

Secured Transactions Law in Japan

SECOND PACIFIC-RIM COLLOQUIUM ON
ECONOMIC DEVELOPMENT AND THE HARMONIZATION OF
COMMERCIAL LAW

SHANGHAI, CHINA – JANUARY 8-10, 2015

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[1] Secured Transactions under the Civil Code of 1896 (1)

- JCC of 1896 still in force as originally enacted (with very few exceptions).
- Heavy reliance on “immovable” as collateral.
 - High and stable value of land.
 - No practical non-possessory security right in “movables” under JCC
 - Only possessory “pawn/pledge” available for movables.
 - Equipment and inventory financing difficult under JCC.

[2] Secured Transactions under the Civil Code of 1896 (2)

- Practice of Security Interests in “movables”
 - Retention of Title Sales
 - Transfer-Security Right (*joto-tanpo*)
 - Title transferred, and upon repayment of debt, title re-transferred.
 - BUT no physical transfer of possession is involved.
 - Perfection achieved by “constructive” transfer of possession
 - “aggregated goods” or “circulating inventory” allowed (floating charge)
- Assignment of Receivables
 - Perfection achieved by individual “notification” to third party obligor (Art 467 JCC)
 - Difficult to assign receivables in large volume

[3] ST Law Reform in the “Lost Two Decades”: Overview

- “Burst of the Bubble Economy” (early 1990s)
 - Land price hike, followed by steep depreciation resulted in huge amounts of “bad loans” secured by land.
- Insolvency Law Reform (late 1990s - 2003)
 - **Ex post** solution to “bad loans”
 - E.g., New rule: security right extinguished by payment of current price of the encumbered asset in “DIP” procedure. This allows flexible use of “going concern value” of the business which is larger than its “liquidation value”.
- Secured Transactions Law Reform (mid 2000s)
 - **Ex ante** perspective: facilitation of financing

[4] Reform of Perfection Rules (1)

- Regarding Transfer-Security Rights: reform of perfection by “constructive transfer of possession”
- Impact of UNCITRAL secured transactions instruments (e.g., 2001 Receivables Convention, 2007 Legislative Guide)?
- Chronologically, NO:
 - 1998 Act on Special Rules to the Civil Code Concerning the Perfection of Transfer of Receivables
 - 2004 Act on Special Rules to the Civil Code Concerning the Perfection of Transfer of Receivables and Movables
- Underlying principles, NO:
 - Functional Approach (substance over form)?

[5] Reform of Perfection Rules (2)

- Perfection (third party effectiveness) achieved by “registration” of “transfer/assignment”
 - indexed and searchable by identifier of the Transferor/Grantor
- However, it does NOT replace the Civil Code perfection method of:
 - Transfer of Possession (Civil Code)
 - Actual transfer of possession
 - Constructive transfer of possession
- Creates a “dual” perfection system

[6] Shortfall 1: Insufficient Public Notice

- Problem vis-à-vis Prospective Competing Creditors
 - “Registration” and “constructive transfer of possession” given equal weight: earlier in time has priority ... lacks predictability
 - Registration of “transfer” not “security interest”
 - Not all security interests in movables can be registered:
No transfer of title in “retention of title sales”
 - Denial of “substance over form”

[7] Shortfall 2: Third Party Purchasers Favored

- Third party purchasers of encumbered asset favored over registered transferee/secured creditor
 - *Good faith* purchaser (Art 192 JCC) beats registration
 - Purchaser in “the ordinary course of business” beats registration (Supreme Court Decision, July 20, 2006, Minshu 60-6-2499 [security interest in inventories (aggregated goods)])

[8] Shortfall 3: Cumbersome “registration” requirement

- Transferor/Grantor must be incorporated
 - to avoid problem of indexing/searching
- Joint application by transferor/grantor & transferee/secured creditor required
- Description of encumbered asset must be detailed: Description by
 - “type of asset”; **AND**
 - characteristics that makes the movable distinguishable from others (e.g., serial number); **OR** location of the movable
 - Description such as “all assets” not allowed

[9] Shortfall 4: Limited Disclosure

- General searcher may obtain only a “Summary of the File” (Special Rule Art 11)
 - showing the filing activities of the grantor, without identifying the encumbered asset.
- Full disclosure of the file limited to:
 - Transferor/Grantor and Transferee/SC; and
 - “Parties having Interest” listed by ordinance
 - Third party acquirer of movable, third party obligor of the receivable, attaching creditor, etc.
- Concern over “privacy” prevailed

[10] Shortfall 5: Limited Access

- Electronic Registry
 - In addition, filing/searching in person or by mail available at Tokyo's Nakano Registration Office (only one office nationwide)
- Time of Operation
 - Not 24 hours/day, 7 days/week
 - Electronic Registration: Weekdays 8:30-17:15 JST(movables), 8:30-21:00 JST (receivables)
 - Electronic Search : Weekdays 8:30-21:00 JST, some Saturdays 8:30-17:00 JST
- Little use of IT, little consideration for international transactions

[11] Why so “timid”?

- Stark contrast with UNCITRAL’s robust functional, integrated, and comprehensive approach.
- Why?
 - Traditional negative image of collateralizing movables/receivables
 - Providing collateral as signal of financial trouble
 - Culture?
 - Resistance to “change” in existing practice?
 - Legislators taking “precision” too seriously?
 - Sideline: 2000 E-commerce enabling legislation meticulously listing **every** statutory writing requirements that should be amended to allow electronic documents.

[12] What should be done?

- Finding the right button/addressee:
 - Borrowers (who are not united)
 - Policy Agencies:
 - Law as an instrument for industry policy and economic growth

[13] REFERENCES (in English)

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- **Morita, Osamu (2011):** “Timid Cousin in the Far East: The Security Right Registration in Japan and the UCC Filing” *University of Tokyo Journal of Law and Politics*, Vol. 8, pp.20-58

Thank you!