

## Privity of Contract in Financial Leasing

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### *Abstract*

*This article examines the classical doctrine of privity of contract in the context of financial leasing transactions. According to the doctrine of privity, rights and duties originating from a certain contract shall only affect the parties to that contract. Despite the fact that the doctrine still is an undisputable main rule in Finnish law, exceptions to it are necessary. This is partly due to the fact that modern forms of exchange, finance and contractual practice require flexibility. The situation may be that a third party, who is formally not a party to a contract, is de facto comparable to a contractual party.*

*An example of a situation where the traditional and dogmatic division into inter partes and ultra partes relationships should be slightly reconsidered is a financial leasing transaction. Financial leasing is an established tripartite form of finance where, in short, the financier A purchases an object from the supplier B and leases it to the customer C who chose the object. The established practice in financial leasing transactions is that the supplier B and the financier A enter into a sales contract and the financier A and the customer C into a lease contract, which essentially differs from an ordinary lease contract on movable property. No formal contractual relationship between the supplier B and the customer C exists. However, it can be argued that a specific relationship – that is de facto comparable to a contractual relationship – does exist between the supplier B and the customer C.*

*The main focus of this article is on examining the relationships of the parties to the leasing transaction. It is argued that the examination should not be limited to the formal contractual relationship but deviating from the doctrine of privity should be possible if reasonable grounds weighty enough exist. What is to be considered “reasonable ground weighty enough” is examined mainly on the basis of the practical arguments developed by Olli Norros. In addition, due to*

*the special features of a financial leasing transaction it is argued that financial leasing should be recognized as an independent form of finance. Thus, the relationships between the parties to the transaction should be examined considering the purpose of the parties, the situation de facto as well as the financial leasing transaction as a whole.*

## **Full Article**

### **1 Introduction**

The binding effect of a contract is traditionally understood to be limited only to parties of a certain contract: contractual rights and duties only affect the contracting parties. This legal principle is widely known as the doctrine of privity of contract. Traditionally this doctrine has also been the most distinguishing feature between contract and property law both in common and civil law countries<sup>1</sup>. The mechanical distinction between *inter partes* and *ultra partes* relationships has been predominant. Traditional theory states that proprietary rights, or rights *in rem*, are binding on third parties where contractual rights are not<sup>2</sup>. However, in later judicial discussion it has been discerned that judicial evaluations based purely on the mechanical distinctions between different branches of law do not reflect the judicial and social situation *de facto*.

One of the topical judicial phenomena where the wavering of limits between contract and property law, as well as the wavering of *inter partes* and *ultra partes* relationships actualize nowadays, is financial leasing. Shortly put, financial leasing is a form of finance in which a finance company A purchases an object from a supplier B and leases it to the customer C who has chosen the object.

Normally the object is movable property – vehicles as well as manufacturing and data processing equipment, to mention just a few<sup>3</sup>. Reasons for choos-

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1 See e.g. Kartio JJ 1997, p. 152, Atiyah 1981, p. 265 and Zitting 1951, p. 73–75.

2 Hoffrén 2008, p. 219.

3 According to the Official Statistics of Finland, the majority of leasing objects leased during the year 2008 were cars and other vehicles (37.9 %), data processing equipment (25 %) and manufacturing equipment (19.2 %). In addition, the portion of leased vessels, airplanes and trains was 2.8 %. See Statistics Finland, Rahoitusleasing 2008. According to the same statistics leasing is mostly used in the mercantile industry.

ing financial leasing vary. Leasing being less capital-intensive than purchasing, a customer company C may avoid excessive debt liabilities by leasing the object. In addition, it may shift the risk of the fluctuation and lowering of the object's value to the financier, as well as enhance its tax planning.

Financial leasing transactions are not statutory<sup>4</sup>. However, these tripartite transactions are widely used and more or less established practice does exist<sup>5</sup>. Referring to the above definition of financial leasing, in a financial leasing transaction parties A and B enter into a sales contract and parties A and C into a lease contract. According to the traditional – and would I say dogmatic – theory, between C and B no contractual relationship nor contractual rights or duties exist. However, the issue is not that straightforward. One would state that financial leasing should not be considered as a specific type of transaction or a specific type of contract but as a transaction that consists of an ordinary lease contract and of an ordinary sales contract. However, remarkable differences compared to ordinary contracts exist, especially considering the lease contract. Due to these differences, extending the effects of the contract beyond the parties and deviating from contractual privity may actualize.

A central question that remains unanswered in Finnish law and jurisprudence is that on which occasions and on which grounds can deviation from the privity of contract happen. No general doctrines, principles or rules exist on how to define when the contract has effects beyond the contract-

4 However, we have written regulation on how the financial leasing is to be treated in the company's accounting. See IAS 17 of the IFRS on Leases, which provides that at the commencement of the lease term, *lessees* shall recognize financial leases as assets and liabilities in their balance sheets at amounts equal to the fair value of the leased property. In taxation, the main rule is that the *lessee* makes deductions in its taxation on the rental payments and the *lessor* makes depreciations on the owned property i.e. leasing object. The taxation may, however, be different if the leasing is regarded *de facto* as purchase. This exemplifies the fact how evaluation in taxation and in civil law is based on the formal view of "legal ownership", meanwhile the evaluation in accounting is based on the view of "economic ownership". In more detail see Torkkel 2006, p. 490–498. Similarly Tepora–Kaisto–Hakkola 2009, p. 430–431.

5 Comparing the statistics from the years 2006, 2007 and 2008, it can be stated that the volume of financial leasing is increasing. Between the years 2006 and 2007 the financial leasing investments increased by 24 %, in 2007 being in total EUR 1.9 billion. The amount of the financial leasing rents, in turn, increased by 13 %, in 2007 being in total EUR 1 billion. Between the years 2007 and 2008, the financial leasing investments increased by 13 %, in 2008 being in total EUR 2.2 billion. The financial leasing rents, in turn, increased by 8 %, being in total EUR 1.1 billion in 2008. See Statistics Finland, Rahoitusleasing 2007 and Rahoitusleasing 2008.

ing parties. Due to the fact that occasions (one of them being financial leasing) are numerous and ambiguous, it is not reasonable to regulate all of them on the basis of the contract type by written, and often inflexible, law.<sup>6</sup> However, it is also clear that some general rules are needed in order to define when the contractual effects may be extended in a reasonable and foreseeable way. In this paper I will mainly examine and focus on two issues. Firstly, I will shortly discuss the origins of the doctrine of privity, its current status in Finnish law and take a view on the arguments developed in order to deviate from the doctrine. Secondly, I will analyze the status of the privity doctrine in the context of financial leasing transactions realized in business-to-business relations.

## **2 Privity of Contract**

### **2.1 Short Introduction**

The classical doctrine of privity of contract can be divided into two branches. Firstly, according to “the burden rule”, the contracting parties may not impose a burden on third parties by a contract. Secondly, according to “the benefit rule”, regardless of the intentions of contracting parties third parties may not enforce a contract containing benefits conferred to them.<sup>7</sup> Simply put, according to the privity doctrine rights and duties originating from a certain contract shall only affect the parties to that contract.

It is a fact that the privity of contract has a place in almost all legal systems. However, its position and importance varies. Especially in English law, the privity of contract is an elementary principle<sup>8</sup>. In fact, the history of the doctrine can be traced back to English law, to the mid-19<sup>th</sup> century. As a curiosity, it is worth mentioning that the leading case establishing the doctrine

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6 Hemmo OMSL 2002, p. 25.

7 Bridge 2001 EDINLR, p. 1–2. See also Collins 1993, p. 283–286 who regards the doctrine having three aspects: burdens, rights and immunities for third parties. With the latter, Collins means that a contract cannot purport to give legal immunity to a third party, e.g., immunity from claims.

8 Atiyah 1981, p. 265.

as a mainstay in English law was *Tweddle v. Atkinson* (1861)<sup>9</sup>. Prior to this there was no clear position in English law on the rights and duties of a third party<sup>10</sup>. In *Tweddle v. Atkinson* the facts and circumstances were that the fathers of an engaged couple contracted each to pay certain sum of money to the son, i.e., fiancé of the engaged couple. The fathers died before paying the marriage portion. The Court held that the son, i.e., promisee not party to the contract, could not enforce the contract due to the fact that there was no consideration<sup>11</sup>.

## 2.2 Exceptions to the Doctrine

In modern law the privity doctrine is no longer literally applicable. The new and dynamic forms of economic exchange and contractual practice require flexibility to the main principle. In the following I will shortly discuss the main developments and exceptions to the privity doctrine, both in the context of English law and in the context of Finnish law. The English law will only serve as a starting point and as a point of comparison for the later discussion. Thus, the intention is not to make an exhaustive comparative analysis on the status of the privity doctrine. Indeed, comparing the status of the doctrine here would not be convenient due to the essential differences in common and civil law legal systems.

### 2.2.1 England

Despite the historically strict interpretation of the privity doctrine in England, a considerable number of exceptions have been developed to the prin-

9 However, before this in *Price v. Easton* (1833) the privity doctrine was also considered, but the reasoning of judges differed essentially. See e.g. Beatson 1998, p. 408, Treitel 1991, p. 529 and Khawar Tul. L. Rev 2002, p. 2. The doctrine of privity was again later reaffirmed in e.g. *Beswick v. Beswick* (1968). It was held in *Beswick v. Beswick* that a person, here widow, could not enforce in her personal capacity a contract entered into between the widow's deceased husband and his son. This was due to the fact that the widow was not party to the contract and had provided no consideration for it. However, the widow was allowed to sue the son in the capacity of the administratrix of her husband's estate. See in more detail e.g. Atiyah 1981, p. 267–269.

10 See e.g. Treitel 1991, p. 407–408 and Khawar Tul. L. Rev 2002, p. 2.

11 The requirement of consideration is crucial in common law contracts. Each party to the contract must give up some specified right of liberty. If only one party offers consideration, the undertaking is not reciprocal and thus not binding (unless it is made in the form of *deed*). See e.g. Beatson 1998, p. 88–90, Treitel 1991, p. 63 and Collins 1993, p. 51–52. In addition, it is worth mentioning that the relationship between privity and consideration is close. See also Palmer AMJLH 1989, p. 1, who asks: “Is privity a distinct doctrine or merely an aspect of the requirement of consideration?”

ciple<sup>12</sup>. To mention a few, there are assignment of rights, contracts of agency and insurance contracts<sup>13</sup>. The historical point in English law considering the exceptions to doctrine of privity was, however, the enactment of the Contracts (Rights of Third Parties) Act 1999<sup>14</sup>. By the Act itself, a third party may enforce a contract without being a party to it. It must be emphasized, that the purpose of the Act is to create *rights* for a third party, not duties. Thus, as for duties the traditional privity doctrine still applies. However, in order to enforce rights, certain conditions need to be fulfilled. The Act provides, among other issues, that a third party may enforce a contractual term only if the contract *expressly provides* it or the term *purports* to confer a benefit to the third party (see Chapter, Section 1)<sup>15</sup>.

Before entering into force, the Act caused many concerns on how the courts would apply it<sup>16</sup>. Critics have, among other issues, focused on the ambiguous term “purports”. To be on the safe side, these concerns have on many occasions led to the entire exclusion of the Act through a contractual clause<sup>17</sup>. This may be even unfortunate due to the fact that application of the Act could be useful e.g. in equipment financing. Providing the end user of the equipment a direct right to enforce the sales contract entered into between the supplier and financier would allow the end user to enforce the supplier’s warranty contained in the contract.<sup>18</sup> In addition, as intended, the Act adds substantial commercial advantage as English law is now in line with the law of Scotland, most European countries as well as with the laws of other common law countries such as the United States<sup>19</sup>.

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12 Bridge EDINLR 2001, p. 2.

13 See more in detail Atiyah 1981, p. 267–281 and Bridge EDINLR 2001, p. 2.

14 The Act is available at <http://www.opsi.gov.uk/acts/acts1999a>, last visited 7 April 2009.

15 In addition, the third party must be expressly *identified* in the contract by name, as a member of a class or as answering a particular description (see Chapter 1, Section 3). Other interesting conditions, but without great relevance regarding the topic of this paper, are provided by the Act as well. E.g., the Act does not confer a right on a third party to enforce a term of a contract otherwise than subject to and in accordance with other terms of the contract (Chapter 1, Section 3). In addition, contracting parties may not rescind or change the contract in a way as to extinguish or alter a third party’s entitlement without his consent (Chapter 2, Section 2).

16 This observation is based on numerous articles written during the years 1999–2001.

17 See e.g. Bridge EDINLR 2001, p. 4.

18 McKnight J.I.B.L.R. 2004, p. 34–35.

19 Dean J.B.L. 2000, p. 2.



The first occasion where the Act has been considered was the *Colman J. Nisshin Shipping Co Ltd v. Cleaves & Co Ltd* (2003). The case concerned shipping charter contracts entered into between the owners and the charterers. The contracts provided that the charterers would pay a commission to the brokers who were not parties to the contract. When the brokers sought to enforce their rights, the charterers claimed they did not have an intention nor was there a positive statement in the contract to confer benefits to the brokers. The court held in favour of the brokers. It stated that the contracts “purported” to confer rights to the brokers in accordance with the Act in question.<sup>20</sup>

### 2.2.2 Finland

In Finland the doctrine of privity has not historically been interpreted as strictly as in England. In the following, I will shortly describe some of the numerous exceptions to the privity of contract that have been considered in Finnish law and jurisprudential discussion<sup>21</sup>. The first exception is the contract made in *favour* of a third party<sup>22</sup>. This doctrine has been clear for long, unlike in English law. The second one is the *succession of rights* to a third party where the transferee has the possibility to present contractual claims to the original contracting party<sup>23</sup>. The third judicial construction is the situation in which a contract is concluded *via a representative*<sup>24</sup>. All the three exceptions mentioned above can be regarded as classical ones.

The newer exceptions can be roughly divided into those currently in force on the basis of written legislation and into those not supported by written legislation. Thus, the validity of the latter must be evaluated case by case on the basis of principles and arguments. The first exception currently in

20 McKnight J.I.B.L.R. 2004, p. 35–36.

21 This description is partly based on the clarifying roundup made by Olli Norros in his doctoral thesis. Norros 2007, p. 32–89. As will be noted, situations are various and no general legislation on the legal status of the third party exists. In addition, it must be emphasized that the description made in the following is not exhaustive.

22 See Norros 2007, p. 32–36.

23 Norros 2007, p. 36–43.

24 The authorization can be divided into statutory and to authorization based on contract. The latter again can be divided into direct and indirect authorization. Norros 2007, p. 43–50. In addition, a delegate’s liability in direct authorization is provided in Finland by written law. According to the Contracts Act (228/1929) Section 25, a person purporting to be an agent of another shall compensate a third person for any loss suffered because the transaction does not bind the alleged principal.

force on the basis of written law is *product liability*, in which a party other than the supplier is liable for the damages caused by the product<sup>25</sup>. Worth mentioning are also *consumer contracts* where consumers have been provided with rights to direct claims to a business party who has caused the defect but who is not in contract with the consumer<sup>26</sup>.

An example of the newer exceptions developed and not supported by written law are *commission contracts* that include, for example, *a professional's liability* to a third party, e.g. attorney's or banker's liability. If certain requirements are fulfilled, for example, if a professional is aware of a third party interest and should understand that his actions will injure the third party, the professional's liability may be justified.<sup>27</sup> *Real estate sales agent contracts* are also an example of commission contracts. In real estate sales agent contracts the real estate agent and the purchaser are not in a contractual relationship. However, wrong particulars given by the agent regarding the object should allow the purchaser to present claims based on the contract entered into between the seller and the agent<sup>28</sup>. *Chain of contracts*, in turn, is a judicial construction where a party to a contract is also a party to another contract regarding transfer of a certain physical performance, for example a product<sup>29</sup>. Keeping in mind the definition of the topic of this paper, the last but, not the least, exceptions not supported by written law are the different *tripartite financing transactions*, such as factoring and leasing<sup>30</sup>.

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25 The Product Liability Act (694/1990) has been in force since 1 September 1991. Prior to this the legal state on product liability was somewhat unclear despite the fact that in its decision KKO 1984 II 225 the Supreme Court had held the manufacturer liable against the end user. See Norros 2007, p. 50–51.

26 Acts currently providing these general rights to a consumer are Finnish Consumer Protection Act and the Housing Transactions Act. See Norros 2007, p. 62–66.

27 Norros LM 2008b, p. 642 and Norros 2007, p. 55–59.

28 According to the Act on Real Estate and Rental Flat Agency (1074/2000), Section 14, *consumers* currently have this right. Thus, as for consumers, the exception is currently in force on the basis of written law. However, it remains unclear whether this can be realized in business-to-business sales. See Norros 2007, p. 52–54.

29 Norros himself examines in his research the chain of contracts and more specifically subcontractor's liability to the end user due to a defect in the product that has been transferred through the middleman. See Norros 2008, p. 6–8 and 354. In my opinion, however, the chain of contracts is closely related to financial leasing transactions.

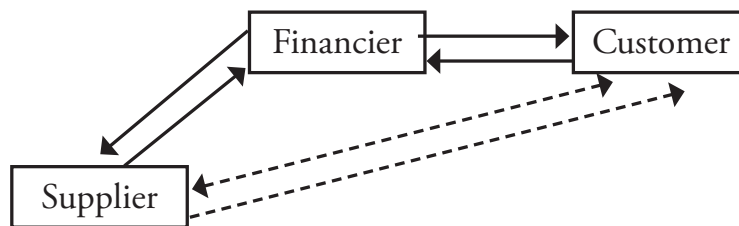
30 Norros 2007, p. 78.



### 3 Leasing

#### 3.1 General

At this point it is useful to take a closer look at the main judicial features of leasing. It must be noted that in Finnish jurisdiction leasing arrangements are not statutory. Neither does established legal praxis exist. Thus, the transaction is mainly based on the common practice of financial institutions<sup>31</sup> and their customers. In Finland, leasing is commonly realized in the form of *financial leasing* instead of *operational leasing*<sup>32</sup>. In brief, financial leasing means the leasing of movable (or, more rarely, immovable) property, in which the *financier* (the lessor) obtains ownership of certain object needed from the *supplier* and leases it to the *customer* (the lessee) on a fixed, long-term lease contract.<sup>33</sup> The result is a special, tripartite financial transaction that can be presented as follows<sup>34</sup>:



1. Negotiations between S and C on acquiring the object.
2. S makes a sales offer to F regarding the object, the offer including C's approval.
3. By accepting the offer, S and F enter into a sales contract, and F and C, in turn, into a lease contract. In addition, a repurchase contract regarding the object may be made between S and F.

31 During the year 2008 in total 23 corporations offered leasing services as financiers. Nine of the total 23 were credit institutions (banks) and 86 % of the rental payments were accrued by them. 14 % of the rental payments were accrued by the remaining 14 other corporations. See Statistics Finland, *Rahoitusleasing 2008*.

32 Operational leasing is a short-term leasing in which the leasing object is not usually leased for the object's whole economic life to the same lessee. Thus, the same object may be leased successively to various lessees during its life cycle. In addition, in operational leasing the lessee as well as the lessor may have the right to denounce the contract and the lessor usually has the duty to take care of the object's maintenance.

33 See e.g. Tepora 1988, p. 249–250, Takki 1980, p. 239–240.

34 The figure and its specifications are based on the figures drafted by Jarno Tepora. See Tepora 1988, p. 250–252.

4. F orders the sales (or lease) object to be delivered from S directly to C.
5. S transfers object's possession to C and sends the invoice to F. After C has approved the delivery, F pays the selling price to S.
6. C pays the first amount of the rent when the invoice matures and the following rents in accordance with the provisions of the lease contract entered into between F and C.
7. After the end of the term, C may have different options depending on the lease contract: a) to return the object to F, b) to continue the lease period, or more rarely c) to use his call option.

### 3.2 Notices Regarding Relationships

In the following I will highlight the most essential features regarding the relationships of the parties to the financial leasing *transaction* and exclude all other third party relationships that traditionally have been regarded as questions of property law. The following chapters are discussed based on an assumption that the parties are corporations and that the leasing object is movable property, which is normally the case.

#### 3.2.1 *Financier – Customer: Lease Contract*

In Finland lease contracts in financial leasing are usually based on standard contractual terms drafted by the financier, e.g. bank or other finance company. However, contractual practice regarding financial leasing contracts (hereinafter “lease contracts”) is well established. Differences compared to ordinary lease contracts on movable property are significant.

To begin with, a lease contract is a *fixed-term* contract. Neither the financier nor the customer shall denounce the contract before the basic term period has ended. During the basic term period the purchase price of the leasing object becomes “paid” by the customer in the form of rents<sup>35</sup>. However, the customer may assign the contract providing that the financier accepts the

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35 The length of the basic term period is calculated on the grounds of leasing object's estimated life in a way the purchasing price is to be fully compensated. The financier's profits, interests and other expenses are also taken into account. See Takki 1980, p. 262.

new party acquired by the customer. Fixed term does not, however, prevent the parties from *rescinding* the contract on grounds of an essential breach of contract by the other party.<sup>36</sup> In addition, when the basic term period has ended, the customer usually has an option to continue the lease contract with renting prices remarkably lower compared to the basic term or even use his possible call option<sup>37</sup>.

Unlike in ordinary lease contracts, in financial leasing contracts it is provided that the customer carries the risk of accidental destruction and damage of the leasing object. In addition, the customer is responsible for the maintenance of the object. According to Takki, these terms are established commercial customs in financial leasing and could be considered valid even without explicit contractual term as *naturale negotiae*.<sup>38</sup> Further, unlike in ordinary lease contracts, in the established leasing practice, the customer also has the duty to insure the object or at least defray the insurance premiums. The last difference to mention, though not the least, is that the financier is usually discharged from liability regarding the (quality) defect<sup>39</sup> or delay in delivery of the object as well as the object's suitability for the intended use. Takki considers the latter being valid without explicit contractual term as *naturale negotiae*. As for the quality defect and delay, a specific contractual term is, according to Takki, required.<sup>40</sup>

36 An essential breach is usually required, e.g., a customer's delay in rental payments. See Takki 1980, p. 262–264 and 274.

37 See figure 1, specification number 7. However, call options are rare nowadays because of the risk that the lease contract may be evaluated judicially as a hire purchase contract as defined in the Act on Hire Purchase 91/1966. This may create problems regarding third parties and taxation. See e.g. Tepora 1988, p. 251 footnote and Takki 1980, p. 266. In addition, in its decision KKO 1973 II 87 the Court held that considering the factual circumstances and the transaction as a whole, a leasing contract was to be evaluated as a hire purchase contract.

38 Takki 1980, p. 266–268.

39 In Finnish law the defects can be divided into *quality defect*, *legal defect* and *delay*. Legal defect in the object means that the object assigned is encumbered with third party rights, e.g. title or lien to the object. Legal defect may lead on to a situation where the assignee, e.g. lessee loses possession of the object assigned. See e.g. Hemmo 2008, p. 402–411. It is clear that the *quality defect* is usually excluded in the financial leasing contracts from the financier's liability. However, the legal effects are more ambiguous. See Tepora 1988, p. 268–270, who argues that the financier is liable for the legal effects encumbering the leasing object. This issue cannot, unfortunately, be discussed in detail in this paper.

40 See Takki 1980, p. 268–271.

As a conclusion it must be emphasized that the purpose of the financial leasing contract – as the purpose of the whole transaction – is that the financier works purely as a financier in order to finance the investment needed in the commercial practice of the customer. The customer chooses the object as well as the supplier, the object is delivered directly to the customer and the customer approves the object after having examined it.<sup>41</sup> However, it also must be noted that the financier is not an ordinary creditor. On the grounds of special features and differences compared to ordinary lease contracts, the distribution of liabilities discussed above may be considered, in my opinion, to at least some extent as reasonable. The Supreme Court's stand, which was delineated by the recent decision KKO 2008:58, however, differs from that outlined above. In its legal practice the Supreme Court has evaluated lease contracts formally on the basis of ordinary lease contracts. The decision in question will be discussed in more detail in Chapter 4.4.

### *3.2.2 Supplier – Financier: Sales Contract and Repurchase Contract*

As the leasing transaction is based on two separate contracts, the sales contract entered into between the supplier and financier is detached of the lease contract discussed above. The sale of the leasing object is a normal exchange of goods and belongs to the scope of application of the Sale of Goods Act (hereinafter "Act"). The provisions of the Act are subject to the terms of the contract between the parties (Section 3). Thus, if not otherwise agreed, the provisions of the Act apply. For example, the risk regarding the object passes to the purchaser when delivery of the object takes place (Section 13). After delivery, the purchaser must duly examine the object (Section 31). The purchaser loses the right to rely on a defect if he does not give notice to the supplier within a reasonable time after discovering the defect (Section 32). Neither can the purchaser rely on a defect he has been aware of at the time of the conclusion of the contract (Section 20).<sup>42</sup>

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41 See Tepora 1988, p. 264–265 and Millqvist 1986, p. 138–139.

42 As for legal defect, there is a specific provision in the Act, Section 41(2), according to which the purchaser is *always* entitled to damages for losses incurred from a third-party claim that existed at the time of the conclusion of the contract if he neither knew nor ought to have known of the claim.

In addition, the supplier and the financier may contract on the supplier repurchasing the leasing object on the financier's demand when the basic rental period has ended (*repurchase contract*). It is worth noting that this contract may limit the customer's options; the customer cannot, for example, continue the lease.<sup>43</sup>

### 3.2.3 Supplier – Customer: No Contract

Though there is no contractual relationship between the supplier and the customer, some special features of their relationship must be considered. To begin with, due to the discharge in the financier's liability regarding defect, delay and suitability, the customer should be granted legal remedies to direct claims at the supplier. This can be effectively realized by a) the supplier's *warranty* b) conferring this right to the customer in a sales contract entered into by the supplier and the financier (*contract made in favour of a third*) c) *transferring* the financier's rights to direct claims against the supplier or d) *authorizing* the customer to enforce claims on behalf of the financier<sup>44</sup>. However, interpretational problems arise in situations where these judicial remedies granted to the customer are not clearly defined and especially in situations where none of them have been used.

It needs to be considered whether the supplier is in any case liable towards the customer. According to both Takki and Tepora, providing that the financier is discharged from liability by a contractual term, the customer shall have the right to direct claims to the supplier without e.g. financier's specific authorization or other contractual term. Takki and Tepora argue that otherwise the customer's legal protection would be incomplete and unfair.<sup>45</sup> Furthermore, according to Muukkonen and Swedish legal scholar Millqvist, whether or not the financier is specifically discharged from liability, the customer shall principally always – and despite the lack of contractual relationship – have the right to direct claims at the supplier. Muukkonen grounds his view on practical arguments, especially aspects of justness. He also points out that the transaction must be considered as a whole. Millqvist also argues his stand with practical arguments. In addition, Millqvist's approach differs

<sup>43</sup> See Tepora 1988, p. 251 footnote.

<sup>44</sup> See Millqvist 1986, p. 144.

<sup>45</sup> See Takki 1980, p. 271–272 and Tepora 1988, p. 266–267.

from the others' in a sense that despite the formal positions of the parties the supplier shall be directly and fully liable for the breaches and not only "through" the financier. However, depending on the circumstances, the financier's and the supplier's liability should be joint and several.<sup>46</sup> Similar to the stand presented by Millqvist, according to the specific provision of the UNIDROIT Convention on International Financial Leasing, the supplier's liability towards the customer is equivalent to contractual liability<sup>47</sup>. However, Finland has not ratified the Convention<sup>48</sup>.

An additional question to the issue of whether the customer has a right to make claims against the supplier is how *wide* is the customer's legal protection and thus how wide is the supplier's right to make defence and invoke contractual terms limiting its liability. The literature is more or less silent on the issue. Tepora, however, points out that in the lease contracts it is usually provided that the customer has a right to use all legal remedies the financier could<sup>49</sup>.

It must be emphasized that the approving stands discussed above are stands represented in the *academic literature*. The viewpoint of the *legal practice* might again differ<sup>50</sup>. In its precedent KKO 2008:31 the Supreme Court held that the purchasers of the shares of the housing corporation were not allowed to make claims due to certain moisture defects in the housing unit against the contractor, i.e. the constructor. The Court argued that no contractual relationship existed between the purchasers and the contractor, but only between the contractor and the founder shareholder, i.e. the original

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46 See Muukkonen LM 1988, p. 634–635 and Millqvist 1986, p. 147.

47 See UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May 1988), Article 10.1 according to which "the duties of the supplier under the supply agreement shall also be owed to the lessee as if it were a party to that agreement and as if the equipment were to be supplied directly to the lessee. However, the supplier shall not be liable to both the lessor and the lessee in respect of the same damage." See also Article 10.2 in which the customer's rights are limited by providing that "nothing in this article shall entitle the lessee to terminate or rescind the supply agreement without the consent of the lessor".

48 Finland has signed the Convention in 30 November 1990. The Convention and information on implementation available at <http://www.unidroit.org/english/conventions/c-main.htm>, last visited 7 April 2009.

49 In addition, according to Tepora in legal praxis the preliminary approach has been similar. See Tepora 1988, p. 268.

50 Similarly as regards the lease contracts and the Supreme Court decision KKO 2008:58, discussed in Chapter 3.2.1.



seller of the shares of the housing corporation.<sup>51</sup> The Court emphasized that the valid main rule is that a third party is not allowed invoke a contract to which he is not a party if not otherwise enacted. It can be argued that the Court's reasoning was extremely formal. However, Norros points out the judicial importance of the precedent in question may be minor due to the Court's reasoning being extremely tightly bound to the written law, as well as due to the fact that the facts and circumstances of the case took place in the 1980s. Thus, later legal developments that are more open on extending the contractual liability could not be considered by the Court.<sup>52</sup>

## 4 Extending Contractual Liability

To begin with, it must be emphasized that *extending contractual liability* and *becoming party to a contract* should be distinguished. The latter judicial construction is excluded from this paper. The possibility that a contract confers – with purpose or without purpose of the parties – rights or duties to a third party, does not directly mean that a contractual relationship has been established<sup>53</sup>.

### 4.1 Contractual Liability and Tort Liability

Traditionally, three forms of liability are distinguished in Finnish law. *Contractual liability* is applied in contractual relationships with the aim to ensure contractual commitment. *Tort liability* applies when no contractual relationship exists between the injured and the party causing damage. *Un-*

51 The question was, thus, of *a chain of contracts*, consisting of a contractor, a founder shareholder i.e. original seller and a purchaser. See the commentary on the case Norros LM 2008a, p. 644. The judicial array, as already mentioned before, is comparable to the one in the financial leasing transactions.

52 According to Norros it is clear that later legislative developments cannot be considered by the Court, not even through the general doctrines that may have been changed by legislative amendments. He argues, however, that there should be no obstacle on considering later developments in other legal sources such as case law, judicial literature and practical arguments. See Norros LM 2008a, p. 646 and 654–655. If understood correctly, Norros calls for wider argumentation from the Court, argumentation that takes into consideration especially the practical arguments. This is despite the fact that the facts of the case have taken place before the new ways to argument have been developed. In my opinion evaluation in these situations should be, however, critical and careful in order to maintain legal certainty.

53 See e.g. Norros 2007, p. 116–117. See also Hemmo 1998, p. 26–27, who points out that a party's obligation to perform is independent of the definition contractual liability. In my opinion, a party's obligation to perform is parallel to the common law countries' requirement of consideration (see footnote 8).

*just enrichment*, in turn, is usually applied in situations where none of the two is applicable. The latter being more or less exceptional, the choice of application is usually made between the tort and contractual liability. These divisions have traditionally had an important normative function.<sup>54</sup>

Norros states, however, that despite the strict division between the tort and contractual liability, a “grey area” between the two has developed. This argument is mainly based on legal praxis and recent legislative amendments<sup>55</sup>. In various precedents the Supreme Court has indicated that on the grounds of practical arguments, at least to some extent contractual liability may be applicable despite the inexistence of a specific contract<sup>56</sup>. According to Norros, the liability applied by the Court cannot be categorized as tort or contractual. Norros finds it problematic that the Court has on many occasions dismissed the analytical consideration of the different forms of liability.<sup>57</sup>

The question follows: what is the normative base for the liability of the supplier towards the customer in financial leasing transactions? According to Hemmo, when the effects of a contract extend beyond the parties, the transaction’s purpose and real nature must be considered. If a party is aware on the grounds of general and established practice, that his actions affect some other contractual relationship in a certain way, contractual liability is arguable.<sup>58</sup> Norros shares this stand and further emphasizes the role of practical arguments; contractual liability is arguable in a formally extra-con-

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54 See e.g. Hemmo 1998, p. 1–4.

55 An example of such an amendment is the Section 14 of the Act on Real Estate and Rental Flat Agency (1074/2000).

56 See e.g. KKO 2001:70 where the Court held a bankruptcy trustee liable for damages caused to creditors. The Court argued that because the trustee’s task was based on law *ipso jure* and not on e.g. a contract, the liability was not contractual nor tort, but something in between, “of a different type”.

57 See Norros 2007, p. 125–133. Examples of the few cases where the Supreme Court has considered the normative classification of different forms of liability are KKO 1999:19 and 1992:165. In the former case the Court held that no commission relationship, i.e. contractual relationship, existed between the accounting division and the injured party. The accounting division had, however, failed in its responsibilities and was thus liable for the injured party in accordance with the general contractual principles. In the latter case the Court held that the bank having drafted a faulty deed of gift was liable for the grantee on a contractual basis despite the fact that no contractual relationship existed. The Supreme Court decision KKO 1992:3, in turn, is an example of a decision where the Court did not specifically consider the form of liability but held the bank liable for the payment that was made to a wrong bank account. However, e.g. Hemmo has come into the conclusion that the Court did apply in this decision contractual liability without specifically considering the issue. See in more detail Hemmo 1998, p. 321–326.

58 See Hemmo 1998, p. 302–303.

tractual relationship if there are *substantial* grounds weighty enough<sup>59</sup>. Now considering the purpose and established practice of the leasing transactions described in Chapter 3 and providing these features appear in an individual case, in my opinion, the contractual liability is arguable in the relationship between the supplier and the customer instead of tort. To give an example, in financial leasing the supplier who has given the particulars regarding the object is normally fully aware of being a party to a financial transaction as well as of the consequences of failure of performance. Thus, the situation is somewhat similar to a contractual relationship.

## 4.2 The Concept of Contract

As mentioned, the strict division into *inter partes* and *ultra partes* does not meet the case in evaluating when a contract extends its legal effects beyond the parties. In Chapter 4.1, I came into the conclusion that extended contractual liability is arguable in financial leasing contracts instead of tort. Thus, contractual legal effects shall be derived from a certain contract. The following approach that slightly re-considers the concept of contract is in my opinion a useful starting point to the discussion on extended contractual liability.

Utilizing the analytical method<sup>60</sup> of civil law, Pöyhönen (currently Karhu) breaks the concept of contract into different elements and dimensions. In his approach instead of a *stable* all-or-nothing concept, the contract should be regarded as a continuous *process* of relations. This procedural concept of contract includes three dimensions or sub-concepts. The *substantial* dimension includes the changing combination of contractual obligations, liabilities and remedies supporting the latter ones. The *personal* dimension means that besides the contractual parties, third parties may as well have some rights or duties. Worth emphasizing is that the rights and duties of the par-

<sup>59</sup> See Norros 2007, e.g. p. 133.

<sup>60</sup> Shortly put the analytical method aims to break general concepts into sub-concepts, which better describe the actual judicial circumstances. The analytical method was developed as a criticism to the German conceptual jurisprudence that aimed to develop general and all-embracing concepts from which legal consequences were to be derived. In Finland the groundbreaking legal scholar in the branch of analytical method was Simo Zitting who broke the concept of ownership into normative sub-concepts. Peculiar to the analytical method was that no legal consequences should be derived from the concepts. See in more detail e.g. Zitting 1951, p. 1–102 and Tepora 1984, p. 26–32.

ties need not be symmetrical. The *temporal* dimension means that the binding effect and cessation of a contract cannot be exactly defined. In addition, they often happen silently and unnoticed.<sup>61</sup>

### 4.3 Evaluating Ways to Argument

As Norros states, extended contractual liability is arguable only if there are substantial grounds weighty enough. Practical arguments are central.<sup>62</sup> Practical arguments may be defined as arguments that consider the social and economical realities and consequences of a certain decision. Though practical arguments are often used, especially in the branch of property and contract law, their contents are rarely defined in detail.<sup>63</sup> Thus, it is not straightforward to say on which grounds practical arguments may be regarded as weighty enough in order to extend the contractual liability<sup>64</sup>.

Let's take a few examples of the arguments discussed in Finnish jurisprudential literature that aim to argue for extended contractual liability. The *interest of exchange* may be regarded as one of the most used practical arguments or principles<sup>65</sup>. According to Niemi, a third party benefiting unilaterally, as well as the unjust burdening of a third party, must both be considered as disturbances in economic exchange. Thus, the application of e.g. principle of *justice* should not be limited to purely contractual relationships<sup>66</sup>. Kartio brings out a general rule according to which in exchange every undertaking should fulfil the prerequisite of *honour and honesty*<sup>67</sup>. Mononen, instead, discusses a *special relationship* comparable to contractual relationship. To be

61 See more in detail Pöyhönen 1988, p. 211–231.

62 Norros 2007, p.133 and 278.

63 See Klami LM 1996, p. 468.

64 In my opinion, taking into account the doctrine of sources of law, an important issue to consider is to what extent the practical arguments are valid sources of law. As a source of law is generally defined as a basis that has been generally accepted by the legal community, similarly the practical arguments that are to be applied must be generally accepted. Unfortunately, this issue cannot be discussed in this paper in more detail.

65 Klami criticizes the interest of exchange being often used in favour of the addressee of the undertaking without considering more deeply how the approach affects the reliability of exchange in long-term. He also emphasizes that more *empirical* research is needed on the possible consequences. See Klami LM 1996, p. 468 and 471–472.

66 See Niemi 1996 who discusses this on the basis of thinking and theories of Gauthier, p. 175–179 and 202.

67 Kartio JJ 1997, p. 158–159.

regarded as special, some features characteristic to contractual relationships must be recognisable.<sup>68</sup>

It is presumable that none of the views is useful as such when leasing contracts are considered. This is mainly because of the views' generality and abstractness. In the following, I will highlight the main points of the arguments developed by Norros who seems to be the first one aiming to systemize the possible argumentation on extended liability more in specific terms, especially in contractual chains.<sup>69</sup>

#### 4.3.1 Closeness of the Relationship

According to Norros, in a contractual chain some special *proximity* between the subcontractor (hereinafter "supplier", i.e. contractual party) and the end user (hereinafter "customer" i.e. third party) must exist in order to differentiate it from an ordinary extra-contractual relationship<sup>70</sup>. In this examination only the factual circumstances that could be observed by the supplier when concluding the contract may be taken into account<sup>71</sup>. In a more detailed examination regarding closeness of the relationship, the first issue to be considered is that the customer shall be a) *identified* by the supplier<sup>72</sup>. This is based on the fact that in a common contractual relationship a party is usually contracted with and committed to a specific party. In addition, extended contractual liability is reasonable only if the supplier was conscious of the reassigning of the object to the customer.<sup>73</sup>

Secondly, the supplier may be held liable only if the supplier has been able to b) *foresee the damages* caused by the defectiveness of the object. Here it

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68 There must be e.g. a) some consideration and conversancy b) some approval, consent or mutual understanding c) duties and d) the right to supervise other party's actions and expect a certain level of quality. See Mononen BLF 2005, p. 106.

69 It is worth reminding that Norros concentrates in his research on *contractual chains* and evaluates these arguments on this basis. Essential is the chain and relationships between *subcontractor*, *middleman* and *end user*. I, instead, evaluate these arguments in the light of financial leasing transactions.

70 See also Hemmo 1998, p. 281 who sets as a prerequisite the "special relationship" between the contractual and third party. A special relationship enhances the possibility for the liable party to identify persons entitled to contractual compensation.

71 Norros 2007, p. 178.

72 It is not required, however, that the party should be able to *exactly* define the future assignees.

73 See in detail Norros 2007, p. 180–188.

must be considered to what extent the supplier is aware of the object's future environment of use, how significant is the risk for damages of the defective object<sup>74</sup>, does the middleman (hereinafter "financier") have the possibility to detect and repair the defect in the object and how established is the practice between the parties.<sup>75</sup>

Thirdly, it must be examined whether the customer had a specific c) *confidence* with the supplier and his performance<sup>76</sup>. Fourthly, the supplier's d) *negligence* regarding the defect in his performance is to be examined. Intention or gross negligence may strengthen and extend the liability.<sup>77</sup> The examination regarding foreseeability (b) may be regarded as the most significant in the overall examination, the status of the latter two (c–d) being only supplementary. Norros points out that if the damage caused to the customer has been clearly foreseeable by the supplier, no other arguments for the closeness of relationship are needed<sup>78</sup>.

#### 4.3.2 *Hindering the Immediate Channel of Compensation*

After well-founded consideration Norros comes to the conclusion that the *prima facie* principle should be claiming damages from the immediate channel<sup>79</sup>. In leasing contracts the immediate channel is the financier. Other conclusion would be unjust from the supplier's point of view and would occasionally release the financier fully and groundlessly from liability. However, the aforementioned principle is flexible: the customer may submit claims directly to the supplier if it is *clearly impractical* to direct claims to the financier.<sup>80</sup> Situations where hindering the immediate channel result as clearly impractical, can be divided into *factual* and *judicial*. Factual hindering covers situations where the primary liable is insolvent, unreachable or

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74 This is crucial mainly in chain of contracts to define how broad the risk formed by the subcontractor's object is among the overall risks of the defected object reproduced and reassigned by the middleman. See Norros 2007, p. 195–196.

75 See in detail Norros 2007, p. 189–203.

76 See in detail Norros 2007, p. 203–218.

77 See in detail Norros 2007, p. 219–228.

78 Norros 2007, p. 228.

79 Norros emphasizes that this is despite the fact that in our legal system the general stand especially in jurisprudential literature has more or less been that the hindering of the immediate channel of compensation is not required. See Norros 2008, p. 245.

80 See in detail Norros 2007, p. 230–250.



has quit his business. Judicial<sup>81</sup> hindering covers *inter alia* contractual terms that discharge the liability of the immediate channel.<sup>82</sup> It must be emphasized that the prerequisite on the closeness of relationship must be fulfilled. In addition, the third party may invoke the hindering of the immediate channel only if he was not aware of the hindering when concluding the contract.<sup>83</sup>

#### 4.3.3 *The Influence of the Contractual Content*

Contractual contents of the two contracts in financial leasing may further define the liabilities between the parties to the transaction. The following may also partly answer the question regarding the wideness of the supplier's liability, and on the other hand the customer's legal protection<sup>84</sup>. Norros divides the influence of the contractual content into sub-questions, as follows: does a) the customer have the right to invoke the terms of the contract in force between the supplier and the financier; b) the supplier the right to invoke the terms of the contract in force between the financier and the customer; c) the supplier the right to invoke the terms of the contract in force between him and the financier; and d) the customer the right to invoke the terms of the contract in force between him and the financier?<sup>85</sup> As a main rule Norros suggests that the answer to all aforementioned questions is affirmative. This conclusion is mainly and in general based on the fact that if the privity is to be broken, it must be two-way.<sup>86</sup> However, exceptions exist. Regarding the topic of the paper, worth mentioning are the reclamation terms regarding notice due to a defect in the object, e.g., time limits and requirements on the form and contents of the notice. Norros concludes that the supplier has a right to invoke towards the customer reclamation the terms of the contract in force between the supplier and the financier but not of the contract in force between the financier and the customer. The starting point is that making notice only to the supplier is sufficient

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81 Judicial reasons are more closely related to the issues discussed under the following topic on the contractual content.

82 See in detail Norros 2007, p. 251–275.

83 Norros 2007, p. 276.

84 See Chapter 3.2.3.

85 See Norros 2007, p. 278–280.

86 See arguments in detail Norros 2007, p. 281–307.

and reasonable<sup>87</sup>. Thus, the customer shall make the notice in time and in form<sup>88</sup> defined in the sales contract. It would be unjust if the supplier could invoke terms unknown to him and on these grounds dismiss the customer's notice.<sup>89</sup>

#### 4.4 Supreme Court Precedent KKO 2008:53

As mentioned before, financial leasing transactions are not statutory and no established legal praxis exists. However, in the recent decision KKO 2008:53, given 23 May 2008, the Supreme Court delineated its stand in a remarkable way regarding the status of the parties to leasing transactions. In this case the facts and circumstances were that the plaintiff, financing company GE Capital Equipment Finance Ab (hereinafter "GE Capital") had concluded a leasing contract with the defendant Salon West-Hair Oy (hereinafter "West-Hair") on equipment needed in the customer's commercial practice. However, West-Hair had rescinded the contract and defaulted on its rental payments due to the fact that the leasing object had been constantly broken despite the supplier's efforts to repair the object. The leasing contract (general contractual terms drafted by the plaintiff) included an ambiguous term 10 § that *inter alia* discharged GE Capital from the liability regarding defects in the object. In addition, the term provided – somewhat ambiguously – that the lessee has both the right as well as the duty to represent the lessor in the disputes concerning the supplier's duties provided in the *sales contract*. In order for the lessee to denounce the lease contract the lessee shall have acquired a final judgement that justifies rescinding the sales contract with the supplier. In the defendant's opinion this term was unclear and thus unfair.

The Supreme Court stated that due to the fact that no statutory law nor established legal praxis exist, nor had GE Capital proved that established

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87 Norros argues this mainly on the grounds of provisions in special legislation, e.g. Code of Real Estate (540/1995), Chapter 2, Section 26(3), according to which the buyer shall give notice of a defect that he has found out about and his claim based on it to the merchant instead of the seller.

88 Norros also points out that notice made in a form that clearly defines the defect and so fulfills the general requirements of law would be acceptable and reasonable.

89 See Norros 2007, p. 313–329. Other exceptions discussed by Norros see, p. 308–313 on adjustment of contracts, p. 329–340 on arbitration clauses and p. 340–346 on the effect of gross negligence.

practice exists in financial leasing especially regarding the financier's discharge from liability, the rights and duties of the parties shall be defined on the grounds that the parties to the transaction have been contracted. Furthermore, the Court held that because West-Hair was not party to the *sales contract* and because the contractual term 10 § of the *lease contract* was ambiguous and therefore interpreted to the drafter's detriment, GE Capital was considered liable for the defect and West-Hair had right to rescind the lease contract<sup>90</sup>. However, this decision was the result of voting. Two of the five members of the Court stated in their dissenting opinion that financial leasing is an established form of financing whose main features and principles a party to the transaction must be aware of. Simply put, the real purpose of leasing should be considered.

At this point it must be noted that in addition to the precedent KKO 2008:53, the Supreme Court has also given some other, earlier decisions related to leasing<sup>91</sup>. However, the one with the greatest relevance regarding the topic of the paper and the similarity with the already discussed decision is the Supreme Court decision KKO 1997:130, given 29 January 1997<sup>92</sup>. In this case the Court similarly held that between the financier and the customer, rules and principles of the ordinary lease contracts on movable property apply. Thus, the legal status of the parties shall be defined according to their contract<sup>93</sup>.

The decision KKO 2008:53 indicates that the Court is not willing to acknowledge the financial leasing transactions as an independent form of financing. This is despite the fact that leasing is a feasible, widely used and

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90 Before the decision of the Supreme Court, the District Court of Helsinki held that the leasing contract had to be interpreted as an ordinary lease contract on movable property. The Court held that the term 10 § was to be regarded as unilateral and onerous and thus was *not part* of the contract. In addition, however, the Court held that the contractual term was unfair in accordance with the Contracts Act, Section 36, and could not be taken into account. The Court of Appeal held the District Court's stand. On criticism of the District Court's argumentation see Wuolijoki LM 2008, p. 828.

91 See e.g. KKO 1997:6, KKO 1988:89 and 1985 II 177. Various precedents partly assert the fact that financial leasing is widely and often used.

92 In decision KKO 2008:53, the District Court made reference to this precedent in its argumentation.

93 The ambiguous contractual terms drafted by the financier were therefore interpreted to the financier's detriment and the customer had the right to rescind the contract due to a defect in the leasing object.

more or less old form of financing<sup>94</sup>. In addition, to some extent it can be sensed that the Court it is not too willing to deviate from contractual privity on these grounds. In order to avoid confusion, however, it must be emphasized that the decisions discussed above do not exactly touch core of the paper's topic. The decisions, especially KKO 1997:130, mainly concern the customer's right to make claims against the *financier*. Thus, they do not concern the issue of the customer's right to make claims against the non-contractual party, i.e., the *supplier*. The Court did not even have to directly commit on the issue and thus was not forced to consider the extended contractual liability. However, if the Court would have argued the opposite in its decision KKO 2008:53, the Court would have, in my opinion, indicated that financial leasing is a special and established form of financing that has to be evaluated consistently with its purpose. If the decision was negative to the defendant, would he then be allowed to make direct claims and start new successful proceedings against the supplier? If we look at the contractual term 10 § that ambiguously authorizes the defendant to it, this may be the case. If we, however, think of a situation where no contractual term that authorizes the customer to make claims against the supplier exists, or a situation where such a term is fully unclear, would the customer still have this right? This situation refers to Millqvist's thinking on the supplier's liability not only "through" the financier but directly and fully as such<sup>95</sup>.

In the following, I will shortly make some comments on the question raised here and on the decision KKO 2008:53 regarding the relation between the customer and the supplier in light of practical arguments discussed in Chapter 4.3. Considering firstly the *closeness of the relationship* between the supplier and customer, according to the facts of the case the customer has chosen the object together with the supplier in a close contact. It is clear the supplier is able to identify the customer. In addition, it is presumable that the damages caused by the object to the customer were foreseeable by the supplier: the financier did not choose, examine or know of its further usage and worked purely as a financier having no expertise on the equipment. Thus, in my opinion it is obvious that some kind of a "special relation-

94 Financial leasing practice started in Finland in 1965 when two leasing companies Vuokrausluotto Oy and Leasing-rahoitus Oy were established. See Takki 1980, p. 255.

95 See Chapter 3.2.3.

ship” exists between the supplier and the customer. As discussed earlier, Norros takes as a *prima facie* principle that damages should be primarily claimed from the immediate channel of compensation. Only if this is *hindered*, claims may be directed to the secondary channel. A contractual term or even an *established practice* that discharges a party from liability may be, in my opinion, regarded as hindering the immediate channel. In addition, if we take as a starting point that the customer’s rights are limited to the contract entered into between the supplier and financier, it cannot be regarded as surprising and unjust for the supplier: if not the customer, then the financier would invoke that contract. This further supports the supplier’s liability, not the financier’s. In addition, claiming damages from the financier will cause additional expenses when two processes result<sup>96</sup>. A more economical option in tripartite transactions would be that the third party directly claims the damages from the party liable.

My opinion would be different if the financier was more active and if the real circumstances of the case in general differed from the established practice of leasing transactions. As Millqvist points out, the liability between the financier and the supplier should be joint and several: the liability *de facto* depends on the circumstances *de facto*<sup>97</sup>. In other words, the evaluation should be overall, taking as a starting point the procedural concept of contract and considering the real purpose of the judicial construction. As Tepora has emphasized in the context of hire purchase contracts, the judicial consequences should be evaluated keeping in mind the *purpose* of the hire purchases<sup>98</sup>. Further, according to Muukkonen, when analyzing tripartite transactions, there is no reason for asking who is the seller and who the purchaser due to the fact that mechanical classification does not give a truthful picture of the legal status of the parties<sup>99</sup>. As a conclusion, when considering the extension of contractual liability in financial leasing, the real *purpose* of the transaction and the purpose of the parties involved should be taken into account without limiting the evaluation to contractual relationships. In addition, the *awareness* of the parties regarding the aforementioned purposes should not be dismissed.

96 See Norros 2007, p. 161–162.

97 Millqvist 1986, p. 147.

98 Tepora 1984, p. 9.

99 Muukkonen LM 1988, p. 637.

As I have come into the conclusion that the supplier's contractual liability is justifiable on certain occasions, it must be also discussed whether the supplier has a right to invoke the contractual terms limiting its liability. The question is thus how *wide* the supplier's liability is and in turn, how wide are the customer's rights. As discussed in Chapter 4.3, exceptions to the main rule, according to which each party to the transaction has a right to invoke the contract entered into between the other parties, are necessary. Assuming, for example, that the financier has been discharged from liability by a contract in force between the financier and the customer, it is somewhat reasonable – and logical – that the supplier shall have no right to invoke these contractual terms to its own credit and thus extinguish the customer's rights. The supplier shall, however, have a right to invoke the contractual terms limiting its liability in force between the financier and the supplier. This interpretation prevents the supplier from benefiting from advantageous contractual terms concluded between the supplier and the customer and, more importantly, from facing unexpected liabilities<sup>100</sup>.

## 5 Conclusions

It can be concluded that the privity doctrine has not lost its stand either in English or in Finnish law. However, it is remarkable how in both systems the deviation from the privity doctrine is useful and even indispensable in certain situations in order to give some flexibility to the legal system and in order to meet the practical needs of real exchange<sup>101</sup>. However, this deviation should be foreseeable, well defined and arguable. Weakening the main rule in which most actors trust must obviously be restrained. Otherwise the extended liability would lead into a phenomenon called *floodgate* where the claims for damages become unpredictable<sup>102</sup>. This, however, should not lead to a situation where the actor causing damage, for example the sup-

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100 See Norros 2007, p. 347, where it is pointed out that the interpretation in question also prevents the extended contractual liability from producing unjust and unexpected results and thus endangering legal certainty.

101 See McKnight's example on equipment financing contracts in Chapter 2.2.1

102 See Hemmo 1998, p. 276–277. It is not probable, however, that in e.g. leasing transactions the extended liability between the supplier and the customer would result in unpredictable claims for damages. As seen in Chapter 4.3, the contractual contents limit a third party's rights to make claims.



plier, unduly avoids his liability<sup>103</sup>. In order to prevent these possible ill effects, we need well-founded and reasonable, case by case consideration and argumentation. As discussed earlier, Norros seems to be the first one in Finnish jurisprudence to consider and systematize in detail the arguments on the grounds of when it is and when it *may* be reasonable to deviate from contractual privity. The arguments developed are not exhaustive nor decisive but useful and indispensable *tools* in legal consideration, discretion and argumentation.

Considering the status of the privity of contract in the context of leasing transactions, it has been concluded that the deviation from the privity of contract is justifiable, providing there are reasonable grounds weighty enough. When deciding whether the grounds are reasonable and weighty enough, one must take into account the *de facto* circumstances and evaluate the closeness of the relationships of the parties to the transaction, the possible hindering of the channels of compensation as well as the contractual terms involved. The most important thing is, however, to consider the *purpose* of the parties. In my opinion, this interpretational principle should be extended to *ultra partes* relations and not limit its applicability to the interpretation of purely contractual relations.

Though I have already expressed my stand, there is still one counter-argument to consider. With its decision, the Supreme Court clearly indicates that the status of the parties involved in financial leasing should be defined by contracts. The argument according to which there is a need to be able to manage contractual risks contractually<sup>104</sup>, is valuable. Thus, what prevents the parties to a leasing transaction entering into a common, three-party contract between the supplier, customer and financier where the rights and duties of each party would be clearly defined?<sup>105</sup> This may work or, on the contrary, turn out to be problematic when trying to harmonize different interests. Traditionally in Finland, a well-functioning and foreseeable contractual practice, confidence and purpose-orientated interpretation of contracts have made it possible to draft simple and short contracts with low transac-

103 See Norros 2007, p. 159–161.

104 See Norros 2007, p. 148–152.

105 See also Tepora–Kaisto–Hakkola 2009, p. 433, where it is pointed out that also other alternative ways to realize the financial leasing transaction exist.

tion costs. This has been regarded as an important competitive advantage. It is not desirable to threaten this by dismissing the parties' *purpose* even though no formal contractual relationship exists, especially when there are reasonable and weighty grounds to regard the relationship as *special*. The Supreme Court precedent indicates, however, that even greater care will need to be taken when drafting financial leasing contracts<sup>106</sup>.

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106 There might be some hope left still. As Wuolijoki LM, p. 831, points out, the Court argued in its decision KKO 2008:53 that the plaintiff had not *proved that established contractual practice* in financial leasing exists. According to Wuolijoki this indicates that the possibility of acknowledging financial leasing as a special and independent form of financing was left open. Luckily, the Supreme Court of Finland is allowed to change its mind in the future.

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**Abbreviations**

AMJLH	American Journal of Legal History
BLF	Business Law Forum
DL	Defensor Legis
EDINLR	Edinburgh Law Review
J.I.B.L.R.	Journal of International Banking Law and Regulation
J.B.L.	Journal of Business Law
JJ	Juhlajulkaisu (Anniversary volume)
KKO	Korkein oikeus (Finnish Supreme Court)
LM	Lakimies
OMLS	Oikeusministeriön lausuntoja ja selvityksiä (Ministry of Justice publications: statements and legislative reforms)
Tul. L. Rev	Tulane Law Review