

# **LEGAL ASPECTS OF LEASING**

**A Critical Review of Egyptian Law No. 95 of 1995 on Finance Lease**

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## **INTRODUCTION**

### ***First: Evolution of Leasing as a Credit Mechanism***

Enterprises need to acquire funds in order to meet production requirements and to discharge costs. As long as the finance is appropriate in its size and conditions, it will achieve its goals in the successful completion of the project, increasing its value, profits and competitive ability in the market. Finance has several and varied sources as it may be self-finance or market finance <sup>(1)</sup>.

Self-finance depends on the inherent abilities of the enterprise either through the liquidity sources available to it or through creating such liquidity in order to obtain the funds necessary to provide for the day - to - day requirements or to conduct the desired expansions. The forms of self-finance include, for example, increasing the capital, in the case of a shareholding company by the issue of new shares for public subscription; or by increasing the value of the shares and the shareholders shall settle the excess amount or increasing the

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(1) Dr. Ali Said KHADEM, *Legal Aspects of Finance Lease* (Dar El Nahda AlArabia, Cairo 1990); at pp 1 - 2; Dr. Monuir SALEM & Dr. Abdullah SALEM, *Finance Lease - Legal, Accounting and Organizing Aspects* (Cairo, 1997) at pp 9 - 10.

shares; or in the case of a partnership by taking the participation of a new partner <sup>(2)</sup>.

In some cases, it is difficult to obtain the self-finance for a project particularly in the case of one man enterprise. Further, self-finance by increasing the capital is not an easy matter even for an enterprise which takes a company form. If the company is a partnership, the company's memorandum of association may prevent the entry of a new partner and it may be difficult for the existing partners to fulfill the value of such increase <sup>(3)</sup>. If the company is a shareholding company for example, the finance by increasing the capital is usually a complicated process with its perils. It is complicated as the law requires the fulfillment of certain conditions and the completion of complicated procedures to effect the said increase. Increasing the company's capital may also have its perils. Such increase may require the expansion of the enterprise size and it may be against its interest if the market cannot accommodate such expansion <sup>(4)</sup>. Furthermore, the

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(2) *SALEM & SALEM, Finance Lease, ibid. at p. 10; Abdel Rahman KORMAN, The Contract of Finance Lease - Comparative Study (Dar El Nahda AlArabia, Cairo 1996); at p 6. KHASEM, Legal, supra note no. 1 at p 3.*

(3) *KHASEM, Legal Aspects of Finance Lease, ibid. at p. 3 - 4.*

(4) *For the conditions and methods for increasing the Capital of Shareholding Company, see: Dr. Mostafa Kamal TAHA, Summary of*

increase of the company's capital by taking the participation of new partners may decrease the profits accruing to the old shareholders, especially if the increase is to be utilized in fulfilling the urgent and standing needs of the project and not to carry out the expansion and acquisition of new markets <sup>(5)</sup>.

Besides, financial institutions play a vital role in fulfilling the financial needs of the enterprises. Lending is considered the traditional form for finance such as the enterprise when it obtains a loan from a finance entity like a bank for example or by borrowing from the public like the case of a shareholding company when it issues securities for public subscription <sup>(6)</sup>.

Borrowing as a finance tool is surrounded by risks for the two parties: the lender and the borrower. As regards the lender, he is exposed to a serious danger in case of the borrower's bankruptcy and the lender may not be saved in avoiding such danger by the loan guarantees which he may obtain, especially, if the loan amount is huge compared to the

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=*Commercial Law (Monshat El Maraf - Alexandria)* pp. 363 - 364.

(5) *It is to be mentioned that the capital companies such as the joint stock company may issue bonds in order to obtain the needed finance, see: KHASEM, Legal Aspects of Finance Lease, supra note no. 1 at p 4.*

(6) *SALEM & SALEM, Finance Lease, supra note no. 1 at p. 10.*

assets remaining from the collapsed enterprise. In addition, the lender may refuse, due to economic considerations, to lend huge amounts for long period and with a fixed interest fearing the project's failure and its inability to make settlement <sup>(7)</sup>. As regards the borrower, it may be difficult for him to obtain the loan amount as required from the finance entity, for example, when he has been already granted other loans whether from the same finance entity or from other body, besides the high cost of borrowing because it is usually linked with a fixed interest or compound interest on the accrued interests in the commercial dealings. Furthermore, obtaining specific guarantees by the lender from the borrower may limit thereafter the liberty of the latter to dispose of all or some of his assets with the appearance of the borrowing enterprise as a debtor in front of others, which may be detrimental to his reputation and credit <sup>(8)</sup>. Finally, borrowing as a finance form may not be adopted by some finance bodies on the basis that it is violating the traditions of the Islamic Law being linked with a fixed interest (usury).

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(7) Said KHASEM, *Legal Aspects of Finance Lease*, *supra* note no. 1 at p. 4.

(8) KORMAN, *The Contract of Finance Lease - Comparative Study*, *supra* note no. 2 at pp. 8 - 9; Faiz Naim RADWAN, *The Contract of Finance Lease (LEASING)*, (second edition 1997) at p. 21.

It is not an easy matter for the shareholding companies to resort to borrowing from the public by launching securities for public subscription as the same is governed by complicated legal procedures, and it may not be in the interest of the company to adopt such form of borrowing if the company's finance needs are of short term or limited value<sup>(9)</sup>. Instalment schemes as a finance tool may not be suitable for large size enterprises; besides, it will not secure for the finance entity the sufficient guarantees in case of the bankruptcy of the buyer even if such sale is linked with the condition of reserving title until full payment has been made<sup>(10)</sup>.

In the beginning of the second half of the present century, the financial institutions, particularly the banks,

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(9) KHASEM, *Legal Aspects of Finance Lease*, *supra* note no. 1 at p. 4.

(10) *Installment sale* is defined as "Commercial arrangement by which buyer makes initial down payment of the balance in installments over a period of time. In accounting for such sales, the seller may either account for the profits on basis of each installment payment received or the entire amount in the period of the sale ....", and is also defined as "A sale in which the buyer makes periodic payments and generally the seller reserves title until full payment has been made".

A sale on credit is defined, however, as "A sale of property accompanied by delivery of possession, but where payment of the price is deferred to a future day" see BLACK's law Dictionary, sixth edition (West Group 1990), referred to hereinafter as BLACK's, at p. 799, p. 1338 and p. 1339.

created what is known thereafter as finance lease (leasing) to work as the mechanism of medium or long-term finance forms. By virtue of such system, the finance entity shall lease assets to an enterprise after buying these assets at its request in consideration of a specific charge to be agreed upon between them. This charge is comprised of a group of elements represented in the cost of consuming the leased assets, the administrative and financial costs, the profit decided on the amount paid for buying the assets.

Due to its numerous advantages, Leasing has become familiar in USA with a speed so high and successful that the commercial and industrial projects depending on the same in finance are currently exceeding 88% of all projects in these sectors; the percentage is so high in the field of the petroleum projects that it reaches more than 93% of the total thereof<sup>(11)</sup>. Subsequently, Leasing became known in some European countries in the beginning of the sixtiets when it met with great success especially in France. The US expression "Leasing" continued to be used in Europe until recently

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(11) RADWAN, *The Contract of Finance Lease (LEASING)*, *supra* note no. 8 at p. 16. And for the evolution of leasing as a finance mechanism in the U.S.A and universally, see Hani M. DOWIDAR, *The Legal Regime of Finance Leasing - A Critical Study in French Law (Dar El Gama Al Gadida Llinasher 1994)* at pp 17 - 30.



without translation <sup>(12)</sup>.

***Second: Description of the Leasing Process***

Leasing starts when a commercial or industrial enterprise; i.e, the finance applicant or (the Lessee), applies to a finance entity (the financier) or (the lessor) such as a Leasing company or a bank to finance the process of obtaining the necessary fixed assets for its activity, replacing or updating them <sup>(13)</sup>. The finance entity, instead of lending to the finance applicant to fulfill his need for obtaining the required assets, concludes another contract with him, which is the Leasing contract. Under the said contract, the finance entity undertakes to lease the assets, which the finance applicant is desirous to obtain. According to the conditions stated in the contract, the finance applicant can define the specifications of such assets. The lessee can also specify to the finance entity the source from which the assets should be

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(12) *For a comprehensive history of LEASING, see: Jacques de Theux de MEYLANDT et MONTJARDIN, le Leasing Mobilier en Belgique: Aspects Pratiques, Comptables et Fiscaux (BRUYLANT BRUXELLES 1989) at pp 17 - 18; KHADEM, Legal Aspects of Finance Leasing, supra note no. 11 at p. 5.*

(13) *SALEM & SALEM, Finance Lease, supra note no. 1 at p. 10; DOWIDAR, The legal regime of finance lease - A critical study in French law, supra note no. 11 at pp 25 - 26.*

purchased <sup>(14)</sup>. The finance entity, after studying the status and the condition of the enterprise requesting the finance, purchases these assets but it may authorize the finance applicant upon special power of attorney or agency to buy these equipment or machinery. Then, the finance entity delivers them on lease basis to the finance applicant for a specific period stipulated in the contract concluded between them and against a certain charge <sup>(15)</sup>. The charge consists of a group of certain elements in the form of the cost for consuming the leased assets and the administrative and financial costs incurred by the finance entity in addition to the profit decided on the amount paid by it for purchasing these assets <sup>(16)</sup>.

The finance applicant (the lessee) at the end of the Leasing contract shall have one of three options usually stated in the contract namely: First, either to renew the lease contract under the same conditions of the original contract or under other conditions which should observe in its definition

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(14) KORMAN, *The Contract of Finance Lease*, *supra* note no. 2 at pp. 132 - 133.

(15) *Ibid.* at p. 133; Dr. Hosam Eldin Abdel Ghani ELSAGHIR, *Finance Lease* (Dar ElNahda AlArabia, Cairo 1994) at p. 23.

(16) David WAINMAN, *LEASING* (Sweet & Maxwell 1995) at pp. 3-4;

the depreciation percentage of the said assets; Second, the lessee may desire to terminate the contract and in such event, he should return to the finance entity the leased assets and finally, the lessee may request from the finance entity to purchase these assets which he has utilized and used in his capacity as a lessee <sup>(17)</sup>. In this last event, upon specifying the purchase price, the depreciation, which would have happened to such assets throughout their Leasing period, should be taken into account. In all events, the lease period is always equivalent approximately to the economic or assumed lifetime of the leased assets <sup>(18)</sup>. It is worth mentioning that this third option which enables the lessee to buy the assets upon the expiry of the Leasing contract period is not among the contract features in accordance with US and British laws, but it has become one of the elements of the contract after the passing of its application in the Latin systems as we shall

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=KORMAN, *The Contract of Finance lease*, *supra* note 2 at p. 119.

(17) SALEM & SALEM, *Finance Lease*, *supra* note no. 1 at p 11.

(18) KORMAN, *The Contract of Finance Lease*, *supra* note no. 2 at p 9. Nevertheless, in case the lessee choses to buy the leased assets, the rental value shall not equal the assumed lifetime of the leased assets since the lessee has to pay a purchase price, though this price equals a small percentage of the total value of the assetss, see: DOWIDAR, *The Legal Regime of Finance lease*, *supra* note no. 11 at p. 379.

see subsequently while discussing the Egyptian law <sup>(19)</sup>.

***Third: The Financial and Economic Importance of Leasing***

Leasing is a complex process in which the legal relations are several and interactive. There is a direct relation between the finance applicant and the finance entity and such relation is governed directly by the Leasing contract, on the one hand. On the other hand, there is a direct relation between the finance entity and the assets supplier or seller and such relation is governed by the sale contract <sup>(20)</sup>.

Leasing has several advantages, some of which are mentioned below, for the finance applicant or the lessee, the finance entity or the lessor, and the seller or the supplier.

***A- Advantages For the Finance Applicant (The Lessee)***

1- The finance applicant may obtain the necessary

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(19) ELSAGHIR, *Finance Lease*, supra note no. 15 at pp. 12 - 13. For example, section 2 A - 103 of the Uniform Commercial Code (UCC) in the United States provides that a finance lease is "a lease in which the lessor does not select, manufacture, or supply the goods, but enters into a contract with a third party supplier to acquire goods specifically for the purpose of leasing them to the lessee", see: BLACK's, supra note no. 10 at p 630.

(20) SALEM & SALEM, *Finance Lease*, supra not no. 1 at pp 10 - 11.

finance for his project without incurring any costs prior to possessing the assets <sup>(21)</sup>. Thus, Leasing is distinguished from other banking finance mechanisms in which the financier stipulates the obtaining of sufficient real or personal guarantees. Further, Leasing does not stipulate the settlement of advance financial installments out of the equipment or machinery price; thus it is better than installment sale and sale on credit in which the seller usually stipulates an advance payment from the price of the sold item <sup>(22)</sup>.

2- Leasing is considered as of less cost in the economic aspect in comparison with other finance tools because it gives the finance applicant the opportunity to carry out its project without being forced to freeze a part of the financial liquidity of the project that is required to be paid in order to settle the value of the requested assets. The same is not challenged by the obligation of the finance applicant for the payment of the rental value under Leasing contract, as he will be able to bear and pay such rental value out of the yields he collects upon investing the capital assets. Therefore, the

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(21) *KHASEM, Legal Aspects of Finance Lease, supra note no. 1 at p. 12.*

(22) *DOWIDAR, The Legal Regime of Finance Lease - A Critical Study in French Law, supra note no. 11 at pp. 620 - 621; KORMAN, The Contract of Financial Lease, supra note 2 at p. 29.*

project seems – when it uses Leasing – as if it performs self-finance<sup>(23)</sup>.

3- Leasing contributes to a large extent in updating the enterprises and assisting them continuously to cope with technology developments especially those enterprises in which the depreciation percentage of the assets is high or those enterprises requiring the use of the latest technology means. According to the Leasing contract, the finance entity (the lessor) may undertake to provide the lessee with the latest capital assets under the contract whether by addition thereto or replacement thereof<sup>(24)</sup>.

4- Leasing contributes, to a large extent, in improving the picture of the lessee enterprise's budget. The rent payment and related expenses do not appear in the liabilities column of the project budget as the same is considered to have been included within the production cost then; accordingly, the finance applicant shall appear before others in a good position so that his chance to obtain another credit in the form

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(23) KORMAN, *The Contract of Finance Lease*, *ibid.* at pp. 30 - 31; KHADEM, *Legal Aspects of Finance Lease*, *supra* note no. 1 at pp. 15 - 20.

(24) SALEM & SALEM, *Finance Lease*, *supra* note no. 1 at p. 15; KHADEM, *Legal Aspects of Finance Leasing*, *ibid.* at pp. 20 - 21.

of loan for example would be possible without being precluded in this regard by the Leasing which he has already obtained <sup>(25)</sup>.

5- Leasing provides financial and tax benefits to the lessee as legislation in some countries permits the rental value, payable by the lessee to the lessor, to be deducted compulsorily from the lessee's profits in accordance with tax laws. An example of this is the provision of Article 25 of the Egyptian Law No. 95/1995 on Leasing which provides that *"the rental value payable during the Accounting Year is considered among the costs to be deducted compulsorily from the lessee's profits according to the tax statutes"* <sup>(26)</sup>.

There is no doubt that such financial and tax benefits available to the lessee in Leasing indirectly lead to lower the price of the assets and this consequently results in reducing the rental value which the lessee is required to settle under the Leasing contract.

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(25) KHASEM, *Legal Aspects of Finance Lease*, *ibid.* at pp. 13 - 15; KORMAN, *The Contract of Financial Lease*, *supra* note no. 8 at pp. 29 - 30.

(26) See, for example, articles 24 & 25 of the Egyptian law on finance lease no. 95 of 1995, published in the Official Journal, Volume 22 (supplementary) June 2, 1995.

***B. Advantages for the Finance Entity (Lessor)***

1. The Leasing contract, as a finance tool, is consistent in general with the provisions of the Islamic Shari'at as the finance entities are not forced to add fixed interests on the accounts of their customers. This is because the proceeds obtained by the finance entities after deducting whatever they paid as a price for buying the assets they lease to the customer, are profits decided in accordance with the applicable rules. Hence, there will be no suspicion of the usurious interest, which is the normal accusation attributed to lending as a finance tool <sup>(27)</sup>.

2. Leasing is considered a safe finance tool for the finance entity compared to other finance tools such as credit sales, lending, and installment sale. In case of bankruptcy of the enterprise requesting the finance, the lender or the seller shall enter the bankruptcy as an ordinary creditor subject to pro rata distribution. Even if the finance entity does obtain certain real guarantees from its customer, the same shall not remove the risk entirely as the finance entity may be exposed

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(27) *The Kuwaiti law no. 12 of 1998 on the Establishment of Investment and Leasing Companies which expressly prohibits the charge of any usury interest.*



even in such event to the risk of competition by the creditors with priority rights or the non recovery of assets from the bankruptcy. The Leasing process enables the finance entity to avoid such risks as the leased fund shall not be removed from the proprietary rights of the finance entity which shall have the right to recover it without being exposed to the competition of the creditors of the bankrupt lessee<sup>(28)</sup>.

3. Under the Leasing system, the finance entity shall not be liable for the latent defects of the leased assets. Although the lessor's obligation for the guarantee of the latent defects is among the obligations arising from the lease contracts in general, such obligation is absent in case of Leasing contract<sup>(29)</sup>. The ground for the same is that the lessee in the Leasing contract is the party who specifies to the lessor the machinery and the equipment which the latter is required to purchase and he shall define their specifications as well as inspect, examine and test them before the lessor enters into a contract for purchasing them. Furthermore, the lessor may

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(28) KORMAN, *The Contract of Finance Lease*, supra note no. 2 at p. 27; KHASEM, *Legal Aspects of Finance Lease*, supra note no. 1 at p. 25; SALEM & SALEM, *Finance Lease*, supra note no. 1 at p. 16; DOWIDAR, *The Legal Regime of Finance Lease - a Critical Study in French law*, supra note no. 11 at pp. 103 - 105, Dr. Ali Gamal ElDin AWAD, *Banking Operations- Legal Aspects* (1989) at p. 678.

(29) ELSAGHIR, *Finance Lease*, supra note no. 15 at p. 35.

authorize the lessee to contract for buying these assets. As the lessee is the party who takes up the defining, examining and inspecting these machinery and equipment, no obligation would devolve upon the lessor for the guarantee of the latent defects. In addition, the lessee under the Leasing contract shall have the right of recourse directly to the seller or the supplier of the assets in case latent defects have appeared therein <sup>(30)</sup>.

4. When the finance entity (the lessor) delivers the assets to the lessee by virtue of the Leasing contract, the same shall not expose the lessor to a high risk in case of destruction or damage of such assets while being under the lessee's possession as the lessor usually obliges the lessee to obtain an insurance policy that covers the perils which these assets may be exposed to so that if the peril occurs, the right of the lessor shall extend to the insurance amount of compensation. The common practice is to add the insurance premium to the

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(30) *A latent defect is defined as "one which is not apparent to buyer by reasonable observation". See BLACK's, supra note no. 10 at p 418. Article 13 of the Egyptian law no 95 of 1995 entitles the lessee to have a direct recourse on the supplier or the contractor by using the lessor's right of action emanating from the contract against them except any action for dissolving the contract itself and without prejudice to the lessor's right to preserve his recourse to the supplier or the contractor. See also, KORMAN, The Contract of Finance Lease, supra note no. 2 at pp 106 - 108.*

rental payments, which the lessee should pay according to the Leasing contract <sup>(31)</sup>.

5. The finance entity (the lessor) usually enjoys – according to law – several benefits like taxes and customs exemptions for the capital assets which are contracted for and which are the subject matter of the Leasing contract. There is no doubt that these exemptions have a direct effect in reducing the purchase price which consequently means a reduction in the rental payments which the lessee undertakes to pay <sup>(32)</sup>.

### ***C. Advantages for the Seller (the Supplier – the Contractor)***

Leasing is considered an appropriate mechanism for the seller to obtain a prompt cash price for the sold equipment

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(31) *Article 10/2 of the finance lease law no. 95 of 1995 states that the lessor is entitled to stipulate the insurance of leased fund, so he is guaranteed obtaining the whole rental value for the remaining period of the contract at the price fixed thereof. Generally, for the obligation to insure the leased fund, see: DOWIDAR, The Legal Regime of Finance Lease - a Critical Study of French law, supra note no. 11 at pp. 416 - 422; KORMAN, The Contract of Finance Lease, supra note no. 2 at p. 28.*

(32) *In the United States, for example, the Federal Government, in order to encourage new capital investments, has permitted a tax exemption with the internal revenue service. According to that exemption the tax - payer enjoys "an investment tax credit", see: SALEM & SALEM, Finance Lease, supra note no. 1 at pp. 16 - 17.*

or capital assets as the finance entity (the lessor) has the financial capabilities to effect the prompt settlement of the price. Then, the seller can obtain the sufficient liquidity, which gives him the ability to expand the size of his investments, compete in the market, renew his activity, update his products and increase his technology<sup>(33)</sup>. Even when the finance entity (the lessor) buys capital assets from the seller in accordance with a certain settlement schedule on credit basis, there is a great advantage still existing which can be achieved by the seller i.e. the seller will not be exposed to severe risks in collecting the installments as his lessor client is a financial institution having its reputation and position in the market<sup>(34)</sup>.

Besides the advantages realized by the parties involved, the Leasing process has positive implications on the national economy in general. It helps improving the picture of the balance of payments of the state in case the lessor is a foreigner as remitting the cash abroad is restricted to the rental value instead of paying the entire price for the assets in

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(33) *KHASEM, Legal Aspects of Finance Lease, supra note no. 1 at pp 26 - 27; KORMAN, The Contract of Finance Lease, supra note no. 2 at p. 31.*

(34) *SALEM & SALEM, Finance Lease, supra note no. 1 at pp. 12 - 14.*

one payment. Leasing also aims at financing the required investments for the enterprises at 100% due to the fact that the finance amount is being paid against a rental value to be settled over medium or long term and consequently, it is possible for these enterprises to procure capital assets, expand their existing activity or set up additional activities and create new employment opportunities which are considered as an addition to the national economy in general <sup>(35)</sup>.

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(35) *Ibid. at p. 12.*

**CHAPTER ONE**  
**FEATURES AND FORMS OF LEASING**  
**AND DISTINGUISHING IT FROM OTHER**  
**SIMILAR OPERATIONS**

***First: Features of Leasing Operation***

The Leasing operation, as a compound process, is distinguished by that it is one of finance mechanisms established upon the personal consideration for its parties and it is also considered a commercial transaction.

***1 - Leasing is a Finance Mechanism***

The objective of finance lease is more than merely allowing the lessee a right to use the leased assets or benefit thereof. The advantage for the financial institution is that it does not buy the capital assets and then wait until the appearance of a lessee desirous to enter into a contract to lease whatever it has purchased, but the financial institution shall purchase the fund intended to be leased at the direction and request of the lessee who defines the specifications of such fund as suitable with his project components. Thus,

Leasing is a finance mechanism <sup>(36)</sup>.

Furthermore, the original objective contemplated by the lessor from retaining title and proprietary rights over the leased fund is to secure the recovery of the same in case of the lessee's bankruptcy, insolvency or his abstention from paying the rental value agreed upon. The lessor is not buying the capital assets in order to possess or use but he purchases them upon the request of his customer lessee, reserving the ownership as a matter of guarantee and, here appears the care of the lessor to obtain the value he expects against the price of the leased capital assets in addition to his profit during the contract period <sup>(37)</sup>. Therefore, the Leasing contracts may provide that the lease period shall not be subject to cancellation. Along these lines, article 11/2 of the Egyptian Law on Finance Lease provides that *"it may be agreed on the entitlement of the lessor for the whole rental value even if the lessee has not utilized the leased fund as long as the*

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(36) RADAWAN, *The Contract of Finance Lease*, supra note no. 8 at pp. 33 - 34.

(37) *It is contended that the financial institution works on behalf of the lessee as an agent when it purchases the assets from the supplier or the seller or the contractor. For a full discussion on the application of agency rules, see: RADAWAN, The Contract of Finance Lease, supra note no.8 at pp. 130 - 135; ELSAGHIR, Finance Lease, supra note no. 15 at pp. 30 - 31.*

*reason is not attributed to the lessor”.*

In confirmation of the financial and credit nature of the Leasing transaction, the agreed limitation of the Leasing period shall be equal to the economical life of the leased equipment or/and machines, provided that the lessor insures recovering all his investments during the contract period <sup>(38)</sup>. Also, the legislation in many countries, has permitted the lessee to own the assets leased thereto by announcing to do so at the end of the contract period and according to the conditions provided therein. This choice is permitted from one side only and that is the lessee. The lessor may not reject the sale if the lessee expresses his wish to purchase the leased

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(38) *KHASEM, Legal Aspects of Finance Lease, supra note no. 1 at pp. 57 - 58; It is worth mentioning that the period of leasing shall depend largely on the nature of the subject matter of the contract, e.g. if the leased assets are movable items then the leasing period shall be from two to five years, but if the subject matter of leasing is an immovable then the period of leasing shall be from ten to fifteen years, see: RADWAN, the Contract of Finance Lease, supra note no. 8 at p. 180. “Under the “full payout lease” (which might be the deal normally offered for instance for small items of office furniture and equipment), the rentals are calculated to reimburse the lessor the entire cost of the items, plus “interest” on that amount: or to put it another way, the rentals are calculated assuming that when the lessee hands the assets back at the end of the lease term, the lessor needs to realise nothing to provide him his target profit”. See: David WAINMAN, LEASING, supra note no. 16 at p. 6.*



object and pay the agreed price <sup>(39)</sup>. Also, the lessor on the other hand cannot force the lessee to purchase. The rentals paid by the lessee to the lessor during the Leasing contract period must be taken into consideration for determining the purchase price. Article 5 of the Egyptian Leasing Law No. 95 of 1995 stipulates that *“the lessee is entitled to select to purchase the leased object wholly or partially on the date and against the price determined in the contract, provided that the Leasing amount (rentals) paid must be taken into consideration while determining the price”*. There is no doubt that these features confirm the financial nature of the Leasing operation and that the lessor’s aim of owning such assets is not the ownership itself, but the lessor’s guarantee on the finance granted to the lessee. Also, the lessee’s objective from this operation is not renting itself but to obtain the finance required for the project as indicated by his obligation to settle a rental value that equals the purchase price of the assets leased thereto during the contract period.

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(39) *This means that leasing includes an implied promise to sell on the part of the lessor, a promise which cannot be withdrawn unilaterally, see: ELSAGHIR, Finance Lease, supra note no. 15 at pp. 50 - 51.*

***2- Leasing is Established on Personal Consideration.***

The Leasing contract being one of the credit operations is based on the personal consideration concept, where each of the contracting parties shall be trustworthy in the contracting process. This trust between the parties usually comprises a group of elements such as precedent dealing and each party's fulfillment of its previous warranties, and other factors such as the personal reputation of each of the contracting parties i.e. financial stability enjoyed by it ...etc. In implementation of the same, the finance entity (lessor) usually demands from the lessee to submit documents underlying and confirming the nature and volume of activity and his ability to settle his obligations resulting from this contract as well as other documents confirming trust which must be available to conclude the contract <sup>(40)</sup>.

An example of the personal considerations in the Leasing contract is the provision of Article 16 of the Egyptian Leasing Law which states that the assignment of the contract to another party is conditioned on obtaining the lessor's approval provided that the original lessee shall remain as a

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(40) KORMAN, *The Contract of Finance Lease*, supra note no. 2 at pp. 44 - 45.

joint guarantor to the assignee's execution of his obligations towards the lessor. This also includes the provisions of Article 19 of the said law which stipulates that the Leasing contract shall be automatically terminated without the need for any excuses or the adoption of any judicial procedures in case the lessee becomes bankrupt or insolvent and without the need to adopt any liquidation procedures by the lessee if it is a body corporate and regardless of whether the liquidation is compulsory or voluntary unless it is for amalgamation.

### ***3- Leasing is Considered a Trade Transaction***

#### ***(a) For the Finance Entity (lessor):***

There is no doubt that the Leasing transaction is considered as a commercial activity for the finance entity be it one of the banks or one of the other financial institutions such as the Leasing company, when it purchases capital assets for the purpose of Leasing them in accordance with the provisions of Article 4/1 of the Egyptian Commercial Law<sup>(41)</sup>.

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(41) Article 4 of the new Egyptian Trade Law no. 17 of 1999 provides that "The following works shall be considered commercial activities: A- Purchase of movables whatever their kind with the aim of selling or leasing them as they are, or after shaping them in another form, and also selling or leasing these movables B- Renting the movables with the aim of leasing them, and also leasing these movables ....". See also, KHASEM, *Legal Aspects of*

Even in the case in which Leasing is conducted by the finance entity without previously purchasing what it leases, the transaction may be considered as commercial on the basis that such entity is conducting the transaction on professional basis and accordingly gains the capacity of a merchant. Thus, all activities conducted and related to its business are considered as commercial activities.

In all cases, if the financing entity is a bank then Leasing, being a financing operation which is part of the bank transactions and activities, is considered as a commercial activity on the basis of its being part of the bank's transactions <sup>(42)</sup>.

***b) For the Lessee***

The commerciality of the Leasing operation for the

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=Finance Lease, *supra* note no. 1 at p. 89.

(42) Article 5 of the Egyptian law no. 17 of 1999 provides that: "The following activities shall be considered trading works in case they are exercised by way of profession:

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F- Banking and money exchange transactions". See, Dr. Mostafa Kamal TAHA, *Commercial law (Dar El Gama Al Ghadida Llinasher - no year of publication)* at pp 70 - 71; Ali Gamal Eldin AWAD, *Banking Operations - Legal Aspects (1989)* at pp. 675 - 676, KHASEM, *Legal Aspects of Finance Lease, supra* note no. 1 at pp 89 - 90; RADAWAN, *The Contract of Finance Lease, supra* note no. 8 at p. 89.

lessee depends on the nature of his activities. If the lessee is a merchant, such as having a commercial or industrial project, then the conclusion of a Leasing contract from his side shall automatically be considered as a commercial activity due to its being conducted by the merchant for the needs of his business. If the lessee is an individual who is not a merchant, then his conclusion of a leasing contract shall not be considered as commercial to him <sup>(43)</sup>.

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(43) *This is merely an application of the theory of accessory commercial transactions according to which the works and acts carried out by the merchant in the course of business dealings shall be considered also trade transactions. In this respect article 8 of the Egyptian law no. 17 of 1999 provides that " 1- Works that are carried out by the trader for business affairs connected with his trade shall be considered commercial works. 2- All works carried out by the trader shall be considered related to his trade, unless otherwise established". Some writers advocate that leasing, being similar to borrowing or lending contracts should be considered a trade transaction in every single case, even where the lessee is not a trade enterprise. This opinion relies on the ruling of the Egyptian Court of Cassation whereas it was ruled that loan contracts concluded between banks and their customers, whether those customers are merchants or not, should be regarded as commercial contractss subject to trade law. See, Civil Cassation, 27 June 1963, the court of cassation decisions annual year report year 14, pp 936 - 946. For the same opinion, see: RADWAN, The Contract of Finance Lease, supra note no. 8 at pp. 90 - 91. In our opinion, the ruling of the court of cassation, mentioned above, should be limited to loan contracts, and should not extend to reach leasing contracts. See for the same opinion, KHASEM, Legal Aspects of Finance Lease, supra note no. 1 at pp. 90 - 91. For criticising the above ruling of the court of cassation, see: Mostafa K. TAHA, Commercial Law, supra note no. 42 at pp. 68 - 69.*

#### ***4- Leasing is a Compound Operation***

The Leasing operation is a compound transaction as it embraces more than one stage for its formation.

The Leasing operation begins with a promise of Leasing from the party requesting the finance, followed by an implied agency from the finance entity (lessor) in which the finance applicant (lessee) shall be as an agent for the lessor in negotiating with the seller or supplier of the assets, whereas he may, in accordance with this agency, determine the technical and standard specifications of the leased object according to his needs. In fact, the lessee may also and according to this power of attorney, negotiate the purchase price which the lessor shall pay as well as the delivery conditions and other terms. Usually the agency rules are applied to this stage of the process. In fact, according to this agency, the lessee may conclude the purchase contract with the seller and receive the capital assets therefrom directly <sup>(44)</sup>.

Subsequently, the purchase process shall be performed and in which the sale contract rules are applied, between the

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(44) RADWAN, *The Contract of Finance Lease (LEASING)*, *supra* note no. 8 at p. 50 and at p.70, DOWIDAR, *The Legal Regime of Finance Lease*, *supra* note no. 11 at oo. 256 - 265.

finance entity (lessor) and the seller/supplier, especially in regard to the terms for the determination and settlement of the price, allocating the saleable material, and other rules applied to the obligations resulting from the sale contract <sup>(45)</sup>.

Thereafter, the Leasing process itself shall be executed. In this stage, the possession of the leased assets is transferred from the lessor to the lessee requesting the finance in order to benefit therefrom through the contract period. Also, the general rules of the ordinary lease contract are applied in a way that does not contradict the nature of the transaction itself.

Finally, the lessee is granted three options: he may request the renewal of the contract for another period under the same conditions or different conditions, or request the termination thereof, or express his wish to own such assets by purchasing them from the lessor. In this last case, the lessor is required to fulfill the lessee's wish and conclude the sale contract in accordance with the Leasing conditions and

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(45) Mario GIOVANOLI, *la Jurisprudence Suisse en Matière de Leasing*, in *le Leasing: Industriel, Commercial et Immobilier* (publication: centre du droit d'entreprise de l'université de lausanne 1995) at p. 21.

terms<sup>(46)</sup>.

Accordingly, "Leasing" is a compound transaction as more than one legal set of rules are interconnected in regard to the formation thereof, namely rent contract rules, agency contract rules, sale contract rules as well as the rules required as per the nature of the transaction itself.

***Second: Distinguishing between the Leasing Transaction and other Similar Transactions:***

As "Leasing" is a compound transaction related to more than one contract such as sale, rent and agency, it may resemble certain other transactions, which require in their nature the implementation of certain sale or lease rules as the case may be. Particularly, a distinction should be made between "Leasing" and the Leasing sale, credit sale and operating lease.

***1. Leasing – Leasing Sale:***

Leasing sale represents a contract in which the lessee undertakes to pay the agreed rental for a certain period and if he pays such rent in full, the lease shall be turned into sale

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(46) Jacques de Theux de MEYLANDT et MONTJARDIN, *Le Leasing Mobilier en Belgique*, supra note no. 12 at pp. 18 - 21.



and the rentals paid shall be considered as the price of the lease, bearing in mind that this price is payable in regular installments. The seller usually adopts this type of contract to protect himself from the risks of the lessee's disposing of the contracted object to others. In this contract, the lessor maintains the ultimate ownership whereas he can recover whatever may be in the possession of the lessee if the latter refrains from settling any of the due installments. Also, the lessee shall be a trustee on the leased item and shall be exposed to the penalty of mistrust in case of disposing the same <sup>(47)</sup>.

In fact, the correct tailoring of this contract is that it is a sale contract even if the contracting parties have named it a lease contract. This fact may be evidenced by the transfer of the title to the buyer on retroactive basis that goes back to the contract date of conclusion and not from the payment date of the last installment of the agreed rent.

With regard to the Leasing operation, even though it contains the lessee's selection to purchase the leased fund at

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(47) RADWAN, *The Contract of Finance Lease*, *supra* note no. 8 at pp. 61 - 63; KORMAN, *The Contract of Finance Lease*, *supra* note no. 2 at pp. 46 - 47; Mario GIOVANOLI, *la Jurisprudence Suisse en matière de leasing*, *supra* note no. 45 at pp. 34 - 35.

the end of the contract period, the lessee, if he wishes to make this selection, should conclude another new contract with the lessor (sale contract), the title of the contracted object shall be transferred, not from the time of concluding the Leasing transaction but from the time of concluding the sale contract at the end of such transaction when the lessee announces his wish to purchase, provided that the price agreed upon in the Leasing contract itself is settled. This is the ruling of Article 12/ 2 of the Egyptian Finance Lease Law which stipulates that *“if the lessee purchases the leased object, the title thereof shall not be transferred unless he pays the full price fixed in the contract”*.

Accordingly, the Leasing transaction contains a promise to sell from the lessor's side. The sale shall not be made unless the lessee expresses his wish to purchase at the end of the Leasing contract period. The sale may not take place at all at the end of the Leasing transaction and that is if the lessee does not express his request to purchase. If the sale occurs upon the lessee's announcement of his wish to purchase then the date of concluding the sale and the transfer of the title shall be from the time of such announcement, contrary to the Leasing sale in which the transfer of title takes place effective from the beginning of the contract itself.

## **2. Leasing and Renting (Operating Lease)**

Renting contract (Operating lease) is a contract according to which the lessee acquires equipment, machines, and other assets to conduct his activities i.e. cars, trucks and other required items <sup>(48)</sup>. The resemblance between Leasing and renting (operating lease) is that the subject of each of them is a certain object, which the lessee cannot own with his limited financial status or capabilities and thus seeks to acquire it by means of Leasing. However, there remain certain differences between the two contracts.

On the one hand, the leased assets in the operating lease are owned by the lessor substantially i.e. before concluding the renting contract. In other words, the subject of the operating lease contract comprises of assets which are

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(48) David WAINMAN, *LEASING*, *supra* note no. 16 at p. 21; KHASEM, *Legal Aspects of Finance Lease*, *supra* note no. 1 at pp. 75 - 76; RADAWAN, *the Contract of Finance Lease*, *supra* note 8 at pp. 53 - 54; Jacques de Theux de MEYLANDT et MONTJARDIN, *Le Leasing Mobilier en Belgique*, *supra* note no. at pp 23 - 24. Operating Lease may be defined as "A lease agreement, usually cancellable, which provides the lessee with the use of an asset for a period of time which is considerably shorter than the useful life of the asset. Unlike a capital lease, the lessee in an operating lease does not assume the economic risks of ownership, and the lessor generally provides all of the maintenance and services on the leased asset", See: BLACK's, *supra* note no. 10 at p. 1091.

originally owned or manufactured by the lessor in his capacity as the producer or owner thereof. In the Leasing contract, the lessor purchases certain assets for the purpose of leasing them upon the request of the customer requesting the finance. Frequently the Leased assets are not originally owned by the lessor.

On the other hand, the lessor, in the operating lease contract, in his capacity as the owner, shall bear the responsibility of the leased equipment or tools as being fit for the purpose they leased for, and to insure them even though the lessee shall bear these expenses upon estimation of the rentals <sup>(49)</sup>. In the Leasing contract case, the lessor does not bear the responsibility for the accordance of the leased items with the purpose they are designated for. Also, he is not liable for any latent defects that may appear, besides he is not obligated to obtain an insurance coverage for the leased items. The reason for this is that the lessee in the finance lease transaction is the party that determines the specifications of the leased object and inspects it to insure its conformity with the specifications. Furthermore, he is authorized by the lessor to receive them from the seller.

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(49) KORMAN, *the Contract of Financial Lease*, *supra* note no. 2 at p. 49.

Finally, operating lease differs from finance lease, in respect of the financing period. Usually, the former is used in short term financing on the basis that the rent period is not sufficient to cover the depreciation of the estimated life of the rented item. Accordingly, the lessor rents the same item more than once to more than one person according to various consecutive contracts. However, finance lease suits the needs of middle and long term financing, whereas Leasing is made for a period that would be mainly sufficient to cover the depreciation of the leased object within its estimated lifetime. Hence, the Leasing transaction basically has a financing nature.

### ***3- Leasing and installment Sale.***

The difficulty of distinguishing between the Leasing transaction and the installment sale arises in the case where the lessee expresses his wish to own the leased object at the end of the Leasing contract. Some jurists contend that the Leasing installments paid by the lessee during the contract period represent the payments to own the leased object at the end of the agreed upon period and that the amount paid by the lessee as the price of purchase, if he declares his selection to own the leased fund, may be considered the last installment

of the sale price <sup>(50)</sup>.

Nonetheless, there is a clear difference between Leasing and installment sale. In the Leasing contract case, the intent of both parties is directed towards Leasing and not sale. Also, the transaction may never end with sale if the lessee doesn't exercise his right in announcing the option to own, as the Leasing transaction ends to that extent. In case of installment sale, the will of both parties is directed since the beginning of the contract towards sale with all its legal effects, among which is the transfer of title and ownership at the moment the contract is made <sup>(51)</sup>.

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(50) *The confusion between Finance Lease and installment sale may specially arise when the last contract is accompanied with the condition that title of ownership shall be transferred to the buyer only after full payment of all installment is made. See, DOWIDAR, The Legal Regime of Finance Lease, supra note no. 11 at pp. 620 - 621.*

(51) *DOWIDAR, The Legal Regime of Finance Lease, ibid. at pp. 624 - 634. A confusion may also arise between financial lease and credit sale. The later is defined as "a sale in which the buyer is permitted to pay for the goods at a later time, as contrasted with cash sale. Any sale with respect to which consumer credit is extended or arranged by the seller. The term includes any contract in the form of bailment or lease if the bailee or lessee contracts to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the property and services involved and it is agreed that the bailee or lessee will become, or for no other or for a nominal consideration has the option to become, the owner of the property upon full compliance with his obligations under the contract, see: BLACK's, supra note no. 10 at pp. 369 - 370.*

***Third: Distinguishing between Finance Lease Contract and Ordinary Lease Contract***

Some writers have assumed that the Finance Lease contract does not differ from the ordinary lease contract. Both contracts contain the obligation of the lessor to place certain things in the possession of the lessee to benefit therefrom for a certain period. Accordingly, the legal structure of the finance lease contract should not differ from the legal structure of the ordinary lease contract. This view cannot be refuted by the fact that the finance entity (Lessor), in the Leasing transaction, purchases the assets upon the request of the customer and after signing the Leasing agreement itself. This contract includes a promise to lease, binding on both parties. Legislation in various countries has ruled that the promise to lease - similar to the promise to sell - becomes obligatory Leasing to both parties as long as the contract subject matter and the rent value as well as the period are determined in the promise<sup>(52)</sup>.

Those of the opinion that the finance lease contract

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(52) For a comprehensive discussion, see: Mario GIOVANOLI, *la jurisprudence Suisse en Matière de leasing*, *supra* note no. 45 at p. 45; DOWIDAR, *The Legal Regime of Finance Lease*, *supra* note no. 11 at pp 586 - 604; RADWAN, *The Contract of Finance Lease (LEASING)*, *supra* note no. 8 at pp. 46 - 55.

should be amalgamated within the category of the rental contracts and the necessity of subjecting them to the same legal system, stipulate that the availability of the choice for the lessor to purchase the assets which are the subject of the Leasing process does not nullify the fact of the leasing contract being considered a rent in its technical meaning. Their justification in this respect is that this choice is made available after the expiration of the original contract period, as if a new contract is established between the parties according to this selection. This other contract is the sale contract. This is evident by the fact that the Leasing contract period is determined according to the assumed life of the contract item, whereas they are depreciated during such period. Add thereto that the lessee's ownership of the Leased items is not one of the contract's fundamental elements, a fact which is derived from the concept that the lessee may not exercise the purchase right. Accordingly, the contract expires with the end of its period for being an ordinary lease contract. Also, the fundamental obligations in the ordinary lease contract are applicable in the financial Lease contract, among which are the lessee's obligation to pay for benefiting from the contract items for a certain period, lessee's obligation to maintain the leased fund, lessee's obligation not dispose of the leased fund throughout the contract period and the



obligation not to sub-lease the same without the lessor's consent. Also the lessor, in the finance lease contract, as it is the case in the ordinary lease contract, bears the risks of the availability of the rented items in possession of the Leasing enterprise as in the case of damage or defect. The financial Lease contract, as it is in the case of the ordinary lease contract, is terminated by operation of law in case the lessee becomes bankrupt<sup>(53)</sup>.

Even though there is a common resemblance between the finance lease contract and the ordinary lease contract in regard to certain basic rules, they differ in many aspects and it is incorrect to qualify Leasing as a sort of renting only<sup>(54)</sup>.

Initially, the Leasing process comprises renting of the assets contracted upon. However, the rent in this case represents one of the several stages of which this transaction consists. In addition to rent rules there are other rules from agency contract and the contract of promise to sell and other rules from the sale contract which may be applicable to finance lease. The ordinary lease contract of items represents

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(53) RADWAN, *The Contract of Finance Lease (LEASING)*, *ibid.* at pp 51 - 52.

(54) *Ibid.* at p. 49.

a dual relationship between the lessor and the lessee according to which the lessor places under the disposal of the lessee the contracted items for a limited period to benefit therefrom against a regular rental value. Also, the rented fund is mainly owned by the lessor who is capable of renting the same fund more than once to more than one person. However, in finance lease the leased fund is not usually owned by the lessor (finance entity) at the time of the agreement. In fact, the lessor in such transaction usually authorizes the lessee to determine the specifications of the subject matter, selection thereof and contracting with the supplier or seller in regard thereto. And, the Leasing period usually extends to cover the assumed age of the subject fund. Accordingly, the finance entity, in the majority of cases, cannot lease them once again to another person<sup>(55)</sup>.

Secondly, the ordinary lease contract differs from the finance lease contract in regard to the powers of the parties at the end of the contract. In the former contract, the lessee is obliged to return the rented items to the lessor unless they may agree later on to renew under the same conditions or other conditions. However, in the latter contract, as we

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(55) DOWIDAR, *The Legal Regime of Finance Lease*, *supra* note no. 11 at p. 595.

mentioned earlier, the lessee has the choice between returning the leased items to the lessor or renewing the contract or electing to purchase the leased items. All these choices constitute a fundamental characteristic of the finance lease contract and the lessor shall not be able thereafter to prevent the lessee from exercising his rights in the selection i.e. the ability to purchase the leased items becomes available to the lessee automatically upon entering the leasing relationship without being conditioned to the lessor's will, as the lessee may request to own the leased item at the end of the contract and pay the price agreed upon <sup>(56)</sup>.

Thirdly, the finance lease contract differs from ordinary lease contract in regard to the scope of obligations arising from both contracts. In the former contract, the obligation of maintenance and repair of the leased items lies on the part of the lessee. Also, the lessor does not guarantee any latent defects in the leased fund. All this differs from the case in the ordinary lease contract, whereas the obligation of maintenance and the guarantee of latent defects lie on the part of the lessor. Also, the installments in the finance lease contract mature fully from the lessee even if he does not benefit from the leased fund as long as the frustration of the

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(56) *EL SAGHIR, Finance Lease, supra note no. 15 at pp. 27 - 28.*

contract is not attributed to the lessor<sup>(57)</sup>. Such matters are not permitted generally in the ordinary lease contract as it is determined that the rent is paid for benefiting from the rented items and to the extent of the benefit.

***Fourth: Forms of Leasing Transaction:-***

The leasing transaction takes three main forms. It may be leasing of movable items and/or leasing of real estates, or it may be a subsequent Leasing or what is known in the English terminology as "Lease back".

***a) Leasing of Movable Things***

Movable things may be a subject matter of the Leasing contract. The lessor is obligated to lease certain movables or those liable to be determined, to the lessee against a certain rental value agreed upon by both parties<sup>(58)</sup>.

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(57) Article 11/2 of the Egyptian law no. 95 of 1995 on finance lease provides that the parties may agree that the full rental value shall be due to the lessor, even in such a case where the lessee has not made any benefit of the leased assets provided that the frustration of the contract is not attributed to the lessor.

(58) Article 2/1 of the finance lease law no 95 of 1995 which provides that the lessor shall be obligated to lease to the lessee certain movable owned directly by him or that shall be received by him from the contractor as a result of specific contract, e.g (sale), and that such a lease shall be in return of a rental value that shall be subject to an agreement between the lessor and the lessee.

It is conditioned that the leased movable things should be capital assets such as machines or equipment or other items agreed upon by both parties. Also, the leased movable may be intangible funds such as the "Goodwill" or "Fonds de Commerce" as long as all required elements for its existence are available <sup>(59)</sup>. The Egyptian legislature was successful when it defined the movable fund as one fit to be the subject of the Leasing contract when it stated in article 1 of the finance lease law that the leased fund may be ".....Real or

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(59) "*Fonds de Commerce*" is a French expression that refers to the totality of both intangible assets, e.g. trademark, trade name, reputation, clientship ...; and tangible assets such as goods, machines, equipment ... etc. The Anglo Saxon System recognizes a different concept which is called "Goodwill". The last term is defined as "The favor which the management of business wins from the public. The favorable considerations shown by the purchasing public to goods or services known to emanate from a particular source. *White Tower System v. White Castle System of Eating Houses Cooperation*, C.C.A. Mich., 90 F. 2d 67, 69. Property of an intangible nature commonly defined as the expectation of continued public patronage. *In re Marraige of Lukers*, 16 Wash. App. 481 - 558 p. 2d 279 - 280. The custom of patronage of any established trade or business; the benefit or advantage of having established a business and secured its patronage by the public. And as property incident to business sold, favor venor has won from public, and probability that all customers will continue their patronage. It means every positive advantage that has been acquired by a proprietor in carrying his business, whether connected with the premises in which the business is conducted, or the name under which the business is conducted, or with the name under which it is managed, or with any other matter carrying with it the benefit of the business" see, BLACK's *supra* note no. 10 at p. 694.

intangible movables..... except cars allocated for transporting passengers (motor vehicles) and motorbikes”..

***b) Leasing of Real Estates.***

The enterprise requesting the finance may resort to one of the financial institutions to provide its need of real estate or establishments to conduct its activities therein or construct the same, and thereafter lease the same property to the enterprise. This form is presented in three assumptions<sup>(60)</sup>.

In the first assumption, the buildings or constructions or the land are directly owned to the financial institution. In this case, the Leasing contract is concluded directly between the institution in its capacity as the lessor and the lessee requesting the finance for a certain period and against a certain rental value. The Egyptian legislature has permitted

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(60) See: Mario GIOVANOLI, *la Jurisprudence Suisse en Matière de leasing*, supra note no. 45 at pp 82 - 84; KHADEM, *Legal Aspects of Finance Lease*, supra note no. 1 at pp. 88 - 89; DOWIDAR, *the Legal Regime of Finance Lease*, supra note no. 11 at pp. 44 - 71; KORMAN, *the contract of financial lease*, supra note no 2 at p. 75. In particular, see: Hani M. DOWIDAR, *Land as a Subject to Finance Lease (Dar El Gama Al Gadida 1999)*. Article 2/2 of law no. 95 of 1995 on finance lease stipulates that leasing is considered a finance lease when the lessor is obligated to lease to the lessor such immovables or constructions established by the lessor and on his own expenses with the intent to lease them to the lessee, and according to the conditions, specifications and rental value provided for in the contract itself.

this assumption to be considered as a Leasing. We believe that this case is not more than an ordinary lease contract of buildings or constructions which is subject to the rental laws related thereto. The Egyptian legislature admitting this form as a Leasing is considered as unjustified expansion.

The second assumption represents the case in which buildings or constructions are not initially owned by the financial institution granting the finance. Such institution purchases the buildings which are erected according to the specifications and conditions determined by the party requesting the finance, and thereafter leases the same thereto for a certain period and against a certain rent <sup>(61)</sup>.

The third assumption represents the case in which the party requesting the finance is the owner of the land but needs certain financial capabilities or financing services to erect buildings and constructions on the said land and thereafter the financial institution provides the same. In this

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(61) *It is funny that the Egyptian legislature has ignored mentioning this assumption in article 2 of the finance lease law. Nevertheless, it goes without saying that the case in which the finance entity undertakes to purchase immovables in order to lease them to the finance applicant (the lessee) represents an important practice for leasing of immovables. The Egyptian legislature, however, should not be excused from omitting such an assumption.*

case, we face a combined situation. The land itself is owned by the party requesting the finance (Lessee) while the buildings and constructions erected thereon are owned by the financial institution (Lessor) which leases them to the lessee based on a Leasing contract. This situation may give rise to complicated problems upon expiry of the Leasing contract if the lessee does not express his wish to own such buildings and constructions which are owned by the lessor but erected on a land owned by the lessee. In order to solve this problem the financial institutions, if they agree to finance their customers according to this assumption, usually purchase the land itself from the finance applicant upon approval on the Leasing process so that it would be the owner of both the land and the building at the time of concluding the contract, hence no problems arise upon the contract expiration. However, according to the Leasing contract the lessee keeps the right to exercise any of the selections granted thereto according to the said contract. He may request the renewal, the termination thereof or to announce his request to own. In this last selection, the title of the land and buildings erected thereon devolves upon him and he shall be obligated to pay the purchase price to the lessor<sup>(62)</sup>.

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(62) *This assumption falls within the ambit of article 2/3 of law no. 95*



c) **"Lease - Back"**

The Lease back process is one of the forms invented by business in the United States and which has been transferred to France thereafter <sup>(63)</sup>. Also the Egyptian legislature has adopted the same as per article 2/3 of the Leasing law No. 95 of 1995.

According to this form of Leasing the, financial institution purchases certain items from the funds of the applicant and thereafter places these items under the disposal of the previous owner but upon Leasing basis with a promise to re-sell the same upon expiration of the Leasing contract if the lessee (former owner) expresses his wish of purchase.

The Egyptian legislature has defined this form of Leasing transaction in article 2/3 of the Leasing law by stipulating that *"the validity of any contract, according to which the lessor obliges to lease any fund to the lessee on Leasing basis if the ownership of the fund is transferred by*

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=of 1995.

- (63) According to American law, lease-back is defined as a "Transaction whereby transferor sells property and later leases it back. In a sale leaseback situation, for example, R would sell property to S and subsequently leases such property from S", see BLACK's, *supra* note no. 10 at p. 990. For further discussion on lease-back according to Swiss law, see: Mario GIOVANOLI, *la Jurisprudence Suisse en Matière de Leasing*, *supra* note no. 45 at pp. 84 - 86.

*the lessee to the lessor, shall be dependable on the conclusion of the Leasing contract*". In implementation thereof the party requesting the finance (Lessee) transfers the title of his funds, be it a real-estate or tangible assets, to a financial institution (Lessor) while retaining the right to repurchase the same upon settlement of the price, as per a Leasing contract accompanied by an obligatory promise to sell from the side of the financial institution (Lessor).

This form of Leasing has an obvious practical importance, as the Americans have created it to assist the enterprises, which have material assets but lack liquidity cash. One of the financial institutions purchases those funds, and thereafter the applicant acquires the needed cash to continue his project while at the same time achieving a distinguished advantage which is represented in the non-abandonment of his capital assets which he had sold to the financial institution. In fact, he takes possession of the said funds in the form of Leasing while retaining the rights to repurchase them upon expiration of the lease period based on an obligatory promise to sell by the lessor<sup>(64)</sup>.

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(64) *KHASEM, Legal Aspects of Finance Lease, supra note 1 at pp. 148 - 149; DOWIDAR, Land as a Subject to Finance Lease, supra note no. 60 at pp 141 - 148; KORMAN, The Contract of Finance Lease, supra note no. 2 at pp 25 - 26.*

## **CHAPTER TWO**

### ***LEASING CONTRACT CONDITIONS***

Objective and formal conditions are required in order to conclude the Leasing contract. The objective conditions are necessary for the validity of the act between the two contracting parties but the formal conditions, basically aim at advising third parties about the act.

#### ***First: The Objective Conditions***

The objective conditions necessary for the validity of the Leasing contract are: the consent, the subject matter, the consideration and the legal capacity.

#### ***A- The Consent***

The Leasing contract is a consensual contract in which conclusion does not require writing in a certain official form<sup>(65)</sup>. The consent issued by the two parties must be free

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(65) RADWAN, *The Contract of Finance Lease (LEASING)*, *supra*, note no. 8 at p. 95; DOWIDAR, *The Legal Regime of Finance Lease*, *supra* note 11 at p. 239. A consensual contract is "a term derived from the civil law, denoting a contract founded upon and compleated by the mere consent of the contracting parties, without any external formality or symbolic act to fix the obligation" see BLACK's, *supra* note no. 10 at p. 304.

from defects like mistake, coercion, fraud and exploitation. Defect in consent rarely happens in the Leasing contracts unless there is a mistake in the person of either contracting parties and such a mistake was substantial, like providing inaccurate information about the financial or industrial status of the lessee and upon which the consent to finance is given. In such event, the contract may be nullified on the basis of substantial mistake <sup>(66)</sup>. The contract may also be nullified e.g. if the lessee commits fraudulent acts in order to appear as a successful enterprise so as to obtain of the finance <sup>(67)</sup>. The offer and acceptance are usually issued in Leasing after studies and negotiations are held between the two parties. The enterprise requesting the finance shall apply to the financial institution asking to lease a certain fund and that is the offer but such offer is required to be accompanied by the necessary information and data such as identity of the finance applicant and if he is a natural person or juridical person. If he is a juridical person like a company, what is the legal form adopted by it? What is the type of the activity? What is the size of the capital? The finance application should also be supported by the feasibility studies pertinent to

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(66) *RADWAN, the Contract of Finance Lease (LEASING)*, *ibid.* at p 96.

(67) *Ibid.* at pp 96 - 97.

the required extensions of constructions as well as the guarantees enhancing the ability of the enterprise requesting the finance to fulfill its obligations arising of the contract. In all events, the furnished information should be authenticated and accompanied with the documents requested by the finance body (the lessor) <sup>(68)</sup>.

Accordingly, the finance body shall study the financial position of the enterprise requesting the finance, its current and future capabilities. It shall also determine the rental value to be collected during the lease period, the profits to be calculated upon the finance, fixing the price for selling the assets if the lessee declares his desire to own them at the end of Leasing. In other words, the finance body shall study whatever may affect its finance decision <sup>(69)</sup>.

Then, another stage starts i.e. the stage of putting the acceptance issued from the finance body into effect, as such body shall search for a seller or supplier who provides the

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(68) DOWIDAR, *The Legal Regime of Finance Lease*, supra note 11 at pp 240 - 244; KORMAN, *the Contract of Finance Lease* supra note no. 2 at pp 52 - 54.

(69) See: *The Executive Regulation for Implementing the Law of Finance Lease* (published in ALAWAKHE AL-MASRIA - issue no. 291 "supplementary issue" 21 December 1995) - article 4.

finance applicant with his needed assets. If the required fund is in the form of a real estate or structures, the finance body shall search for a seller or contractor who undertakes the execution of the specifications fixed by the finance applicant. If the required fund is machinery, the finance body shall be required to search for the specified quality and measurements etc.. Although the purchase contract is supposed to be concluded directly between the finance body and the seller or the supplier, the finance body takes care to encourage the finance applicant to participate in this stage in one form or another such as authorizing him to personally select the requested assets <sup>(70)</sup>. This will exempt the finance body (the lessor) from the guarantee of latent defects because the finance applicant (the lessee) is the party who inspects the leased fund and selects it by himself <sup>(71)</sup>. In order to apply the same, article 7 of the Egyptian Leasing Law provides that ***“the owner of any enterprise may, before concluding the Leasing Contract, negotiate directly with the supplier or the contractor concerning the specifications of the funds necessary for his enterprise or the method of manufacturing or constructing it upon a prior written***

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(70) ELSAGHIR, *Finance Lease*, *supra* note no. 15 at pp. 30 - 31.

(71) KHASEM, *Legal Aspects of Finance Lease*, *supra* note no. 1 at pp

*approval from whoever shall undertake the lease. Such approval should contain the issues which shall be the subject matter of negotiations to be conducted between the enterprise owner and the supplier or contractor”<sup>(72)</sup>.*

It is noticed that the enterprise requesting the finance is normally obliged to sign a delivery record stating the entry of the leased fund into his possession <sup>(73)</sup>. Such record is considered substantial because it is connected with the payment by the finance body of the price to the seller. The finance body may also take the precautionary measures for

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=126 - 127.

(72) *It is submitted that the results of negotiations shall not be binding on whoever shall undertake the lease except within the limits and to the extent approved and notified to the entrepreneur as well as the supplier or contractor. In all cases, whoever undertakes the lease shall not be bound by any subsequent agreements concluded between the entrepreneur and the supplier or the contractor. See article 4 of the Executive Regulation, supra note 69.*

(73) *Article 8 of the Egyptian Finance Lease Law provides that, in such a case, where the lessor permits the lessee to receive the leased assets directly from the supplier or the contractor, then delivery shall be in accordance with the terms and specifications agreed upon and mentioned in the delivery record indicating the condition of the leased assets as well as the defects, in case they exist. The lessee is entitled to refuse accepting the leased fund if the supplier or contractor declines from writing a delivery record mentioned herein before. Also, article 5 of the Executive Regulation mandates that the lessee shall be liable to the lessor for any data (information) relating to the leased fund and mentioned thereto in the delivery record. See: The Executive Regulation supra note no. 69.*

itself towards the seller by inserting what is called the recovery condition. The lessee may not be able after a period from the contract date to fulfill his undertakings arising from the Leasing contract such as the payment of the rental value due to disorder in his works or due to any other reason and the finance body may not be saved from the risk by the guarantees it takes from the lessee because it, as a buyer, is liable for the price towards the seller regardless of payment by the lessee. In addition, the finance body shall bear the liability of the leased assets which shall be returned to it while the finance body does not need such assets in principle as it has purchased them in order to lease it. Therefore, the finance body usually inserts a condition in the purchase contract with the seller or the supplier which obliges the latter to restore the leased fund if the lessee sustains any misfortune which may lead to his inability to continue fulfilling his contractual obligations due to any reason whatsoever <sup>(74)</sup>. There is no doubt that the existence of the said condition may encourage the finance body to take the initiative in performing the Leasing operations without fear.

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(74) DOWIDAR, *The Legal Regime of Finance Lease*, supra note no. 11 at pp 502 - 511.



***B- Subject Matter of the Contract (The Leased Fund):-***

Leasing contracts often extend to assets such as machinery, supplies and equipment needed by the commercial, industrial, agricultural, professional, trade or service enterprises for the purpose of either to start a new activity or continue an existing one by updating and providing it with the advanced technology <sup>(75)</sup>.

Some writers contend that the subject matter of the Leasing contract embraces all the tangible movables regardless of the purpose of finance. Therefore, the movables prepared for the personal use of the lessee are fit as a subject for Leasing operation even if they are not designated to any of the purposes of the productive, professional, trade or agricultural etc.. activity <sup>(76)</sup>. Those who advocate this opinion rely upon the freedom of the contract, and hence the liberty of the parties to determine the scope of their contract. This opinion would imply that the Leasing operation extends to include the house furniture, domestic equipment and

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(75) *For the definition of the fund subject matter of the leasing contract, See: article 1 of the Executive Regulation, supra note no. 69.*

(76) *RADWAN, The Contract of Finance Lease (LEASING), supra note no. 8 at pp 101 - 102.*

computers for the purpose of personal use and otherwise<sup>(77)</sup>.

The foregoing opinion is expanded unreasonably. It is desirable that Leasing should be restricted to funds destined for the purpose of conducting the commodity or service or productive operations in general<sup>(78)</sup>. If the leased funds are computers for example, they shall be appropriate to be a subject matter of the Leasing operation in case where the lessee is a company, bank or enterprise which shall use them in its professional activities but, if the lessee intends to use those computers for personal purposes then they cannot be subject to a Leasing contract. In fact, the Egyptian legislature itself has supported this view by excluding cars and motorbikes from the funds which can be subject of Leasing contract, because they are usually allocated for personal purposes<sup>(79)</sup>. However, if the cars are allocated to transport passengers in a tourism or investment enterprise or any

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(77) *This is an argument submitted by the advocates of the loose interpretation of article 1 of the French law of July 2nd, 1966. See: RADWAN, The Contract of Finance Lease (LEASING), ibid. at p. 101.*

(78) *KHASEM, Legal Aspects of Finance Lease, supra note no. 1 at pp 104 - 105.*

(79) *See: The Executive Regulation for Implementing the Law of Financial Lease (published in ALAWAKHE AL-MASRLA - issue no. 291 "supplementary issue" 21 December 1995) - article 4.*

transportation enterprise then they can be considered as a subject matter of Leasing.

The intangible movables may be a subject matter of Leasing contract such as the Goodwill "Fonds de commerce", patents, trademarks, and industrial logos <sup>(80)</sup>. There is no doubt that considering the goodwill as a subject of the Leasing contract will participate in making the financial policy of small trade enterprises as successful where the finance body, upon the request of its customers shall purchase this form of intangible property from others and lease them back to the finance applicant against a certain rental value during the contract period. Thereafter, the finance entity grants the lessee the three choices at the end of the contract, one of which is to purchase the goodwill.

In fact, Leasing may be applied to shares issued by the joint stock companies <sup>(81)</sup>. This aspect is usually applied to shareholding companies wishing to obtain the funds required for their activities. Instead of borrowing from financial institutions or from the public by means of issuing bonds, the

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(80) KORMAN, *The Contract of Finance Lease*, *supra* note no. 2 at 76.

(81) DOWIDAR, *The Legal Regime of Finance Lease*, *supra* note no. 11 at p 38.

shareholding company issues new shares. Based on an agreement with the finance body, this latter subscribes in the shares. Thereafter, the finance body leases the same shares to the same shareholding company, which has issued them for a certain period during which the company is obliged to pay a specific rent. Eventually, the company shall be able to obtain the required finance. Also, at the end of the Leasing contract the company would be able to purchase such shares from the lessor (finance body) and pay the price thereof (which usually represents the remaining balance of the nominal share value). There is no doubt that this mechanism confers upon the shareholding company a great advantage by giving it the opportunity to acquire all the needed funds without having recourse to borrowing or the subscription of new shareholders.

Finally, real estates may be subject of Leasing contracts as long as the purpose of Leasing them is to finance industrial, commercial, professional, service enterprises (factories - hotels - theaters... ). Accordingly residential real estates are excluded from the scope of leasing.

**C. Consideration** <sup>(82)</sup>

The consideration of the contract is the motive behind contracting. The consideration of concluding the Leasing contract is financing. From the standpoint of the commercial, industrial, agricultural or professional enterprise the consideration of the contract is the need to obtain the required funds necessary for the enterprise, as it cannot with its current capabilities obtain the same <sup>(83)</sup>. From the point of view of the finance body (lessor) the consideration of the contract is to invest certain funds by purchasing them and then Leasing the same in order to receive the rental value, in addition to a certain profit, provided that the rent value charged by the lessor for the contract shall equal the estimated age of the leased asset.

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(82) *The term "consideration is almost equivalent to the term "cause" recognized in civil law countries. Generally, consideration is defined as the "The inducement to a contract. The cause, motive, price, or impelling influence which induces a contracting party to enter into a contract. The reason or material cause of a contract. Some right, interest, profit or benefit accruing to one party, or some forbearance, detriment loss, or responsibility, given, suffered or undertaken by the other". BLACK's, supra note no. 10 at p. 306.*

(83) *KHASEM, Legal Aspects of Finance Lease, supra note no. 1 at p. 108.*

The aforementioned consideration is a legitimate one as it does not violate public order or the morals, and it does not contradict the basic principles of Islamic law (Sharia'h), as the amount received by the finance body consists of two elements: the purchase price of the leased fund, in addition to the predetermined sum of profit, without placing any fixed interest on the purchase price.

However, if the motive behind contracting is usage of the leased fund for objectives contrary to public order or morals then, the contract would be absolutely null <sup>(84)</sup>.

#### ***D- Legal Capacity***

In order for the leasing contract to be valid both lessor and lessee must be qualified and have the required legal capacity.

##### ***1- Lessor's capacity***

The Lessor may be a natural person or a juridical person. This requirement is indicated in article 1 of the Egyptian Leasing Law which stipulates that "***Every and each***

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(84) *Ibid. at p. 107.*

*natural or juridical person may conduct Leasing operations after due registration in accordance with the provisions of the law. The Lessor may be a bank if permitted to do so by the board of directors of the Central Bank according to the conditions and procedures determined in the permit decision*". The Egyptian Legislature permits natural persons to conduct Leasing operation. This matter is not limited to juridical persons, as applied by other legislatures such as the French legislature. According to the French Law no one except enterprises such as companies or banks or other financial institutions having the juridical personality are permitted to conduct Leasing operations. Also, at the same time, these enterprises are required to abide by the decisions made by the National Credit Council <sup>(85)</sup>. In the United States, Leasing operations are normally carried out by banks<sup>(86)</sup>.

Accordingly, Leasing operations in the United States

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(85) DOWIDAR, *The Legal Regime of Finance Lease*, supra note no. 11 at pp. 114 - 128, and in particular at pp. 116 - 117; KORMAN, *The Contract of Finance Lease*, supra note no. 2 at pp 64 - 65; ELSAGHIR, *Finance Lease*, supra not no. 15 at pp. 9 - 10, KHADEM, *Legal Aspect of Finance Lease*, supra note no. 1 at pp. 95 - 100.

(86) RADWAN, *The Contract of Finance Lease (LEASING)*, supra note no. 8 at p. 111.

and France are limited to the banks as well as the commercial companies pursuing Leasing operations professionally, and they are subjected to the central banks control because they are considered credit operations. There is no doubt that this procedure aims at protecting the parties dealing with financial institutions.

The attitude of the Egyptian legislature in allowing the performance of leasing by natural persons is highly criticized for being a threat to the credit system in general. Leasing is considered as a credit operation which must basically be conducted by banks. If certain companies are permitted to work in this field, they must submit certain guarantees such as the availability of minimum limit of the paid up capital and the submission to a control authority such as the central bank while fulfilling certain requirements such as registration in the lessor's record and obtaining a permit to practise such operation <sup>(87)</sup>.

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(87) However, the Egyptian Legislature stipulates certain conditions in order for natural persons to have the permission to conduct leasing operations. See: article 9 of the Executive Regulation, *supra* note no. 69.



## *2- Lessee's capacity*

The Lessee is the enterprise that applies for the finance. It may be a natural person such as commercial or industrial or professional institutions or it may be a juridical person such as a company<sup>(88)</sup>. If a natural person conducts commercial or industrial business he must have the required capacity to conclude the Leasing contract being commercial contract however, if the lessee is a professional such as a doctor or an engineer or a lawyer then he must be legally qualified to do so because he shall be obliged to pay the rentals. Also, he will be able at the end of the contract to purchase the leased fund if he requests to do so.

If the lessee is a juristic person such as a company then the subject matter of the Leasing contract must be within the objectives contained in the articles of association. e.g. a tourism company is not permitted to conclude a Leasing contract to finance an agricultural or industrial project because they are not within its powers. Also, the capacity of the juridical person is limited to the goals or objectives for which it was established.

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(88) Article 1 of the Egyptian law on Financial Leasing no. 95 of 1995.

### ***Second: Formal Conditions***

It was previously stated that the Leasing contract is a consensual contract which does not require a certain form. The contract is concluded upon offer and acceptance of both parties. However it has been the custom to write Leasing contracts in order to protect the contracting parties specially when those contracts extend over a long period of time. Therefore, it is better to preserve the rights and obligations resulting from the contract in a written document. In fact, both the French and the Egyptian legislatures require that the contract should be announced according to certain procedures. This indicates that writing has become necessary for the sake of registration <sup>(89)</sup>.

#### ***A) Writing***

Writing is not a prerequisite for the conclusion of financial lease contracts. Leasing contracts are, therefore, of consensual nature. The absence of writing does not nullify the contract or affect its validity. There is no doubt that once the

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(89) For example, article 19 of the Executive Regulation provides that it is necessary to attach with the registration application a copy of the Finance Lease Contract. This means that writing is a condition for registration.

contract is embodied in writing, it shall be the document upon which the parties may rely thereupon to prove their mutual rights and obligations. Though writing is a method used for evidence, the financial lease contract, being a trade transaction, shall be proven by all means of evidence<sup>(90)</sup>.

The writing, in which the contract is drawn up, may be conventional or official. Usually banks resort to authenticate the Leasing contracts in order to adequately preserve their rights in case of disputes with their customers.

### ***B) Authentication***

The aim of announcing the Leasing contract is to notify third parties in regard to the nature of the relationship that connects the lessor and lessee and to the nature of the lessee's possession of the assets as being a temporary possession for the purpose of benefiting therefrom, and in order to prevent the lessee from appearing as an owner before third parties<sup>(91)</sup>.

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(90) KORMAN, *The Contract of Finance Lease*, supra note no. 2 at pp 82 - 83; RADWAN, *The Contract of Finance Lease*, supra note no. 8 at pp. 115 - 116.

(91) For the importance of authentication of leasing contracts, see:

There is no doubt that the contract registration represents a protection for third parties and the lessor. It represents a protection to third parties by notifying them not to grant credit facilities to the lessee such as lending money to him, based on his appearance as the owner of the assets in his possession while this guarantee proves false latter on. Also, registration is a protection for a lessor against third parties so that none-of these funds go out from the general guarantee of the lessor's creditors. In fact, the registration itself is considered as a protection for the lessee himself because the notation in the register of the Leasing contract adds more protection in case the lessor alienates the leased assets to a new buyer, whereas the lessee's right in the lease shall be valid against the transferee.

According to an old practice, the authentication took the form of placing certain marks and data on the leased assets indicating that they are owned by the lessor and that the lessee's possession thereof is for benefiting purpose only<sup>(92)</sup>.

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=DOWIDAR, *The Legal Regime of Finance Lease*, *supra* note no. 11 at p. 180; KHADEM, *The Legal Aspects of Finance Lease*, *supra* note no. 1 at p. 111.

(92) RADWAN, *The Contract of Finance Lease (LEASING)*, *supra* note no. 8 at p. 117.

Recently, the French legislature has required that a special register should be made to record Leasing contracts pertaining to tangible assets. This authentication should be made at the commercial court as well as the commercial chambers at the courts of first instance. The French legislature has obligated the financial institution granting the finance to register the finance lease contract on the basis that it is in its interest to inform third parties about its title in the leased fund. Based on authentication, the lessor would be able to defend his title to the leased fund against third parties specially the lessee's creditors and his successors. If authentication is delayed, the lessor would not be able to defend his title unless the third party's bad intention and knowledge of the nature of the lessee's possession of the leased fund is proved. If the leased fund is a real-estate the contract must be registered in the official mortgage office in the same manner and method according to which official real-estate mortgage is registered<sup>(93)</sup>.

The Egyptian legislature stipulates that the Leasing contract pertaining to movables and real estates should be registered in a special register to be established for this

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(93) DOWIDAR, *The Legal Regime of Finance Lease*, *supra* note no. 11 at pp 193 - 196, 203 - 204.

purpose. The first paragraph of Article 3 of the Egyptian financial lease law reads as follow: *“the concerned administrative authority shall prepare a register for the registration of lessors. Also, it shall establish another register for the Leasing contracts concluded or executed in Egypt or in which one of the parties is residing in Egypt as well as the sale contracts related thereto and any amendment thereto. The registration must specify the leased fund, the description of the contracting parties, their legal capacity with regard to the fund, contract duration and the details contained in the sale contract”*.

Accordingly, the Ministry of Commerce and Economy must prepare a special record to register the Leasing contracts concluded or executed in Egypt or in which one of the parties is residing in Egypt. The law has also demanded the registration of the sale related to the Leasing contract in case the lessee selects to purchase the leased fund at the end of the Leasing period.

The Egyptian legislature, in Article 17 of the Leasing law, stipulates that all amendments made on the contract as well as all assignments made by lessors must be recorded in the register pertaining thereto. Third parties may not be

challenged for entry, amendment or assignment except from the date of notation in the register.

The legislature as per the Egyptian Law has imposed significant effects on the registration in the Leasing contract register. Article 6 of the said law stipulates that *“notwithstanding the rights of the state, effective from the date of registration, no lessee or any third party shall be permitted to object to the lessor in regard to any right that contradicts the details of the Leasing contract in which it was registered according to the provision of article 6 of this law”*.

Hence, if the Leasing contract data and information are registered in the register kept for this purpose according to the law then, such details would be an evidence against third parties and no person shall be entitled to challenge the lessor in contradiction to those data and information. In implementation thereof, if the lessee becomes bankrupt the lessor may retrieve the leased fund which shall not be entered in the lessee's bankruptcy.

However, the non-registration of the Leasing contract does not nullify it. The only effect that may result in this case

is the inability to challenge innocent third party who acts in good faith even though the contract itself is considered as having a legal binding effect between the parties thereof.

Based on the above, the lessor's interest is apparent in accelerating the registration of the Leasing contract in the contracts register as soon as the contract is concluded, in order to preserve his right as the owner of the leased fund against third parties <sup>(94)</sup>.

Whereas the recording in the Leasing contract register is considered an evidence against third parties, the Egyptian legislature has permitted every person to approach the concerned administrative authority to obtain a copy of the register details. Article 3/4 of the Leasing law stipulates that *"every and each person is permitted to obtain a copy of the registered details (data) in both registers after payment of the fixed fee"*.

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(94) Review chapter 3 of the Executive Regulation, *supra* note 69.



## **CHAPTER THREE**

### ***EFFECTS OF THE LEASING CONTRACT***

The leasing contract entails mutual obligations and rights for its parties i.e. the lessor and the lessee. Rights and obligations generated from such contract are similar to those arising from the ordinary lease contract however, due to the special nature of the Leasing operation, the said rights and obligations arising therefrom warrant a different treatment.

#### ***First: Lessor's Obligations***

##### ***1- The Undertaking for Delivery***

The lessor undertakes to deliver the leased fund to the lessee. The fund should be in a good condition to perform the purpose agreed upon in the contract <sup>(95)</sup>. The two parties shall have the liberty to agree on the place and date of delivery. The lessor undertakes to make the delivery regardless of whether the fund is under his possession if he is

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(95) *In this respect, article 8 of the Egyptian Finance Lease Law provides that if the leasing contract permits the lessee to receive the leased fund directly from the supplier or the contractor, then delivery shall be in accordance with the terms and specifications agreed upon and subject to a delivery record stating the condition of the delivered fund and of any defects thereof.*

the owner thereof, or if he has to purchase it from a seller or supplier <sup>(96)</sup>. In case of Leaseback, the leased fund is actually under the disposal of the lessee and therefore, the delivery shall be inevitable by changing the legal capacity of the fund holder from an owner to a lessee.

The lessee is usually authorized to take delivery of the leased fund from the seller or the supplier and the same should be done according to the conditions and specifications agreed upon as well as a taking over record in which the condition of the leased fund should be described <sup>(97)</sup>. The lessee may refuse to take delivery of the leased fund if the supplier or the seller refrains from writing the delivery record<sup>(98)</sup>. The lessee shall bear the responsibility for non-compliance of the leased fund with the specifications stated in the delivery record <sup>(99)</sup>.

If the lessee receives the leased fund without writing

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(96) RADWAN, *The Contract of Finance Lease (LEASING)*, *supra* note no. 8 at pp 191 - 192.

(97) SALEM & SALEM, *Finance Lease*, *supra* note no. 1 at p 32.

(98) KORMAN, *The Contract of Finance Lease*, *supra* note no. 2 at p. 100.

(99) *This shall in case the lessee accepts the leased fund without protesting, since he shall be considered acting as an agent for the lessor.*

down a delivery record, he shall be exposed to a high risk as he cannot thereafter have recourse to the seller or the supplier if it appears that such fund has defects at the time of receiving it and the said defects are discovered at a latter stage.

## **2- *The Obligation of Maintenance:***

According to the general rules, the maintenance obligation in the lease contract shall be the responsibility of lessor <sup>(100)</sup>. However, the Leasing institutions used to transfer such obligation to the lessee due to the fact that such fund is kept and possessed by the lessee for the contract period. The same meaning is confirmed by the fact that the lessee is the party who selects the said fund in accordance with his needs and determines the specifications thereof. Therefore, the interest of the lessee shall be preserved by performing the regular and periodical maintenance of the leased fund especially if he has the intention to declare the desire of buying the fund under lease <sup>(101)</sup>.

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(100) *David WAINMAN, LEASING, supra no. 48 at p 10.*

(101) *RADWAN, The Finance Lease Contract (LEASING), supra note no. 8 at p. 194.*

Thus, the Egyptian legislature stipulates in article 9 of the Leasing law the obligation of the lessee to use and maintain the leased funds in accordance with the purposes designated for them and according to the directions issued by the lessor in respect of the technical instructions to be followed whether they are determined by him or by the supplier himself<sup>(102)</sup>.

### ***3- The Obligation of Guarantee***

In accordance with the general rules, the lessor undertakes the guarantee for whatever may preclude the lessee from utilizing the leased fund whether due to any act by the lessor himself, his subordinates (Servants) or by third parties and this is known as the guarantee not to interfere with the contractual relationship. The lessor also undertakes in accordance with the general rules to guarantee that the leased fund is free from the latent defects, which renders it impossible to utilize such fund or leads to reducing the utilization thereof. Also, if the fund is depreciated, such depreciation shall be for the account of the lessor<sup>(103)</sup>.

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(102) SALEM & SALEM, *Finance Lease*, *supra* note 1 at p. 32.

(103) See articles 571 - 578 of the Egyptian Civil Code.

***A- Extent of the lessor's Obligation for the Interference Guarantee***

The lessor secures to the lessee that the contract shall not be hampered or interfered with by him or by third parties. On the one hand, the lessor shall be responsible for his conduct or acts as the same shall entail a faulty selection of the leased funds as if he himself and without an authorization from the lessee, selects the leased fund depending on the general description which the lessee informs him about and without ascertaining completely the accurate description. Here, the lessor cannot have recourse to the lessee to recover the costs he would have incurred or to compel the lessee to take over the leased item because if the lessee refuses to take over, the same shall jeopardize the lessor and the lessee shall have the right to request the revocation of the contract with compensation <sup>(104)</sup>.

On the other hand, the lessor shall guarantee for the lessee against interference with the contract by third

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(104) KORMAN, *The Contract of Finance Lease*, supra note no. 2 at pp 102 - 103; SALEM & SALEM, *Finance Lease*, supra note no. 1 at p. 33.

parties<sup>(105)</sup>. Third parties are considered to include the seller or the buyer as for the lessee if such interference may preclude utilizing the leased fund at any form whatsoever. As an example for the forgoing, the lessor prevents the payment of the balance of the purchase price to the seller or the supplier and then, the latter in return shall revoke the contract and recover the leased fund, which unavoidably affects the lessee.

It is worth mentioning that the provisions of the interference guarantee are among the public order and hence, no agreement may be made to the contrary thereof in case of the lessor's fraud as every agreement provides for the exemption from, limiting the prevention or defect guarantee shall be considered null if the lessor fraudulently conceals the reason for that guarantee<sup>(106)</sup>.

The Egyptian Legislature provides for the obligation of the lessor concerning such guarantee under article 14 of the Leasing Law by stating that “ *The lessor shall be responsible for his acts or deeds which lead to a faulty*

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(105) Compare, however, DOWIDAR, *The Legal Regime of Finance Lease*, supra note no. 11 at p. 302. See: RADWAN, *The Contract of Finance Lease (LEASING)*, supra note no. 8 at pp. 196 - 197.

(106) Article 578 of the Egyptian Civil Code.

*selection of the leased funds or enable the supplier, contractor or third parties to prevent the lessee's utilization of the leased funds at any aspect".*

***B- Extent of Obligation for the Guarantee of the Latent Defects.***

According to the general rules, the lessor guarantees to the lessee the defects which prevents his benefit from the leased fund or lessens that benefit significantly. Also, he guarantees the defects which he explicitly undertakes that they are not existing in the Leased fund unless otherwise agreed upon <sup>(107)</sup>.

However, as the lessee is the party that determines the specifications of the leased fund and is authorized by the lessor to select the seller, inspect the said fund and receive it directly from the seller, therefore, the lessee is the party that has the opportunity to confirm the integrity of the leased fund and that it is free from any defect which may affect benefiting therefrom. The lessor, in the Leasing operation, may not have any relation in regard to the determination or inspection of the leased fund. Therefore, the lessor is usually exempted

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(107) Article 576 of the Egyptian Civil Code.

in the contract from guaranteeing latent defects in the leased fund in such cases <sup>(108)</sup>. Therefore article 9/2 of the Egyptian Leasing Law stipulates that *“the lessee is also obliged to notify the lessor of any average (occurrences) to the leased fund that may prevent benefiting therefrom wholly or partially according to the procedures contained in the contract related to the said funds”*.

### ***C. Destruction of the leased fund***

As the lessor, in the leasing contract, retains the title of the leased fund, he shall bear the consequences of the its destruction whenever the same occurs due to reasons beyond the lessee's control such as natural disasters or due to the action of third parties.

Article 10/2 of the Egyptian Leasing Law stipulates that *“the lessor shall bear the consequences of the destruction of the leased fund if it occurs due to reasons beyond the lessee's control. The lessor may insure the*

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(108) ELSAGHIR, *Finance Lease*, supra note no. 15 at p. 35; RADWAN, *The Contract of Finance Lease (LEASING)* supra note no. 8 at p. 200; DOWIDAR, *The Legal Regime of Finance Lease*, supra note no. 11 at pp 300 - 304; KORMAN, *The Contract of Finance Lease*, supra note no. 2 at p. 106; Dr. Ali Gamal ELDIN AWAD, *Banking Operations - Legal Aspects* (1989) at pp 676 - 677.



*leased funds in a way that would guarantee recovery of the rental value for the rest of the contract period and according to the price determined therein*". Accordingly, the rule in the Egyptian Law is that the liability of destruction shall be borne by the lessor. However, the finance entity (lessor) may reserve its rights by inserting a condition in the Leasing contract indicating the necessity of having the leased fund insured by the lessee so that the insurance would guarantee the lessor's rights in the said fund. Also, the lessor may include a condition in the contract that prevents the lessee from canceling the insurance policy without obtaining the lessor's prior consent <sup>(109)</sup>.

We notice that the lessor, being the owner of the leased fund, may obtain an insurance document in his name directly and include the insurance premiums paid by him within the rentals, which the lessee is obliged to pay <sup>(110)</sup>.

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(109) DOWIDAR, *The Legal Regime of Finance Lease*, *supra* note no. 11 at pp. 416 - 418; KORMAN, *The Contract of Finance Lease*, *supra* note 2 at p. 110; SALEM & SALEM, *Finance Lease*, *supra* note no. 1 at p. 33; RADWAN, *The Contract of Finance Lease*, *supra* note no. 8 at pp 201 - 202.

(110) DOWIDAR, *The Legal Regime of Finance Lease*, *Ibid.* at p. 418.

***Second: Lessee's Obligations***

The lessee undertakes according to the Leasing contract to maintain and repair the leased fund, pay the agreed rent, return the leased fund to the lessor if he decides not to purchase it; besides he is obliged to bear civil liability for the damages caused by the leased fund to third parties.

***A- The Lessee's Obligation for Maintenance and Repairs***

The lessee undertakes to maintain i.e. to watch over the leased fund in order to prevent the occurrence of any damages or defects therein. Also, he undertakes to repair the leased fund if any defects or damages occur therein. Although these two obligations are originally the responsibility of the lessor as per the general conditions of the ordinary lease contract, the special nature of the Leasing contract mandates that they should be borne by the lessee for being the party who determines the specifications of the leased fund and receives it from the seller or vendor. Article 9/1 of the Egyptian Leasing Law lays down this obligation by stipulating that *"the lessee is obliged to use, maintain and repair the leased funds in a way that suits its designated objectives ...."*.

According to a condition in the Leasing contract, the lessor may follow up the lessee's execution of its obligations periodically to confirm that the lessee carries out maintenance and repair requirements. The lessor, by doing so, is actually protecting his own fund in the first place. Also, this process cannot be construed as interference by the lessor in the lessee's affairs, as the lessor has the right of control in order to avoid the misuse of the leased fund. Hence, the lessee is obliged to notify the lessor of any occurrences that may prevent benefiting from the leased fund wholly or partially according to the procedures contained in the contract <sup>(111)</sup>.

As long as the lessee has possession of the leased fund to benefit therefrom, he must safeguard the same throughout the Leasing contract period. He shall be considered as having breached the trust if he forfeits, misappropriates, or embezzles the leased fund, subject to proving a criminal intent on his part (mistrust crime) e.g. lessee's retaining the leased fund upon expiry of the contract and non payment of the purchase price as well as the lessee's disposal of the leased fund by sale causing damage to the lessor <sup>(112)</sup>.

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(111) *Article 9/2 of the Egyptian Finance Lease Law.*

(112) *ELSAGHIR, Finance Lease, supra note no. 15 at p. 40.*

### ***B- Lessee's Obligation to Pay the Rent***

The essential obligation of the lessee is the payment of the rent agreed upon under the contract<sup>(113)</sup>. The agreement on the rentals, the place and dates of payment are left to the discretion and mutual understanding of both parties<sup>(114)</sup>. However, it is usually considered in the estimation of the rent that it should cover the purchase price within the Leasing contract period, in addition to certain profit percentage and the costs incurred by the lessor<sup>(115)</sup>. A down payment is

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(113) David WAINMAN, *LEASING*, *supra* note 48 at p. 7.

(114) Article 11/1 of the Egyptian Law No. 95 of 1995 on Finance Lease.

(115) "Under the 'full payout lease' (which might be the deal normally offered for instance for small items of office furniture and equipment), the rentals are calculated to reimburse the lessor the entire cost of the items, plus 'interest' on that amount: or to put it another way, the rentals are calculated assuming that when the lessee hands the assets back at the end of the lease term, the lessor needs to realise nothing to provide him his target profit. If they can in fact be sold, the lease agreement will often provide that a substantial proportion of the proceeds should go to the lessee as a rebate of rentals. It is therefore the lessee who bears the whole of the risk that the assets will fail to realise whatever price he expected when he signed the lease that they should be capable of producing at its end. A less usual method of achieving the same effect is as follows. The rentals are calculated on the footing that the asset will realise (say) twenty per cent of its original cost when sold at the end of the term, so that although the lessor is still financing the whole of the asset's cost, he assumes that eighty per cent of that principal will be repaid by the lessee, and twenty per cent by the asset's sale, (the lessee of course also

usually made upon the lessee's receipt of the leased fund. Thereafter, settlement is to be made at regular periods which may be monthly, semi annual or annual payments as agreed by both parties under the contract <sup>(116)</sup>.

Article 19 of the Egyptian Leasing Law stipulates that the contract shall be automatically terminated without the need for any justifications or any judicial procedures to be adopted in case the lessee fails to settle the agreed rent in time and according to the contractual conditions <sup>(117)</sup>.

According to the general rules in the lease contracts, the rent is usually paid for benefiting from the leased item <sup>(118)</sup>. Thus, no rent shall fall due if benefit is not obtained. However, the Leasing contract has broken this rule, so that the lessee shall be obliged to pay the rental value even if he does not benefit from the leased fund as long as the reasons

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*=paying the whole 'interest' element). Then, if the asset realises more than the target sum, the lessee participates only in the excess. But correspondingly, if it realises less, the lessee is liable to pay an extra 'rental' to make good what would otherwise have been the lessor's residual loss. Any such final rental, but particularly one whose size cannot be calculated until the asset has been sold, is referred to as a 'balloon rental'." See, David WAINMAN, LEASING, supra note 48 at p. 6.*

(116) Article 11/1 of the Egyptian Finance Lease Law No. 95 of 1995.

(117) SALEM & SALEM, Finance Lease, supra note no. 1 at p. 3.

(118) Article 579 of the Egyptian Civil Code.

are not attributed to the lessor. The reason for this fact is that the lessor in such contract shall purchase the fund based on instructions from and for the benefit of the lessee in order to lease the fund to the lessee. Also, the lessor originally is not in need of this fund and he may not be able to dispose of it thereafter to another person. Accordingly, it would be fair for the lessee to settle the rent in full even if he does not benefit from the leased fund. Article 11/2 of the Egyptian Leasing Law stipulates that *"it may be agreed on the entitlement of the lessor to the full rental value even if the lessee does not benefit from the leased fund as long as the reasons are not attributed to the lessor"*.

In certain cases, the sale price paid by the lessor to the seller or vendor may be reduced, e.g. once any workmanship defects are discovered in the leased fund. In such assumptions, the rent which the lessee is obliged to pay may be reduced, as estimating the rent installments shall take into consideration the purchase price paid by the lessor<sup>(119)</sup>. If a reduction is made on the purchase price, the reduction may be applied on the rent with the same percentage unless otherwise agreed upon by both parties. In this way a type of

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(119) KORMAN, *The Contract of Finance Lease*, supra note no. 2 at pp. 121 - 122.

balance is achieved in the performance of both parties and here, the financing role of the lessor is confirmed thereunder. In this context, article 22/2 of the Egyptian Leasing Law stipulates that *"if the determination is limited to reducing the sale price due to defects in the industry of the leased fund or a shortage therein, a reduction must be made in the rent installments and the sale price agreed upon in the Leasing contract with the same reduction percentage unless it is otherwise agreed upon"*.

In any case, the financing institutions usually demand from the lessees certain guarantees for the settlement of the rent. As the mortgage of the leased fund cannot be presented as a guarantee from the lessee's side because it is simply owned by the lessor himself, personal guarantee is considered as one of the significant methods to secure and safeguard payment of the rent.

#### ***C- Lessee's Obligation to Return the Leased Funds***

As a general rule, the lessee undertakes to return the leased funds to the lessor due to the temporary nature of the contract period except if the lessee wants to own it by expressing his desire to purchase. Article 20 of the Egyptian

*Leasing Law stipulates that "upon termination of the contract without being renewed or the leased fund is purchased, the lessee, the syndicate or the liquidator, as the case may be, is obliged to hand over the leased fund to the lessor in the same condition agreed upon by virtue of the contract. If the lessee refrains from delivery, the lessor may submit a petition to the judge of summary actions at the competent court to obtain a delivery order (injunction). All procedures and provisions contained in Article 194 of the commercial and civil law of procedures shall be followed with regard to this petition.*

*All concerned parties may file their complaint in this respect either by objection before the process server upon execution or through normal procedures for filing a case within three days from the date of service. In both cases, the competent judge shall look into the petition as soon as possible.*

*The judge may, upon the request of the petitioner, suspend the matter under complaint until a judgement is delivered in the complaint. The judge shall determine the complaint either by supporting, amending or canceling".*



***D. Does the Lessee Have the Right of Recourse Directly to the Seller or Supplier?***

The lessee is not a party to the purchase contract of the assets leased to him. The said contract is concluded between the lessor and the seller or the supplier. Although the lessee is considered as an outsider or third party in the purchase contract itself, he has the right to recourse directly against the seller or supplier because he is the actual party benefiting from this fund and he is usually the party who determines the specifications of the said fund, deciding and inspecting it. Therefore, article 13 of the Egyptian Leasing Law stipulates that ***“the lessee may recourse directly against the supplier or contractor in all lawsuits arising for the lessor from the contract concluded between him and the supplier or the contractor, except in case of rescission of contract, without prejudice to the lessor’s right of recourse to the supplier or the contractor in this respect”***.

Giving the lessee the right of recourse directly to the seller, supplier or contractor has its logical justifications as the lessor usually exempts himself by means of conditions he inserts in the Leasing contract; such as the condition for the exemption of guarantee of defects, or exemption of liability

to damages that may attach to the leased fund. If the lessee could not have the right of direct recourse to the supplier or seller then, he would have lost any other way of recovery. In addition, even if it was correct that the lessee is considered as an outsider from the purchase contract concluded between the seller or supplier and the lessor, he (i.e. the lessee) is in fact connected to the contract because he is authorized by the lessor to select, determine and inspect the said leased fund. He may also issue the delivery record on behalf of the lessor<sup>(120)</sup>.

In application of the forgoing, the lessee may request the seller to decrease the sale price (the purchase price of the leased fund due to certain latent defects in the workmanship thereof) and the reduction in the said price shall result in a reduction in the rent installments which the lessee is obliged to pay to the lessor. The lessee may also ask the seller to repair the leased fund if it has certain defects and / or to pay compensation therefore.

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(120) *This means that according to the Egyptian Finance Lease Law, the lessee shall have a direct action against the supplier or contractor. See: KORMAN, The Contract of Finance Lease, supra note no. 2 at pp. 131 - 133. For different legal theories for the recourse of the lessee, see: DOWIDAR, The Legal Regime of Finance Lease, supra note no. 11 at pp 329 - 364.*

However, the Egyptian Legislature has excluded the rescission lawsuit, as the lessee is not permitted to seek recourse thereunder to the seller or supplier, otherwise the same would mean that he may be released from his obligations towards the lessor if the termination is determined with regard to the purchase contract because of the retroactive effect of rescission of contract in which the seller would be entitled to recover the fund under the contract <sup>(121)</sup>.

***E. Could the Lessee Assign the Leasing Contract to Third Parties?***

The effective rule is that Leasing contracts are based on personal considerations and hence, the lessee may not assign them to others so that the lessor would be forced to deal with another person. However, the lessee, subject to the lessor's approval, may assign the contract to another lessee. In such event, the original lessee shall be a guarantor of the assignee (the other lessee) for the execution of his obligations according to the contract if the lessor approves the same <sup>(122)</sup>. Also, the other lessee (assignee) undertakes to pay to the lessor directly the due rent as per the contract effective from

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(121) Article 13 of the Egyptian Finance Lease Law No. 95 of 1995.

(122) Article 16/1 of the Egyptian Finance Lease Law No. 95 of 1995.

the date on which the lessor notifies him about his approval. The assignee shall not insist towards the lessor on the rent he accelerated prior to this date <sup>(123)</sup>.

The lessor may also assign the Leasing contract to another lessor. This assignment is not valid against the lessee except as from the date of his notification. This assignment shall not prejudice the rights and guarantees of the lessee from the original lessor. All the rights and obligations resulting from the leasing contract shall be transferred to the new lessor in a way that does not affect the rights and guarantees of the lessee <sup>(124)</sup>.

Notation of the Leasing contract assignment, whether from the lessee's or from the lessor's side, shall be effected in the special register designated for Leasing contracts. No objections may be raised against third parties for the transfer except as from the date of entry in the said register <sup>(125)</sup>.

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(123) *Ibid.* article 16/2.

(124) *Ibid.* article 15/1.

(125) *Ibid.* article 17.

***F: Lessee's Selections upon Expiration of the Contract Period***

We have pointed out that the lessee has one of three choices at the end of the Leasing contract: either he selects to purchase the leased fund (most likely) or he may request the renewal of the Leasing contract for other periods and finally he may return the leased fund to the lessor <sup>(126)</sup>.

***First: Purchase Option***

The lessee may decide to purchase the leased fund especially if it is a real estate or other movable assets which are not subject to wear and tear through technological factors. The Leasing contract contains a promise from the lessor according to which he undertakes to sell the leased fund if the lessee expresses his wish in this respect. The lessor and the lessee must agree in the Leasing contract on all issues relating to such purchase <sup>(127)</sup>.

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(126) *Ibid.* article 5.

(127) *The purchase may take one of two forms: "the 'bargain purchase option' permits its holder to acquire the asset for a purely nominal sum, well below what might be expected to be its open market value at the point at which the option may be exercised. The "fair value purchase option" is the antithesis, as its name clearly indicates." See: David WAINMAN, LEASING, supra note 48 at p. 22.*

On the one hand, a specific date must be determined for declaring the purchase selection so that the lessee during that period shall exercise this option; otherwise he shall be considered as having abandoned that option. If such a date is not determined in the Leasing contract itself, which is unlikely to happen, the lessee may announce this desire at a suitable time prior to the expiration of the contract period. Also, the contract usually contains clauses stating how the lessee may declare his desire of purchase such as by a registered letter or other methods<sup>(128)</sup>.

On the other hand, the contract must contain a certain article that specifies the price which the lessee undertakes to pay to the Lessor in case of expressing his desire to purchase the leased fund. If such price is not determined, usually both parties agree on the basis according to which the price shall be determined. In estimating the price, it shall be taken into consideration the rent installments paid by the lessee during the validity period of Leasing contract during which the assumed life of the leased assets are depreciated. This means that the purchase price would be reduced according to the

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(128) KORMAN, *The Contract of Finance Lease*, supra note no. 2 pp. 153- 154. However, title shall not be transferred to the lessee unless he pays the purchase price in full according to the contract, article 12/2 of law no. 95 of 1995.

depreciation of the leased fund <sup>(129)</sup>.

If the lessee expresses his wish to purchase then, the buyer undertakes to conclude a sale contract with the lessee in which the lessor shall be the seller while the lessee shall be the buyer. The sale shall be made according to the terms and conditions stated in the Leasing contract, especially with regard to the price determination. The conclusion, confirmation and registration of the sale contract shall be subject to the rules and regulations in both the civil and commercial laws according to the nature of the fund.

### ***Second: Renewal of the Leasing Contract***

Upon expiry of the Leasing contract, it may be in the interest of the lessee to request the renewal thereof instead of expressing his desire to purchase the leased fund. Contract renewal shall be made according to new conditions to be agreed upon by both parties. Usually, the original contract includes the basis on which renewal shall be made in order to avoid any problems between the lessor and the lessee and in order to prevent any arbitrary action from the side of the lessor to deny contract renewal. It is common in the Leasing

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(129) Article 5 of the Finance Lease Law No. 95 of 1995.

contract that the renewal terms are easier than the terms of the original contract, especially with regard to the value of the rent installments which are usually less than those stated in the original contract. The reduction of the rent installments in the original contract is basically attributed to the fact that the leased assets are about to be depreciated in the original contract period <sup>(130)</sup>.

It should be kept in mind that the renewal of the Leasing contract must be explicit. In general, leasing contract renewal should not be implicit. In fact, the contract renewal must be in writing so that it could be authenticated. Article 5/2 of the Egyptian Leasing Law stipulates that *"in all events, the contract cannot be renewed or extended implicitly whether the lessee is notified of the expiration of the contract period or not"*.

### ***Third: Returning the Leased Fund***

If the lessee does not express his wish to purchase the leased fund and if no agreement is reached between the lessor and the lessee on the renewal of the Leasing contract, then

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(130) RADWAN, *The Contract of Finance Lease*, supra note no. 8 at p. 228.



the lessee shall be obliged to return the leased fund to the lessor. The returning of the leased fund is an obligation on the part of the lessee and not a mere choice given to him <sup>(131)</sup>. The lessor is entitled to force the lessee to return the leased fund.

If the lessee fails to return the leased fund in the same condition and under the same terms agreed upon in the contract, he shall be considered as breaching the trust if the lessee's refraining from returning is without justification.

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(131) *David WAINMAN, LEASING, supra note no. 45 at p. 7.*

## CHAPTER FOUR

### **DISSOLUTION AND TERMINATION**

#### **OF THE LEASING CONTRACT**

Usually the lessor inserts in the Leasing contract certain cases in which the Leasing contract would be considered as automatically dissolved without the need for any excuses or a judicial judgement. Among these cases: Lessee's failure to pay rent in time, bankruptcy or insolvency of the lessee, liquidation of the company and total loss of the leased fund. The Egyptian Legislature has confirmed that the leasing contract shall be terminated by operation of law in the aforementioned cases even where the parties themselves have not stipulated the same <sup>(132)</sup>.

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(132) *Article 19 of the Egyptian Law on Finance Lease Law No. 95 of 1995. It is to be mentioned that there could be a difference between dissolution and termination of the contract. "The dissolution of a contract is the cancellation or abrogation of it by the parties themselves, with the effect of annulling the binding force of the agreement, and restoring each party to his original rights". Termination, however is a term that "refers to an ending, usually before the end of the anticipated term of the lease or contract, which termination may be by mutual agreement or may be by exercise of one party of one of his remedies due to the default of the other party ..... under the uniform commercial code, 'termination' means legally ending a contract without its being broken by either side". See: BLACK's supra note no. 10 at p. 473 & p. 1471.*

***A. Lessee's Failure to Pay Rent in Time***

The Leasing contract may provide for a condition according to which the contract would be considered dissolved if the lessee fails to pay one or a specific number of installments in time. According to this condition dissolution shall automatically take place without the need for any excuses or the issuance of a judicial judgement <sup>(133)</sup>. However, the lessee shall have the right to resort to the court with regard to his dispute for the reason that gave rise to dissolution such as, pleading that he did not delay the rent as provided in the contract <sup>(134)</sup>. Also the lessor, in spite of the contract dissolution, shall have the right to claim the delayed rent from the lessee and to execute accordingly against his funds. The contract termination does not release the lessee from his obligation to pay the rent.

In certain Leasing contracts the lessee is obliged to pay the balance rent for the remainder of the contract period in case of terminating the contract before its agreed date of expiration. Accordingly, the contract is dissolved and the

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(133) DOWIDAR, *The Legal Regime of Finance Lease*, supra note no. 11 at pp 481 - 482.

(134) KORMAN, *The Contract of Finance Lease*, supra note no. 2 at pp 175 - 176.

lessee shall be obliged at the same time to settle the installments for the remainder of the contract period during which he did not actually benefit from the leased assets. The condition ruling for the obligation of the lessee to bear the rental value for the remainder of the contract period prior to termination is considered as a penalty condition and the rent collected by the lessor in this case shall be considered a contractual compensation to the lessor for the damages which have befallen him due to the dissolution, especially, as he may not normally be able to lease the same assets to another person because leasing depends on the personal capacity of the lessee and the specifications of the assets which have been determined by the latter according to his needs. Thus, it would be difficult to find another lessee<sup>(135)</sup>.

#### ***B. Bankruptcy or Insolvency of the Lessee***

The Leasing contract depends on the personal consideration of the parties. The lessee contracts with a

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(135) RADWAN, *The Contract of Finance Lease*, supra note no. 8 at pp 219 - 227. For a comprehensive discussion of the penalty condition, see: KHASEM, *The Legal Aspects of Finance Lease*, supra note no. at pp 139 - 147. The Egyptian Legislature permits the agreement that the lessor shall collect the full rental value, even in case the lessee does not benefit of the leased fund, as long as the reason for that is not attributed to the lessor (article 11/2).

reputable and well-known financial institution in the market in order to fulfill his needs without delay. Also, the financial institution, in its capacity as a lessor, does not enter into any Leasing relationship except after having due trust and confidence that its customer (lessee) would be able to fulfill the requirements of the contract. The lessee's obligation to pay the rent is considered as a current and on going condition. There is no doubt that the judgement passed in regard to the bankruptcy or insolvency of the lessee shall undermine the trust and subvert the personal consideration on which the contract is based. Thus, the contract is terminated and the lessor retrieves his fund, which shall not be part of the lessee's bankruptcy, and the lessee's creditors shall not have any right over this fund <sup>(136)</sup>.

### ***C. Liquidation***

If the lessee is a company, it shall, upon termination, undergo a certain stage called the liquidation period. During this period the personal capacity of the juridical person shall remain valid in spite of expiry and according to the level and requirements that are necessary for liquidation. The reasons for this are that the liquidator, during the liquidation period,

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(136) Article 19/b of the Egyptian Finance Lease Law.

shall continue to execute the contracts concluded by the juridical person during the period that preceded the dissolution. However, the Egyptian Legislature has determined that, as the Leasing contract is based on the personal consideration, the continuation thereof during the liquidation period through a person other than the lessee, such as the liquidator, may demolish the personal capacity on which the contract is based. Article 19/C of the Egyptian Leasing Law stipulates that the contract should be considered as automatically dissolved without the need for any notice or taking any judicial procedures in case of taking the liquidation procedures towards the lessee if he is a juridical person whether the liquidation is compulsory or voluntary<sup>(137)</sup>.

#### ***D- Destruction of the Leased Funds***

The leasing contract is terminated by operation of law if the leased fund is destroyed entirely and it shall be equal in this regard that such destruction shall occur due to the force majeure or a reason attributed to either party: the lessor or the

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(137) SALEM & SALEM, *Finance Lease*, supra note no. 1 at p. 34.

lessee <sup>(138)</sup>.

As for the partial destruction of the leased fund, it shall not lead to the total loss of the subject matter of the contract. Then, the contract shall not expire unless the destroyed portion prevents the benefit from the leased fund <sup>(139)</sup>.

The general rule is that the consequences of the leased fund destruction lies upon the shoulder of the lessor as long as the lessee has no connection therewith <sup>(140)</sup>. Based on the total loss of the leased fund the obligation of the lessor terminates due to the impossibility of execution, and the obligations of the lessee shall expire in return; thus the contract becomes legally terminated.

As the leased fund remains in possession of the lessee throughout the Leasing contract period and as the lessor is the party that bears the consequences of the leased fund destruction, the lessor usually obliges the lessee to obtain in his favor an insurance policy covering the risks which the

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(138) *Ibid.* at p. 34; Article 21 of the Egyptian Finance Lease Law..

(139) This result may be deduced from the language of article 21/1 of the Egyptian Finance Lease Law, since it mentions only the case of total destruction.

(140) Article 10/2 of the Egyptian Law No. 95 of 1995.

leased fund may encounter and that would guarantee that the lessor may recover the insurance compensation in case of total loss <sup>(141)</sup>.

However, if the causes of the leased fund destruction are attributed to the lessee he shall be obliged to continue payment of the rental value on its maturity date or to pay the balance thereof, taking into consideration the insurance compensation which the lessor may receive. It is noticed that the lessee's payment of the balance rental value for the remainder of the contract period in this case shall be considered as a type of compensation to the lessor <sup>(142)</sup>.

#### ***E- Impact of Companies Merger on Leasing Contracts***

Usually, merging takes place between companies either by means of annexing or unifying. The annexing method represents the merging of one or more juridical person into other juridical person where the merged company disappears while the merging company survives. Merging may be by means of unification where one or more juridical persons merges together, then all shall expire and cease so

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(141) *Ibid.*

(142) *Article 21/2 of the Egyptian Law No. 95 of 1995.*



that a new juridical person is established to replace all of them<sup>(143)</sup>. The last assumption is sometimes called consolidation.

Merging leads to the disappearance of the merged juridical persons. The vanishing of the legal personality of the merged company shall consequently lead to the cessation of its pre-merging obligations including those arising of the Leasing contract. However, it is legally determined that in cases of merging, the merging company shall be considered as a successor of the merged company with regard to its obligations. Accordingly, as a general rule, merging can't be considered as a reason for the termination of the Leasing contract, as the rights and obligations arising from this contract shall pass from the merged juridical person to the merging juridical person or the new juridical person

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(143) *Merger is defined as "an amalgamation of two corporations pursuant to statutory provision in which one of the corporations survives and the other disappears. The absorbtion of one company by another, the former losing its legal identity, and later retaining its own name and identiy and acquiring assets, liabilities, franchises, and powers of former, and absorbed company ceasing to exist as separate business entity ..... It differs from a consolidation wherein all the corporations terminate their existence and become parties to a new one". See BLACK's, supra note no. 10 at p. 988.*

emanating from such merging <sup>(144)</sup>. The merging company is considered as a successor, which legally replaces the merged juridical person in all rights and obligations resulting from the contract. The lessee or the lessor, being a merged juridical person, are equal in this respect.

It is noticed that the Egyptian Legislature in article 19/C of the Leasing law has excluded merging from the cases in which the contract is considered as automatically terminated provided that the rights of the lessor contained in the contract are not prejudiced. As merging is considered as an amendment to the Leasing contract due to the change of personality of one of its parties "lessee or lessor", merging should be authenticated and affixed in the contracts register.

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(144) Article 19/c of the Egyptian Finance Lease Law No. 95 of 1995.

## **CONCLUSION**

The Egyptian Legislature has treated Leasing in several provisions which could have been done without most of them. The general rules in the civil code and commercial law would have been most sufficient to cope with many of leasing problems. However, the Egyptian Legislature is commended for adopting decisive solutions for several legal problems caused by Leasing in practice utilizing in this regard the experiences of other countries namely, the French experience, and regrettably excluding the seeking of guidance from the American practice despite its significance as being the environment in which the Leasing phenomenon originated, a matter which has had a major impact on drafting the articles of the current law as well as the solutions adopted by the Legislature in this regard.

The Leasing concept depends basically on distinguishing between use or benefit and title. While title is proved in favor of the lessor, the lessee is entitled to use the leased assets against a regular rental value valid throughout the contract period without having to borrow or provide certain guarantees and with an opportunity to own these

assets upon expiry of the Leasing contract for a minor sum of money, the basis of which are usually agreed upon in the Leasing contract itself. Meanwhile, the Leasing contract provides the lessor with the most significant guarantees which include his retention of the title in the leased assets throughout the contract period so that he shall be able to recover them in case of the lessee's default in payment of the rent and which also provides him with safety upon lessee's bankruptcy and the possibility of recovering the leased assets through the bankruptcy process without any competition from other creditors.

Although the Egyptian legislature has achieved a remarkable success in the making of a legislative framework for leasing however, there are certain criticisms which should have been avoided. Among these is that the Leasing law has permitted both natural persons and juridical persons to conduct Leasing operations. The Egyptian Legislature should have prevented persons other than juridical persons to conduct such Leasing operations where the natural persons would be prohibited to conduct such operations due to their vital impact on the national economy. The Leasing transactions should have been limited to shareholding companies that provide the ability to collect capitals and

permit governmental bodies to have certain supervision over the activities of these companies.

In view of the intended privatization policy in Egypt, leasing appears as a prominent financing method used to push forward the production process and to provide industry with the latest modern and advanced technology. It may be appropriate for the Egyptian Legislature to complete the legislative framework of Leasing by issuing a law which regulates the activities of Leasing companies as done by the State of Kuwait when it issued a law which regulates Leasing and Investment Companies <sup>(145)</sup>.

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(145) *See law no. 12 of 1998 of leasing and investment companies, published (Kuwait Alyom, issue no. 362 year 44, 1998).*

