1984). *See also* Council Directive 85/374 of 25 July, 1985, on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products.



## APPENDIX I

UNIDROIT CONVENTION  
ON INTERNATIONAL FINANCIAL LEASING

THE STATES PARTIES TO THIS CONVENTION,

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

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

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

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

HAVE AGREED as follows:

CHAPTER I - SPHERE OF APPLICATION  
AND GENERAL PROVISIONS

## Article 1

1.- This Convention governs a financial leasing transaction as described in paragraph 2 in which one party (the lessor),

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

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

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

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

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

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

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

4.- This Convention applies to financial leasing transactions in relation to all equipment save that which is to be used primarily for the lessee's personal, family or household purposes.

## Article 2

In the case of one or more sub-leasing transactions involving the same equipment, this Convention applies to each transaction which is a financial leasing transaction and is otherwise subject to this Convention as if the person from whom the first lessor (as defined in paragraph 1 of the previous article) acquired the equipment were the supplier and as if the agreement under which the equipment was so acquired were the supply agreement.

## Article 3

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

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

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

2.- A reference in this Convention to a party's place of business shall, if it has more than one place of business, mean the place of business which has the closest relationship to the relevant agreement and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of that agreement.

#### Article 4

1.- The provisions of this Convention shall not cease to apply merely because the equipment has become a fixture to or incorporated in land.

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

#### Article 5

1.- The application of this Convention may be excluded only if each of the parties to the supply agreement and each of the parties to the leasing agreement agree to exclude it.

2.- Where the application of this Convention has not been excluded in accordance with the previous paragraph, the parties may, in their relations with each other, derogate from or vary the effect of any of its provisions except as stated in Articles 8(3) and 13(3)(b) and (4).

#### Article 6

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

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

### CHAPTER II - RIGHTS AND DUTIES OF THE PARTIES

#### Article 7

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

(b) For the purposes of this paragraph "trustee in bankruptcy" includes a liquidator, administrator or other person appointed to administer the lessee's estate for the benefit of the general body of creditors.

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

3.- For the purposes of the previous paragraph the applicable law is the law of the State which, at the time when a person referred to in paragraph 1 becomes entitled to invoke the rules referred to in the previous paragraph, is:

(a) in the case of a registered ship, the State in which it is registered in the name of the owner (for the purposes of this sub-paragraph a bareboat charterer is deemed not to be the owner);

(b) in the case of an aircraft which is registered pursuant to the Convention on International Civil Aviation done at Chicago on 7 December 1944, the State in which it is so registered;

(c) in the case of other equipment of a kind normally moved from one State to another, including an aircraft engine, the State in which the lessee has its principal place of business;

(d) in the case of all other equipment, the State in which the equipment is situated.

4.- Paragraph 2 shall not affect the provisions of any other treaty under which the lessor's real rights in the equipment are required to be recognised.

5.- This article shall not affect the priority of any creditor having:

(a) a consensual or non-consensual lien or security interest in the equipment arising otherwise than by virtue of an attachment or execution, or

(b) any right of arrest, detention or disposition conferred specifically in relation to ships or aircraft under the law applicable by virtue of the rules of private international law.

## Article 8

1.- (a) Except as otherwise provided by this Convention or stated in the leasing agreement, the lessor shall not incur any liability to the lessee in respect of the equipment save to the extent that the lessee has suffered loss as the result of its reliance on the lessor's skill and judgment and of the lessor's intervention in the selection of the supplier or the specifications of the equipment.

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

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

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

3.- The parties may not derogate from or vary the effect of the provisions of the previous paragraph in so far as the superior title, right or claim is derived from an intentional or grossly negligent act or omission of the lessor.

4.- The provisions of paragraphs 2 and 3 shall not affect any broader warranty of quiet possession by the lessor which is mandatory under the law applicable by virtue of the rules of private international law.

## Article 9

1.- The lessee shall take proper care of the equipment, use it in a reasonable manner and keep it 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 the previous paragraph.

## Article 10

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

were to be supplied directly to the lessee. However, the supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

2.- Nothing in this article shall entitle the lessee to terminate or rescind the supply agreement without the consent of the lessor.

#### Article 11

The lessee's rights derived from the supply agreement under this Convention shall not be affected by a variation of any term of the supply agreement previously approved by the lessee unless it consented to that variation.

#### Article 12

1.- Where the equipment is not delivered or is delivered late or fails to conform to the supply agreement:

(a) the lessee has the right as against the lessor to reject the equipment or to terminate the leasing agreement; and

(b) the lessor has the right to remedy its failure to tender equipment in conformity with the supply agreement,

as if the lessee had agreed to buy the equipment from the lessor under the same terms as those of the supply agreement.

2.- A right conferred by the previous paragraph shall be exercisable in the same manner and shall be lost in the same circumstances as if the lessee had agreed to buy the equipment from the lessor under the same terms as those of the supply agreement.

3.- The lessee shall be entitled to withhold rentals payable under the leasing agreement until the lessor has remedied its failure to tender equipment in conformity with the supply agreement or the lessee has lost the right to reject the equipment.

4.- Where the lessee has exercised a right to terminate the leasing agreement, the lessee shall be entitled to recover any rentals and other sums payable in advance, less a reasonable sum for any benefit the lessee has derived from the equipment.

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

to which this results from the act or omission of the lessor.

6.- Nothing in this article shall affect the lessee's rights against the supplier under Article 10.

### Article 13

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

2.- Where the lessee's default is substantial, then subject to paragraph 5 the lessor may also require accelerated payment of the value of the future rentals, where the leasing agreement so provides, or may terminate the leasing agreement and after such termination:

(a) recover possession of the equipment; and

(b) recover such damages as will place the lessor in the position in which it would have been had the lessee performed the leasing agreement in accordance with its terms.

3.- (a) The leasing agreement may provide for the manner in which the damages recoverable under paragraph 2 (b) are to be computed.

(b) Such provision shall be enforceable between the parties unless it would result in damages substantially in excess of those provided for under paragraph 2 (b). The parties may not derogate from or vary the effect of the provisions of the present sub-paragraph.

4.- Where the lessor has terminated the leasing agreement, it shall not be entitled to enforce a term of that agreement providing for acceleration of payment of future rentals, but the value of such rentals may be taken into account in computing damages under paragraphs 2(b) and 3. The parties may not derogate from or vary the effect of the provisions of the present paragraph.

5.- The lessor shall not be entitled to exercise its right of acceleration or its right of termination under paragraph 2 unless it has by notice given the lessee a reasonable opportunity of remedying the default so far as the same may be remedied.

6.- The lessor shall not be entitled to recover damages to the extent that it has failed to take all reasonable steps to mitigate its loss.

#### Article 14

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

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

### CHAPTER III - FINAL PROVISIONS

#### Article 15

1.- This Convention is open for signature at the concluding meeting of the Diplomatic Conference for the Adoption of the Draft Unidroit Conventions on International Factoring and International Financial Leasing and will remain open for signature by all States at Ottawa until 31 December 1990.

2.- This Convention is subject to ratification, acceptance or approval by States which have signed it.

3.- This Convention is open for accession by all States which are not signatory States as from the date it is open for signature.

4.- Ratification, acceptance, approval or accession is effected by the deposit of a formal instrument to that effect with the depositary.

#### Article 16

1.- This Convention enters into force on the first day of the month following the expiration of six months after the date of deposit of the third instrument of ratification, acceptance, approval or accession.

2.- For each State that ratifies, accepts, approves, or accedes to this Convention after the deposit of the third instrument of ratification, acceptance, approval or accession, this Convention enters into force in respect of that State on the first day of the month following the expiration of six months after the date of the deposit of its instrument of ratification, acceptance, approval or accession.



### Article 17

This Convention does not prevail over any treaty which has already been or may be entered into; in particular it shall not affect any liability imposed on any person by existing or future treaties.

### Article 18

1.- If a Contracting State has two or more territorial units in which different systems of law are applicable in relation to the matters dealt with in this Convention, it may, at the time of signature, ratification, acceptance, approval or accession, declare that this Convention is to extend to all its territorial units or only to one or more of them, and may substitute its declaration by another declaration at any time.

2.- These declarations are to be notified to the depository and are to state expressly the territorial units to which this Convention extends.

3.- If, by virtue of a declaration under this article, this Convention extends to one or more but not all of the territorial units of a Contracting State, and if the place of business of a party is located in that State, this place of business, for the purposes of this Convention, is considered not to be in a Contracting State, unless it is in a territorial unit to which the Convention extends.

4.- If a Contracting State makes no declaration under paragraph 1, the Convention is to extend to all territorial units of that State.

### Article 19

1.- Two or more Contracting States which have the same or closely related legal rules on matters governed by this Convention may at any time declare that the Convention is not to apply where the supplier, the lessor and the lessee have their places of business in those States. Such declarations may be made jointly or by reciprocal unilateral decisions.

2.- A Contracting State which has the same or closely related legal rules on matters governed by this Convention as one or more non-Contracting States may at any time declare that the Convention is not to apply where the supplier, the lessor and the lessee have their places of business in those States.

3.- If a State which is the object of a declaration under the previous paragraph subsequently becomes a Contracting State, the declaration made will, as from the date on which the Convention enters into force in respect of the new Contracting State, have the effect of a declaration made under

paragraph 1, provided that the new Contracting State joins in such declaration or makes a reciprocal unilateral declaration.

#### Article 20

A Contracting State may declare at the time of signature, ratification, acceptance, approval or accession that it will substitute its domestic law for Article 8(3) if its domestic law does not permit the lessor to exclude its liability for its default or negligence.

#### Article 21

1.- Declarations made under this Convention at the time of signature are subject to confirmation upon ratification, acceptance or approval.

2.- Declarations and confirmations of declarations are to be in writing and to be formally notified to the depositary.

3.- A declaration takes effect simultaneously with the entry into force of this Convention in respect of the State concerned. However, a declaration of which the depositary receives formal notification after such entry into force takes effect on the first day of the month following the expiration of six months after the date of its receipt by the depositary. Reciprocal unilateral declarations under Article 19 take effect on the first day of the month following the expiration of six months after the receipt of the latest declaration by the depositary.

4.- Any State which makes a declaration under this Convention may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal is to take effect on the first day of the month following the expiration of six months after the date of the receipt of the notification by the depositary.

5.- A withdrawal of a declaration made under Article 19 renders inoperative in relation to the withdrawing State, as from the date on which the withdrawal takes effect, any joint or reciprocal unilateral declaration made by another State under that article.

#### Article 22

No reservations are permitted except those expressly authorised in this Convention.

### Article 23

This Convention applies to a financial leasing transaction when the leasing agreement and the supply agreement are both concluded on or after the date on which the Convention enters into force in respect of the Contracting States referred to in Article 3 (1)(a), or of the Contracting State or States referred to in paragraph 1 (b) of that article.

### Article 24

1.- This Convention may be denounced by any Contracting State at any time after the date on which it enters into force for that State.

2.- Denunciation is effected by the deposit of an instrument to that effect with the depositary.

3.- A denunciation takes effect on the first day of the month following the expiration of six months after the deposit of the instrument of denunciation with the depositary. Where a longer period for the denunciation to take effect is specified in the instrument of denunciation it takes effect upon the expiration of such longer period after its deposit with the depositary.

### Article 25

1.- This Convention shall be deposited with the Government of Canada.

2.- The Government of Canada shall:

(a) inform all States which have signed or acceded to this Convention and the President of the International Institute for the Unification of Private Law (Unidroit) of:

(i) each new signature or deposit of an instrument of ratification, acceptance, approval or accession, together with the date thereof;

(ii) each declaration made under Articles 18, 19 and 20;

(iii) the withdrawal of any declaration made under Article 21 (4);

(iv) the date of entry into force of this Convention;

(v) the deposit of an instrument of denunciation of this

Convention together with the date of its deposit and the date on which it takes effect;

(b) transmit certified true copies of this Convention to all signatory States, to all States acceding to the Convention and to the President of the International Institute for the Unification of Private Law (Unidroit).

IN WITNESS WHEREOF the undersigned plenipotentiaries being duly authorised by their respective Governments, have signed this Convention.

DONE at Ottawa, this twenty-eighth day of May, one thousand nine hundred and eighty-eight, in a single original, of which the English and French texts are equally authentic.