Equipment Leasing Law in Korea

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# Equipment Leasing Law in Korea

Won-Mo Ahn*

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I. INTRODUCTION

Equipment leasing has been growing rapidly in the Republic of Korea [hereinafter Korea] as a readily accessible alternative to traditional bank financing. The purpose of this article is to inform the practitioner interested in doing business in Korea of the laws, demands, expectations, and pitfalls of the leasing laws in Korea. This article will discuss the general trend toward equipment leasing in Korea, the Leasing Industry Promotion Law (LIPL), administrative regulations of which the practitioner needs to be aware, and miscellaneous points of interest that are necessary to properly become involved in leasing transactions.

II. EQUIPMENT LEASING IN KOREA

A. General Trends in the Leasing Business in Korea

Since the 1970s, the Korean government has promoted the leasing industry in order to facilitate the acquisition of capital goods through use of foreign capital. This policy has a regulatory side as well, geared to conservation of foreign exchange. In 1972, the Korean government insured that equipment leasing (1) has no possibility of diverting funds from productive industries; (2) does not require companies to bear burdensome collateral obligations;
and (3) allows domestic businesses to use their professional knowledge of leasing companies in international finance customs and practices.¹

Initially, governmental involvement in the leasing business was extensive. The Korea Industrial Leasing Company Limited was incorporated in 1972 by the Korea Development Bank, a state bank strongly controlled by the Ministry of Finance. To facilitate this unfamiliar mode of finance, and to remove impediments created by other conflicting administrative regulations, the Leasing Industry Promotion Law² was enacted in 1973.³

With the policy-oriented support of the Government, Korea Development Leasing Corporation (KDLC) and Whashin Tiger Leasing Company Limited (later changed to Cheil City Lease) entered the leasing business in 1975. However, the technique of financing leases remained unfamiliar to most ordinary businessmen until the early 1980s. Equipment leasing was even less known among lawyers. Many legal professionals associated any transaction called a ‘‘lease’’ with forms of real estate conveyances. The LIPL was concerned only with the administrative aspects of leasing and not with contractual issues. Therefore, leasing companies and their lawyers had to spend several years after the proclamation of the legislation to educate the courts and the bar on the proper theoretical characterization and treatment of equipment leasing transactions.

More than twenty specialized leasing companies and six multifaceted financial companies are currently engaged in the leasing business⁴ in Korea.⁵ The total share of equipment leasing

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¹. KOREA DEVELOPMENT LEASING CORPORATION, LEASING TRANSACTIONS 11 (1988) [hereinafter KDLC LEASING TRANSACTIONS].
². Law No. 2664 (1973) (amended 1973) [hereinafter LIPL].
⁴. Many of these companies are subsidiaries of commercial banks or regional industrial groups. See infra Appendix A (listing major leasing companies in Korea).
⁵. The government opened the door to multifaceted financial companies in 1975 by enacting the Law Concerning Multifaceted Financial Companies. The capacity to engage in leasing transactions was further expanded to include venture capital companies in 1987 by the Law Concerning Promotion of Venture Capital Companies.
in private sector facility investment was 10.9% in 1989. The amount of outstanding lease contracts exceeded 3.6 trillion won (approximately U.S. $5 billion) in 1990. Industrial machinery, office machinery and medical equipment are the three major areas in which equipment leasing has become common. Aircraft leasing and other leveraged or transnational leasing activities have been slower to emerge.

B. Tax Aspects of Equipment Leasing in Korea

Periodic lease payments are deductible as business expenses because they are characterized as “rental charges for the use of the assets” under the Korean Corporate Tax Law. Usually, the lease term is shorter than the statutory amortization period for capital acquisitions, and the lessee can realize benefits of tax deferral by accelerated depreciation. For ordinary depreciable assets acquired by purchase, only 90% of the acquisition cost is allowed to be depreciated within the statutory depreciation period. In the case of leases, however, 100% of the acquisition cost is deductible during the lease term. For purchases financed with bank loans, only interest payments and depreciation allowance can be deducted as expenses. No other especially favorable treatment for equipment leasing transactions, such as double dip tax deductions, is provided under the Korean tax law. For the purpose of guiding proper tax reporting, General Administrative Rules of the Corporate Tax Law have been promulgated by the Office of National Tax Administration under the direction of the Ministry of Finance.

6. KDLC Leasing Transactions, supra note 1, at 8.
8. Id. at 12.
10. KDLC Leasing Transactions, supra note 1, at 41; JOONG HEE LEE, LEASE ACCOUNTING 22-30 (1988).
Furthermore, for corporate accounting of all companies participating in lease transactions, a Guideline for Accounting Treatment of Leases has also been adopted by the Security Management Committee under the authority of the Law Concerning Outside Audits of Joint Stock Corporations.\textsuperscript{12}

III. THE LEASING INDUSTRY PROMOTION LAW (LIPL)

A. Overview

The Leasing Industry Promotion Law is an unusual statute because it was designed to promote a specific financial industry. Many countries where leasing is conducted have a different legislative approach to the finance leasing business. In the United States, the rights and responsibilities of parties to financial leases are governed by the provisions of Uniform Commercial Code article 2A.\textsuperscript{13} No federal law specifically regulates the administrative aspects of the leasing business. In Japan, neither special laws nor special provisions designed to regulate equipment leasing transactions are found in Japan’s Civil Code. Instead, administrative rules issued by the tax authorities are regarded as the most important guidelines for leasing practice in the U.S. and Japan.\textsuperscript{14} There is no special legislation on equipment leasing in Germany. Instead, the Stipulation Control Law and many well-shaped judicial precedents serve to regulate the leasing business.\textsuperscript{15}

Conversely, special legislation to regulate administrative aspects of the equipment leasing business have emerged in France and

\textsuperscript{12} Law No. 3297 (1980) (as amended). Article 13 of this law authorized the formation of the Securities Management Committee to establish the Corporate Accounting Guideline. Under article 131 of this Guideline, the Guideline for Accounting Treatment of Leases was adopted on January 1, 1985.

\textsuperscript{13} See U.C.C. art. 2A, § 103(g) (1987).

\textsuperscript{14} In Japan, the Tax Collecting Agency recently issued an administrative directive which sharply narrowed the availability of double-dip leases. In the U.S., the Tax Reform Act of 1986 significantly reduced the benefit of lease financing. See M. Berwind, Equipment Leasing § 52.02 (1990).

\textsuperscript{15} KDLC LEASING TRANSACTIONS, supra note 1, at 259.
B. Legal Specifics of Equipment Leasing

1. Leasing Defined

The LIPL defines leasing (of equipment) as follows:

"Leasing" shall mean equipment financing which could be described as follows: A leasing company, through newly acquiring or leasing specified objects selected by the lessees, may allow them to use such objects without any direct responsibility for their maintenance and management for more than the period stipulated under the Presidential Decree, and during that period, shall receive a payment by installments periodically as the fixed price thereof. There shall also be a mutual agreement between the parties concerned regarding the disposal of the objects after the close of that period.

2. Modes of Acquisition Available to Leasing Companies

The selection by the lessee of the object to be leased is a condition precedent to its acquisition by the lessor. The lessor may assist the lessee in various ways to identify proper equipment, but the person finally responsible for selection of the object is the

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16. France enacted the Law Concerning Corporations Doing Leasing Business on July 2, 1966. A Leasing Business Act was also enacted in Belgium.

17. Under a traditional civil law system, it is difficult to recognize the special tripartite relationship among the lessor, the lessee and the supplier. It is also still troublesome to construct the lessor-lessee relationship. See Cuming, supra note 9, at 50-51.

18. Brazil, Spain, and Canada have also enacted special legislation on financial leasing. See id. at 41.

19. LIPL, supra note 2, art. 2(1).
lessee. The lessee should specify and select the equipment without primary reliance on the skill and judgment of the lessor.\textsuperscript{20}

The lessor should acquire the new object by way of purchase from the supplier (or lease from another lessor) only after the selection by the lessee. Equipment which already has been acquired prior to the selection by the lessee or which was selected by the lessor independently cannot become a subject of an equipment leasing transaction under LIPL.\textsuperscript{21}

3. \textit{Maintenance and Management Responsibilities}

In principle, the lessor does not assume the responsibility for maintenance and management of the leased object. This point reflects a difference between an equipment lease and traditional leases or bailments for hire. However, the lessor may voluntarily assume the maintenance responsibility pursuant to a mutual agreement with the lessee.\textsuperscript{22}

4. \textit{Term of the Lease}

To prevent excessive tax avoidance from depreciation of total acquisition cost over an unreasonably short period, the LIPL fixes minimum lease terms according to statutory estimates of the remaining useful life of each object.\textsuperscript{23} In the case of an object whose remaining life, as set forth in article 49 of the Enforcement Decree of the Corporation Tax Law, is five years or less, the lease term must be equivalent to at least 70\% of such life. In the case of an object whose useful life is over five years, the lease term is required to be a period equivalent to at least 60\% of such useful life.\textsuperscript{24}

\textsuperscript{20} Cuming, \textit{supra} note 9, at 48.
\textsuperscript{21} KDLC \textit{LEASING TRANSACTIONS, supra} note 1, at 239.
\textsuperscript{22} Id. at 240.
\textsuperscript{23} JOONG HEE LEE, \textit{supra} note 10, at 89.
\textsuperscript{24} Enforcement Decree of the Equipment Leasing Industry Promotion Law, Presidential Decree No. 7109, art. 2 (1974) (as amended) [hereinafter LIPL Enforcement Decree].

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5. **Method of Lease Payment**

In principle, lease payments are to be paid in equal installments over the lease term. Other forms of payment such as top-heavy or bottom-heavy methods are also allowed if the parties so agree.

6. **Disposal of Leased Objects upon the Expiration of the Lease Term**

If a lease contract expires by lapse of the lease period, the lessee should return the leased object to the lessor, unless otherwise agreed at the outset of the lease agreement. To dispose of the leased object in another manner, at the time of contracting, the parties should definitively agree to such alternative disposition.²⁵

7. **Financing Versus Leasing**

Some people regard equipment leasing transactions as leases of personal property under the traditional civil law system.²⁶ This characterization stems from the fact that (1) the legal title of the equipment is continuously retained by the lessor during the lease term; (2) the leased object is returned to the lessor at the end of the lease term unless otherwise agreed; and (3) the lessee normally makes lease payments in equal installments during the lease term.

However, the above characterization overlooks the financing aspect of lease transactions. From a standpoint based on the historical development and intrinsic processes of these transactions, equipment leasing is a sophisticated financing technique supporting acquisition and use of equipment by lessees with many tax and financial benefits. It parallels the concept encountered in hire-purchase financing of ships and aircraft, nonrecourse real estate...
financing, or corporate financing methods used in mergers and acquisitions.

IV. ADMINISTRATIVE REGULATIONS UNDER THE LIPL

A. Licensing of Leasing Businesses

Entry into the leasing business requires a license issued by the Ministry of Finance (MOF).\textsuperscript{27} Issuance of licenses is decided under MOF policy considerations relating to the current state of the general leasing business and other financial situations. The acquisition of a license is far easier now than it was several years ago. To establish a leasing company, the minimum amount of authorized capital is three billion won (approximately U.S. $4.2 million). Leasing companies should take the form of a joint stock company.\textsuperscript{28}

B. Regulation of Business Operations

Leasing companies must operate their business in accordance with an Operating Manual. Each company submits its proposed Operating Manual to the MOF at the time of license application. If a company subsequently wishes to amend its manual, they must first obtain MOF approval.\textsuperscript{29} Operating manuals must contain (1) the kind and method of business operation; (2) the means of fund-raising; (3) certain rates including interest and fees, by line of business; and (4) formulas for calculating the fees. Other important matters related to operations must be set out in accordance with the pertinent administrative rules of the MOF.\textsuperscript{30}

\textsuperscript{27} LIPL, \textit{supra} note 2, art. 3; LIPL Enforcement Decree, \textit{supra} note 24, art. 2(2).
\textsuperscript{28} LIPL, \textit{supra} note 2, art. 4; LIPL Enforcement Decree, \textit{supra} note 24, art. 5.
\textsuperscript{29} LIPL Enforcement Decree, \textit{supra} note 24, arts. 3, 4.

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1. **Activities of Leasing Companies**

A leasing company may conduct deferred payment sales and other business activities such as regulated rentals which are peripheral to its main activity of leasing. The company can also issue guarantees related to leasing or deferred payment sales.

2. **Cancellation of License**

The MOF may cancel the license of a leasing company if (1) any provision of the laws or of a company’s articles of incorporation is contravened; (2) a company is deemed unable to attain its purpose because of deterioration in financial or management conditions; or (3) failure to follow orders of the MOF under the LIPL. Prior to cancellation, the MOF should provide a reasonable period to cure the above defects.

C. **Specified Objects**

1. **Eligible Specified Objects**

The objects eligible for leasing are classified as follows: “(a) Facilities, equipment, machinery and instruments; (b) heavy machinery, vehicles, vessels and aircraft; (c) real estate and properties directly related to the objects of (a) and (b).”

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Rule No. 2221-619 (1987) [hereinafter Standing Rule].

31. Deferred payment sale “shall mean material financing which could be described as follows: A leasing company, through newly acquiring the specified objects selected by lessees, shall deliver such objects to them, and, during the period stipulated in the Presidential Decree, shall receive a payment by installments periodically as the price and interest, etc., thereof. There shall be mutual agreement between the parties concerned regarding the time of ownership transfer and other conditions.” LIPL, supra note 2, art. 7.

32. Id. art. 7(3).

33. Id. art. 17; LIPL Enforcement Decree, supra note 24, art. 12.

34. LIPL, supra note 2, art. 7-2(2).
2. Restrictions on Specified Objects

The concrete scope of the specified objects for which leasing is available, is restricted by the LIPL Enforcement Decree. These restrictions are based on the types and uses of property, as well as users and sources of procurement financing.

a. Scope of Lease Subject Matter

Fixtures—specified objects affixed to land or buildings (except where such objects are leased together with the land or buildings)—are restricted. Additionally, specified objects imported from overseas which are not new goods cannot become the object of a leasing transaction.

b. Restrictions on the Lessee and Usage

To guarantee that the leased objects be used for productive business activity, specified objects cannot be leased unless they are to be used by a person who registered as an entrepreneur under article 197(2) of the Income Tax Law. Thus, consumer leasing is not allowed in Korea. Leasing specified objects not directly used for the lessee’s business purposes is also prohibited. Specified objects used in businesses or applications deemed to accelerate luxurious consumption and those designated by the MOF as unnecessary for a sound economy are also prohibited from leasing. These designations coincide with certain restrictions on lending by financial institutions to businesses classified as extravagant.

35. LIPL Enforcement Decree, supra note 24, art. 6(1).
36. Id. art. 6(3).
37. Id. art. 6(5).
38. Id. art. 6(4).
39. Id. art. 6(6).
40. Operating Guideline on Credit Providing Business Activities of Financial Institutions, Monetary Board Ordinance § 3, Addendum: Prohibited Sector on Credit, item 3 (July 23, 1982) (as amended).
D. Lease Charges

1. Lease Payments

Under current practice, lease payments should not exceed the amount of the acquisition cost plus an incremental charge equivalent to interest during the term of the lease. In principle, the lease payments for each period should be the same, although the parties may agree on variable payments subject to maximum limits on total payments. Each installment lease rental amount is determined as follows:

Lease rental = acquisition cost x rental rate.

2. Acquisition Cost

The acquisition cost of the specified object is the sum paid by a leasing company, including the following costs which are directly required to procure the specified objects:

a. The price ex factory or the import price;
b. expenses required to open a letter of credit;
c. national and local taxes and customs duties;
d. warehouse charges and wharfage;
e. cost of loading, unloading, transportation, and delivery;
f. impositions, public charges, and insurance premiums;
g. trade agent’s fees and customs clearance fees; and
h. interest accrued on the purchase payments as of the commencement of the lease term, in connection with procurement.

The interest rate charged should not exceed the interest rate on regular loans by banking institutions.

41. LIPL Enforcement Regulation, supra note 30, sched. Preparation Standard to Operating Manuals § 3(A).
42. KDLC LEASING TRANSACTIONS, supra note 1, at 244.
43. LIPL Enforcement Regulation, supra note 30, sched. Preparation Standard to Operating Manual § 3(B).
3. **Applicable Interest Rates**

The equivalent interest rate per annum for lease payments may not exceed a maximum margin of 5% over the following basic interest rates:  

a. For Korean won currency funds, the interest rates on guaranteed corporate debentures;  

b. for foreign currency funds, a standard international interest rate decided by the MOF such as the LIBOR rate; and  

c. for leases of specified objects which have been leased from overseas, the interest rate applied to the leasing company at the time of the head lease.

If a lease payment is not made at the agreed time, default compensation may be determined contractually within the limits of the default interest rate applied to regular loans by banking institutions. In such cases, application of the usury ceiling in the Interest Limitation Law is excluded.

**E. Identification of Leased Equipment**

A leasing company must attach tags to leased property, indicating that they are subject to a lease. The tags should be made of durable material, and their position and size should be such that they are readily distinguishable.

**F. Special Treatment for Leasing Transactions**

To encourage use of leasing, the LIPL provides certain favorable provisions for leasing companies with regard to other administrative regulations.

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44. *Id.* § 3(C).
47. LIPL Enforcement Regulation, *supra* note 30, art. 5(2); *id.* Annex I.
1. Issuance of Debentures

A leasing company may issue debentures up to ten times the total amount of its capital stock, reserve fund, and other surpluses. This is a special exception to the provisions of article 470 of the Korean Commercial Code, which otherwise restricts the amount of debentures to twice the above capital level.\(^{48}\) Therefore, lessors may enjoy a high leverage effect. This exception purports to ease supply of funds to finance lease transactions.

2. Access to Governmental Financing

Lessors may be permitted access to government arranged funds which usually have very favorable terms and conditions. If a businessman is qualified to use such state programs but chooses to lease equipment, the lessor is entitled to borrow the same funds, under the same conditions, for purposes of leasing the equipment to a qualified lessee. This support is not confined to local currency funding.\(^{49}\)

3. Customs Duties

Usually, the person who imports the goods is nominated as the taxpayer liable to settle import duties. However, where the leasing company imports the specified objects which are eligible for exemption or reduction of customs duties under the Customs Law, the lessee may then be nominated as the taxpayer and will be liable for payment of duties instead of the leasing company.\(^{50}\)

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48. Id. art. 7(3); LIPL Enforcement Decree, supra note 24, art. 6(2).
49. When the government put restrictions on offshore borrowing to curb the post-1986 growth of the money supply, lessors became eligible to borrow foreign currency holdings from the government under favorable conditions. See KDLC LEASING TRANSACTIONS, supra note 1, at 7.
50. LIPL, supra note 2, art. 8.
4. Import and Transfer of Foreign Goods

Notwithstanding the provisions of the Foreign Trade Act, a leasing company may directly import specified objects for the purpose of the leasing.\textsuperscript{51} If the specified objects to be leased by a leasing company are equipment or facilities for the purpose of earning foreign currency, the performance obligation of earning foreign currency under article 23(3) of the Foreign Trade Act is to be fulfilled by the lessee.\textsuperscript{52}

5. Special Treatment with Respect to the Pharmaceutical Law

A leasing company may directly import medical equipment and instruments for the purpose of leasing, notwithstanding the restrictions in article 34 of the Pharmaceutical Law. A leasing company may freely transfer the equipment, notwithstanding the prohibition in article 42 of that law.\textsuperscript{53}

6. Remittance of Rentals Abroad

In those cases where a leasing company subleases to a domestic sublessee property leased from abroad, remittance of rentals payable to the foreign lessor are secured.\textsuperscript{54} Procedures for such remittances follow the relevant provisions of the Foreign Exchange Control Act.\textsuperscript{55} The terms and conditions of the lease contract should be approved beforehand under the Act.

\textsuperscript{51} Id. art. 9(1).
\textsuperscript{52} Id.
\textsuperscript{53} Id. art. 11.
\textsuperscript{54} Id. art. 12.
\textsuperscript{55} LIPL Enforcement Decree, supra note 24, art. 10.
7. **Special Treatment with Regard to Administrative Measures**

When a leasing company acquires, imports, or leases certain objects, and the lessee has arranged all of the legal requirements, such arrangements are regarded as having been made by the leasing company.

8. **Special Treatment for Title Registration**

Where a leasing company leases heavy equipment or vehicles, the required title registration may be made in the name of the lessee upon the decision of the leasing company, notwithstanding the provisions of the Heavy Equipment Control Law and the Vehicle Control Law.

A leasing company wishing to register or record the ownership of ships or aircraft for the purpose of leasing shall be regarded as an entity meeting all requirements for such registration or recording during the term of the lease thereof, so long as the lessee satisfies all requirements for title registration or recording in accordance with the provisions of article 2 of the Ship Law or article 6 of the Aviation Law.

9. **Special Treatment with Regard to Obligations of the Owner**

Because beneficial ownership is attributed to the lessee, various duties assigned to the owner of the specified objects under other laws or regulations shall be performed not by the leasing company but by the lessee as a party concerned when the lessee uses the specified objects through leasing.

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56. The legal requirements include government approval, permission and recommendation, and other administrative measures.
57. LIPL, supra note 2, art. 13; LIPL Enforcement Decree, supra note 24, art. 11.
58. LIPL, supra note 2, art. 13-2(1).
59. Id. art. 13-2(2); LIPL Enforcement Decree, supra note 24, art. 11-2.
60. LIPL, supra note 2, art. 13-3.
10. Responsibility for Indemnification

When a lessee who operates heavy equipment or vehicles under lease injures another person by an illegal act, negligently or wilfully, the leasing company is not regarded as a vicarious operator of the vehicle under the pertinent provisions of the Automobile Damages Compensation Guarantee Law. Lessors therefore need not carry separate insurance to indemnify damages arising from the misconduct of employees or agents of the lessee.61

V. ADDITIONAL ISSUES IN LEASING TRANSACTIONS

A. Rights and Obligations of Each Party

1. Obligations of the Lessor

Upon signing of the lease contract, the lessor places an order to the supplier (manufacturer or seller) for the specified objects in accordance with the specifications, quantity, and other purchase terms designated by the lessee.62 Selection of the object and nomination of the supplier shall be initiated not by the lessor but by the lessee.

With respect to delivery obligation, it is disputed whether the lessor guarantees delivery of the specified objects to the lessee.63 In the case of imported equipment, the lessor clearly assumes the primary responsibility for arranging delivery to the lessee, for import procedures all are taken by the lessor in its name. However, in domestic transactions, physical delivery to the lessee is made by the third-party manufacturer or supplier. In the latter case, the lessor’s control over a third-party supplier is limited. Thus, it has been argued that the lessor should not be liable for nondelivery of the objects.

61. Id. art. 13-4.
62. KDLC LEASING TRANSACTIONS, supra note 1, at 80.
63. Id. at 100.
However, the financing character of such leasing is not totally separable from procurement of the object. The lessor can influence the supplier through withholding or releasing payments for the objects. Therefore, it is reasonable for the lessor to assume the delivery duty as against the lessee.

Even if the duty of delivery by the lessor is recognized, the lessor may be exempted from responsibility for delays in delivery of leased objects. Since the lessee freely selected the supplier, it is fair that the lessee assume the risks arising from situations under the supplier’s control.

2. Obligations of the Lessee

The lessee is entitled to select the specified object and supplier. This is the most crucial point in an equipment leasing transaction. During the lease term, the lessee is entitled to possess and use the specified object to earn a profit. At the end of the term, the lessee may exercise an option for purchase or for extension of the lease term if such options are provided in the lease contract from the outset.

The total amount of the lease payment becomes an unconditional obligation of the lessee at the time of the lease contract. The lessee normally pays this sum in equal installments over the lease term. The amount paid to the lessor includes interest, expenses, and profit margin of the lessor.

There is no direct or contingent counter consideration linking each installment to the matching period of use. In this respect, finance leasing is different from traditional land leasing. The lessee must take care of the specified object with the due diligence used by ordinary reasonable persons engaged in same business using such specified object. In most cases, the lessee assumes the duty of maintenance and repair of the specified object.

64. *Id.* at 92.
65. Technically, the obligation is accrued at the time that the lessor pays the purchase price to the seller.
66. *Id.* at 85, 114.
The lessee must report on its business operation status to the lessor if the lessor so requests. The lessee must assume all third-party liabilities arising from use of the specified object, other than product liability. The lessee, at lessee's expense, is responsible for settling such liabilities.

At the end of the lease term, unless otherwise agreed, the lessee should return the specified object to the lessor. In case of early termination of the lease contract or loss of the specified object, the lessee must pay a stipulated loss value to the lessor. The lessee should take no action that may negate the legal ownership of the lessor in the specified object. The lessee cannot transfer, sublease, or pledge the specified object without prior permission of the lessor. Tags which clearly demonstrate the ownership of the lessor should be affixed by the lessee. In many cases however, tags are not so conspicuous as to preclude voluntary or involuntary unauthorized transfer of the specified object to an innocent third party.

B. Certificate of Acceptance

1. Rejection by the Lessee

In ordinary cases, the lease term commences from the date the lessee signs and delivers the Certificate of Acceptance to the lessor. If the lessee rejects the specified object for any reason, the remedies available to the leasing company become a concern. Under general rules of the Korean Civil Code, the obligee should cooperate with performance of the obligation by the obligor. Thus, if (1) the lessor tenders the specified object according to the contract; (2) the lessee voluntarily or involuntarily rejects the tendered object; (3) such rejection is attributable to the lessee; and (4) such rejection is illegal, then the lessor's obligation of due diligence is limited to willful misconduct or gross negligence.

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67. Id. at 85.
68. CIVIL CODE, arts. 401-03.
69. KDLC LEASING TRANSACTIONS, supra note 1, at 103.
The risk shifts from the lessor to the lessee, and the lessor may seek compensation for damages. The lessor may dispatch a notice requiring the lessee to accept the object within a specified period, otherwise the lessor is free to terminate the lease contract.

2. *Delay in Issuance of the Certificate of Acceptance*

The Certificate of Acceptance is issued to verify the time and occurrence of acceptance by the lessee. If the lessee fails to issue the Certificate of Acceptance within the pre-agreed period without a reasonable cause, the lessee becomes obligated to pay lease payments after the pre-agreed period lapses. If there is no definite period in the lease contract, the lessee's payment obligation commences after a reasonable period which is customary in the business in which the leased equipment is used. If the lessee continues to delay performance of its obligation, the lessor may terminate the lease contract and request damages.\(^7\)

C. *Disclaimer of Warranty by the Leasing Company*

1. *Warranty of Fitness for a Particular Purpose; Defects in the Specified Object*

Under Korean laws governing ordinary sales contracts, the seller should deliver property which is free of defects in quality and utility. If there is a qualified defect, the buyer can reject tender, rescind the contract, and seek compensation from the seller.\(^7\)

In equipment leasing contracts, however, the lessor does not assume this kind of warranty liability to the lessee. The contract forms used by Korean leasing companies uniformly exclude such liability on the ground that the critical aspects of the specified object (e.g., capacity, specifications, and type) and the supplier are

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\(^{70}\) *Id.* at 106.

\(^{71}\) *Civil Code,* arts. 580-84.
selected and decided by the lessee.\textsuperscript{72} Most court decisions and scholarly opinions recognize this rationale and disallow the invocation of bad faith or abuse of right claims.\textsuperscript{73}

As capital equipment transactions in Korea take place between experienced businessmen, the foregoing approach has been accepted. But when consumer leasing is involved, these general disclaimers of warranty liability may be modified for consumers.

2. Exceptions to the Disclaimer

A warranty disclaimer may not be enforced by the court if the lessor has expressly guaranteed the quality and capacity of the specified object. Additionally, if the lessor has a special relation with the supplier of the specified object, so as to be regarded as substantially the same entity, the disclaimer will not be enforced.

3. The Lessee’s Remedies

The lessee can only require the supplier of the specified object to cure the defect within a reasonable period. If the defect is so significant as to defeat the object of the contract itself, the lessee may request the lessor to rescind the purchase agreement with the supplier.

D. Repair and Maintenance

In a traditional lease (hire and rental relationships), the lessor should maintain and repair the goods so that the lessee is able to use them in accordance with the original intent of the lessee.\textsuperscript{74} However, in the case of equipment leasing, the lessor’s responsibility is limited to passive tolerance of the lessor’s use of the specified object. Moreover, the lessor has no practical

\textsuperscript{72} See, e.g., KDLC LEASING TRANSACTIONS, supra note 1, Model Lease Contract Form, art. 13 (showing clear disclaimers of the warranty responsibility).

\textsuperscript{73} Judgment of Aug. 19, 1986, Supreme Court of Korea, 84 Da-Ka 503, 504.

\textsuperscript{74} CIVIL CODE, art. 623.
capability to maintain and repair the broad range of items it has leased to lessees in many diverse business. Therefore, all of the lease contract forms used by Korean leasing companies exclude responsibility for maintenance and repair from the obligations of the leasing company. Conversely, these forms compel the lessee to assume the above responsibility during lease term. The court decisions and most scholars agree with upholding these forms. In the case of maintenance leases, some lessors may be responsible for maintenance and repair of the specified object. This results from an additional specific agreement between the parties for the purpose of rendering additional service.

E. Transfer of Risk to the Lessee

After the de facto acceptance by the lessee, if the specified object is lost or severely damaged without the fault of either party, all lease contract forms in use attribute the risk of loss to the lessee. Due to this allocation of risk, the lessee should pay a stipulated loss payment even though use of the specified object is impossible. It is not unfair to place such risk and duty to pay on the lessee because equipment leasing is functionally equivalent to financing an installment purchase. Moreover, as most specified objects are insured at the inception of the lease contract, it is rare for the lessee to bear the full burden of the stipulated loss value.

F. Bankruptcy and Reorganization Issues

1. Bankruptcy of the Lessee

As the legal title of the specified object is retained by the lessor, the lessor has rights superior to other creditors. The leasing company can request that the trustee return the specified good.
despite the commencement of bankruptcy proceedings. Under Korean law, the trustee may, on his or her own judgement, elect to terminate or to continue to perform an unexpired lease contract.

2. Reorganization of the Lessee

In the reorganization of the lessee, the receiver may assume or reject an unexpired lease contract at will. If the receiver decides to continue the contract, the lessee can continue to use the specified object. If use of the object continues, the receiver must make the lease payments at each scheduled payment date. Unpaid lease payments are treated differently in the reorganization proceeding according to the date of payment. Delinquent lease payments which were originally due prior to the commencement of reorganization are regarded as “in-plan” debt and subject to reduction under the subsequent organization plan. The unpaid amount of lease payments which are due after the commencement of reorganization are regarded as “commonly beneficial” debt. Payments on commonly beneficial debts are made only by permission of the court during the remaining lease term.

3. Reorganization of Lessee’s Guarantor

When a lessee’s guarantor commences the reorganization procedure, the lessor may report the entire amount of outstanding unpaid lease payments (or stipulated loss value) to the court as in-plan debt of the guarantor. Faithful payment by the lessee does not hinder the lessor from such reporting against the guarantor. In most cases, the amount of the guarantor’s liability to the lessor may be substantially reduced under the reorganization plan. If the lessor does not take such measures when a guarantor enters

80. Id. art. 50.
81. Corporate Reorganization Act, Law No. 1214, art. 103 (1962) (as amended).
82. KDLC LEASING TRANSACTIONS, supra note 1, at 214.
83. Corporate Reorganization Act, supra note 81, art. 108.
84. CIVIL CODE, art. 437, proviso.
reorganization proceedings, the leasing company may still pursue payment against the lessee and other guarantors through other channels.

4. **Bankruptcy of the Lessor**

Even though legal title of the specified object remains with the leasing company, the trustee cannot request that the lessee return the specified object to the estate unless the trustee elects to terminate the lease contract. In this case, the lessee should return the specified goods to the trustee. If the lessee suffers damages from unexpected termination of the contract, the lessee can report a claim for compensation of damage to the court as an in-plan creditor.

If the trustee elects to continue to perform the lease contract, the lessee should make the lease payments as usual. In many cases, the lessee will prefer to continue the lease contract rather than to return the specified object to the trustee during the lease term. The trustee can avoid the lease contract if it falls under the prohibition of fraudulent transfers. In this case, the lessee should return the goods and cannot report a claim to the court.

5. **Reorganization of the Lessor**

The receiver of the lessor may assume or reject the unexpired lease contract at the receiver’s discretion. If the receiver decides to continue a certain lease contract, the lessee may continue to use the specified object and must make each lease payment on the specified date. Even though the legal title of the specified object is retained by the lessor, the receiver of the lessor cannot request that the lessee return the specified object to the estate unless the receiver elects to terminate the lease contract. In the case of

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86. *Id.* art. 51.
87. *Id.* art. 64.
88. Corporate Reorganization Act, *supra* note 81, art. 103.
termination of the contract, the lessee should return the specified goods to the receiver. If the lessee suffers damages from unexpected termination of the contract, the lessee can report a claim for compensation to the court as a reorganization or in-plan creditor.

VI. CONCLUSION

Equipment leasing is becoming more popular in Korea because bank credit is prohibitively tight for most companies. The taxation benefits are not a strong motive for many companies involved in lease financing.

Administrative aspects of the leasing business are strictly regulated by the Ministry of Finance under the LIPL. Transactional aspects, however, are relegated to the court. Korean courts will usually apply the Civil Code of Korea and other relevant authorities evolved from the civil law system to settle the issue.

Article 2A of the Uniform Commercial Code specifically deals with the transactional side of personal property leasing. As leasing transaction law was originally developed in the U.S., Korean courts can find references to article 2A useful, notwithstanding the fundamental differences between the two legal systems.
APPENDIX A
LIST OF MAJOR LEASING COMPANIES IN KOREA

<table>
<thead>
<tr>
<th>Name of Company</th>
<th>Incorpor. Date</th>
<th>Capital (billions of won)</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea Development Lease</td>
<td>Dec. 1972</td>
<td>25</td>
<td>Korea Development Bank, NCB, Korea Exchange Bank</td>
</tr>
<tr>
<td>Korea Development Leasing Corp.</td>
<td>Feb. 1975</td>
<td>47.2</td>
<td>Korea Long Term Credit Bank, Korea Commercial Bank, Orix Corporation</td>
</tr>
<tr>
<td>Cheil City Lease</td>
<td>Jan. 1975</td>
<td>10</td>
<td>Cheil Bank, Citi Bank</td>
</tr>
<tr>
<td>Hanil Lease</td>
<td>Oct. 1984</td>
<td>20</td>
<td>Hanil Bank, Tokai Bank</td>
</tr>
<tr>
<td>Pusan Lease</td>
<td>Sept. 1985</td>
<td>20</td>
<td>Pusan Bank, Kyungman Bank, local investors</td>
</tr>
<tr>
<td>Daegu Lease</td>
<td>Oct. 1985</td>
<td>10</td>
<td>Daegu Bank, local investors</td>
</tr>
<tr>
<td>Korea Industrial Lease</td>
<td>Oct. 1985</td>
<td>20.2</td>
<td>Industrial Bank of Korea, Kwangju Bank, Chunbuk Bank</td>
</tr>
<tr>
<td>Korea Consolidated Financial Co.</td>
<td>Sept. 1976</td>
<td>15</td>
<td>Boston Bank, Barclay Bank, five domestic commercial banks</td>
</tr>
<tr>
<td>Kukje Consolidated Financial Co.</td>
<td>May 1977</td>
<td>23</td>
<td>Hyundai Group, Korea Exchange Bank</td>
</tr>
<tr>
<td>Hanbul Consolidated Financial Co.</td>
<td>Mar. 1977</td>
<td>18.5</td>
<td>Societe Generale, Hanjin Group</td>
</tr>
</tbody>
</table>

89. Incorporation date does not mean the opening date of equipment leasing business operations in cases other than that of specialized leasing companies.
<table>
<thead>
<tr>
<th>Name of Company</th>
<th>Incorp. Date</th>
<th>Capital (billions of won)</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia Consolidate Financial Co.</td>
<td>Mar. 1978</td>
<td>15</td>
<td>Daehan Spinning and Weaving, Yasuda Trust and Banking</td>
</tr>
<tr>
<td>Hanywe Consolidated Financial Co.</td>
<td>Sept. 1977</td>
<td>15</td>
<td>Kommerz Bank, Korea Exchange Bank</td>
</tr>
<tr>
<td>Chojeung Lease (Puchun)</td>
<td>July 1989</td>
<td>10</td>
<td>Choheung Bank, local investors</td>
</tr>
<tr>
<td>Whaneon Lease (Ahnyang)</td>
<td>July 1989</td>
<td>20</td>
<td>Korea Exchange Bank, local investors</td>
</tr>
<tr>
<td>Scooeon Lease (Sungnam)</td>
<td>July 1989</td>
<td>10</td>
<td>Seoul Trust Bank, local investors</td>
</tr>
<tr>
<td>Hanmi Lease (Suwon)</td>
<td>July 1989</td>
<td>10</td>
<td>Nanmi Bank, local investors</td>
</tr>
<tr>
<td>Sangeon Lease (Pusan)</td>
<td>July 1989</td>
<td>10</td>
<td>Korea Commercial Bank, local investors</td>
</tr>
<tr>
<td>Cungbuk Lease (Chungju)</td>
<td>July 1989</td>
<td>10</td>
<td>Chungbuk Bank, local investors</td>
</tr>
<tr>
<td>Chungchong Lease (Daejon)</td>
<td>July 1989</td>
<td>10</td>
<td>Chungchong Bank, local investors</td>
</tr>
<tr>
<td>Chunbuk-Sinbo Lease (Chunju)</td>
<td>July 1989</td>
<td>10</td>
<td>Credit Guaranty Fund, local investors</td>
</tr>
<tr>
<td>Kyungin Lease (Masan)</td>
<td>July 1989</td>
<td>10</td>
<td>Kyungki Bank, local investors</td>
</tr>
<tr>
<td>Korea Technology Development</td>
<td>Apr. 1981</td>
<td>42</td>
<td>Government, 100 Private Companies</td>
</tr>
<tr>
<td>Korea Technology Finance</td>
<td>Nov. 1984</td>
<td>22.6</td>
<td>Korea Development Bank, ADB</td>
</tr>
<tr>
<td>Korea Development Investment</td>
<td>Dec. 1982</td>
<td>12.1</td>
<td>Five short-term finance companies (Hankuk, Seoul, Hanyang, Daehan, Chungang)</td>
</tr>
</tbody>
</table>