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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

STUDY GROUP
ON THE
LEASING CONTRACT

TENTATIVE OBSERVATIONS OF THE MINISTRY OF JUSTICE OF JAPAN

ON THE REVISED TEXT OF THE UNIFORM RULES

Rome, September 1980

Observations

1. Outline of Leasing Business in Japan

i. Background

The first leasing business in Japan came into being when the Japan Leasing Corporation was founded in 1963. Then, Orient Leasing Company and Tokyo Lease Company were founded successively, followed by general trading companies which set up a "leasing department" in their organizations. About 1970, a number of general leasing companies whose activities were centered around financial leasing were founded one after another.

In 1971 the Japan Leasing Association was established. The role of the Association is to endeavor to solve many problems which have aroused in connection with leasing business and make the leasing industry prosper. In 1975 the Association studied to draft model lease agreement as one of its important role.

In the field of the leasing business, considerable internationalization has been achieved. There are an increasing number of Japanese firms that are expanding their business activities by setting up affiliated firms overseas in Hong Kong, Southeast Asia, Latin America, U.S.A. and The People's Republic of China, and in cooperation with foreign investors. Namely, only few contracts are concluded by the Japanese lease company directly. The lease transaction is so much affected by tax laws and accounting regulations, that the affiliated firms overseas have to conclude lease agreements taking account of local tax laws and accounting regulations.

ii. Legal Practice

Since there is no special law which governs the sui generis form of leasing transaction usually referred to as "financial equipment leasing" in Japan, the legal relationship between three parties involved has to be construed in accordance with the lease contract between a leasing company and a lessee and the sales contract between the leasing company and a seller.

Each leasing company has its own forms regarding to the two contracts and these forms are not unified yet. However, most of leasing companies deal with financial lease transaction in the following way:

- (1) A lessee chooses equipment and a seller.
- (2) The lease contract is concluded between the lessee and a leasing company.
- (3) The sales contract is concluded between the leasing company and the seller.
- (4) The seller renders the equipment to the lessee.
- (5) The lessee examines the equipment and, if the nature or the content of the equipment fulfills the necessary condition of the contract, he issues a receipt thereof to the leasing company.

(6) The leasing company pays the price to the seller.

The following special provisions are usually included in these contracts.

(1) The lease contract

- (a) The lessee may not terminate the lease contract in the middle of the term of lease.
- (b) The leasing company shall not take any responsibility for the delay of delivery of the equipment or its defects.
- (c) The leasing company does not bear the risk of loss or damage of the equipment.

(2) The sales contract

- (a) The right to request compensation for damages against the seller is assigned from the leasing company to the lessee.
- (b) The seller bears the risk of loss or damage of the equipment until the lessee hands over a receipt to the leasing company.

Although there is no Supreme Court decision concerning to the validity of these provisions yet, these provisions are recognized valid by the district courts.

As you would imagine by the explanations above, the lease contract is concluded subject to a suspensive condition and the lease term begins from the moment when a receipt is handed over to the leasing company. Secondly, the seller does not sign (join) the lease contract as a party nor the lessee signs the sales contract in order to handle lease transactions speedy. There is no contract between the lessee and the seller in a strict sense.

II. Remarks on the Draft

1. General

The draft uniform rules govern many aspects of legal problems which occur in the lease transactions. I must say, however, that there aren't enough provisions which govern rights and duties of the parties in the actual practices, for example, the duties of paying rentals, prohibition of transfer of the equipments, etc. In this respect, I would like to point out some items to be included in the draft rules later.

Among four alternative versions, in my opinion, the third alternative revised text is most appropriate and I would like to comment on this text unless mentioned otherwise.

As regards the usage of words, I don't think "financer" is good choice to identify the leasing company, because the word infers that the leasing company is not a lessor but a money lender. So, I prefer "lessor" and "lessee" to "financer" and "user".

2. Article by Article

(1) Article 1

Although I admit that the extent of application of the transaction, which the uniform rules govern, is necessary, I wonder if it is appropriate to have such definition as this article provides. I think it would be better to make this article simpler and to have another article which governs the substance of the lease transaction in the uniform rules.

As regards the phrase "a term which takes the period of amortisation of the equipment" in sub-paragraph 5, it is advisable not to use the word "amortisation" because lease contract is concluded without taking account of the period of amortisation of the equipment in some countries (In Japan, "depreciation" of the equipment is taken into account.) and the lease term presents the most serious problem in tax laws.

(2) Article 2

Since the uniform rules do not need such provisions as this article, especially paragraph 1 of this article, this article should be deleted. If this article is remained, it seems better to clarify the meaning of the words "recognized as a valid transaction". Do these words exist on the assumption that there may be some room where an Contracting State does not admit the category of the lease transaction and regards the transaction as sales contract with financing or normal rental contract even after it ratifies the future Convention? Or do these words only mean that the transaction was done without fraud, duress or misunderstanding?

I am afraid that this article as it stands makes the whole structure of the uniform rules unclear.

(3) Article 3

It rarely happens that the supply contract is amended in Japan. But, the term of payment may be modified, for example from cash payment to payment by a bill, in which case the consent of lessee is not necessary. Accordingly, the words ",except the term of payment," should be added after the words "(hereinafter referred to as the "supply contract")".

(4) Article 4

Neither there exists public notice system of the leasing agreement nor the rules which are referred in paragraph 2 of this article in Japan. In this case, can this article be regarded as nonexistent entirely?

(5) Article 5

(a) The uniform rules should have the provisions which stipulate that the lessee shall not affix or attach the equipments to the real property without the consent of the lessor.

(b) Regarding to Unless-clause, I see no reason why the lessor shall reimburse any encumbrancer or owner for the cost of damage. According to the first part of this article, the lessor may remove his equipment from the real property only if he has priority over the claim of any person having an interest in the real property concerned. So, imposing an obligation upon the lessor to reimburse even in such a situation would be contradictory itself. In practice, the lessor and the lessee stipulate in the lease contract that the lessee shall bear all costs and expenses in such a case as this article refers.

(6) Article 6

(a) Regarding as paragraph 1, may this paragraph be construed as not governing the tortious duties to the third party? It is very difficult question who should be liable in respect of tortious duties of the equipment provided for the use of the lessee to the third party.

(b) Paragraph 3 of this article handles a very delicate question. There is a case in Japan in which a lessee claims the leasing company for the damage owing to the defect of the equipment on the ground that the leasing company recommended the equipment. If this paragraph is remained as it stands, the leasing company will speak nothing about the equipment and the lessee will never be able to get informations about the equipment. Some leasing companies, however, were established as affiliated companies of the suppliers and some of these companies have leasing contract form in which they declare that they will take any responsibility for damage caused by supplying the equipment. I would like to propose to alter latter part of this paragraph from "where and to the extent that he has actively intervened, etc." to "where the supplier and the lessor are substantially affiliated with each other".

which stipulate that, after the third party's estimation of the equipment, the price so estimated shall be deducted from the rental and other costs and expenses. However, the third alternative may prohibit this practice.

(c) Paragraph 2

In practice, the lessor and the lessee usually agree that the former may declare the lease contract avoided upon default by the latter in the performance of his contractual duties immediately, namely without giving him the additional period of time to perform his contractual duties, in order that the former may not lose time in case of the latter's insolvency. It is reasonable to add the words "unless otherwise agreed by the parties" in the adequate place of this paragraph.

Regarding to the interest rate, the parties should be admitted to agree on the other rate than mentioned in this paragraph.

(d) Paragraph 3

Compared with the revised text, I would like to recommend to adopt the third alternative.

3. Supplement

The tentative draft uniform rules handles only some of legal problems in the lease transaction. I think it seems to be advisable to add some provisions which stipulate the following matter:

- (1) The obligation of payment; the lessee must pay rentals. The time from when he must do.
- (2) The lessee's obligation to examine the equipment or to notify the lessor the fact that he has received the equipment.
- (3) Passing of risk.
- (4) The obligation of remedy.
- (5) The obligation of using the equipment with reasonable care.
- (6) The legal relationship of the three parties after tendering the equipment and before the examination of the equipment.
- (7) Prohibition of transferring or permitting the equipment to be used by a third person.
- (8) Elimination of the place where the equipment is to be used.
- (9) Legal relationship of the three parties after the expiration of the term of the lease, including the obligation to return the equipment.

(7) Article 7

(a) Paragraph 2

The meaning of the words "as against the financier" in the 2nd line is unclear. If the words implies that the lessee is entitled to withhold payment in case of delay in delivery or the defect of the equipment, the case can be governed by paragraph 1 of article 8.

(b) Paragraph 3

I don't think that the contents of variant I of the revised text prepared by the secretariat (hereinafter referred to as the "revised text") is co-ordinate each others. Variant II of the revised text might cause a difficult problem of how to explain the ground of the lessee's right to claim to the supplier. Third alternative revised text is best choice among all alternatives.

(8) Article 8

(a) Paragraph 1

Compared with the third alternative, I would like to recommend to adopt the revised text. The third alternative is thought to be unreasonable because it gives the lessee some room where he need not pay rentals although he uses the equipment. Regarding to the revised text, it is advisable to clarify the meaning of the word "valid" in line 4.

(b) Paragraph 2

Where the lessee terminates the leasing agreement by virtue of this paragraph, the lessor should be entitled to terminate the supply contract. Two contracts should have a linkage where the supplier fails to make a valid tender of the equipment within the time specified in Article 7 (2).

(9) Article 9

(a) Generally

Most of Japanese leasing companies have the lease contract form which admits them to declare a part of or entire amount of rental and other costs and expenses immediately due and payable in the event of default by the lessee in the performance of his contractual duties. I wonder if we should re-consider on this article which way we should take, present Article 9's approach or forfeiture way of the benefit of time.

(b) Paragraph 1

Compared with the third alternative, I would like to recommend to adopt the revised text. The third alternative confronts the problem of imposing the liability upon the lease company, which is not a professional seller, to sell the equipment in a commercially reasonable manner. It has also the problem how to handle matters in case of the lessor's breach of this obligation. Some of the lease contracts have provisions