

Recent Updates on the Civil Code Reform

Japan is in the process of carrying out its first comprehensive reform of contract law (and the relevant general rules) (the **Reform**) since the enactment of the Civil Code in 1896. As it covers a broad range of legal topics, the Reform will affect many types of contracts such as share purchase agreements, construction contracts, loan agreements and general terms and conditions of transactions with consumers (e.g. terms of accounts). The Reform will have a far-reaching impact on the Japanese legal and business community, from lawyers and in-house lawyers to business persons involved with contracts and legal matters. This client briefing provides an overview of the upcoming Reform, outlining the envisaged timeline for those changes and highlighting some major areas which will be affected by the Reform.

Timeline and Background

A "Working Group on the Civil Code (Law of Obligations)" (the **Working Group**) was established by the Ministry of Justice in 2009 and has been working towards submitting a draft Reform bill to the Diet (the Japanese Parliament) in 2015.

The Working Group submitted an interim proposal (*chukan shian*, the **Interim Proposal**) for public comment in February 2013, and this consultation period has since closed. The next step for the Working Group is to submit an outline of the Reform bill, which is expected to take place around July 2014.

The purpose of the comprehensive reform is to revise and update the more than century-old Civil Code to become legislation that is more appropriate for governing modern day Japanese society, which has changed significantly since the time the Civil Code was enacted. The Reform also aims to codify into statute the general principles of law that have been derived from accumulated court precedents, so that the Civil Code might become more understandable to its users.

Major areas affected by the Reform

Although the Reform covers a wide range of topics, there are certain notable items that could impact various businesses. These are described in detail below.

Assignment of claims

Under the current Civil Code, the perfection of an assignment of claims can generally be achieved by way of notice from an assignor or acknowledgement from a third party obligor. In addition to these methods of perfection, a registration system for perfection is also available for legal entities in respect of monetary claims. One of the suggestions in the Interim Proposal is to allow for perfection by way of the registration system for all assignments of monetary claims, not just those for legal entities. Under such suggestion, perfection by way of notice or acknowledgement will no longer be an option. However, many law practitioners and business persons have shown strong opposition towards this idea because its adoption would involve radical changes to the current perfection system and could impose a burden on their businesses.

Apart from the perfection system, other topics relating to the assignment of claims are also currently under discussion, such as the validity or non-validity of an assignment of non-assignable claims and the incorporation into the Civil Code of rules formed by court precedents regarding the assignment of future claims.

General Terms and Conditions (*yakkan*)

The current Civil Code does not contain any provisions about general terms and conditions (GT&C¹). The Reform aims to include a definition and requirements for GT&C in the Civil Code and also to include certain new regulations, such as the invalidation of unjust terms in GT&C. If this Reform comes into effect, companies will need to review whether any of their contracts fall within the definition of GT&C, and if they do, revise such contracts as necessary to comply with the new regulations.

Pre-contractual liabilities

The current Civil Code does not contain any express provisions² about pre-contractual liability arising out of bad faith conduct that occurs during the formation period of a contract (e.g. unfair termination of negotiations, lack of information supply). The Japanese courts, on the other hand, have developed rules through court precedents. The Reform aims to reflect such rules on pre-contractual liability in the Civil Code. However, given that court precedents are created on a case-by-case basis, it is unclear how those judgments can be generalised when the precedents are codified into the Civil Code. As such, this should continue to be monitored.

Statutory rate of interest

Under the current Civil Code, the statutory rate of interest is 5%. The Reform aims to decrease this rate to 3% at the time the Reform becomes effective and introduce a mechanism for reviewing the statutory rate each year. This Reform does not affect any agreed interest rates. Given the decrease in the statutory rate, it will become more important to stipulate agreed interest rates in contracts. In addition, this Reform will affect claims arising from tort or unjust enrichment, as agreed interest rates are not applicable to such claims.

Other areas likely to be affected by the Civil Code Reform

In addition to the above-mentioned topics, the Interim Proposal will cover a broad spectrum of other areas including:

- General principles for juridical acts (*houritsu kouい sousoku*)
- Mental capacity (*ishi nouryoku*)
- Demand for performance (*rikou seikyuuken*)
- Damages caused by non-performance of an obligation (*saimu furikou ni yoru songai baishou seikyuuken*)
- Termination of contracts (*kaijo*)
- Assumption of risk (*kiken futan*)
- Delay in acceptance (*juryou chita*)
- Obligee's subrogation right (*saikensha daiiken*)
- Right to request avoidance (fraudulent act) (*sagai kouい torikeshi ken*)

¹ General terms and conditions (*yakkan*) generally means the terms and conditions of an agreement pre-made by one party that are expected to become effective as the terms and conditions of the agreement without being negotiated by the other party. A typical example of general terms and conditions is conditions of carriage for trains. Also, agreements such as account agreements and terms of service on Internet websites are generally understood as general terms and conditions. The precise definition of general terms and conditions under the revised Civil Code is under discussion by the Working Group, but it is likely that agreements like the above will be considered as general terms and conditions under the revised Civil Code.

² The Japanese courts apply the general principles of good faith (Article 1, Paragraph 2 of the Civil Code).

- Claims and obligations among multiple parties (excluding guarantee obligations) (*tasuu toujishakan no saiken oyobi saimu*)
- Guarantee (*hoshou saimu*)
- Securities (*yuuka shouken*)
- Assumption of obligations (*saimu hikiuke*)
- Transfer (assignment) of contractual status (*keiyakujo no chii no iten*)
- Payment (*bensai*)
- Set-off (*sousai*)
- Novation (*koukai*)
- Release (*menjo*)
- Employment agreements (*koyou keiyaku*)
- Consignment agreements (*inin keiyaku*)

In certain areas, established rules set up by the Supreme Court will simply be incorporated in the Civil Code. In other areas, the current rules will be amended. Each company must consider whether and how such changes will impact its business.

Conclusion

The Reform of the Civil Code (especially the rule changes) will inevitably require companies to revise their contracts to comply with and/or adjust to the new rules, which may be time consuming. As the Working Group has not shown the clear direction of reforms on some key topics, it will be important to continue monitoring the Working Group's discussions in the future.

Where Japanese legal concepts have been expressed in English, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

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