

BREACH OF CONTRACT BEFORE DUE MATTERS IN PROVISIONAL REGULATION ON FINANCIAL LEASE TO BE CONSIDERED

by Prof. Dr. LÊ VĂN TỀ & LÊ THỊ HIỆP THƯƠNG

In financial lease service, on legal aspect, the equipment is under ownership of lessor, but the lessee has the right to use the equipment. This method helps the lessor avoid certain risks involved in money lending because the leased equipment will be used correctly, the lessor also has the right to inspect the use of equipment and retrieve the equipment if risks occur. Moreover, this method is more flexible than other normal methods of leasing because the lessee bears full responsibility towards the equipment. To lessee, the financial lease service is very useful and appropriate, and it could make up for shortcomings of other methods of financing.

The financial lease contract is the legal basis for separating two rights of the lessor (ownership) and of the lessee (possession). In order to protect their rights, both parties must agree that the financial lease is non-cancellable. However, in reality, there are many cases in which the breach of contract before due not only ensures both parties their interests, but also brings about benefits that will disappear at the end of the period of the lease. Therefore, in spite of its noncancellability, the lease could be ended before due if both parties agree on it.

1. Common cases of breach of contract in foreign countries

In foreign countries, especially ones with developed leasing industry, the breach of financial lease before due is considered as one of big benefits and a characteristic of this service. Usually, there are four cases of breach of contract before due:

- Casualty: In this case, one party is affected by force majeure, or fails to perform his obligations, or shows his intention not to perform

his obligations, then the lease will be cancelled before due in order to protect the other party, and the other party has a right to claim damages.

- Restructure: If the contract contains clauses that cause damage or difficulties to the lessee, the lessee can ask for a temporary breach of contract and negotiate with the lessor about adjustments made to the contract. Naturally, the lessor has the right by law to refuse to negotiate, however, most requests, if they are reasonable, are approved by the lessor.

- Pay off: In this case, the lessee has got enough money and wants to pay off the equipment. Facing this request, the lessor usually examines where the lessee's source of money comes from. The lessor will refuse the request if the source of money comes from another leasing company because to say "yes" to this request means to send the customer to the rival. If the money comes from the lessee's own source of finance (retained profit, equity capital, amortization, etc.), the request is usually granted on the condition that the lessee will pay all interest and other charges that the lessor will receive if there is no breach of contract before due.

- Early out: this case takes place when the lessee wants to replace the equipment with more modern one. The lessor usually agrees to take back the equipment if he runs a big leasing house and the equipment is still modern enough to let or sell.

2. Problems arising from the breach of contract before due according to the provisional regulations on financial lease

The provisional regulations on the financial lease service in Vietnam (included in the Decree 64/CP issued

on Oct.9,1995) affirmed that the financial lease is noncancellable (Point 3, Article 19), and the breach of contract before due is provided for by the Article 24 which is as follows:

Article 24: Breach of contract before due

1. *The leasing company can cancel the lease before due if:*

- *The lessee fails to pay rent as required by the lease.*

- *The lessee violates one of the terms (or clauses) of the contract.*

- *The lessee becomes insolvent (because of bankruptcy, company dissolution, etc.)*

- *The lessee has a third party acting as a guarantor and this guarantor becomes insolvent, but the lessee finds no other guarantor approved by the lessor.*

2. *The lessee can cancel the lease before due if:*

- *The leasing company doesn't deliver the equipment on time.*

- *The leasing company violates one of the terms (or clauses) of the contract.*

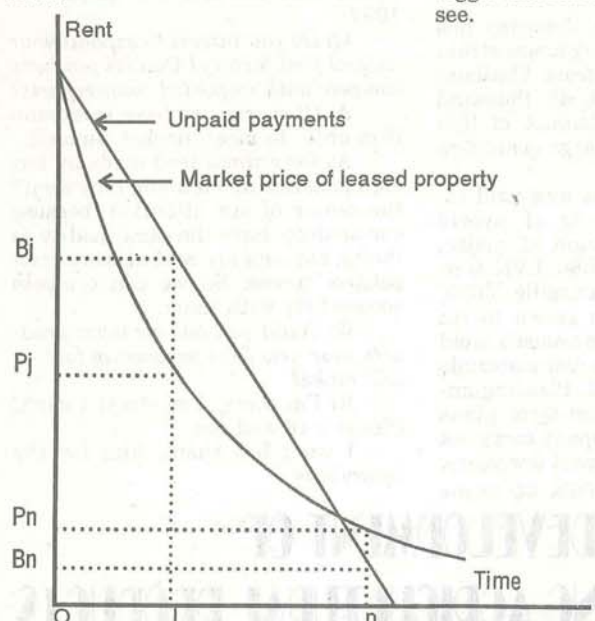
3. *The financial lease can be cancelled before due if the equipment is lost or irreparable.*

Thus, according to this Article, all cancellations agreed on by both parties aren't recognized. This matter can cause the lessee a lot of losses which could be avoidable if the contract is cancelled before due. This matter also makes the financial lease less flexible than other methods of financing because these methods allow the borrower to pay debts before due. Maybe it's wise to add to the Article 24 a rule allowing the contract to be cancelled if both parties agree to do so.

In addition, it's necessary to re-examine the Point 1, Article 25 pro-

viding remedies for breach of contract before due. It's reasonable for the lessor, under circumstances mentioned in the Point 1, Article 24, to cancel the contract and the lessee has to suffer all losses from the breach. However what are ruled by the Point 1, Article 25 (the lessee has to pay all rents stated in the contract and the lessor has the right to retrieve leased property) is unreasonable and too unfavorable for the lessee.

We must recognize that when the lessee pays all rents stated in the contract, the most important obligation of the lessee ruled by the contract is performed before due, that is, from the ethical aspect, his rights to the leased property must be taken into consideration, although he has violated the contract. Thus, if the lessee pays all rents, the lessor can't simply retrieve the leased property. The following figure can clarify this argument:



n: due date
j: time of cancellation
Bj, Bn: unpaid payments at j and n
Pj, Pn: market prices of leased property at j and n

The figure shows that if the lessee performs his obligations normally until n (time), the unpaid payment will be Bn, and the market price of the leased property will be Pn. If all rents are paid at j (time), the unpaid payment can't be larger than Bn (exactly, the present value of Bn at j is B'n, and B'n), and from ethical aspect, the lessor can't enjoy the market price of leased property larger than Pn (exactly, the lessor can only receive the value of Pn at j which is P'n, with P'n).

Thus, at j, if the lessor receives all rents stated in the contract, and retrieves the leased property, he gains a profit equivalent to Pj-B'n, in addition, the lessor can use the rents received and leased property retrieved to embark on a new venture. Apparently, the more the lessor gains, the more the lessee loses and the earlier the time of cancellation, the bigger the losses suffered by the lessee.

So in dealing with the breach of contract before due, it's reasonable to take losses suffered by the lessee into consideration. Returning to the above-mentioned example, at j, the lessee can suffer a loss equivalent to Bj-Pj, because the market price of the leased property at j is lower than the unpaid payment. This is the sum of money that the lessee has to pay to the lessor. Thus, at that time, the lessor holds both the property and the compensation. To embark on a new venture, the lessor has to spend some more time and money, so the lessee has to cover these costs. In addition, a fine could be charged on the lessee for his breach of contract with a view to saving the lessor the breach of contract.

In our opinion, in the Point 1, Article 25, we need only rule that the lessee must pay for the damage caused by the breach of contract before due. Otherwise, this regulation must be made more specific and reasonable.

We hope that our opinions will be of service to the making of the official regulation on financial lease.

