

Client Alert

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Civil Code amendments affecting real estate transactions

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Civil Code amendments affecting real estate transactions - Volume Three

In this alert, we highlight some of the key amendments to the Civil Code that will impact lease transactions.

Lease Term

The maximum length of a lease term under the Amended Civil Code will be extended to 50 years from 20 years under the current Civil Code.

Under the current Civil Code, the maximum term of a lease (which is not subject to the Act on Land and Building Leases) is limited to 20 years¹ (no limitation on the minimum length)².

However, there has been a growing need for a longer lease term to provide for stable occupancy, for example for leases in solar power projects, leases of land for golf courses, and leases of movable assets such as heavy machinery.

In addition, because there is no special reason for limiting the maximum length of a lease term to 20 years, the Civil Code will be amended to extend the maximum lease term to 50 years³, which is consistent with term permitted to emphyteusis (*eikosakuken*) under the Civil Code. There is no maximum length of term for leases which are subject to the Act on Land and Building Leases.

Transfer of Lessor's Position

The Amended Civil Code crystalizes the judicially created doctrine that when ownership of a leased property is transferred to another party, the lessor's position will, in principle, be automatically transferred from the assignor to the assignee without the need to obtain consent from any lessee, and in conjunction with that codification, but the Amended Civil Code will newly provide that the lessor's position will remain with the assignor if the assignor and the assignee so agree and the assignor will lease the property from the assignee (sale and lease back transaction)⁴.

In a sale and lease back transaction⁵, consents from each and every tenant were required to be obtained in order to have the assignor remain as a lessor

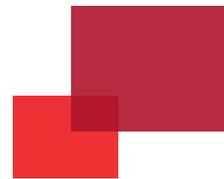
¹ Current Article 604

² Under the Act on Land and Building Leases, lease term for a lease of land for building ownership purposes is required to be 30 years or more, but there are no requirements for the term of a building lease. This will not be affected by the amendments to the Civil Code.

³ New Article 604

⁴ New Article 605-2. In this sale and lease back transaction, the assignee will be a lessor, the assignor will be a lessee and sub-lessor, and the tenant will be a sub-lessee.

⁵ A transaction such as an owner of a leased property assigning its ownership of such property to an assignee and at the same time assignee leasing back such property to the assignor. As a result, the assignor will act as a master lessee and can continuously lease the property to



and this imposed a significant burden on the parties to the transaction. However, when the Amended Civil Code becomes effective, as long as the assignor and the assignee agree to have the assignor remain as a lessor, the tenants' consent is no longer necessary.

Repair

Lessor's Obligation to Repair

Under the current Civil Code, the lessor has an obligation to repair the leased asset to the extent required to enable the use of such asset⁶.

In addition to this provision, the Amended Civil Code will provide that the lessor will have no such repair obligation if repair is required due to a matter attributable to the lessee⁷.

Lessee's Right to Repair

Under the current Civil Code, it was not clear whether the lessee may repair the leased asset itself and even if so, it was also arguable whether the lessor has an obligation to reimburse the lessee's costs in undertaking repair itself.

The Amended Civil Code will make it clear that the lessee has a right to repair the leased asset (i) if the lessor fails to repair the leased asset within reasonable period after the lessee provides notice to the lessor of the need for repair or the lessor becomes aware of the need for repair or (ii) in the case of emergency⁸. The lessee will be able to claim reimbursement of the costs of repair from the lessor.

Reduction of Rent in case of Partial Loss of Leased Asset

The current Civil Code provides that if any part of a leased asset is lost due to reasons not attributable to the negligence of the lessee, (i) the lessee may demand a reduction of the rent in proportion to the value of the lost portion, and (ii) if the purpose of the lease is not achievable with the remaining portion only, the lessee may terminate the agreement⁹.

The Amended Civil Code will instead provide that the rent will be automatically reduced (without any notice or demand by the lessee) and widen the scope of circumstances requiring a rent reduction by providing that a reduction will apply not only in case of any loss but also if the leased asset cannot be used¹⁰. Also in relation to termination, the Amended Civil Code allows the lessee to terminate the agreement even if the lessee is negligent¹¹.

Restoration to Original Condition (make good)

Although almost every lessee needs to restore the leased asset to its original condition when the lease terminates or expires, there is no provision

tenants (the tenants will become sublessees). This transaction is often used in real estate securitization projects.

⁶ Current and New Article 606

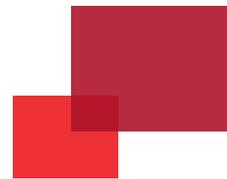
⁷ New Article 606

⁸ New Article 607-2

⁹ Current Article 611

¹⁰ New Article 611.1

¹¹ New Article 611.2



regarding the lessee's obligation to restore the premises under the current Civil Code.

The Amended Civil Code now sets out the lessee's obligation to restore the leased asset to its original condition¹². The concept is widely accepted in the market but the Amended Civil Code clearly excludes normal wear and tear and aging, and also loss or damage not attributable to the lessee.

Guarantor

In some cases, the lessor may require that the lessee have someone guarantee the lessee's obligations under the lease agreement.

The provisions of the current Civil Code with respect to such guarantees will be amended such that if an individual person is asked to act as guarantor for obligations owed by the lessee under the lease agreement, the maximum amount (*kyokudo gaku*) to be guaranteed by such individual guarantor needs to be described in the lease agreement or the guarantee agreement (as the case may be)¹³.

Also, when the lessee asks such an individual to guarantee its obligations under the lease agreement, in general, the lessee needs to provide its financial information, etc. to such individual before the execution of the lease agreement or guarantee agreement (as the case may be)¹⁴. In addition, if requested by the guarantor during the lease term, the lessor may be required to provide information regarding the amount or extent of the lessee's obligations such as current rent, the status of payment by the lessee, etc. to the guarantor¹⁵.

¹² New Article 621

¹³ New Article 465-2

¹⁴ New Article 465-10

¹⁵ New Article 458-2