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Time of Request: Tuesday, November 02, 2010 00:21:17 EST
Client ID/Project Name:
Number of Lines: 1443
Job Number: 1843:250748202

Research Information

Service: Terms and Connectors Search
Print Request: Current Document: 1
Source: Doing Business in Japan
Search Terms: § 2.02 Special Types of Contracts: Selected Issues

Doing Business in Japan

CHAPTER 2 Contracts and Business Activities

2-2 Doing Business in Japan § 2.02

§ 2.02 Special Types of Contracts: Selected Issues

[1] Sales [RESERVED]

[2] Loans and Banking

[a] In General

[i] Types of Financial Institutions. Financial institutions in Japan include a central bank, government-related institutions, and private institutions. They are authorized by respective enabling laws and regulations and are supervised and regulated by the government.

The Bank of Japan is the central bank, the only bank in Japan authorized to issue currency notes. The Bank of Japan also acts as a bank's bank by providing loans to, discounting notes submitted by, and accepting deposits from, other financial institutions. It functions as the bank for the Japanese government by providing loans, dealing in and underwriting national debentures, accepting and paying out government-related deposits, and accepting, paying, and managing foreign currency which is deposited in the Foreign Exchange Fund Special Account.

Government-related financial institutions are those institutions which have been established for purposes of accomplishing particular policy objectives, and their activities are ordinarily in the so-called economic policy loans and investments. They are funded by the Economic Policy Funds, bonds, debentures, and borrowed funds.

[ii] Commercial Banks

[A] Definitions. The enabling law for commercial banks is the Banking Law. n210 Article 2 of the Banking Law defines a bank as follows:

"Article 2

(1) The term "Bank" as used in this Act means a person who operates banking business under the license of the Prime Minister prescribed in Article 4(1).

(2) The term "Banking Business" as used in this Act means business that performs any of the following acts:

(i) Both acceptance of deposits or Installment Savings, and loans of funds or discounting of bills and notes; or

(ii) Conducting of exchange transactions."

In other words, the essence of a bank is acceptance of deposits from a large and unidentified group of people and utilizing the funds so deposited in making loans, discounting notes or engaging in exchange transactions. It may be noted that Article 2 of the Act on Regulation of Receiving of Capital Subscription, Deposits, and Interest Rates, etc. n211 prohibits any person or entity other than those legally recognized as financial institutions from accepting deposits from a large unidentified group of people.

A license form the Prime Minister is required for the operation of a bank, under Article 2 of the Banking Law. If a bank whose main office is located outside Japan desires to establish a branch, liaison office, or agency in Japan, it must designate a representative officer for each place of business in Japan and obtain a license from the Prime Minister in accordance with the Banking Law. Once a license is granted, the business is deemed to be a banking business and is subject to supervision by the Prime Minister under the Banking Law.

[B] Types of Commercial Banks and Their Activities.

Commercial banks are banks which are engaged in general banking business. Besides the acceptance of deposits, making of loans, discounting of notes, and exchange transactions, commercial banks engage in activities collateral to the banking business.

Banks in principle may not engage in a securities business. Article 33, paragraph 1 of the Financial Instruments and Exchange Act prohibits banks from engaging in "the Securities-Related Business or Investment Management Business." However, the provisory clause in Article 33, paragraph 1 permits the banks to conduct sales or purchase of Securities or Transactions of Securities-Related Derivatives (i) for the purpose of its own investment or (ii) on an account of a person who entrusts based on a trust contract. In addition, Article 33, paragraph 2 permits banks to conduct brokerage with written orders or conduct sale or purchase, intermediary, or brokerage of certain categories securities or derivative transactions.

Commercial banks make both long-term and short-term loans. For convenience, commercial banks can be classified into three groups according to size and function. The three groups are nationwide banks, local banks, and foreign banks.

[C] Nationwide Banks. The banks which have their main offices in large cities and are engaged in nationwide banking business include Bank of Tokyo-Mitsubishi UFJ, Mizuho Bank, Mizuho Corporate Bank, Sumitomo Mitsui Banking Corp., and Japan Post Bank.

In addition, the banks engaging in trust business in addition to banking business include such banks as Mitsubishi UFJ Trust and Banking, Sumitomo Trust and Banking, Chuo Mitsui Trust and Banking, Mizuho Trust & Banking, and Resona Bank.

[D] Local Banks. Local banks have their main offices in the smaller cities and do their business within their respective localities. There are multiple local banks in each prefecture. They are primarily involved in business

transactions with local businesses.

[E] Foreign Banks. Foreign banks include the branches, liaison offices, and agencies of banks chartered in foreign countries. Although foreign banks may engage in the business of accepting deposits and making loans as domestic banks do, their primary business is foreign exchange transactions.

[F] Financial Institutions for Medium-Sized and Small Enterprises. Medium-sized and small enterprise financial institutions include credit finance companies, credit co-operative associations, labor finance companies, and commerce and industrial cooperative central finance companies. These financial institutions are established pursuant to their respective enabling laws, such as the Small and Medium-Sized Enterprise Cooperative Act, n212 the Labor Credit Association Act, n213 and Central Credit Association for the Commercial and Industrial Cooperatives Act. n214 Although the primary purpose of these financial institutions is to serve small and medium-sized enterprises, the nature of their business is essentially the same as that of a commercial bank, and at times, the larger mutual banks with substantial assets conduct business in much the same way. Membership financial institutions like credit finance companies or credit co-operative associations stipulate qualifications of their members in its articles of incorporation and those who enter into transactions with such institutions must be their member.

[iii] What Services Are Available at a Bank? In general, business people expect from a bank such services as deposits, settlement of notes and checks, loans, remittances, and collections. Most banks offer all of these services. Standard services offered by a commercial bank are as follows:

1. Deposit: current deposit, ordinary deposit, notice deposit, term deposit, tax-reserve deposit, special deposit, and transfer account;

2. Loan: loan on notes, certificate of deposit, overdraft protection, discount of notes, acceptance, and loan of investment securities;

3. Domestic Exchange: remittance, payment, and collection of notes;

4. Foreign Exchange: export (purchase and/or collection of export bill of lading), import (letter of credit, settlement of import bill of lading), remittance and collection;

5. Ancillary Services: derivative transactions, safe-keeping, rental of safe deposit boxes, and agency operations such as dealing with payments for investment securities and interest coupons.

In addition, a commercial bank offers management and foreign trade consultation services to its customers, generally without a fee.

Banks in Japan typically operate many branches, and the branch networks of most large banks cover the entire country. Although banks are restricted by law in the securities business, their services are wide-ranging, from the acceptance of deposits from individuals to the financing of plants and equipment of large multinational enterprises. They establish subsidiaries to operate credit card businesses and provide lease-financing and data-processing services, thus segregating these collateral functions from their main functions.

This chapter gives emphasis to the main domestic services offered the general public, such as deposits, loans, and domestic exchange. Such collateral functions as credit card transactions and securities-related activities are discussed in separate chapters.

[iv] Qualifications Necessary for Transacting Business with a Japanese Bank

[A] Classification of Residents and Non-residents. Classification of residents and non-residents is irrelevant to

nationality.

According to the definition in the Foreign Exchange and Foreign Trade Act n215 (Article 6 of the Foreign Exchange and Foreign Trade Act):

(1) The term "non-residents" shall mean natural persons and juridical persons other than residents.

(2) The term "residents" shall mean:

(i) natural persons having their domicile or residence in Japan;

(ii) judicial persons having their principal office in Japan; and

(iii) the branch offices, local offices or other offices in Japan of non-residents.

Essentially, the classification of residents and non-residents makes no difference in possible transactions.

However, a yen deposit of a non-resident is a "non-resident yen deposit" and is subject to the following legal regulation:

- Restriction on making or receiving payments of funds between a resident and a non-resident (Article 16 of the Foreign Exchange and Foreign Trade Act); and

- Restriction on the payment and other transactions in the case of a subject (country) of economic sanctions by the United Nations (Articles 16 and 21 of the Foreign Exchange and Foreign Trade Act).

[B] Transactions with Foreign Juridical Persons.

A foreign juridical person means a judicial person established under the law of a foreign country and includes a foreign company and a foreign judicial person other than foreign company.

A foreign judicial person is not necessarily vested with capacity to hold rights in Japan. However, Civil Code of Japan vests certain types of foreign judicial person with capacity to hold rights so that it can conduct activities in Japan as a judicial person. Foreign judicial persons approved under the Civil Code of Japan are any nation, any administrative division of any nation (such as a state), any foreign judicial person approved by a law or treaty, and any foreign company.

[C] Transactions with Foreign Companies. A foreign company means a company incorporated under the law of a foreign country. When it operates in Japan, a foreign company in principle is allowed a same extent of capacity to hold rights as the same kind of company or the most similar kind of company in Japan and is subject to the same laws and regulations as such company (Article 823 of the Companies Act). n216 A foreign company that has its head office in Japan or whose main purpose is to conduct business in Japan may not carry out transactions continuously in Japan

(Article 821 of the Companies Act). When a foreign company intends to carry out transactions continuously in Japan, it shall specify its representatives in Japan (Article 817 of the Companies Act), and shall complete necessary registrations (Article 933 through 936 of the Companies Act). These provisions are for the purpose of preventing incorporation of a company under a foreign law in order to evasion of Japanese laws and do not reject foreign companies' investments in Japan or their launching businesses in Japan.

[D] Transactions with Foreign Nationals. A foreign national means a natural person who does not have Japanese nationality. In Japan, foreign nationals are vested in principle with capacity to hold rights (Article 3 of the Civil Code), however, some rights are restricted by applicable laws or treaties. Concerning the application of laws, the "Law concerning the Application of Laws in General" n217 stipulates various provisions.

[E] Banking Transactions and the Law.

Japan has no law directly regulating banking transactions. Even the Temporary Interest Rate Adjustment Law n218 determines only the maximum interest rate; it does not necessarily have private law consequences. Various provisions of the Civil Code are applied, however, according to the nature of a given transaction. For example, the provisions on "loan for consumption" are applied to bank loans, those on "deposit for consumption" are applied to deposits in banks, and those on "mandate" govern exchange transactions. Civil Code provisions determine legal relationships only generally and, therefore, are not sufficient for bank transaction purposes. In order to fill the vacuum, each bank has adopted a detailed standard agreement for bank transactions, and each transaction is based on such a standard agreement. Japan Bankers Association adopted model standard agreements and standard regulations. Each bank has revised its own standard agreements and standard regulations to conform to the model.

For example, all loan transactions are based on the model loan agreement contained in the Model Agreement on Bank Transaction adopted in 1962 (abolished in 2000). The model agreement is executed by the borrower prior to the initial loan transaction, and supplementary agreements are executed when necessary.

In contrast to the single standard loan agreement, which is applicable to all kinds of bank loans, model deposit agreements are diverse, and tailored to each kind of deposit. Current account transactions are governed by the Model Current Account Transaction Regulations adopted in 1974, which succeeded the Model Current Transaction Account Agreement adopted in 1969. Other deposits are governed by the model rules adopted in 1973.

Otherwise, with respect to actual problems, each bank revises its procedures reflecting the development of case law. As a law for the purpose of protection of consumers, there is the Consumer Contract Act, n219 which is also applicable to banking transactions.

[v] Prevention of Money Laundering and Obligation of Customer Identification Verification. For the purpose of prevention of money laundering, under the Act on Prevention of Transfer of Criminal Proceeds, n220 a bank is obligated to verify customer identification in the following cases:

(i) The bank commences with a customer a continuous transaction such as opening a deposit account, rental of a safe deposit box, and loan transaction;

(ii) A transaction with a one shot customer involving cash exceeding two million yen; and

(iii) There is any suspicion about the customer identification even once a verification process of customer identification has been conducted.

Customer Identification must be verified with official identification documents. For individuals, such documents as a passport, a driver's license, and an alien registration certificate are among the designated official identification

documents for this purpose and the "name", "domicile" and "date of birth" are the identifying matters. For judicial persons, a bank verifies "name" and "location of its head office or principal office" with a certificate of registered matters and, in addition, obtains the identification confirmation of such a natural person who takes charge of the transaction with the bank.

When customers do not cooperate with the bank in identification confirmation, the bank may refuse to enter into a transaction or to fulfill the obligations under a deposit contract.

[b] Deposits

[i] In General. For a customer, a deposit with a bank is a means for the settlement of checks and notes, receipt of remittances, management of cash for daily disbursements, and savings. Current deposit accounts are utilized for the settlement of checks and notes ordinary deposit accounts for the management of cash; and term-deposit accounts for savings.

Since the demand for money is always strong in Japan, a bank may not be able to arrange a loan when it is needed by a customer. For this reason, corporations often take out loans in order to maintain necessary liquidity in case they develop a sudden need for money. It is illegal as an unfair business practice to demand an excessive deposit balance as a condition for extending a loan (as an unfair business practice to the extent that deposit transactions arise as a side effect of a loan transaction).

[ii] Deposit Book and Deposit Certificate. In accepting deposits, a bank issues a deposit book or a deposit certificate to a customer. When the depositor requests withdrawal of deposit, the bank requests the depositor to submit the deposit book or deposit certificate. The legal character of a deposit book and a deposit certificate is an evidentiary document which proves the deposit contract and the existence of deposit claim (not a valuable instrument).

[iii] Deposit Agreement. While a deposit contract is a deposit contract for consumption, the civil code alone cannot rule all of the deposit transactions. In addition, as deposit transactions are those with many and unspecific customers, a bank cannot enter into contracts with different contents for each of the depositors. Thus, the process of entering into a transaction is such that the bank prescribes standardized contents of a contract and the customer by agreeing to it.

[iv] Interest Rate on Deposit. Financial institutions prescribe in their deposit rules that they pay certain interest to the deposits other than current deposit. Although a maximum interest rate on deposit is established for each kind of deposit in accordance with the Temporary Interest Rate Adjustment Law, the determination of interest rate on deposit is completely liberated due to deregulation, except that current deposit bears no interest. The bank determines its deposit interest by making reference to the trend of market interest rates.

[v] Current Deposit

[A] Current Deposit Transaction Accounts. Funds for the payment of notes and checks are deposited in "current deposit transaction accounts". Promissory notes are widely used for payment in commercial transactions in Japan, and checks are also commonly used.

A uniform promissory note system exists to prevent excessive use of notes Under this system, banks accept notes only if they are in the prescribed form Checks must also be in the prescribed form. This does not prohibit the use of other forms of notes or checks, but, as a practical matter, notes and checks which do not conform have little commercial value. Thus, it is necessary to establish a current deposit transaction account with a bank and obtain note and check forms generally used by banks.

[B] How to Open a Current Deposit Transaction Account. When an application is made for a current deposit

transaction account, a bank will investigate the credit standing of the applicant. If it is not acceptable, the bank will decline to open the account. This is not only because of the risk of extra work or of loss for the bank as a result of dishonor of instruments, but also to protect the credit standing of the bank itself.

When a bank decides that there is no problem with credit standing of the applicant, the bank usually accepts the application and opens an account.

Upon opening a current deposit transaction account, a customer registers his signature and/or seal. The bank will pay a check if the signature or seal on it agrees with the registered signature or seal. In Japan, seals are more widely used in banking transactions than signatures, but the latter have been gaining more acceptance recently.

When these procedures have been carried out and an account has been opened, the bank issues note and check forms. A customer needs to pay fees for the issuance of note and check forms.

[C] Rules for Current Deposit Transaction Accounts. There is a set of rules referred to as the Current Deposit Transaction Account Rules (hereafter cited as the "Rules"). These rules function as a contractual agreement defining the rights and liabilities of the customer and the bank. The Japanese Bankers Association has adopted model rules, and based on this model, each bank drafts its own rules to be inserted in the contract with the customer. The basic rules at each bank are generally similar. As the bank issues a copy of the rules to the customer at the time of opening the account, the customer should read the rules carefully.

The rules concern the procedures for current deposit account transactions and the laws regarding them. The salient points are as follows:

[I] Payment Funds (the Rules, Articles 1 through 6). Current deposits are made with cash, securities, such as bills and notes, which can be exchanged and funds remitted from other banks. n221 A hold is placed on deposits of securities until it has been confirmed that they will not be dishonored. n222 The status of securities payable at the depository bank is confirmed on the day of deposit. A deposit of securities payable at other banks is generally not available for use for two banking days after the deposit. Any provisional credit given to the depositor is cancelled upon dishonor. n223 The amount of deposit of notes and checks is determined by the amount appearing in a designated place for amount on the securities. n224

[II] Payment (the Rules, Articles 7 through 12). When a check or note is presented for payment during the period allowed for presentation, a bank pays against the document out of the funds in the current deposit account of the drawer-customer. n225 When the funds in the account are insufficient to meet payments of all documents presented, the bank may elect to pay against any documents at its discretion. When the deposit balance is insufficient to pay, the bank may refuse to pay against a note or a check and dishonor it. If the customer is creditworthy, the bank may pay at its discretion in excess of the deposit balance (an excessive drawing). If the bank elects the excessive drawing, the customer is obligated to pay the bank immediately. n226 Payments out of current deposit accounts are generally made by notes or checks. On occasion, interest and fees payable to the bank and specially requested by the customer may be debited from the account without the use of checks or notes. n227

Although the Checks Act has provisions for certification of payment (*shiharai hosho*), a bank does not usually certify payment. When certification is requested, the bank usually issues a treasurer's check.

[III] Matters to be Reported (the Rules, Articles 14 through 16). The customer is obligated to file with the bank information concerning his seal, signature, name, business name, representative(s), manager(s), address, and telephone number. The bank can discharge its obligations of notifying the customer by acting upon the information supplied by the customer.

[IV] Certificate of Seal (the Rules, Article 17). The bank has a duty to examine the seal or signature on a presented instrument and confirm that it agrees with that registered by the customer. The bank is not liable for payment made after this examination unless negligence in this process is shown. The duty of care owed by the bank is not limited to the confirmation process. The bank must examine the check or note form for authenticity, and be aware of customers' loss and theft reports. However, unless there are other suspicious circumstances, the bank is generally not held liable for payments made after it confirms the agreement of the signature with the registered signature. Therefore, the customer should be extremely careful about the safekeeping of the seal and signature.

[V] Irregular Checks and Notes (the Rules, Articles 18 through 20). In Japan, there are many notes and checks circulating in commerce which do not conform to the requirements of the Bills Act and the Checks Act. These include checks and notes without date of issue or without a specified payee. These notes and checks are not legally enforceable since they lack essential terms. However for commercial convenience, banks are authorized to pay against these irregular checks and notes. n228

A lined check is widely utilized in Japan. This is a check that a bank cannot pay against unless the person presenting it has an account with the bank. n229 However, since there is a banking custom that a lined check can be paid to a noncustomer if it is endorsed by the maker, this banking custom is specifically included in the Rules. n230

In addition, there is a provision concerning payment against an instrument issued by a corporation and made payable to a director of the corporation. Such payment is violative of the restrictions against self-dealing. However, since a Supreme Court decision n231 held that the defense of invalidity of such a check could not be set up against a claim of a holder in due course, the rules include a provision which allows the bank to pay against such an instrument without observing all procedures mandated by law. n232

[VI] Other Provisions. Other provisions of the Rules are as follows:

Article 21: no interest is paid on a current deposit transaction account;

Article 22: the customer's questions as to his transaction records will be answered only according to the internal procedures of the bank;

Article 23: current deposit transaction accounts may not be transferred or pledged;

Article 24: a current deposit transaction account can be cancelled at any time;

Article 25: check and note forms are to be returned to the bank upon the closing of the account;

Article 26: current deposit account transactions are governed by the rules of the clearing house.

There is in the Rules a warning that if there should be any adverse condition in the customer's credit record such as suspension of transaction, the bank will report it to the Personal Credit Information Center. n233

A "Personal Credit Information Center" is a division of an association of banks and is established to promote the smooth running of individual credit transactions. To prevent unfair damage to the credit standing of individuals, record retention is limited to five years, and complaint processing mechanisms have been established. Centers are cooperated by member banks of the Bank Association of a given area.

[D] Legal Concepts Involved in Current Deposit Transaction Account. A current deposit transaction account is based upon a contractual undertaking between a customer and a bank. The contract consists of a mandate contract in which the bank is mandated to make payments against instruments drawn by the customer, and a deposit for

consumption in which funds are deposited with the bank.

This contract should not be understood as a third party beneficiary contract. In other words, the bank has no obligatory duty toward a holder of an instrument. It does have a contractual obligatory duty toward the customer based on a payment mandate contract. Accordingly, the bank accepts to pay against the notes and checks that come within the Current Deposit Transaction Account Rules. However, once the customer withdraws the payment mandate, the bank again unconditionally stops payment and returns the instruments dishonored. In that case, the bank, because of its duty to report to the clearing house, inquires into the reason for the stop-payment order and dishonors the instrument with the reason given by the customer attached.

Because a current deposit transaction account gives rise to a contractual obligatory duty, the bank owes a duty of the care of a good manager, and must act in good faith. A bank is liable to a customer for damage caused by the banks negligence, for example, damages to the customer's reputation or credit standing resulting from the bank's dishonor of a check for insufficient funds when there were in fact sufficient funds in the customer's account. On the other hand, the customer also owes a duty of care and must act in good faith.

[E] How to Cancel a Current Deposit Transaction Account. Since a current deposit transaction account is a mandate contract, it is governed by the principles set down in the Civil Code. The Code in principle allows the parties to cancel a mandate contract at any time. n234 Article 24 of the Current Deposit Transaction Account Rules specifically sets out this principle. Accordingly, a bank will sometimes cancel a current transaction account when there has been no transaction in the account for a long period of time or when there are repeated delays in making necessary payments.

A cancellation initiated by the bank is rare, since the handling of the account is part of its business. Generally, cancellation by a bank is based on the deteriorating credit standing of the customer such that the bank fears dishonor of instruments, or on a chronic condition of insufficient funds for checks or notes drawn. When a customer is suspended from a clearing house, a bank is prohibited from maintaining a current deposit transaction account for the customer and thus the account is cancelled.

A customer may freely cancel his account at any time. When an individual customer dies, his current transaction account is deemed terminated.

A payment mandate is extinguished immediately upon cancellation. The balance in the account is repaid to the customer, and the customer returns the check and note forms to the bank. After this exchange is completed, all business relations between the bank and the customer are terminated.

[vi] Ordinary Deposit (*Futsu Yokin*)

[A] Ordinary Deposit Accounts. An ordinary deposit account is the most popular form of deposit account. It is payable on demand and is usually used for personal daily expenses, household expenses, or corporate receipts and disbursements. Although checks and notes cannot be drawn against an ordinary deposit account, the account earns interest. Therefore, many corporations find it expedient to keep most of their funds for daily receipt and disbursement purposes in an ordinary deposit account and transfer the funds to a current deposit transaction account when necessary.

A bank usually opens an ordinary deposit account unconditionally and issues a passbook upon registration of a seal or signature. There is no restriction on the amount of deposit or withdrawal. Interest is calculated on the basis of the daily balance, and twice a year the bank settles the account and adds the interest to the principal. The interest rate is the lowest among interest-bearing deposits. Either cash or securities can be deposited. The same securities that can be deposited in a current deposit transaction account can be deposited in an ordinary deposit account. The bank pays after confirming that the seal or signature agrees with the one registered. Unless the bank is negligent in confirming that the signature or seal on a withdrawal form agrees with that registered, the bank is absolved of all liabilities for permitting

the wrong person to withdraw funds. n235

The legal nature of an ordinary deposit account is a deposit contract for use (*shohi kitaku*), and the content of the contract is set out in the Ordinary Deposit Account Rules printed in the passbook. However, it is not a simple deposit contract for use; it has a continuing nature. Therefore, even when several deposits are made at different times, they are treated and considered together as constituting a transaction within one deposit contract. An account is not extinguished even when there is no money in the account; the depositor may make a new deposit in the same account thereafter.

[B] Transfer Accounts (*Koza Furikae*). The system of transfer account is provided for payment of all types of bills of the customer, such as telephone, electricity and gas bills. With this type of account, a prior written request by the customer that the bank pay such bills authorizes the bank to receive bills directly from public utilities and other institutions and to make payments therefor. The bank debits the account of the customer when such bills are paid. This system is widely used in Japan. A settlement account for this service is usually an ordinary deposit account, but a current deposit transaction account may be used. Service charges for a transfer account are paid by those billing the bank, so the service is free to the customer.

[C] Integrated Accounts (*Sogo Koza*). An integrated account (*sogo koza*) is an account in which the bank makes an automatic loan of up to a predetermined amount, to the customer with the customer's term deposit or Japanese public debt securities under custodial safe deposit such as Japanese government bonds as collateral, when the customer's ordinary deposit account has an insufficient balance. Only individual customers can open an integrated account. The bank will automatically make a loan when the balance of the customer's ordinary deposit account is insufficient to meet the withdrawal request. The limit of overdrawn amount is up to ninety percent of the balance of the collateral term deposit account and the maximum amount is two million yen. When the collateral is public debt securities, the limit of overdrawn amount is up to the sum of eighty percent of the face value of coupon-bearing government bonds and sixty percent of the face value of discount government bond and the maximum amount is two million yen. When the collateral includes both a term deposit and a public debt security, the limit of overdrawn amount is the sum of those calculated for each type of collateral.

[vii] Notice Account (*Tsuchi Yokin*). A notice account is an account in which a deposit must be left with the bank for a minimum of seven days and a withdrawal must be accompanied by at least a two-day advance notice. This account is often used by corporations to keep their temporary surplus funds. Furthermore, no partial withdrawal is permitted, and some banks require a minimum deposit.

[viii] Term Deposit Account (*Teiki Yokin*). Term deposits are widely used for individuals' savings and the management of corporate liquid assets. While the depositor cannot demand payment of a term deposit until its maturity date comes, it bears relatively high interest and is utilized for saving purposes.

To open a term deposit account, one registers his seal or signature with the bank and specifies the type of term deposit account and length of term desired. At withdrawal, one endorses the certificate or uses a bank withdrawal form. The bank confirms the agreement of the seal or signature with the one registered and then pays out the principal and interest.

The legal character of a term deposit account is a contract of deposit for consumption with a term agreed on in advance. Interest rate is determined at the time of deposit, except variable rate term deposit. If the bank is satisfied that there is a pressing need for early withdrawal, it may grant such a request. However, it is common to apply the interest rate of ordinary deposit in case of withdrawal prior to maturity.

The following types of term deposits are available:

1. Super Term Deposit: Minimum deposit term is one month and the maximum deposit term may be determined freely by the bank. As for the designation of maturity, one method is to designate the corresponding day of the date of deposit after a deposit term prescribed by the bank as maturity and the

other is to designate a date specified by the customer as maturity.

2. Automatic Renewal Term Deposit: Automatically renewed on maturity, with the same terms and conditions.

3. Maturity-Designated Term Deposit: Term between three months and two years designated by the depositor. Interest rate of the next shorter ordinary period is paid. Period of deferment is one year and the maximum term of deposit is three years. The depositor may request withdrawal at any time after the period of deferment has passed. However, one month prior notice to the bank (designation of maturity date) is necessary for a withdrawal request.

4. Large Amount Term Deposit: The term of deposit is same as that of Super Term Deposit. The minimum deposit amount is ten million yen.

5. Variable Rate Term Deposit: The applicable interest rate during the deposit term varies in accordance with the base indicator and the method of setting interest rate which are predetermined.

[ix] Transferable Certificates of Deposit. Transferable Certificate of Deposit is a deposit with a predetermined term and without a non-transferability agreement. To transfer, it is necessary either to notify or to obtain the approval of the issuing bank. Furthermore, in order to set up the transfer against a third person other than the issuing bank, the notice or approval must be set forth in an instrument bearing an authenticated date. n236 The unit amount for issuance and the term may be determined freely.

[x] Tax Reserve Deposit (*Nozei Junbi Yokin*). This account is used to reserve funds for tax payment. Interest paid on this account is tax exempt. On the other hand, if a withdrawal is made for purposes other than payment of taxes, the interest rate applicable to the period in which such withdrawal is made will be reduced to that of an ordinary deposit.

[xi] Special Deposit (*Betsudan Yokin*). A "special deposit" is any deposit not classified under one of the types discussed above. This category is used by banks for their convenience, and a depositor ordinarily does not specify that his deposit be treated as a special deposit. Interest may or may not be payable, depending upon the nature of the deposit.

[xii] Treasurer's Check (*Jikoatei Kogitte*). A treasurer's check is a check issued by a bank with the bank designated as payor. It is widely used in place of cash in a large cash transaction. When a current account depositor applies for certification of his own check, a bank usually issues its treasurer's check instead. The bank demands payment of the same amount in cash or by check drawn against an account with the bank. The bank deposits the money thus received in a special treasurer's check account and pays against the check when it is presented.

Since the bank is the maker as well as the payor, it is legally liable to pay the check upon presentation. Because there is no contractual relationship between the issue and the bank, it is more difficult to stop payment on a treasurers check than on an ordinary check. A bank will accept an accident report and deal with the check with the issuee's request in mind when the check is presented, but the decision on payment is made by the bank, which is legally liable.

[xiii] Installment Savings (Teiki Tsumikin). In "installment savings," a customer pays set installments over a predetermined period. On maturity, the bank pays a certain amount of money equivalent to the principal with interest. This closely resembles the installment time deposit, but it is considered to involve installment payments rather than deposits. The installments are small, and certain collection efforts are needed. Thus, the service is not offered by many commercial banks, but is mainly a service of the medium and small enterprise financial institutions.

[c] Note Clearance

[i] In General. Bills and notes issued and accepted in commercial transactions are settled through a clearinghouse.

A clearinghouse is established as a collateral institution to the bank association in each district. Each clearinghouse has its own rules. According to the Bills Act (*Tegata Ho*) in Japan, presentation of bills and notes at a clearinghouse designated by the Minister of Justice is an effective presentation for payment. n237

The rules of current deposit transaction accounts are written to follow the rules of the appropriate clearinghouse. After the rules of the Tokyo Clearinghouse were substantially revised in April, 1971, clearinghouse all over the country revised their rules, with the result that the general outline of clearing house rules is similar everywhere in Japan.

[ii] Clearance Procedure. Checks and notes deposited with a bank are presented by the bank to the clearinghouse the following day and reach the payor bank that day. If a check or note is to be dishonored, it will be returned to the presenting bank on the next day of the clearing day. Thus, deposited funds are considered uncollected for two banking days, and cannot be drawn on until that period has passed.

Between banks, the difference between the amounts payable and receivable is settled on each clearing day.

[iii] Settling Securities through Clearance Procedure. Bonds, interest coupons, divided receipts, and exchange certificates, as well as notes and checks, are all securities that can be settled through the clearance procedure. The rules of each clearinghouse determine which of these types of securities it will accept and designates them as "notes". Securities so designated can be deposited directly into current transaction or ordinary deposit accounts.

Promissory notes require more care, since they must be presented on the date payable or within two business days of that date. A past due note is refused payment for lack of the legal effect of presentation even if it is "presented" to the clearinghouse. Thus, unless the prior consent of the payor bank is obtained, it is useless to present a past due note to the clearinghouse.

A post-dated check can be presented for immediate payment, under the Checks Act. n238 Thus, although the maker and the payee have an agreement that the check will not be presented early and that such early presentation would be a violation of contract, a check can be deposited and cleared before the date indicated on its face. The presentation period for payment of checks is ten days, beginning on the issuing date. After this period a check can still be paid, in the absence of a cancellation of mandate for payment, n239 so banks do accept checks after the period and present them for payment.

[iv] Dishonor of Notes

[A] Reasons for Dishonor. Hereafter, both a note and a check are generically described as a note.

The reason for dishonoring a note must be specified by the payor bank. There are three categories of reasons:

Category I--this is the cases of inability to make payment through the payor bank, specifically insufficient funds or no checking account transaction;

Category II--defenses; counterfeit, alteration, theft, loss, fraud, nonperformance of contract, nonagreement of seal, fraudulent use of seal, different form, etc.;

Category III--this is the cases where presentation is deemed to be invalid, such as insufficient formalities, insufficient endorsement, expiration of presentation period, procedure defects; returned mandate, nonarrival of instruction, different rate, mistake in calculation.

No representation can be made of a note dishonored for a reason specified in Category I or II, but representation is possible of a note dishonored for a reason specified in Category III if the defect is corrected.

[B] Report of Dishonor. When a note is dishonored for a reason specified in Category I or II, both the payor bank and the presenting bank are required to submit a report of dishonor to the clearinghouse.

A Case 1 Report of Dishonor is made for Category I reasons, and a Case 2 Report of Dishonor is made for Category II reasons. The only difference between the two types of report is that a protest can be made against a Case 2 Report of Dishonor but not against a Case 1 Report of Dishonor.

The dishonor is listed on the "Dishonor Report" and is reported to all member banks of the clearinghouse. In the case of Category III, there is no need to submit a report of dishonor.

[C] Protest. When a Case 2 Report of Dishonor is filed and the payor of a note has a valid defense to refuse payment of the dishonored note, the payor may ask the presenting bank to submit a protest. The protest must be accompanied by a security deposit of the face amount of the note, deposited with the clearinghouse through the payor bank within three days of the clearing day. This is to show that the payor did not refuse to pay because of insufficient funds. The requirement of deposit may be waived in cases such as those involving counterfeit notes because such a deposit requirement is then deemed an undue burden on an innocent payor. When a protest is filed, the report of dishonor is treated as if it were never filed, unless and until the protest is withdrawn.

After the protest is filed, the payor and the holder of the note negotiate for payment of the note. If the negotiation is not amicably settled, the parties can only litigate as to the obligatory duties on the note. The security deposit is returned to the payor through the payor bank in the following cases:

1. when the disagreement on the note is settled and a settlement report is filed by the presenting bank;

2. when the payor is suspended from transaction because of another dishonor;

3. when the protest is withdrawn;

4. when two years have passed since the date the protest was filed;

5. when the payor dies;

6. when it is determined by final judgment that no obligatory duty existed on the part of the payor on the note; or

7. when presenting bank submitted to the clearinghouse a report on the finalization of payment obligation or a report on the service of an order of seizure.

Therefore, it is a usual practice for the holder of the note to attach the payor's right to the return of the security deposit from the payor bank.

[D] Suspension of Transaction. Anyone who has had a note dishonored twice during any six month period is suspended from transaction with member banks of a clearinghouse for two years. This suspension is effective as to current account transactions and loans from the member banks. Suspension is a disposition arising from an agreement among member banks of a clearinghouse. As such, it does not affect banks which are not members of that clearinghouse. However, as a practical matter, during a suspension it would be impossible to issue notes or checks in the area, and it would be extremely difficult to continue doing business.

Suspension may be cancelled within the two-year period if the suspended persons credit recovers. In such a case, the suspended person must apply to the clearing house through one of its member banks to reinstate his credit. A report of

dishonor or a disposition of suspension mistakenly made by a member bank will be withdrawn.

[d] Loans

[i] In General

[A] Agreement on Bank Transactions. A form agreement called an agreement on bank transactions is used in loan transactions. A borrower is required to submit a signed form agreement to the lending bank. A model agreement on bank transactions has been drafted by the Japanese Bankers Associations, however, it was abolished in April 2000. Presently, while each bank has prepared its own agreement on bank transactions, its principal part is same as the "model" and its content is almost the same among all banks. Loans on notes and discounts of notes, which are two of the most common ways of making a loan, do not require any other agreement. All transactions are carried out according to the terms of the agreement on bank transactions.

The agreement on bank transactions, as a form document, is drafted generally, so as to cover all possible situations, with the bank's interest fully protected in most cases. A bank, however, utilizes its rights only to the extent necessary in view of the borrower's situation. Possibly because of this restraint, almost no Japanese businesses have made a strong demand to amend the agreement on bank transactions.

It is a common practice among Japanese business concerns to draft a solemn agreement (contractual), but to use discretion when problems develop in performing under the agreement. Banking transactions present no exception to this general rule. But there are criticisms. In particular, it has often been pointed out that banks use their superior bargaining power as lenders to extract unduly advantageous terms. This and related problems should be investigated and discussed. n240

In loans other than loans on notes and discounts of notes, contract documents setting out the terms are prepared in addition to the agreement on bank transactions. The bank has printed forms for these documents as well, and the borrowers sign their names and deliver the signed documents to the bank. An agreement on collateral to be offered and a guarantee are treated in a similar manner.

The Model Agreement on Bank Transactions which provides the basis for a loan transaction, will be examined next.

[I] Applicability. Article 1 provides that the agreement on bank transactions will be applicable to all loan transactions and obligations evidenced by notes and Article 13 states that the model agreement will be applicable to transactions throughout the bank, regardless of which branch handles a particular transaction. Article 2 provides that if a particular loan transaction gives rise to obligations evidenced by bills and debt obligations, either may be relied upon. Interest and other charges are provided in Article 3. Interest is individually determined at the time of the loan, but it may be renegotiated during the term of the loan. The penalty for delay is usually fourteen percent per annum. Article 14, in addition, contains a choice of forum provision.

[II] Collateral. A security agreement is customarily requested by a bank when there is a need for collateral. Under Article 4, a borrower has an obligatory duty to offer collateral when the need arises. This means only that the bank has the right to require collateral; it does not mean that all the customer's loans will necessarily become secured. Article 4 also provides that supplied collateral secures all of a borrower's obligations to the bank. However, as for any collateral specifically offered to secure an identified obligation, the tie between the obligation and the collateral is expressly stated so that the collateral is deemed not to be security for other obligations.

[III] Acceleration, Etc. Article 5 provides for situations in which the bank may accelerate the debt of the borrower. Article 6 requires repurchase of discounted bills and/or notes. Upon the occurrence of any event specified in Article 5, para. 1, or upon determination by the bank as to the existence of any circumstances specified in para. 2, the bank may accelerate the debt and may exercise its right of set-off or repossession of collateral.

[IV] Deduction in Account (Set-off and Appropriation). Article 7 through Article 9 provide for deduction in account. When the borrowers obligatory duties have matured, the amount maintained in the deposit account may be set off against the amount of the borrower's obligatory duties. In addition, the bank may appropriate a portion of the deposit for the purpose of reducing the amount of debt obligations this is commonly referred to as appropriation for payment. Set-off and appropriation for payment are grouped together and referred to as "deduction in account." Article 7 deals with deduction in account on the bank's initiative; Article 7 is a provision for set-off initiated by the borrower; Article 8 provides for treatment of bills and notes in the event a deduction in account is made; Article 9 sets out methods of appropriation in the event the bank makes deduction in account; and Article 9 provides for methods of appropriation in the event the borrower sets off the debt obligation.

[V] Allocation of Risk and Indemnification. Article 10 provides that the bank is not liable for any loss beyond the control of the bank. In addition, it sets forth that when a transaction is completed by the bank after checking the seal impression on any instrument relating to the transaction against the registered seal with reasonable care, the borrower will be liable in accordance with the terms of such instrument.

[VI] Reporting Requirement. Upon request by the bank, the borrower must cooperate in the bank's investigation of the borrower's financial condition or request for information.

[VII] Guarantee. When a guarantor is required, the model agreement provides that:

1. The guarantor's liability is joint with the borrower's;

2. The bank is exempted from the duty to preserve collateral;

3. The guarantor will not exercise the right to which he is subrogated without the consent of the bank while the transaction continues;

4. The guarantor must assign the subrogation right to the bank upon the bank's request and without charge to the bank.

At present, banks do not list these guarantee provisions in the model agreement, but instead require a separate guaranty which contains the above-mentioned contents.

[VIII] Control of Interest Rate. The Temporary Interest Rate Adjustment Law n241 and the Policy Board of the Bank of Japan limit the maximum interest rate chargeable in general bank loans and reserve loans on current transaction accounts. In practice, each bank determines its short-term prime rate and long-term standard interest rate by making reference to market interest rates.

Factors that influence determination of actual interest rates include: the period of the loan; the credit rating of an obligor; the manner in which the loan is made; whether or not collateral is provided; and, the purpose of fund. In view of these factors, the bank and the borrower negotiate the actual interest rate. Interest is usually prepaid. Thus both the date when the loan is made and that when it is repaid are included in calculating the period of the loan. Unless there is a special agreement that interest is to be calculated monthly or annually, it is arrived at by multiplying the number of days in the term of the loan by one three-hundred-sixty-fifth (1/365) of the annual interest rate.

[IX] Borrowing Procedure. Those who wish to borrow money from a bank apply to the bank's loan section. Since it is difficult to secure a loan from a bank with which one has had no transaction, a prospective borrower is well advised to apply for a loan from a bank with which he has had an account or to which he is introduced by someone who has had transactions with such bank.

The loan section usually inquires about and requests documents relating to the applicant's legal capacity, type of

business, condition of business, plan for the business in which the loan proceeds will be used, plan of repayment, desired terms of the loan, and collateral to be offered for security. After such data is gathered, those in charge of the application make the initial decision on whether or not to grant the loan request. Their decision is documented and is sent to those responsible for its approval. Usually the main branch of a bank has an investigation division which specializes in the examination of loan applications. From the foregoing it is clear that it is impossible to get an on-the-spot loan. It is advised that a request for a loan be submitted at least half a month to a month prior to the date the funds are needed.

When an approval is given by the branch manager or by the main office, the bank notifies the applicant. Upon presentation by the applicant of necessary documents, such as notes, the bank delivers the loan proceeds by crediting the applicant's bank account. The bank does not deliver cash as the loan proceeds to the applicant when it makes a loan.

[ii] Loan on Bills (*Tegata Kashitsuke*). This is the most common method of making a loan. In this type of loan, the borrower issues a promissory note to the bank, and the bank makes a loan, accepting the note as a certificate for the loan.

Ordinarily, this type of loan is used to generate short-term funds, such as for daily operating expenses. Interest is prepaid for the period from the date of the loan to maturity. The term of the note is usually three months. Thus when a six-month loan is made, the note is renewed once or twice during the six-month period. On the other hand, a stamp tax is imposed on a note, and too frequent renewals of the note may require a large amount of tax and may thus cancel out the advantage of a short-term loan.

The legal character of loans on notes is that of a contract for lease for use of money. The note is understood as issued to ensure the repayment of the loan. Therefore, the place of repayment is usually the office of the bank which made the loan. The bank does not usually negotiate the note except under special circumstances when it discounts the note or offers it as collateral to the Bank of Japan.

When the loan is repaid in full, the bank returns the note and the loan agreement comes to an end. When the repayment is completed before the maturity date, the bank returns the unearned portion of prepaid interest.

[iii] Loan on Certificates (Loan on Deeds) (*Shosho Kashitsuke*). This loan takes the form in which the bank makes a loan in return for the borrowers executing a certificate of indebtedness. This type of loan is utilized for a long-term loan with a period exceeding a year. Customarily, interest is often prepaid at one-month interval.

The legal character of loans on certificates is that of a contract for the loan of money for use. If a certificate of indebtedness is notarized, it becomes an obligation title. An obligation title gives the bank the power to have compulsory execution on the borrower's property upon his failure to perform.

[iv] Overdraft Procedure. This type of loan arises from an agreement collateral to a current transaction account agreement. Under the agreement, the bank sets up a certain lending limit, automatically granting a loan when the depositor's account has insufficient funds to pay a check or note which has been presented.

This is an advantageous loan from the borrower's point of view, because he needs to borrow only the necessary minimum amount. From the bank's point of view, however, the bank is required to reserve funds up to the lending limit at all times, and therefore, interest is set at a higher rate than that of an ordinary loan.

As to the legal character of this loan, two views exist. One holds that it involves only a reimbursement of expenses incurred by mandate, and the other sees it as a variation of a contract for a loan for use. From the point of view of the actual banking business, it is understood that funds necessary to settle notes and checks are loaned when they are called for. But, this loan has an aspect that cannot be explained by viewing it as a reservation for the contract for loan for use.

It is suggested that the character of this arrangement is best understood as a contract for credit provision (i.e., contract for loan for use upon approval) which is not provided for in the Civil Code. According to this view the bank makes a loan for settlement of notes and checks as performance of its contractual obligation.

[v] Discounts of Notes (Commercial Bills) (*Tegata Waribiki*). A discount of a note is a loan which involves the following process. The borrower receives a commercial note (a note drawn and received to settle a commercial account between two traders), and the bank "buys" the note and pays the borrower for the note. In "buying" the note, the bank discounts from the face amount of the note the amount representing interest which would accrue from the date of discount to the maturity date of the note. This amount, which is equivalent to interest, is called the "discount charge".

When a discounted note is dishonored, the borrower is liable to the bank as an endorser of the note, and, as the one who requested the discount, is obliged to repurchase the note.

The legal character of a discount of a note is considered to be that of the purchase and sale of the note. The bank has, as against the one who requests the discount (the borrower), the right to demand repurchase of the note. The bank may demand collateral or a guarantee to secure this right.

It should be noted that there may be an occasion where there are numerous notes, each in an amount so small that it would be tedious to discount all the notes. On such occasions, the bank may take in all the notes as collateral and make a loan in the amount represented by the total amount of the notes.

[vi] Guaranteed Acceptance (*Shiharai Shodaku*). These are transactions in which a bank guarantees the performance of a customer of the bank to a third person upon request by the customer. The legal relationship between the bank and the customer is a contract for mandate of guarantee. The bank acquires the right to indemnity from the customer if and when the bank performs the obligatory duty guaranteed by it. In order to secure this right, the bank asks the customer to submit an acceptance agreement which specifies the terms of the agreement and an application for acceptance which states the contents of the main obligatory duty to be guaranteed and those of the guarantee. When necessary, the bank requests collateral or a guarantee from the customer.

The guarantee may be made by issuance of a guaranty or by a guarantee of note. The effect of such a guarantee is determined by its contents and by the Bills Act if only a guarantee of note is involved. Among the various types of guarantees, there is a guarantee on a specific obligatory duty, and a guarantee with a maximum limit, which guarantees to a certain maximum monetary limit all obligatory duties arising within a specified period. In either case, it is customary to require that an obligee of the underlying performance present its claim to the bank within a certain period, such as two months, after the expiration of the guarantee period.

The bank collects a guarantee charge for this service. The annual charge ranges from 0.5 percent to two percent of the amount of the obligatory duty guaranteed by it. Ordinarily, the period of guarantee is calculated from the day the bank guarantees the performance to the day the guarantee is returned. In cases where the obligatory duty on the guarantee will surely expire without the return of the guarantee, the period is shortened to include the period up to the day when the expiration of the obligatory duty is assured.

[vii] Loan as Agent (*Dairi Kashitsuke*). This type of loan occurs when a bank acts as an agent of another financial institution. For example, a bank may act as an agent for the Medium-sized and Small Enterprise Finance Corporation. Such agency transactions have developed for the convenience of both financial institutions and prospective borrowers, to alleviate difficulties that may be caused by the lack of service networks in most governmental financial institutions.

In these loans, funds are supplied by the financial institutions. The actual loan, administration, and collection are done by the bank as an agent, with the bank receiving fees for these services. In order to assure a responsible loan policy on the part of the bank, the agent bank is required to insure a certain percentage of the loan, such as eighty percent. From

the borrower's point of view, this type of loan is no different from ordinary loans.

[viii] Consumer Loan. A consumer loan is repaid out of earnings unrelated to the purpose of loan. Its cost to the bank is large since the amount of each loan is small. Therefore, a pure consumer loan is difficult to obtain unless the borrower can offer sufficient collateral, such as marketable securities, or has a high and stable income source. Alternatively, there are standardized "tied loans" and housing loans.

However, banks are aggressive in exploring the consumer credit market. As forms of lending, there are a loan on certificate and a card loan.

A "tied loan" is made to a purchaser of durable consumer goods, such as automobiles, with the loan guaranteed by the seller-manufacturer. A housing loan may be a tied loan with a guarantee by a real estate company. A guarantee by a housing loan guarantee company or an insurance company is available for a housing loan.

These consumer loans tend to take the form of loans on certificates, and repayment is made in equal monthly installments including both principal and interest. Since it is customary for Japanese businesses to pay semiannual bonuses, most repayment plans require larger monthly installments in the two bonus months in order that the monthly payment amount for the other ten months be small enough not to be a burden on the borrower.

Each repayment is automatically debited from the borrowers bank account. If there is a delay in repayment, the guarantor, in a "tied loan," pays the bank, and the seller-guarantor demands indemnity from the buyer-borrower. The seller-guarantor, in order to secure the repayment, retains the ownership right in the goods or holds a mortgage on the purchased house. If it is not a "tied loan," the bank holds the ownership right or mortgage right. In the case of a housing loan, the bank requires as a condition to the loan that the borrower take out life insurance; upon the borrower's death the bank can look toward the insurance proceeds rather than to his heirs.

The Individual Credit Information Center (*Kojin Shinyo Joho Center*) collects information on those individuals who have made late payments and whose bills or notes have been dishonored. Member banks obtain information from the Center for use in considering loan applications.

[e] Security and Guarantee

[i] In General. A bank loan usually requires collateral. Among all possible types of collateral, the banks prefer those which can be foreclosed on without much difficulty. In this sense, the borrowers deposit with the lending bank is the best collateral from the point of view of the bank. However since it is usually impossible to secure the entire amount of a loan with a deposit, the borrower is generally required to offer other collateral and/or guarantors.

[ii] Deposit as Pledge and Set-off.

When a deposit with the lending bank is offered a collateral, a right of pledge (*shichiken*) is established on it. When offered as collateral, the deposit must be accompanied by a certificate of security and a certificate of deposit.

The bank does not ordinarily require a notarized assignment of such deposits when they are offered as collateral. Thus the bank does not acquire priority rights in such collateral over third parties who have obtained a notarized assignment of the obligatory right. This security agreement, therefore, is controlling only as between the bank and the borrower. However, the bank, as against the third party, may set off its claim for repayment against the deposit. In State v. Shinwa Bank Ltd., n242 the court held that a bank could set off its claim against a deposit of a borrower even when it was attached by a third party so long as the loan was made prior to the attachment. Thus the bank depends upon its right to set off instead of relying upon the borrower's deposit as collateral.

In other words, all deposits belonging to the borrower are subject to the bank's right of set-off, and the bank has priority

in collecting its claim through the borrower's deposit.

[iii] Property Collateral. Collateral that can be taken in addition to a deposit includes:

1. obligatory rights (accounts receivable, notes),

2. goods (inventory, bills of lading, warehouse receipts),

3. valuable instruments (stocks, public and private company bonds),

4. real property (land, buildings, foundations),

5. chattels used in business (machinery, equipment).

Property listed in (1) is well suited for use as collateral. Pledge, acceptance of payment in lieu of obligees (*dairi-bensai juryo*), or designation of a transferred account (*furikomi shitei*) are used as security device for accounts receivable. Notes may be subject to *joto tanpo*.

Inventories (2) are difficult to manage and for that reason many banks tend to avoid them as collateral. Bills of lading are primarily used as cargo exchange instruments and are rarely used alone as collateral. Warehouse receipts, however, are used as collateral. Marketable securities (3) are one of the most welcome kinds of collateral. They are either pledged or become subject to *joto tanpo* (by transferring the right to possession). Real property (4) is widely used because its value is fairly stable and, particularly with respect to land, the value rarely decreases. Such property is either mortgaged or becomes subject to *ne-teito* right, base-hypothec (which would secure possible future advances). However since real property is not readily marketable, banks tend to foreclose on it only as a last resort.

Chattels used in business (5) are not welcomed as collateral since they tend to diminish in value rapidly. Therefore, they rarely become subject to a security interest by themselves. They are offered as collateral along with other industrial property when a factory is mortgaged.

When collateral is offered, a bank tries to determine its value by multiplying its market value by certain predetermined fractions. However, since a bank tends to look to income as a source of repayment, it does not necessarily make a loan even when sufficient collateral is offered.

[iv] Personal Security (Guarantee). Frequently a bank requires a guarantor for a loan. A guarantor is usually a representative of the company or a controlling person. This is done not only to assure repayment by relying on the guarantor's assets, but also to make the guarantor realize his responsibility in managing the business.

As a procedure for a guarantee, the guarantor submits a guaranty with maximum guarantee limit and duration of guarantee.

A guarantee in a banking transaction is always joint and several. The guarantor is in all respects as responsible for the loan as the borrower. Therefore, when a default occurs the guarantor's deposit becomes subject to the banks right of setoff, and compulsory execution can be obtained on the guarantor's assets.

[f] Domestic Exchange

[i] In General. Exchange is an essential part of the banking business which helps transfer funds from one area to another. Remittance to Account (*Furikomi*) and Remittance (*Sokin*) are methods to settle claims and liabilities through banks. Remittance is a method to send funds in the cases that the applicant does not have information on the payee's deposit account. Remittance to account is a method to credit certain amount to the payee's deposit account. Presently,

remittance to account is used in most cases and remittance is seldom used. Further, in the case of ordinary remittance, the applicants are limited to local public entities. Collection, in which the flow of funds is opposite to that of remittance and remittance to account, is a method that a bearer of securities such as notes collects funds from an obligor through banks.

[ii] Remittance to Account (*Furikomi*). Remittance to account is a transaction that a bank, at the applicant's request for remittance, remits certain funds to a payee's deposit account at his relationship bank designated by the applicant. The applicant tenders cash and supplies to the bank such information as the payee's bank, branch, account number, and the amount to be remitted.

A remittance to account of other banks must be accompanied by a tender of cash, but when the remittance is made to other branches of the same bank, securities may be used.

The account to which money is remitted usually must be a current transaction account or an ordinary deposit account. The rules and regulations for these accounts provide that funds remitted to the account be accepted as a deposit. Therefore, unless the payee gives other instructions in advance, the money remitted to the account will be credited automatically to the payee's account.

[iii] Collection. At the request of its customer, a bank can collect against securities such as are normally dealt with by the clearinghouse. Securities which can be presented immediately to the same clearinghouse that the bank is a member may be deposited into a deposit account, but those which are to be presented to another clearinghouse or whose payment date is yet to come must be collected by exchange.

[g] Foreign Exchange

[i] In General. Foreign exchange is a transaction which settles international accounts. Foreign exchange in Japan is carried out by authorized foreign exchange banks. Other financial institutions can act as agents of authorized foreign exchange banks, and therefore, almost all banks offer services in foreign exchange. Foreign exchange transactions include export transactions, import transactions, and international remittance.

[ii] Export Transaction. Export transactions consist mainly of either the purchase and collection of export documentary bills accompanied by bills of lading and/or of letters of credit. If an export transaction is based on a letter of credit, the bank notifies the exporter upon receipt of a request by a foreign bank to open a letter of credit account. The exporter tenders to the bank a bill of lading and other necessary documents. Upon confirmation that all the documents conform to the requirements of the letter of credit, the bank buys the draft with the bill of lading and the attached documents. If there exists any nonconformity, the purchasing bank usually requests that the issuing bank amend the terms of the letter of credit. If the nonconformity is minor, the bank may buy the documents upon a guarantee by the exporter that he will be liable for any damages resulting from such nonconformity. The documents thus purchased are forwarded for settlement to the destination designated in the letter of credit. Some letters of credit specify the purchasing bank, but the exporter can tender documents to the bank with which he has regular accounts, and that bank will act as his agent. In export transactions not based on a letter of credit, the bank may purchase or collect on a draft with a bill of lading, depending upon the exporter's and/or the importer's credit. The documents held by the bank are sent to a bank in the area where they are payable for settlement.

[iii] Import Transaction. Import transactions consist mainly of opening letters of credit and settling the documentary bills. The opening of a letter of credit involves the assumption of responsibility on the part of the bank for the importer's obligatory duties, though the bank is not a surety. As with a guarantee, the bank deals with the letter of credit in a payment approval account. Therefore, as with loans, the credit standing of the customer is important, and in some cases, the bank may require collateral before opening a letter of credit. Any required government permit must be obtained before a letter of credit can be opened. When a letter of credit is opened, the opening bank notifies a bank located in the vicinity of the address of the beneficiary.

Upon receipt of the import documents, the bank confirms that the documents conform to the letter of credit and then pays the purchasing bank and requests settlement to the customer. In some cases the bank delays settlement or makes a loan of funds necessary for the settlement. During the delay or the time the loan is outstanding, the bank retains the documents as collateral. However, since the importer cannot carry on his business without receiving the imported goods, the bank may "loan" the goods upon obtaining a trust receipt.

In case the goods arrive before the bill of lading, the carrier may request a letter of guarantee to release the goods without the bill of lading. The bank may issue such a letter of guarantee upon request by the importer.

In an import transaction not based on a letter of credit, the documents may be sent directly from a bank in the exporting country to a bank in the importing country. The bank then notifies the importer. If the transaction is designated as D/P, the bank hands over the documents to the importer upon payment. If it is designated as D/A, the documents are handed over upon acceptance of the draft. The proceeds are remitted to the purchasing bank in the exporting country.

[iv] Remittance and Other Activities. Banks offer additional services relating to remittance abroad, the purchase of remittance notes the purchase and exchange of foreign currency, money orders, and travelers' checks.

[h] Ancillary Businesses. A bank may conduct the businesses only to the extent permitted under the Banking Law. Fundamental activities of the banks are deposit transactions, loan transactions and exchange transactions and are called as Typical Banking Businesses.

In addition to the typical banking businesses, a bank may conduct the Ancillary Businesses, subject to the conditions (i) that the activity has relevancy or affinity with the typical banking business; (ii) that the volume of the activity will not exceed such extent as secondary to the main business; and (iii) that the activity is conducted as a business.

Article 10, paragraph 2 of the Banking Law enumerates examples of Ancillary Businesses. Major examples are listed below:

(i) Guarantee of obligations or acceptance of bills;

(ii) Sales and purchase of securities or transactions of securities-related derivatives limited to those for the purpose of investment;

(iii) Loan of securities;

(iv) Underwriting of national government bonds, etc. or handling of public offerings of the national government bonds, etc. pertaining to that underwriting;

(v) Acquisition or transfer of monetary claims;

(vi) Underwriting or handling of public offering of the specified bonds, etc. pertaining to that underwriting;

(vii) Acquisition or transfer of short-term bonds, etc.;

(viii) Handling of private placement of securities;

(ix) Agency or intermediary service of the business of a person who conducts a bank and other financial business;

(x) Safe-keeping or rental of safe deposit boxes;

(xi) Money exchange business;

(xii) Derivative transactions and intermediary, brokerage or agency service of derivative transactions; and

(xiii) Carbon trading

[i] Businesses Allowed under Laws Other the Banking Law. Besides the above-mentioned businesses, Article 12 of the Banking Law permits a bank to conduct the businesses expressly allowed under the provisions of the other laws. Article 275, paragraph 2 of the Insurance Business Law permits a bank to carry out insurance solicitation activities over the counter and in December 2007 limitation on the products the bank may solicit over the counter was removed. In addition, while Article 33, paragraph 1 of the Financial Instruments and Exchange Act prohibits banks from engaging in "the Securities-Related Business or Investment Management Business", Article 33, paragraph 2 permits banks to conduct brokerage with written orders or conduct sale or purchase, intermediary, or brokerage of certain categories securities or derivative transactions.

[3] Lease

[a] Definition and Scope of the Section

[i] Definition. A lease (*chin-taishaku*) in Japanese law is an informal, consensual contract formed when one party (the lessor) promises to grant the other party (the lessee) the use and enjoyment of a certain thing, in return for the other party's promise to pay rent. n243

The Japanese Civil Code covers leases, along with contracts for sales (*baibai*), loans for consumption (*shohi taishaku*), work contracts (*ukeoi*), agencies (*inin*), and others, as a variety of type contracts (*tenkei keiyaku*), for which the Civil Code provides general terms in the Book of the Obligatory Rights. n244

The obligations of the lessor, which corresponds to the lessee's lease right, and the requirement of the lessee to pay rent, are regarded as contractual obligations; the dual nature of the obligations of the parties result in a fixed parity throughout formation, performance, and any extensions, making a lease a two-sided contract.

As opposed to the common law system, the same legal requirements apply to both leases of immovables and leases of movables. In either case, the right which the lessee receives--the lease right (*chin-shakuken*)--is no more than a contractual right to demand that the lessor grant the use and enjoyment of the thing leased.

Thus, the lease does not fall into the category of real rights (*bukken*), the essence of which is the direct, exclusive control of the thing in question. In certain cases, a superficies (*chijoken*), which allows one to use the land of another for a certain purpose, also functions as a lease. n245 A superficies intended to provide for the ownership of a building is treated as a leasehold similar to the manner in which rights under ground leases are intended to provide for the ownership of a building. Both types are subject to the provisions of the Land and House Lease Act. n246 However, a superficies may be transferred without the consent of the grantor, and may not be extinguished by the grantor where there is a default in rent payments, unless the default continues for more than two years. n247 Because of these and other disadvantages to the landowner, the reality is that virtually all uses of another person's land for the ownership of a building are created using lease contracts, except when a superficies arises by operation of law. n248

[ii] Scope of the Section: Immovable Lease. Under the provisions of the Civil Code, lessees of immovables are in a particularly weak legal position. For example, such lessees may not assign their rights or sublease the property without

the consent of their lessors. They cannot sue a third party to whom their lessors have transferred the leased property, nor can they demand that a third party cease an unlawful interference with their use and enjoyment of the property. If such a lease is for an indefinite period, it may be terminated by either party at any time.

Increased protection for lessees in an immovable lease was a continuous theme of special laws. In order to strengthen such lessee's position, the following statutes were enacted: the Building Protection Act (*Tatemono Hogo Ni Kansuru Horitsu*) enacted in 1909; the Land Lease Act (*Shakuchi Ho*) and the House Lease Act (*Shakukka Ho*) enacted in 1921; the Temporary Management of Urban Leased Land and Leased Houses after Calamity Act (*Risai Toshi Shakuchi Shakukka Rinji Shori Ho*) and the Land and House Rent Control Ordinance (*Chidai Yachin Tosei Rei*), all enacted in 1946.

The legal guarantee of the continuing use of an immovable was achieved to a considerable degree by these special laws, in particular by provisions requiring that the lessor have just cause in refusing to renew a land lease contract or in cancelling a house lease contract. These measures were effective, when the housing situation deteriorated significantly after World War II. In the subsequent high-growth period, the use of immovable lease contracts, especially for land, multiplied. Uniform control of immovable leases, with a bias toward protecting lessees, was questioned, and land lease rights, which were guaranteed almost in perpetuity, came to be criticized on the ground that such rights deterred lessors from supplying land because of the risk of having to pay lessees substantial compensation in order for the lessor to regain full rights to the subject in question.

Consequently, the Land and House Lease Act (Law No. 90, 1991) has modernized the lessor-lessee-relationship and replaced the Building Protection Act, the Land Lease Act and the House Lease Act. n249 Diversification of uniform immovable use is now implemented by the Land and House Lease Act, which will be explained in the following.

[b] Formation of Immovables Lease Contract

[i] In General. Land and buildings on the land are always the objects of distinct ownership rights under Japanese law. Use relationships are also divided between land leases for the purpose of owning buildings, and leases of the buildings themselves. n250 However, the Land House Lease Act does not regulate the entire range of problems involved in immovables leases. Issues such as the requirements for formation of a lease, the period for payment of rent, the lessor's duty to repair, the assignment of the lease rights, subleases, and the effects of default (damages or rescission) are governed as before by general law--the Civil Code. Most of these provisions of the Civil Code are yielding provisions (*nin'i kitei*)--when the parties reach an agreement to the contrary, their agreement takes priority. n251 When there is a custom contrary to a yielding provision and the parties intend to follow that custom, the custom takes priority over the yielding provision. n252 When there is no applicable provision of law, a custom concerning the issue has the same effect as law. n253 In order to avoid application of such a custom, an indication of such intent is necessary. Because these basic principles apply to leases of immovables, parties about to enter a lease contract must consider carefully whether to incorporate a contract term dealing with each of a wide variety of items.

[ii] Real Estate Agents (*fudosan chukaigyo-sha*)

[A] Duties of the Real Estate Agent. A real estate agents is licensed by the Minister of Land, Infrastructure, Transport and Tourism or by the prefectural governor, and serves as a professional agent or intermediary in the sale, exchange, or lease of land or buildings. n254 Each agent must have a regulated numbers of specialists who have passed a prescribed qualifying examination and who have been registered with the prefectural governor. n255 Before a contract is concluded, the agent, through the specialist, must inform the client or the parties to a transaction of the nature of the property, the rights existing on it and the terms of the proposed contract. n256 He or she must faithfully perform his or her duties with loyalty to the parties to the transaction, n257 according to the true purpose of his or her commission and with the care of a good manager (*zenryo na kanrisha no chui*). n258 Accordingly, an agent retained to act as a broker for a transaction must utilize his or her specialized knowledge and experience not merely to locate property or a lessee, but also to investigate and inform the client regarding the condition of the property, the condition of the title, the

capacities of the other party and other matters. When he or she fails in these duties and harms his or her client or other related parties, he or she must answer in damages.

[B] Agent Compensation.

The agent has a right to demand compensation only when a contract has been properly concluded through his or her own efforts. If, however, the client negotiates directly with the other party following an introduction by the agent, and reaches a contract, the agent may demand the same compensation as if the contract has been formed through his or her own brokerage. n259 For brokerage of a lease, the total amount of compensation receivable from both parties is limited to one month's rent. When a premium is paid, the broker may receive from one party, his or her client, a total of five percent of the amount of the premium under two million yen, four percent of the amount of the premium over two million yen and under four million yen, and three percent of the amount over four million yen.

[C] Handling of Grievances. A person with a grievance regarding a transaction handled by a broker may, besides pursuing judicial remedies, seek a speedy resolution by either of the following routes:

1. grievance disposition by the Real Estate Business Surety Association (*Takuchi tatemono torihiki gyo hosho kyokai*);

2. invocation of the Minister of Land, Infrastructure, Transport and Tourism or prefectural governor's power of supervision.

[c] Precontracting Investigation

[i] Items to be Investigated on Behalf of the Lessee. The prospective lessee should inspect the form, surface area, and surroundings of the property and any equipment of the land or buildings on the property and check whether the land or building is occupied by third parties. Land boundary disputes are common in Japan; sometimes it is necessary to request a meeting with adjacent landowners to confirm boundaries with them.

He or she should investigate ownership rights and any encumbrances by going to the registration office with jurisdiction over the land or buildings (Legal Affairs Bureau [*Homukyoku*], District Legal Affairs Bureau [*Chiho Homukyoku*], or their branches or sub-branches) and directly examining the land and building registration books, or by receiving a certified copy of the registration books. Maps showing the land or the location of buildings are also available at the registration office. In some cases, the property has passed to the heirs of a registered owner, but the transfer is not registered. The lessee should then confirm the identity of the heirs by referring to the family register.

Finally, the lessee should inquire at the local government office to determine whether there are any local restrictions on the use of property.

[ii] Items to be Investigated on Behalf of the Lessor The lessor's primary concerns are the lessee's ability to pay rent and the intended use of the property.

[A] Preparation of the Written Contract. Legally a lease may be created by the parties' concurrence in their declarations of intention. Neither a writing nor the delivery of the property is necessary. However, a lease contract is normally executed by the parties. If a broker is involved, he or she must give each party a document stating the contents of the contract. n260 Preparation of a written contract is also desirable as an ultimate confirmation of the contracting intent, and to preserve evidence in the event of a dispute at a later date. If the contract is notarized, it is presumed to be an authentic official document at trial n261 and may be executed upon without trial for liquidated sums if the document so provides. n262

[iii] Cash Payments Accompanying Real Property Leases The lessee must pay rent, and often also concession

money (*kenrikin*), reward money (*reikin*), deposit money (*shikikin*), bond money (*hoshokin*), construction cooperation money (*kensetsu kyoryokukin*), or some other payment. These terms are not legally defined; thus in general the parties' intent determines the legal nature and effect of these payments. In recent years, however, court decisions have given to these cash payments clearer objective meanings.

[A] Concession Money. Concession money, also called reward money, is paid in cash and generally need not be returned upon completion of the contract. The prevailing view regards it as a lump-sum prepayment of part of the rent and is thus given in consideration for the use of the property. Others find grounds for the payments in the establishment of lease rights, or in the geographical advantage of the real estate. According to the prevailing view, when the lease terminates prematurely, the lessee may demand the return of part of the concession money corresponding to the unexpired portion of the lease term, lest there be unjust enrichment. However, since absent agreement between the parties, most decisions reject this view, n263 the contract should clearly cover this contingency.

[B] Deposits. Deposits secure the lessee's obligatory duty to pay rent and other obligatory duties. Generally, if the lessee has unfulfilled obligatory duties upon vacating the property, they may be deducted from the deposit; otherwise the entire amount must be returned. Some deposit arrangements, however, entitle the lessor to return the deposit, less a depreciation charge, irrespective of the lessee's obligatory duties. Normally the deposit amounts to between three and six months' land rent or house rent.

[C] Bonds. Bonds, also called occupation bonds (*nyukyo hoshokin*) or construction cooperation money (*kensetsu kyoryoku-kin*), denote construction capital borrowed from a future lessee to construct the building where the leased property will be located. The money, legally termed "a loan for consumption," is usually repaid after a certain period of occupation of the building, with little or no interest. It is separate and independent from the lease of building space. Often the lessor, by agreement, may apply the bond money towards payment of any unfulfilled obligatory duty of the lessee; the bond then doubles as a deposit. The amount of the bond can equal as much as thirty to sixty month's rent for an apartment. Legal problems include the obligatory duty of a lessor's assignee to repay the bond, and the lessee's rights to repayment of the bond, if the lease terminates prematurely and the contract is silent on the matter.

[d] Delivery of Subject: Registration. Under a lease, the lessor must deliver the property to the lessee in the agreed time, place, and manner. When a lease is subject to the House Lease Act n264 the lessee's rights become effective against third parties upon delivery of the property. n265

Lease rights may be registered to be effective against third parties, n266 but the lessee has no right to demand registration absent a special agreement. n267 This situation has been changed by special laws enacted to help such lessees. n268

[e] Rent

[i] Land Rent and House Rent. Rent paid under a lease of land for the purpose of building ownership is called land rent (*chidai*) and rent paid for lease of a building is called house rent (*yachin*).

Absent an agreement to the contrary, the lessee may pay each month's rent at the end of the month. n269 However, agreements requiring payment in advance are normal.

Unless otherwise stipulated, rent is to be paid at the lessor's present address, n270 at the lessee's expense. n271

An obligatory duty for rent payable yearly or at shorter intervals terminates by prescription after five years of nonperformance, n272 but payments after the prescription becomes completed are valid whether or not the lessee knows of the prescription. n273

[ii] Right to Demand Rent Increase. Under general principles of contract law, an amount of rent once agreed

upon cannot be changed without the agreement of both parties. A real estate lease, however, is a contractual relationship which extends over a long period, and changes which occur in economic conditions over that period can render the initial amount of rent inappropriate. Therefore, the Land and House Lease Act gives the lessor the right to increase the land rent or house rent for cause by a mere unilateral expression of intent. Unlike conventional claim rights (*seikyuken*) this right to claim an increase in land or house rent is not merely a right to demand that the other party do a certain act. Rather, its exercise has the immediate effect of increasing the rent without the lessee's consent. In this sense, it has the characteristics of a formative right (*keiseiken*).

[A] Requirements for Creation of a Right to Demand an Increase in Rent. Absent a special agreement not to increase the rent for a certain period, an increase in the rent may be demanded if an increase in taxes or other expenses connected with the property, a sudden rise in the value of the property, or an increase in the rent of the surrounding property has rendered the rent inappropriate. n274

[B] Effect of Exercise of Right to Demand Rent Increase. A justifiable demand for a rent increase becomes effective when it reaches the lessee, and the rent is increased on the same day. n275 If the amount demanded is excessive, the demand is ineffective with regard to the excess amount.

[C] Steps to be Taken by the Lessee. If the lessee challenges the rent increase demand itself or the amount demanded, he or she may pay an amount he or she considers appropriate (but not less than the previous rent) pending a determination by the court. n276 The lessee may avoid liability by tendering the amount at the agreed time and place, even if the lessor refuses to accept payment, n277 or by paying the rent into an official deposit (*kyotaku*). n278 The lessor will not be deemed to have revoked or altered his or her previous demand for a rent increase if he or she accepts the rent tendered or the money paid into the official deposit.

By refusing to accept any amount less than demanded, the lessor will be deemed to have clearly expressed an intent to refuse similar subsequent payments as well. The lessee can avoid liability by paying the amounts directly into deposit, without having to tender them to the lessor, but when he or she does not deposit the rentals he or she should notify the lessor each time the rent is due, that he or she is willing to pay the amount he or she, the lessee, considers appropriate. n279

Following judgment, the lessee must pay any deficiency, plus interest at ten percent per annum. n280

[iii] Right to Demand Decrease in Rent

[A] Right to Demand Decrease in Rent Under the House Lease Act or Land Lease Act. This right corresponds to the lessor's right to demand a rent increase in its nature and in the effect of its exercise. However, even after the lessor has received a demand for rent decrease from the lessee, the lessor may demand payment of an amount of rent which he considers appropriate (not to exceed the previous rental), until a judgment approving the rent decrease becomes final and binding, n281 and the lessee may not refuse this demand.

Following judgment, a lessor must repay the excess amount received, with interest at the rate of ten percent per annum. n282

[B] Demand for Rent Decrease Under the Civil Code. A lessee may demand a decrease in rent in proportion to the amount of property lost or destroyed through no fault of his or her own. n283 This right has the characteristics of a formative right and the exercise of this right relates back, becoming effective as of the time of the partial loss.

[f] Fees for Common Benefit. Expenses for common benefits (*kyoekihi*) are usually assessed on lessees to cover the cost of upkeep and supervision of common equipment or facilities (such as halls, stairways, cooking areas, elevators, storage areas, and water tanks), and are normally paid in the same manner as rent.

[g] Use and Enjoyment of Leased Immovables The lessee's use and enjoyment of the leased property must conform to the contract or to the nature of the property itself. n284 He must endeavor with the care of a good manager to preserve the leased property until it is returned. n285 These obligation-duties are frequently specified in detail in the lease.

[i] Use and Enjoyment of Leased Land.

[A] Use of Leased Land. The most fundamental contract terms relating to the use of leased land deal with the type and construction of buildings which the lessee may build and own on the land.

Buildings constructed by the lessee on leased land belong to the lessee, and so long as their use conforms to the lease, additions or improvements may be made. However, the lease normally prohibits additions or improvements without the lessor's consent and provides that any violation is ground for rescission of the contract. The clauses have been struck down when the additions or improvements are appropriate to the lessee's normal use of the land and have no extraordinary effect on the lessor, and therefore do not threaten a breach of fiduciary relationship between the parties. n286 The Land and House Lease Act allows a court to give approval to additions or improvements in lieu of the lessor's consent. n287

[ii] Use and Enjoyment of Leased Houses

[A] Use of Leased Houses. Contract provisions most commonly limit the intended uses of leased buildings to a residential use, store use, office use, etc., and may further specify the type of business to be conducted. They often require upkeep and maintenance of the building by the lessee, and in the case of leased space in a building or an apartment, prohibit uses which are detrimental to the neighborhood, such as production of noise, vibrations, or foul odors. Violation of these provisions may be grounds for rescission of the contract, depending on the degree of the violation. n288

[B] Additions, Improvements, and Alterations of Leased Houses. Generally the lessee may not make any addition, improvement, or alteration which results in a fundamental change in the condition of the building. In practice contracts provide that the lessee may do so only upon obtaining the lessor's consent, and that any violation is ground for rescission of the contract without notice. Necessary alterations of the original condition, within the scope of normal uses of a leased dwelling house, may be made without the consent of the lessor. Lessor's right to rescind may not be exercised if the change is minor. n289

Expenses required for additions or improvements are considered beneficial expenses (*yuekihi*), and the lessor is obligated to repay them. The lessee may demand repayment of these expenses only on termination of the lease. n290

[C] Additions to Fixtures. A building lessee may add fixtures to the building, such as floor mats, furnishing, cupboards, clotheslines, plumbing fixtures, and electrical fixtures, so long as they conform to the agreed upon use of the building. The fixtures belong to the lessee and the lessee may freely remove or replace them. On termination of the lease, the lessee may demand that the lessor purchase those fixtures which the lessee had purchased from the lessor or those which the lessee added with the consent of the lessor. n291

[D] Use of Grounds. The lessee of a building normally needs to use the surrounding grounds to a certain extent in order to fully use the building. Accordingly, while an agreement is preferable, the lessee is naturally permitted to use passageways, clotheslines, and the minimum grounds necessary to his or her use of the building. Absent a contrary agreement, the lessee may maintain a small garden or flowerbed on the grounds and may erect a shed, simply constructed bath, or toilet. The lessee's right is thought to be implicit in the lease. Use of the grounds beyond this extent can be grounds for rescission of the contract. n292

[h] Repairs Absent a special agreement, the lessor is responsible for repairs necessary for the lessee's use and

enjoyment of the property. n293 The lessee must inform the lessor without delay if repair is necessary. n294 Lease provisions, however, often disclaim or limit the lessor's responsibility.

[i] When There is No Special Agreement Regarding Repairs

[A] Object of the Duty to Repair. The lessor must repair only if the deterioration or damage creates a serious interference with the lessee's use and enjoyment of the property in accordance with the lease. n295 This, of course, is a question of fact. Anything short of "serious interference" should be repaired by the lessee in performance of his or her duty of custody (*hokan gimu*). n296

The lessor must repair when the lessee is not at fault, i.e., when the lessor, a third person, or a vis major is responsible for the deterioration or damage. The lessor has no duty to repair if the lessee is the one responsible.

The lessor has no duty to repair or restore the property if the "serious interference" amounts to an unrepairable partial or total loss or destruction of the property. In fact, total destruction of the property terminates the lease contract. n297 Even if repair is possible, the lessor is believed to have no duty if the cost is comparable with the cost of new construction. n298 A partial destruction of the property, not attributable to the lessee, allows him to demand a rent decrease. n299

[B] Method of Performance of Duty to Repair. The lessee may not prevent the lessor or his or her agents from entering the property to make the repairs or from carrying in necessary materials. n300 Failing a voluntary performance by the lessor, the lessee may insist on performance and obtain substitute performance by judgment. n301 The lessee may also make the repairs himself and demand reimbursement from the lessor. n302

[C] Relation Between Obligatory duty to Repair and Obligatory duty to Pay Rent. Must the lessee continue to pay rent until repair is made? It was once held that the lessee may merely temporarily withhold payment, and that once repairs are completed he or she must pay the entire agreed rent even for the period prior to repair. Under the currently prevailing views, however, the lessee may either reduce the rent, or, by analogy to Civil Code Article 611, paragraph 1, demand a rent reduction. In either case the decrease must correspond to the degree of interference and the reduced rent must be paid during the period of interference (unless the seriousness of the interference justifies a zero rent). A subsidiary question is whether the lessee may refuse to pay even the reduced rent until the lessor makes repairs. Perhaps the better view is that so long as the lessee continues to use the property despite the interference, he must pay the reduced rent. A different and better approach for the lessee would be to perform the repairs himself and to set off the expenses against rent obligations.

[ii] Special Agreements Regarding Repairs. Most common provisions regarding the lessor's duty to repair disclaim such duty and the duty to reimburse the lessee for repair expenses. These provisions are valid.

Agreements which impose upon the lessee a duty to repair should state the scope of such duty. Absent any agreement the duty is usually limited to minor repairs (common opinion).

[i] Setting-up of Lease Rights: Protection of Lessee's Rights

[i] Meaning. Conflicts between a lessee and a third person who has acquired real rights such as ownership, superficies, hypothec, or pledge to the leased property are discussed in terms of whether the lessee may set up his or her lease right (*chinshaku-ken*) against the third person. If the lessee has satisfied the setting-up requirement, namely the registration of his or her lease right, he may set up his or her right against the third person. Since the lessor is not always cooperative in this regard, special statutes have been enacted by introducing substitutes for the registration requirement to protect the lessee's interests.

[ii] Special Laws Since an unregistered lease of real property may not be set up against persons who subsequently acquire real rights in the real property and often the lessor is reluctant to grant registration of the lease rights, n303

special laws have permitted lessees to set up their rights against third parties without the lessor's cooperation.

[A] Land and House Lease Act. When a land lessee owns a building which is registered, on the land, the lease rights in the land may be set up against third parties. n304 The delivery of a leased building allows the lessee to set up his or her rights against persons who thereafter acquire real rights in the property. n305 If a building lessee is dispossessed illegally, he may bring an action to recover possession within one year of the *disseisin*, n306 and may set up his or her rights against a person who has obtained real rights in the property during that period.

[B] Temporary Management of Urban Leased Land and Leased Houses After Calamity Act. n307 When a building is lost or destroyed because of a fire, earthquake, storm, or other calamity so designated by a government ordinance, one who holds lease rights in the building site, or a substitute lot, continuously from the time of the loss may oppose third parties for five years from the date of promulgation of the ordinance, even without registration of the land lease or registration of the building on the land. n308 The protection of this act is afforded even to the land lessee who had not recorded his or her building before the loss. n309

[iii] Protection of Lease Rights Which Cannot Be Set Up Against Third Parties. In some cases, although the lessee's rights are inferior to those of third parties, a demand that he vacate the property may be regarded as an abuse of a right. n310 When such a lessee demands possession, a third party transferee of the real property who may not assert to hold a justifiable interest must acknowledge the lessee's demand.

[iv] Demand for Removal of Interference Based On Lease Rights. When a third party occupies property subject to a lease, or when a third party interferes with the lessee's occupation of the lease property although he is not entitled to possess it, it is much disputed whether or not the lessee can demand surrender of possession of the property or removal of the interference by the third party based on his or her lease rights. Various theories have been put forward, but the prevailing view is that the lessee does have the power to demand removal of the interference in these cases, even without meeting the setting-up requirements.

[j] Replacement of Lessor

[i] Replacement by Juristic Act (Contract). Ownership status and lessor status are separable when the lessor-owner assigns his or her ownership rights to a third party and the lessee's rights may be set up against the third party, the third party automatically acquires the status of lessor and the former lessor is removed from the lease relationship. n311 The new lessor must register the assignment before he or she can assert his or her lessor status vis-a-vis the lessee. n312

The lessor-owner may, with the lessee's consent, convey to a third party the ownership rights while retaining the lessor status. The new owner must respect the lessee's right to the use and enjoyment of the property only if the lessee's rights may be set up against the world. If the lessee refuses to consent, the better view is that the new owner acquires lessor status and replaces the former owner in the lease relationship despite a contrary agreement between the assignment parties.

With the lessee's consent, the lessor-owner may transfer the lessor status to a third party while retaining the ownership rights. Whether or not the lessee's rights may be set up against the world, the former lessor must respect the lessee's use and enjoyment of the property.

The new lessor acquires all rights and duties of the former lessor under the lease contract, and thus must acknowledge a pre-payment of rent, n313 a provision permitting sublease, n314 and a contractual duty to collect the rent at the lessee's place. n315 The new lessor is presumed to hold in custody the deposit money delivered by the lessee to the former lessor. However, if some rent was owing to the former owner, a set-off is presumed and the new lessor is liable only for the excess of deposit money over unpaid rent. n316

[ii] Replacement of Lessor by Death. A lessor-owner's heirs acquire all his or her rights and duties pertaining to ownership and the lease contract in proportion to their estate. n317 However, the obligatory duty under the lease contract to grant the use and enjoyment of the property is meant to confer a benefit inherently indivisible; the joint heirs bear this duty indivisibly and the lessee may demand performance of this entire obligatory duty from any single joint heir. n318

On the other hand, joint heirs are entitled to or are liable for money payments only in proportion to their estate share. This is the rationale of some decisions n319 which permit each joint heir to demand payment of rent only to the extent of their share estate. A contrary view asserts that the obligatory duty to pay rent is indivisible and that any individual heir may demand payment of the entire amount.

When the estate is later partitioned, not all the heirs, but only those persons who have succeeded to ownership of the real property succeed to the status of lessor, and this succession relates back, becoming effective as of the time the estate was opened. n320

[k] Assignment of Lease Rights; Subleases

[i] General. Under the Civil Code, the lessee may not assign his or her lease rights or sublease the property without the lessor's consent. n321 Any violation is ground for rescission of the lease contract. n322 However, the effect of these provisions has been mitigated by special laws and later decisions.

An assignment of lease rights or a sublease of property without the lessor's consent may not be set up against the lessor, but it is effective between the parties. The assignor or sublessor has an obligatory duty to obtain the lessor's consent without delay. n323 A consent is validly given, whether addressed to the assignee or sublessee, n324 and is irrevocable. n325 It may be given orally, though the lease normally requires a written consent.

In practice the lessor's consent is usually conditioned on payment of a consent fee or a name transfer fee.

If a lessor accepts rent without objection from an assignee or a sublessee, knowing of the assignment or sublease, consent may be deemed to have been given.

Even if an assignment or sublease is without the lessor's consent, the lessor may not rescind the contract when special circumstances prevent the lessee's actions from being regarded as a breach of faith to the lessor. n326

Since in practice the transfer or sublease of the land lease rights accompanies the conveyance of ownership rights in buildings on leased land, a court ruled that the purchaser of such a building when the seller is not the land lessor, is deemed to have acquired the lease rights in the building site even though there is no explicit agreement between the parties. n327 A mortgage on such a building effectively encumbers the lease rights in the building site and a successful bidder stands in the same position. n328 In all cases, however, the person who acquires the lease rights (new building owner) or the sublessee, must obtain the lessor's consent in order to be able to use and enjoy the property in a legal relationship with the lessor, but as seen below, a court permission in lieu of the consent may be applied for.

[ii] Court Permission in Lieu of Lessor's Consent. If a land lessee desires to transfer a building on the land to a third party, but the lessor withholds his or her consent, the land lessee may apply to a court for permission in lieu of the lessor's consent. n329 Similarly, the purchaser of land lease rights at a public auction may apply to the court for permission. n330 Unless it is particularly inappropriate, the court will hear the opinion of an appraisal committee and decide after considering the length of the remaining lease term, past experiences with the lease land, the circumstances requiring the transfer of lease rights or sublease, and all other relevant facts. The court must grant the permission where the sublease or transfer of lease rights does not prejudice the lessor's rights. In appropriate cases, the court may order modification of the land lease terms or a proprietary contribution.

This legal procedure is not available with respect to building lease.

[iii] Effect of an Assignment of Lease Rights or Sublease. When lease rights have been duly transferred the transferee succeeds comprehensively to the lessee's rights and duties, and replaces the former lessee in the lease relationship. Absent a special agreement, a new lessee is not liable for rent arrears or damages.

When property has been duly subleased, the sublessee may use and enjoy the property according to the terms of the sublease contract. The relationship between the lessee (sublessor) and the lessor continues as before. The sublessee also bears duties directly to the lessor. n331 These obligatory duties include the duty to pay rent, in addition to the duty of custody, n332 the duty to conform to the agreed use of the property, n333 and the duty to inform the lessor of the need for repairs. n334 Thus, while the lessor may demand payment of rent from the lessee, he may also demand payment of rent directly from the sublessee up to the limit of the rent called for by the sublease if the lessee fails to pay. The sublessee cannot refuse this demand on the grounds that he has prepaid the sublease rent to the sublessor. n335

Sometimes the lessor is not permitted to rescind the contract even when there has been an assignment of lease rights or sublease without his or her consent. n336 In these cases, the assignee or the sublessee may assert the assignment or sublease against the lessor in the same manner as if the lessor had consented. n337 The legal relationship between the lessor and the assignee or sublessee is effectively the same as if the transfer or sublease had been with the lessor's consent.

[iv] Third Party's Right to Demand Purchase of Buildings. When a third party has acquired a building on leased land, or some other thing which the land lessee has attached to the land by virtue of legal title, and the lessor withholds his or her consent to the assignment of the lease rights or sublease, such third party may demand that the lessor purchase the building or thing at its current value. n338 Functionally, this system permits the third party to elicit the lessor's consent indirectly. The third party's right is regarded as a formative right; when exercised, a contract for purchase of the building or thing at its current value is deemed to have been formed between the third party and the lessor. The third party may refuse to surrender possession of the building until he receives payment of the purchase price. n339 So long as he occupies the land, however, such party has a duty to compensate the land owner with an appropriate amount of rent to prevent unjust enrichment. n340

[l] Death of the Lessee

[i] Inheritance of Lease Rights. When a lessee dies, his or her heirs succeed to the rights and obligation-duties under the lease contract in proportion to their estate shares. n341 Since right under the lease contract to demand the use and enjoyment of the property is to confer a benefit indivisible by its nature, any joint heir may individually demand complete performance from the lessor. If the lessor performs for any single joint heir, he is free from obligatory duty to the other joint heirs. n342

Each joint heir is liable for rent obligatory duties which arose before the start of the estate in proportion to his or her estate share. A rent obligatory duty which arose after the start of the estate is indivisible, since it is regarded as counter value for the indivisible use of the property by the joint heirs. Thus any joint heir is liable for such obligatory duty in its entirety, n343 but payment by one excuses the others from the obligatory duty.

[ii] Succession to Lease Rights by Coresident. The de facto spouse or de facto adopted child of a lessee of a building who dies without heirs acquires the rights and duties of the lessee if such de facto spouse or child was a coresident. n344 The coresident may refuse such succession. When the lessor has heirs living in another place, the coresident cannot become the new lessee, but may invoke the contract rights of the heirs, and insist that the lessor recognize his or her right to live in the building. n345 The coresident must pay the rent in lieu of the heirs to prevent rescission of the lease contract. An heir's demand that the coresident vacate the property may be disallowed as an abuse of right. n346

[m] Term of the Lease, Renewal and Fixed Term Lease

[i] Duration of Immovable Lease

[A] Duration of Land Lease Rights. Making the duration of land lease rights reasonable is one of a long term target for the 2001 reform of immovable lease law. n347

Concerning the duration of land lease rights, contractual freedom of the parties is restricted, and a minimum period is set by law, as before. Previously, minimum term was 30 years for land lease rights having for their object the ownership of a building with a solid structure, and twenty years for other land-lease rights. If the lease term had not been specified in the contract, it was set at sixty years in the case of the former leases and thirty years in the case of the latter. n348 But these distinctions were abolished by the 2001 amendment. Under the Land and House Lease Act, the duration of land lease rights by law or by contract shall be thirty years. The extinguishment of land lease rights through deterioration of the building was abolished. Extension of the duration of land lease rights shall be twenty years for the first renewal after the initial establishment of the land lease rights and thereafter for 10-year terms. n349

[B] Duration of House Lease Rights. As to the duration of house lease rights, it may be agreed by contract, but no particular period of duration is not specified. n350

Formerly, there were no provisions concerning duration where the contract of a building lease was renewed by law. However, courts have decided that the term should be regarded as of no specific duration after such renewal and that the lessor can give notice of termination of lease at any time if the lessor has just cause. This has now become an express provision. n351

The land-lease rights for a fixed term of years and house lease rights for a fixed term of years are related to duration, and are mentioned later in [iii].

[ii] Limitation of Freedom to Cancel Immovables Lease Contracts: Just Cause. The doctrine of "just cause" (*seito no jiyu*) fulfilled an important function in the transformation of immovables lease rights into real rights. It provided that the lessors of land or houses could not refuse renewal of a lease or give notice of termination unless they needed to use the land or house themselves, or there was another "just cause." n352 At the time of postwar confusion when the housing situation was critical, the debate, which made own use by lessors the issue, certainly contributed to the protection of the lessee. But, as the housing situation became somewhat better, it became difficult to solve the problem of adjusting the interests of the parties only by focusing on the existence or lack of lessor's "just cause," and courts began to show a more flexible attitude, taking into consideration, for example, the lessor's offer to pay the lessee in exchange for regaining use of the land.

Just cause is now judged by considering not only the lessor's need for his or her own use, but also the prior history of the lease and present use, as well as allowances, if any, which the lessor offers to pay the lessee as a condition for or in exchange for the surrender of the lease. n353

[iii] The Lease Rights for a Fixed Term of Years

[A] Fixed Term Land Lease. Establishing a system of land lease rights for a fixed term of years, where the parties agree to no renewal, meets requirements for the need for diversification of use of land. Under the Land Lease Act, land lease rights had been supported by guaranteed the duration and just cause. However, land lease rights without renewal are now extinguished by expiration of the term.

Land lease rights are now classified into three types.

(1) Land lease rights for a fixed term of years shall be for fifty years or more. Although not a prerequisite

for its validity, special agreement on non-application for renewal of the contract or for demand of purchase must be made in writing such as by a notarized document. n354

When land lease rights for a fixed term of years are thus extinguished, what is the position of the house-lessee on the leased land? The building can be demolished and the building lease is terminated, because the lessee's right to demand purchase of the building is excluded by agreement. However, since the exclusion of the right to demand purchase is a special agreement, the lessor of the land shall take the place of the lessor of the building if he or she purchases the building by agreement of the parties. If the time when the building is to be demolished is the time of extinction of land-lease rights for a fixed term of years, the building lease shall be terminated at that time. n355

(2) Concerning land lease rights for business purposes, the parties establish land lease rights mainly for owning a building to be used for business purposes, the duration of which is between thirty and fifty years inclusive. The provisions about security of duration, renewal of contract, rights to demand purchase of a building and so on are not applicable in this type of land lease rights. n356 Establishing this type of land lease right requires a writing such as a notarized document. n357 Art. 24 Leasehold buildings with special assignment.

(3) Concerning the land lease rights with special agreement for the assignment of a building, the parties can agree that the building on the land is to assigned to the lessor when thirty years or more have passed after the establishment of such rights. n358 To preserve the special agreement of assignment of a building, the building needs to have previous registration, because the lessor of land shall acquire the ownership of the building after thirty years or more.

What is the position of the lessee of a building? If the building is delivered to the lessee before the reservation to purchase the building is registered, the lease of the building shall be effective against the lessor of the land. n359 Even if not, the Land and House Lease Act protects the right to use a building as a compulsory provision (one that cannot be excluded by agreement), when the lessee of a building requests such use. n360

[B] Fixed Term House Lease. Under the minor amendments concerning house leases, the lease of a building for a fixed term is permitted in the following two cases. The first is for the period building lease where the lessor is absent and where the building cannot be used for a definite period as the lessor's base due to unavoidable circumstances such as a change in one's place of work (occupational transfer), etc. n361 The second is a building lease where it is evident that the building is to be demolished by law, regulation, or contract, after a definite period, and is for the period until such demolition. n362 Special agreements to this effect must be made in writing and describe the unavoidable circumstances. n363

[n] Grounds for Termination of Lease

[i] Completion of the Term. A lease is terminated by completion of the term as determined by agreement or by law.

[ii] Destruction of the Property. When the lease property is entirely destroyed, the lease terminates regardless of who is responsible. The same rule applies when the property deteriorates beyond use.

[iii] Notice of Termination. When the Lease Has No Specified Term. When a lease has no specified term, either party may at any time give notice of termination. n364

Except for leases for temporary use, land leases for the purpose of ownership of buildings do not permit termination upon notice.

Except for leases for temporary use, and for fixed term leases, notice of termination of a building lease by the lessor requires that the lessor need to use the building himself or have some other justifiable reason. n365 As a consequence, numerous cases concern the existence of "just cause." Generally speaking, just cause means a cause which would be recognized as appropriate applying the general sense of the community in consideration of the advantages and disadvantages to each party and other relevant circumstances. The need by the lessor to use the property himself is merely one such circumstance. Recently, the tendering of a removal fee by the lessor to the lessee has been an important consideration reinforcing the just cause. n366

If notice of termination is properly given, the lease is terminated after a certain period beginning the day such expression of intent reaches the other party. This period is one year in the case of land (except that this applies only to those leases for the purpose of ownership of buildings which are for temporary use) or six months for a building (except that the term is three months for temporary use leases, or when the lessee gives notice of termination). n367 When the notice of termination requires just cause, this cause must continue to exist until the completion of such period.

[iv] Rescission

[A] Grounds Which Give Rise to the Lessee's Right of Rescission. The lessee may rescind a lease contract because of the lessor's nonperformance of a duty in accordance with the general provisions of the Civil Code. n368

[B] Grounds Which Give Rise to the Lessor's Right of Rescission. The Civil Code gives the lessor a right of rescission in the event of an assignment of lease rights or sublease without notice. n369 In addition, the lessor may generally rescind a lease contract because of the lessee's nonperformance of a duty, in accordance with the general provisions of the Civil Code. When one party to a contract fails to perform a duty, the other party may give notice of demand for performance within a reasonable fixed period, and may then rescind the contract if the other party fails to perform within that period. n370 However, actual real estate leases impose various duties on the lessee by special agreement (most of which are duties of forbearance, prohibiting certain acts) and give the lessor the right to rescind the contract immediately without notice of demand for performance, in the event the lessee fails to perform a duty, including one of these special duties. The imbalance of rights has led the courts to develop a legal theory of rescission peculiar to leases, called the fiduciary relation (*shinrai kankei*) theory. According to this theory, even when the lessee has violated a duty, the lessor may not rescind the contract if the violation does not destroy the lessee's fiduciary relation to the lessor. On the other hand, when the lessee has committed a breach of faith, creating serious difficulty for continuation of the lease, the lessor may rescind the contract without requiring notice of demand. While academic theories accept the result of this theory, they find the foundation for the lessor's right of rescission in an application, by analogy, of Civil Code Article 628 which specifies the grounds for rescission of an employment contract--like a lease, a continuing contractual relationship--and contend that the lessor may rescind the contract without notice of demand only when this is necessary. The result of the judicial theory is set out below for each cause of rescission.

[I] Assignment of Lease Rights or Sublease Without Notice. Despite the clear language of Civil Code Article 612, paragraph 2, the Supreme Court has held that even when a lessee grants the use and enjoyment of the lease property to a third party without the consent of the lessor, the lessor has no right of rescission under that article if special circumstances exist such that the lessee's act cannot be considered a breach of faith to the lessor. n371 This view has been supported by many subsequent decisions and is now a firmly established precedent.

[II] Nonpayment of Rent. Contract terms usually permit rescission without notice for nonpayment of rent. Their effectiveness is particularly questionable when they permit rescission without notice for one instance of nonpayment of rent. Decisions have interpreted provisions to mean that the lessor may rescind without notice of demand when special circumstances render such action reasonable. A five-month rent arrearage was held to be reasonable ground for rescission without notice. n372

Without the special provision, the lessor must send the lessee notice of demand for payment of rent, in order to rescind

the contract. n373 When a long-term rent arrearage is recognized as a serious breach of faith, however, immediate rescission of the contract without notice of demand has been permitted even when there was no special agreement permitting it. n374 Sometimes non-payment of rent results when the lessor refuses to accept payment--when, for example, the lessor insists on rescission for some other reason and refuses to recognize the existence of a contract. When the lessor clearly expresses an intent not to accept payment, the lessee will not be liable for default of an obligation, whether or not he makes oral tender of the rent, n375 and the lessor may not rescind the contract. When the lessor later recognizes the existence of the contract, and clearly indicates that he will accept the rent without objection if it is tendered, he may then give the lessee notice of demand for payment of rent arrearages, and may then rescind the contract if the lessee fails to pay. n376

[C] Violation of the Duty to Conform to the Agreed Use, Violation of the Duty of Custody, or Violation of Other Special Agreements. Special provisions often permit rescission without notice of demand upon violation of the duty to conform to the agreed use, violation of the duty of custody, or violation of other special agreements. The violations, however, vary greatly in their nature and correctability. Consequently, the decisions do not permit rescission when the violation does not amount to a breach of the fiduciary relationship between the parties, n377 and permits it when the fiduciary duty is breached, making it difficult for the lease to continue. n378

[D] Method and Effect of Exercise of Right of Rescission. The right of rescission is exercised by an expression of intent directed to the other party. n379 When more than one individual occupies the role of one of the parties, n380 the expression of intent must be given to or from all such individuals. n381 A party giving notice of demand of performance to the other party may at the same time express an intent to rescind upon completion of the notice period; this, in fact, is common procedure.

The lease contract terminates when the expression of intent to rescind becomes effective. The rescission has no effect on the legal relations between the parties prior to rescission. n382 Even when one party exercises a right to rescind, either party may demand compensation for damages caused by the other party's default of an obligation right. n383

[v] Rescission by Mutual Agreement. The parties may at any time terminate the contract by mutual agreement, whether or not the lease has a specified term. Since the agreement to rescind is a contract, it may not affect the legal status of third parties. Accordingly, the status of a lawful sublessee will not be affected. n384 As a rule, the lessor of land may not resist a lessee of a building on the land on the basis of a consensual rescission of the land lease. n385

[o] Legal Relations of the Parties After Termination of the Lease. Even after the lease contract is terminated, the parties must return the property, return the deposit, and wind up other affairs.

[i] Lessee's Rights

[A] Right of Removal. When the lease terminates, the property must be returned to the lessor. The lessee is free to remove buildings he owns on leased land, or fixtures he has placed in a leased house. n386

[B] Land Lessee's Right to Demand Purchase of Buildings. When land lease rights are extinguished on completion of the lease term, the lessee may demand that the landowner (lessor) purchase at current value buildings on the land or other things (gates, walls, fences, trees, etc.) he has affixed to the land by virtue of a legal right. n387 The nature and exercise of this right are the same as for a third party's right to demand purchase of buildings. n388 Special agreements disclaiming the right to demand purchase of buildings are void. n389

The lessee does not have this right when the land lease rights are extinguished by rescission because of the lessee's nonperformance of a duty. n390

[C] Right to Demand Purchase of Fixtures. n391 The exercise of the right to demand purchase of fixtures gives rise to the same legal relationship as if a sales contract had been made between the lessee and the lessor. The obligatory

duty to pay for the fixtures is an obligatory duty arising out of the fixtures and not an obligatory duty arising out of the building. Therefore, while the lessee may refuse to deliver the fixtures until the tendering of payment, based on his or her right of retention n392 or his or her right to insist on simultaneous performance, n393 he may not refuse to vacate the property. n394 Special agreements disclaiming the right to demand purchase of fixtures are void. n395

When a lease is terminated by rescission based on the lessee's default of a duty, the lessee does not have the right to demand purchase of fixtures. n396

[D] Right to Demand Compensation for Beneficial Expenses. The lessee may demand compensation from the lessor for expenses incurred for the benefit of the property (beneficial expenses). The lessor may pay either the lessee's out-of-pocket expenses or the amount by which the value of the property is increased (whichever is lower). If part of the benefit is lost before the property is returned to the lessor, the lessee's right to demand compensation for beneficial expenses is also extinguished with regard to that portion. n397

The right to demand compensation for beneficial expenses is a contract right connected to the lease property, and the lessee may retain the property until he receives compensation. n398 Special agreements disclaiming the right to demand compensation for beneficial expenses are valid. Since additions or improvements in the lease property, even without notice to the lessor, constitute beneficial expenses, the lessee acquires a right to demand compensation for these expenses; it is reasonable to exclude this right by special agreement.

The lessee must exercise this right within one year from the time the property is returned to the lessor. n399

[E] Right to Demand Return of Deposit Money. Deposit money is security not only for the lessee's obligation-duties to the lessor arising during the continuation of the Lease, but also for obligation-duties arising after termination of the lease before the property has been returned to the lessor. Thus, when the property has been returned, the deposit money is applied against any unfulfill obligatory duty arising up to that time, and only when deposit money remains does the right to demand return of deposit money become effective. n400 Therefore, a lessee may not refuse to return property on the grounds that the lessor has not returned the deposit money. n401

[ii] Lessor's Rights

[A] Right to Demand Return of the Property. In conjunction with the right to demand return of the property, the lessor probably may also demand that the lessee remove the effects of any violation of the duty to conform to the agreed use, and restore the property to its original condition.

[B] Right to Demand Compensation for Damages. The right to demand compensation for damages must be exercised within one year from the time the property is returned to the lessor. n402 Even after termination of the lease, the lessor may demand that the lessee pay a reasonable amount of rent per day until the property has been returned, based on the contract rent, either as compensation for damages for delay in performance of the duty to return the property, or as an unjust enrichment for continued use and enjoyment of the property.

FOOTNOTES:
(n1)Footnote 210. Law No. 59, 1981.

(n2)Footnote 211. Law No. 195, 1954.

(n3)Footnote 212. Law No. 181, 1949.

(n4)Footnote 213. Law No. 227, 1953.

(n5)Footnote 214. Law No. 74, 2007.

(n6)Footnote 215. Law No. 228, 1949.

(n7)Footnote 216. Law No. 86, 2005.

(n8)Footnote 217. Law No. 78, 2006.

(n9)Footnote 218. Law No. 181, 1947.

(n10)Footnote 219. Law No. 61, 2000.

(n11)Footnote 220. Law No. 22, 2007.

(n12)Footnote 221. Current Deposit Transaction Account Rules, Arts. 3 and 4.

(n13)Footnote 222. *Ibid.*, Art. 2.

(n14)Footnote 223. *Ibid.*, Art. 5.

(n15)Footnote 224. *Ibid.*, Art. 6.

(n16)Footnote 225. *Ibid.*, Arts. 7 and 8.

(n17)Footnote 226. *Ibid.*, Art. 11

(n18)Footnote 227. *Ibid.*, Art. 12

(n19)Footnote 228. *Ibid.*, Art. 18

(n20)Footnote 229. Checks Act, Art. 38.

(n21)Footnote 230. Current Deposit Transaction Account Rules, Art. 19.

(n22)Footnote 231. K. K. Sengokuya v. Tsuchikida, 25 Minshu 900, Oct. 13, 1967.

(n23)Footnote 232. Current Deposit Transaction Account Rules, Art. 20.

(n24)Footnote 233. *Ibid.*, Art. 27.

(n25)Footnote 234. Civil Code, Art. 651, para. 1.

(n26)Footnote 235. *See, e.g.*, Tokyo District Court, 1907 Hanreijiho 73, February 21, 2005 (no negligence by bank where funds were released after verification of correct bankbook and seal, even though they had been stolen by person making withdrawal); *but see*, Tokyo District Court, 1907 Hanreijiho 77, February 28, 2005 (bank had obligation to take greater care than just checking seal and bankbook where name was entered incorrectly on the refund bill and the withdrawal sought was large; court noted that as unlawful withdrawals using a stolen bankbook had became common, banks had duty to exercise more caution).

(n27)Footnote 236. Civil Code, Art, 467, para. 2.

(n28)Footnote 237. Bills Act, Arts. 38, para. 2, and Art. 83. See also Checks Act, Arts. 31 and 69.

(n29)Footnote 238. Checks Act, Art. 29, para. 1.

(n30)Footnote 239. *Ibid.*, Art. 32, para. 2.

(n31)Footnote 240. For example, the practice by consumer finance companies of refusing to provide their debtors with transaction records, even though providing the disclosure was important to the debtor and no burden to the companies; however, the Supreme Court has since ruled that such refusal to disclose is unlawful absent special cause. Supreme Court, Minshu 59.6.1783, July 19, 2005.

(n32)Footnote 241. Law No. 181, 1947.

(n33)Footnote 242. Supreme Court, 24 Minshu 587, June 24, 1970.

(n34)Footnote 243. Civil Code, Art. 601.

(n35)Footnote 244. Civil Code, Arts. 601 to 622.

(n36)Footnote 245. Civil Code, Art. 265.

(n37)Footnote 246. Land and House Lease Act, Art. 2.

(n38)Footnote 247. Civil Code, Arts. 266 and 276.

(n39)Footnote 248. *Ibid.*, Art. 388; Civil Execution Act, Art. 180, 181.

(n40)Footnote 249. *Shakuchi Shakka Ho* (Law No. 90, 1991). See also the Special Measures Act Concerning the Promotion of Supply of High Quality Lease Housing (Law No. 153, 1999).

(n41)Footnote 250. Land and House Lease Act, Arts. 9, 16, 21 (land lease) and Arts. 30, 37 (house lease).

(n42)Footnote 251. Civil Code, Art. 91.

(n43)Footnote 252. *Ibid.*, Art. 92.

(n44)Footnote 253. Act on General Rules for Application of Laws (Law No. 78, 2006), Art. 3.

(n45)Footnote 254. Land and Building Transaction-Business Act (Takuchi Tatemono Torihiki Gyo Ho), Law No. 176, 1952, Arts. 2, 3.

(n46)Footnote 255. *Ibid.*, Art. 15.

(n47)Footnote 256. *Ibid.*, Art. 35.

(n48)Footnote 257. *Ibid.*, Art. 31.

(n49)Footnote 258. Civil. Code, Arts. 656 and 644.

(n50)Footnote 259. The maximum amount of compensation is prescribed by Ministry of Land, Infrastructure, Transport and Tourism, Notification No. 1552, January 23, 1970 and Notification No. 263, April 1, 1989.

(n51)Footnote 260. Land and Building Transaction-Business Act, Art. 37.

(n52)Footnote 261. Code of Civil Procedure, Art. 323, para. 1.

(n53)Footnote 262. Civil Execution Act, Art. 22, item 5.

(n54)Footnote 263. Supreme Court, 8 Minshu 672, March 11, 1954; Supreme Court, 22 Minshu 1422, June 27, 1968.

(n55)Footnote 264. See infra.

(n56)Footnote 265. Land and House Lease Act, Art. 31, para. 1.

(n57)Footnote 266. Civil Code, Art. 605.

(n58)Footnote 267. Great Court of Judicature, 27 Minroku 1378, July 11, 1921.

(n59)Footnote 268. See infra.

(n60)Footnote 269. Civil Code, Art. 614.

(n61)Footnote 270. *Ibid.*, Art. 484.

(n62)Footnote 271. *Ibid.*, Art. 485.

(n63)Footnote 272. *Ibid.*, Art. 169.

(n64)Footnote 273. Supreme Court, 20 Minshu 702, April 20, 1966.

(n65)Footnote 274. Land and House Lease Act, Art. 11, para. 1; Art. 32, para. 1.

(n66)Footnote 275. Supreme Court, 24 Minshu 482, June 4, 1970.

(n67)Footnote 276. Land and House Lease Act, Art. 11, para. 2; Art. 32, para. 2.

(n68)Footnote 277. Civil Code, Art. 492.

(n69)Footnote 278. *Ibid.*, Art. 494.

(n70)Footnote 279. *Ibid.*, Art. 493, proviso.

(n71)Footnote 280. Land and House Lease Act, Art. 11, para. 2, proviso; Art. 32, para. 2, proviso.

(n72)Footnote 281. Land and House Lease Act, Art. 11, para. 3, main clause; Art. 32, para. 3, main clause.

(n73)Footnote 282. Land and House Lease Act, Art. 11, para. 3, proviso.

(n74)Footnote 283. Civil Code, Art. 611, para. 1.

(n75)Footnote 284. Civil Code, Art. 616; Art. 594, para. 1.

(n76)Footnote 285. Civil Code, Art. 400.

(n77)Footnote 286. Supreme Court, 20 Minshu 720, April 21, 1966.

(n78)Footnote 287. Land and House Lease Act, Art. 17, para. 2.

(n79)Footnote 288. See infra.

(n80)Footnote 289. See infra.

(n81)Footnote 290. Civil Code, Art. 608, para. 2. See infra.

(n82)Footnote 291. Land and House Lease Act, Art. 33.

(n83)Footnote 292. See infra.

(n84)Footnote 293. Civil Code, Art. 606, para. 1.

(n85)Footnote 294. *Ibid.*, Art. 615.

(n86)Footnote 295. See Supreme Court, 17 Minshu 1477, November 28, 1963.

(n87)Footnote 296. Civil Code, Art. 400.

(n88)Footnote 297. See Supreme Court, 11 Minshu 2018, December 3, 1958.

(n89)Footnote 298. Common opinion; see Supreme Court, 14 Minshu 1091, April 26, 1960.

(n90)Footnote 299. Civil Code, Art. 611, para. 1. See supra.

(n91)Footnote 300. *Ibid.*, Art. 606, para. 2.

(n92)Footnote 301. *Ibid.*, Art. 414, para. 2; Civil Execution Act, Art. 171.

(n93)Footnote 302. Common opinion; Civil Code, Art. 608, para. 1.

(n94)Footnote 303. See 4 supra.

(n95)Footnote 304. Land and House Lease Act, Art. 10, para. 1.

(n96)Footnote 305. Land and House Lease Act, Art. 31, para. 1.

(n97)Footnote 306. Civil Code, Art. 203, proviso; Art. 201, para. 3.

(n98)Footnote 307. Law No. 13, 1946.

(n99)Footnote 308. *Ibid.*, Art. 25-2; Art. 10.

(n100)Footnote 309. Supreme Court, 11 Minshu 150, January 31, 1957.

(n101)Footnote 310. Supreme Court, 17 Minshu 639, May 24, 1963.

(n102)Footnote 311. See Supreme Court, 18 Minshu, 1354, August 28, 1954.

(n103)Footnote 312. Supreme Court, 28 Minshu 325, March 19, 1974.

(n104)Footnote 313. Supreme Court, 17 Minshu 12, January 18, 1963.

(n105)Footnote 314. Supreme Court, 17 Minshu 1025, September 26, 1963.

(n106)Footnote 315. Supreme Court, 18 Minshu 968, June 26, 1964.

(n107)Footnote 316. Supreme Court, 23 Minshu 1610, July 17, 1969.

(n108)Footnote 317. Civil Code, Art. 899.

(n109)Footnote 318. See Supreme Court, 24 Minshu 415, May 22, 1970.

(n110)Footnote 319. Supreme Court, 13 Minshu 757, June 19, 1959.

(n111)Footnote 320. Civil Code, Art. 909.

(n112)Footnote 321. Article 612, para. 1.

(n113)Footnote 322. Civil Code, Art. 612, para. 2.

(n114)Footnote 323. Supreme Court, 13 Minshu 1412, September 17, 1959.

(n115)Footnote 324. Supreme Court, 10 Minshu 1239, October 5, 1956.

(n116)Footnote 325. Supreme Court, 9 Minshu 698, May 13, 1955.

(n117)Footnote 326. See infra.

(n118)Footnote 327. Supreme Court, 26 Minshu 213, March 9, 1972.

(n119)Footnote 328. Supreme Court, 19 Minshu 811, May 4, 1965.

(n120)Footnote 329. Land and House Lease Act, Art. 19.

(n121)Footnote 330. *Ibid.*, Art. 20.

(n122)Footnote 331. Civil Code, Art. 613, para. 1.

(n123)Footnote 332. *Ibid.*, Art. 400.

(n124)Footnote 333. *Ibid.*, Art. 616; Art. 594, para. 1.

(n125)Footnote 334. *Ibid.*, Art. 615.

(n126)Footnote 335. *Ibid.*, Art. 613, para. 1.

(n127)Footnote 336. See § 2.02[3][n][iv][B][I] infra.

(n128)Footnote 337. Supreme Court, 23 Minshu 855, April 24, 1969.

(n129)Footnote 338. Land and House Lease Act, Art. 14.

(n130)Footnote 339. Defense of simultaneous performance, Civil Code, Art. 533.

(n131)Footnote 340. Supreme Court, 14 Minshu 2227, September 20, 1960.

(n132)Footnote 341. Civil Code, Art. 899.

(n133)Footnote 342. *Ibid.*, Art. 428.

(n134)Footnote 343. *Ibid.*, Arts. 420 and 428.

(n135)Footnote 344. Land and House Lease Act, Art. 36.

(n136)Footnote 345. Supreme Court, 21 Minshu 780, April 28, 1967.

(n137)Footnote 346. See Supreme Court, 18 Minshu 1578, October 13, 1964.

(n138)Footnote 347. See, for the new provisions, the Land and House Lease Act, Articles 3, 4, 7, 8 and 18.

(n139)Footnote 348. Land Lease Act, Art. 2.

(n140)Footnote 349. Land and House Lease Act, Art. 3.

(n141)Footnote 350. *Id.*, Art. 26, para. 1 and Art. 29, para. 2.

(n142)Footnote 351. *Id.*, Article 26, para. 1, proviso clause.

(n143)Footnote 352. Land Lease Act, Art. 4, para. 1; House Lease Act, Art. 1-2.

(n144)Footnote 353. *Id.*, Articles 6 and 28.

(n145)Footnote 354. *Id.*, Article 22.

(n146)Footnote 355. *Id.*, Article 39.

(n147)Footnote 356. *Id.*, Article 23, Paragraph 1.

(n148)Footnote 357. *Id.*, Article 23, para. 3.

(n149)Footnote 358. *Id.*, Article 24, paragraph 1.

(n150)Footnote 359. See id., Article 31.

(n151)Footnote 360. *Id.*, Article 24, Paragraph 2.

(n152)Footnote 361. See id., Article 38, Paragraph 1.

(n153)Footnote 362. *Id.*, Article 39, Paragraph 1.

(n154)Footnote 363. *Id.*, Article 38, Paragraph 2, and Article 39, Paragraph 2.

(n155)Footnote 364. Civil Code, Art. 617.

(n156)Footnote 365. Land and House Lease Act, Art. 6 and 28.

(n157)Footnote 366. See Supreme Court, 25 Minshu 1343, November 25, 1971.

(n158)Footnote 367. Civil Code, Art. 617, para. 1; House Lease Act, Art. 3, para. 1.

(n159)Footnote 368. *Ibid.*, Arts. 540 to 544. For other grounds which give rise to the lessee's right of rescission, see *Ibid.*, Arts. 607, 610, and 611, para. 2.

(n160)Footnote 369. *Ibid.*, Art. 612, para. 2.

(n161)Footnote 370. *Ibid.*, Art. 541.

(n162)Footnote 371. Supreme Court, 7 Minshu 979, September 25, 1953.

(n163)Footnote 372. Supreme Court, 22 Minshu 2741, November 21, 1968.

(n164)Footnote 373. Supreme Court, 14 Minshu 1547, June 28, 1960.

(n165)Footnote 374. Supreme Court, 28 Minshu 467, April 26, 1974; nine years and ten months' arrearment.

(n166)Footnote 375. Civil Code, Art. 493, proviso. See Supreme Court, 11 Minshu 915, June 5, 1957; Supreme Court. 13 Minshu 631, June 2, 1959.

(n167)Footnote 376. Supreme Court, 14 Minshu 2733, October 27, 1960.

(n168)Footnote 377. Supreme Court, 15 Minshu 1939, July 21, 1961.

(n169)Footnote 378. Supreme Court, 6 Minshu 451, April 25, 1952.

(n170)Footnote 379. Civil Code, Art. 540, para. 1.

(n171)Footnote 380. See § 5.12[2][l][ii] supra.

(n172)Footnote 381. Civil Code, Art. 544, para. 1.

(n173)Footnote 382. *Ibid.*, Art. 620.

(n174)Footnote 383. *Ibid.*, Art. 620, proviso.

(n175)Footnote 384. Great Court of Judicature, 13 Minshu 278, March 7, 1934.

(n176)Footnote 385. Supreme Court, 17 Minshu 219, February 21, 1963.

(n177)Footnote 386. Civil Code, Arts. 616 and 598.

(n178)Footnote 387. Land and House Lease Act, Art. 13, para. 1.

(n179)Footnote 388. See § 2.02[3][k][iv] supra.

(n180)Footnote 389. Land and House Lease Act, Arts. 9, 16, 21.

(n181)Footnote 390. Supreme Court, 14 Minshu 108, February 9, 1960.

(n182)Footnote 391. See § 2.02[3][g][ii][C] supra.

(n183)Footnote 392. Civil Code, Art. 295, para. 1.

(n184)Footnote 393. *Ibid.*, Art. 533.

(n185)Footnote 394. Supreme Court, 8 Minshu 16, January 14, 1954.

(n186)Footnote 395. Land and House Lease Act, Art. 30.

(n187)Footnote 396. Land and House Lease Act, Art. 30.

(n188)Footnote 397. Supreme Court, 27 Minshu 798, July 17, 1973.

(n189)Footnote 398. Civil Code, Art. 295, para. 1.

(n190)Footnote 399. *Ibid.*, Arts. 622 and 600.

(n191)Footnote 400. Supreme Court, 27 Minshu 80, February 2, 1973.

(n192)Footnote 401. Supreme Court, 28 Minshu 1152, September 2, 1974.

(n193)Footnote 402. Civil Code, Arts. 621 and 600.