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Amendments to the Civil Code of Japan (Part 1) : Extinctive Prescription and Statutory Interest Rate

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I. Status of the Civil Code under Japanese Law

The Civil Code[1] is one of the most important laws in Japan. It consists of approximately 1,000 articles covering property and contracts as well as family relations and succession. The former stipulates matters

concerning juridical acts, prescription, real rights, security rights, contracts, tort and others. The latter provides for matters concerning marital relations, parent and child relations, succession, wills and others. Civil procedures and enforcement are covered under the Code of Civil Procedure and the Civil Execution Act (not the Civil Code).

II. Background of the Amendments

Since it took effect in 1898, the Civil Code has never had any major amendment except to the titles on family relations and succession. As to the titles on property and contracts, despite the absence of any amendment thereto for around 120 years, numerous judicial precedents have accumulated offering a substantial number of interpretations on each article of the Civil Code, including on property and contracts, throughout that period. However, such judicial precedents are difficult to comprehend and the scope thereof requires careful review.

Based on the foregoing, the titles on contracts have been recently amended (and are scheduled to take effect sometime in 2020) to clarify existing case law and ambiguous provisions, and codify certain principles and concepts. This is called the amendment of the laws of obligations, which is the greatest amendment since the onset of the Civil Code, although it does not make vast changes to the existing rules and mainly codifies the interpretations made in judicial precedents. The titles on real rights will remain unchanged.

This article on extinctive prescription and the statutory interest rate is one of three parts that will outline the major changes to the Civil Code.

III. Extinctive Prescription for a Claim

Before the amendment, the Civil Code stipulated that, in principle, a claim shall be extinguished if not exercised within ten years from the time it becomes enforceable. However, as an exception, any claim regarding a diagnosis by a doctor or any claim regarding construction work shall be extinguished if not exercised within three years; any claim regarding the duties of an attorney or the amount payable for any product or goods sold by a wholesale merchant shall be extinguished if not exercised within two years; and any claim pertaining to freight for transportation or hotel room charges shall be extinguished if not exercised within one year. In addition, any claim relating to a commercial transaction shall be extinguished if not exercised within five years (as stipulated under the Commercial Code). As described above, the periods of extinctive prescription for a claim differ depending on the cause of action. Such difference made it too complicated for lay people to understand, and thus, they ran the risk of making a mistake concerning the extinctive prescription of their claims.

The amended Civil Code will repeal the above system of short-term extinctive prescription periods, and provide that a claim shall be extinguished by prescription if: (i) it is not exercised within ten years from the time it becomes enforceable; or (ii) it is not exercised within five years from the time the creditor becomes aware of its right to enforce the claim, whichever occurs earlier. Under item (i), even if a creditor is not aware of the enforceability of the right, the claim shall be extinguished after the lapse of ten years from the time the right becomes statutorily enforceable. For item (ii), for example, in the case of a contractual claim, since the creditor usually knows the time when

the right becomes enforceable, the claim shall be extinguished after the lapse of five years. Thus, it would be sufficient to note that, in most cases, commercial claims shall be extinguished after the lapse of five years if not exercised within that period.

As to a tort claim under the amended Civil Code, it shall be extinguished after the lapse of three years from the time the aggrieved party becomes aware of the damages and the identity of the perpetrator (or five years if the tort has resulted in injury to the life or body of another person), or twenty years from the time of the tortious act, whichever occurs earlier.

IV. Statutory Interest Rate

1. Outline of the amendment

The Civil Code currently provides for a statutory interest rate of 5% per annum. Thus, interest or delinquency charges accrue at 5% per annum, unless the contracting parties have agreed otherwise. On the other hand, the Commercial Code provides for a statutory interest rate of 6% per annum for commercial matters.

The 5% annual rate is considerably high, if compared with the prevailing interest rates in Japan. Recently, even a fixed-term deposit at a bank bears annual interest at the rate of only around 0.1%.

Based on the foregoing, the amended Civil Code has adopted, as a fundamental revision, a floating system pegged to the market interest rate, which initially starts at 3% per annum and can only change by whole numbers (e.g., 2%, 3%, etc.). This rate will be reviewed every three years; however, if the market interest rate does not undergo any substantial fluctuation, then the former rate shall be kept. The specific method for the calculation shall be prescribed by an order of the Ministry of Justice. In relation to this amendment of the Civil Code, the statutory annual interest rate of 6% for commercial matters will be abolished.

Under the new floating system for the interest rate, the determination of the specific point in time when the statutory interest rate will apply is crucial. Under the amended Civil Code: (i) unless otherwise agreed, the interest accruing on a claim shall be the statutory interest rate "at the time the interest initially accrued," and (ii) the amount of damages due to non-payment of any monetary debt shall be determined pursuant to the statutory interest rate "at the time the debtor initially became liable for the delay in performance."

2. Impact on claims for damages in tort

This amendment of the Civil Code will have a considerable impact on claims for damages arising from tortious acts. Unlike in contracts where the interest rate or rate for delinquency charges is commonly specified by the parties, in tort, there is no agreement on the interest rate.

For instance, if the victim of a traffic accident seeks damages from the tortfeasor for medical treatment of his/her injury, and a lawsuit is filed because no settlement is reached, then it is not uncommon for the victim to obtain payment of such damages only after several years of litigation. Although a victim is entitled to claim for delinquency charges

from the tortfeasor, which will be calculated from the date of the traffic accident until the date of actual payment of the damages, considering that the statutory interest rate will initially be lowered after the amendment of the Civil Code, the amount of such delinquency charges will be lower than that which could have been received by the victim under the Civil Code before the amendment.

On the other hand, there are advantages for the victim. To illustrate, if a traffic accident victim suffers any continuing injury, then his/her income, which, for example, used to be 5 million yen per annum, might be reduced to 1 million yen per annum due to such injury. Although the victim may claim compensation for the loss of future income, the court will not accept a simple multiplication of the difference (in this example, 4 million yen) by the number of years until the mandatory retirement age (for example, 30 years) (in this example, the total will be 120 million yen) because, if the victim is entitled to receive such 120 million yen in full, then it would result in the victim being enriched by the amount of the future interest. This is why the concept of deduction of the interim interest has been adopted, whereby the present value of such 120 million yen is calculated. If the interim interest is deducted at the current interest rate of 5% compounded over a period of 30 years, then the amount the victim will receive will be about 60 million yen. However, since the interest rate will be initially reduced under the amended Civil Code to 3%, it will be advantageous for the victim. In our example, if the interim interest is deducted at the interest rate of 3% compounded over a period of 30 years, then the victim will be entitled to receive the higher amount of more than 75 million yen.

Since insurance companies have a substantial interest in the amount of the compensation for damages, this amendment of the Civil Code concerning the statutory interest rate will be crucially important for them.

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1. Minpo [Civil Code], Act No. 89 of April 27, 1896.

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The New "Minpaku" Law

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1. Introduction

On June 9, 2017, a new law was passed to regulate lodging services known as "Minpaku" services (the "New Minpaku Law").[1] Minpaku services[2] are a form of sharing economy (an economic system in which assets and the like are shared between private individuals by means of the Internet).

2. Past issues concerning the Minpaku business

Minpaku services have yet to become widespread in Japan due to the strict regulations under, among others, the Inns and Hotels Act,[3] which required the operator of such services to obtain a license.[4] This situation called for deregulation.

Minpaku services have also given rise to a number of problems with neighbors. For that reason, there was an urgent need to lay down certain rules to improve the way such services are offered and provided.

3. Gist of the New Minpaku Law

The New Minpaku Law was established to address the issues mentioned above. It aims to achieve a balance by relaxing the existing regulations and introducing regulations that are necessary for the operation of the Minpaku business model.

As a departure from the Inns and Hotels Act, the New Minpaku Law provides that in order for an operator to offer Minpaku services, such operator does not need to obtain the license required under the said Act, so long as the necessary notification of the offering of such services is given.[5] In this respect, the regulation has been relaxed significantly.

The New Minpaku Law only covers lodging services where people are allowed to stay overnight at a "house," which is defined as a building that is recognized as being used for residential purposes.[6] The New Minpaku Law provides that the number of days that a house may be offered for Minpaku services should not be more than 180 days a year because the new law does not consider a house as being used for residential purposes if it is offered for Minpaku services for most of the year.[7]

Also, if an operator offering lodging services (the "Lodging Operator"[8]) plans to be absent from the house and will not manage the lodging services during the period of stay of the lodgers thereat, then such Lodging Operator must outsource the management of the house to a manager.[9]

Certain restrictions are also imposed on Lodging Operators for the sake of promoting the safety and hygiene of the lodgers, and giving consideration to the local residents.

4. Conclusion

The New Minpaku Law has eased existing regulations such as the Inns and Hotels Act and provided appropriate regulations that focus on Minpaku services. The Minpaku business will thus face a big turning point in the future and will likely develop further. In fact, it was reported that e-commerce giant, Rakuten, Inc., and KDDI Corporation will be entering the Minpaku business by providing Airbnb-like platforms with the expectation that this business will have high growth.

The New Minpaku Law is the first law in Japan premised on the sharing economy. Based on this concept, the New Minpaku Law

introduced special rules for operators of the Minpaku business, which are mainly individuals or small-scale business operators, that are different from the rules of the existing Inns and Hotels Act, which are designed to apply mainly to larger entities. The New Minpaku Law was passed as an alternative to revising the Inns and Hotels Act in order to change the existing regulatory framework that applied to the Minpaku business. This pioneering law may bring about changes in the legal system concerning sharing economy in Japan.

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1. Juutaku shukuhaku jigyou ho [The Act on Lodging Services Offered by Using Houses], June 9, 2017. The law will take effect from the date stipulated in a Cabinet Order within one year from the date of the promulgation.
2. Minpaku services means lodging services that are offered by using all or part of a house (such as stand-alone houses and apartments).
3. Ryokan gyo ho [The Inns and Hotels Act], Act No. 138 of July 12, 1948.
4. See "The 'Minpaku' Business in Japan," Oh-Ebashi English Newsletter, 2017 Spring Issue at [http://www.ohebashi.com/jp/newsletter/Newsletter_en_Spring-Issue.pdf].
5. The New Minpaku Law, art. 3, para. 1.
6. Houses that are newly built to offer Minpaku services do not qualify as "houses" under the New Minpaku Law. (Ibid., art. 2, paras. 1 to 3.)
7. Ibid., art. 2, para. 3.
8. Ibid., art. 2, para. 4.
9. Ibid., art. 11, para. 1. The manager of a house for lodging means any person conducting the business of managing houses for lodging outsourced by any Lodging Operator and obtaining remuneration from such operator. The business of such manager may involve the maintenance and preservation of the house necessary for the appropriate conduct of the lodging services being offered by using the house, periodic cleaning, management of the register of lodgers and/or dealing with complaints and the like (Ibid., arts. 2, 5 and 6).

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An Overview of the Civil Rehabilitation Proceedings in Japan

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Insolvency proceedings to restructure a business in Japan may be done by corporate reorganization (*kaisha kosei*) or civil rehabilitation (*minji saisei*). Corporate reorganization is designed for large companies, and it provides a powerful mechanism for the involvement of all interested parties in the reorganization of the distressed company. However, as a trade-off, the procedures in corporate reorganization are generally complicated, strict, and require much time and expenses to conduct. The process from the filing of the petition to the confirmation of the reorganization plan can generally be completed in approximately nine to twelve months under the standard schedule of the Tokyo District Court. In comparison with corporate reorganization, the procedures in civil rehabilitation are simpler, and require lesser time and expenses to conduct. It generally takes approximately five months from the filing of the petition to the confirmation of the rehabilitation plan under the standard schedule of the Tokyo District Court. Also, thanks to its feature that directors of a

debtor company generally keep their positions as described below, civil rehabilitation is generally regarded as being a more debtor-friendly procedure, and, accordingly, debtors are often inclined to resort to civil rehabilitation rather than corporate reorganization. In 2016, with respect to companies with debts of 10 million yen or more, 246 civil rehabilitation cases were filed while only one corporate reorganization case was filed.[1]

Civil rehabilitation proceedings are triggered by the filing of a petition with the court. A debtor may file a petition for the commencement of civil rehabilitation if there is: (i) a suspicion that the factual basis that constitutes a ground for the commencement of bankruptcy (i.e., insolvent or unable to pay debts) will occur to the debtor; or (ii) a suspicion that a significant hindrance to the continuation of the business of the debtor will occur if it repays its debts that are due. A creditor may also file a petition for the commencement of civil rehabilitation if the suspicion referred to in item (i) above exists.[2]

The filing of the petition itself does not have the effect of staying the actions of creditors. To prevent the assets of the debtor from being disposed and used in any preferential repayment prior to the commencement of the proceedings, the court may order a provisional seizure or provisional disposition, or issue any other necessary temporary restraining order concerning the business and properties of the debtor, such as an order to prohibit the debtor from making repayments to its creditors.[3]

In civil rehabilitation, the existing management personnel will continue to manage the debtor company (debtor-in-possession) and no trustee is appointed other than in exceptional cases. In almost all rehabilitation cases, the court appoints a supervisor to monitor the activities of the debtor throughout the proceedings.[4] The responsibilities of a supervisor cover various matters, such as giving consent to certain actions by the debtor, investigating the business and properties of the debtor, preparing an opinion letter on a proposed rehabilitation plan, and supervising the implementation of such plan.

Where a petition for the commencement of civil rehabilitation proceedings is duly filed and the requirements for such commencement are satisfied, the court will, generally within a week thereafter, issue an order for the commencement of the rehabilitation proceedings.[5] The commencement order prohibits creditors from taking actions to collect their claims.

After the commencement order is issued, an unsecured creditor must file a proof of claim with the court.[6] For unsecured creditors who do not file claims, if the debtor is aware of such claims, then although such unsecured creditors would not be eligible to vote on the proposed rehabilitation plan, they can still receive payment pursuant to the rehabilitation plan that is approved by the creditors and confirmed by the court. A secured creditor is not required to file a proof of secured claims (though it still needs to file proof of any unsecured portion of a claim) because a secured creditor may generally enforce its secured claims regardless of the pending rehabilitation proceedings. The debtor then approves or disapproves the claims that have been filed.[7]

The debtor shall evaluate the value of any and all of its properties, and prepare an evaluation report. The debtor shall also prepare an inventory of assets and a balance sheet(s) based on the evaluation.[8]

The debtor shall then prepare a proposed rehabilitation plan specifying matters such as the policy to rehabilitate its business, modifications to the rights of creditors, and the payment plan.[9]

The proposed rehabilitation plan is then approved at a meeting of the creditors by obtaining the consent of both the majority of the voting creditors and the creditors that account for not less than half of the total voting rights.[10] Thereafter, the court shall make an order of confirmation of the rehabilitation plan approved by the creditors unless any of the grounds for disconfirmation exists, such as infeasibility of the plan, the contents of the plan are unfair or inequitable and the like.[11]

Once the confirmation order becomes final and conclusive, the rehabilitation plan becomes effective and the rights of the creditors are modified in accordance with the said plan.[12] A debtor shall implement the confirmed plan, such as by making payments in accordance therewith.[13] If a supervisor has been appointed in the rehabilitation proceedings, then the court will issue an order to close such proceedings when the rehabilitation plan has been executed or three years have elapsed since the confirmation order became final and conclusive.[14] In exceptional cases where a trustee is appointed, the court will issue an order to close the rehabilitation proceedings when the rehabilitation plan has been executed or it has found that the rehabilitation plan will surely be executed.

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1. See https://www.tdb.co.jp/tosan/syukei/pdf/16nen.pdf (in Japanese).
2. Minji saisei ho [Civil Rehabilitation Law], Act No. 225 of December 22, 1999, art. 21.
3. Ibid., art. 31.
4. Ibid., art. 54.
5. Ibid., art. 33.
6. Ibid., art. 94.
7. Ibid., art. 101.
8. Ibid., art. 124.
9. Ibid., art. 163.
10. Ibid., art. 172-3.
11. Ibid., art. 174.
12. Ibid., art. 176.
13. Ibid., art. 186.
14. Ibid., art. 188.

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PRACTICAL TIPS FOR DOING BUSINESS IN JAPAN

Employee Hiring Guidelines in Japan

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There are several laws in Japan against employment discrimination, however, this article will focus only on prohibiting discrimination at the time of the hiring of employees.

In Japan, employers are generally free to recruit and hire employees under the principle of freedom of contract. However, there are several limitations applicable to the hiring process that employers should bear in mind. One limitation in terms of discrimination, and the collection, retention and use of the personal information of applicants is provided in the Employment Security Act[1] (the "Act") and its administrative guidelines issued by the Ministry of Health, Labour and Welfare ("MHLW") (the "Guidelines").[2]

Article 3 of the Act guarantees equal protection and Article 2 of the Guidelines prohibits employers from discriminating on the ground of race, nationality, creed, sex, social status, family origin, previous profession, membership in a labor union, etc., in the recruitment process.

Article 5-4 of the Act requires employers, in recruiting employees, to collect, retain and use personal information of applicants within the scope of the purpose of the business. Furthermore, the Guidelines prohibit employers from collecting the following information:
(i) race, ethnic group, social status, family origin, place of registry, birthplace, and other information that may cause social discrimination;
(ii) ideology and creed; and
(iii) membership in a labor union.

Notwithstanding the foregoing, the above prohibition will not apply if:
(a) it is particularly necessary based on the nature of the job to collect such personal information;
(b) the collection is within the scope of the purpose of the business; and
(c) the employer clearly indicates the purpose of the collection in obtaining such personal information.

It is important to note that the necessity test in item (a) above is strictly applied and is understood to be difficult to meet without a genuine reason why the employer needs to collect such information.

To promote a fair recruitment process, the MHLW publishes every year a guidebook for employers (the "Guidebook"), which currently provides 14 cases that could cause social discrimination.[3] With respect to health checks, which are not allowed in the selection process under the Guidebook, one of the delicate issues mentioned is the question about previous illnesses. Generally speaking, an employer is not allowed to ask such questions unless there is a reasonable or objective need therefor relating to the purpose of the business pursuant to the Guidelines mentioned above. The Guidebook warned that previous illnesses are usually not related to the current ability of an applicant to handle work. Moreover, in cases where the applicant has fully recovered from such previous illness, it is possible that the application of such applicant will be rejected because of the stigma of such illness. As this analysis needs to be done on a case by case basis, an employer should seek legal advice if it is planning to apply any exception under the Guidelines.

For foreign applicants, there are additional guidelines that employers should observe.[4]

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1. Shokugyo antei ho [Employment Security Act], Act No. 141 of November 30, 1947.
2. Guidelines No. 141 originally issued on November 17, 1999, and last amended by Guidelines No. 321 issued on August 19, 2016. The Guidelines were published in the form of a notification (*kokuji*), and no English translation is available. Although the Guidelines are in the nature of an administrative interpretation and they have no legal binding effect, practically speaking, it is highly likely that a breach of the Guidelines would be considered a breach of the relevant legislation by courts.
3. The following eleven items should not be asked of an applicant at the time of the recruitment: (a) place of family registry and birthplace; (b) information about the family such as occupation and assets; (c) housing situation, (d) living conditions; (e) religion; (f) political party supported; (g) ideology, creed and other beliefs; (h) person respected by the applicant; (i) outlook on life; (j) labor union membership and history of union activities as well as social activities such as student activities; and (k) reading preferences. Items (a) to (d) are things that the applicant has no responsibility over. Items (e) to (k) are things that the applicant should be free to choose.
The following three items should be avoided in the selection process: (a) personal background investigation; (b) use of non-standard application forms; and (c) a health check requirement unless there is a reasonable or objective need therefor.
4. For example, employers should check whether they have a valid visa. Also, in hiring new graduates, foreign students with student visas (*ryuugakusei*) should not be discriminated against.

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