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## Overhaul of Japanese Civil Code

Amendments to the Civil Code (hereinafter, Amendment) passed the Japanese Diet, and were promulgated on June 2, 2017.

The Civil Code of Japan (Law No. 89 of 1896 as amended, hereinafter, the Code) was originally enacted in 1896. It is the very basic law governing civil and business activities in Japan. The Code has been reviewed and partly amended as necessary from time to time, but most provisions of the Code have remained unchanged since its enactment, except for the overhaul of Part IV (family law), implemented in 1948. During the past 120 years, the Japanese economy and society have developed far beyond what the Code originally envisioned. In the meantime, case law has supplemented the Code through interpretation of existing provisions and application to actual cases. Although Japan follows a statutory legal system, case law has persuasive authority and forms substantive rule of law in many areas not covered by the Code.

In the interest of stable application of statutes to cases and visibility of the rule of law for the public, an overhaul of the Code by amending relevant provisions has long been expected. The Amendment focuses on updating the provisions relating to contracts, claims, and obligations, and partly updates the general provisions. Other parts of the Code, such as tort, real rights, family, and wills, have not been touched by this Amendment.

Following is an overview of the Amendment's key features, which will be implemented in about two years.

## Key Features of the Amendment

The Amendment makes changes in the following two areas:

1. Updating provisions to reflect changes in social or economic circumstances; and
2. Incorporating unwritten rules and interpretations established by case law and prevailing business practices.

### Reflecting Changes in Social or Economic Circumstances

Japanese society and the economy have vastly changed through the growing volume of transactions, more complex and sophisticated transaction methods, the aging of society, and development in information and communications mediums. As the Code is the primary statute setting forth the fundamental rules for transactions, it is necessary to align the Code with such changes. Following are some examples of the updates included in the Amendment from this perspective:

#### Lowering the Statutory Interest Rate

The statutory interest rate, which is applied when an interest rate or late payment fee is not agreed upon in advance between the parties in a transaction, is currently fixed at five percent per year. Although it is much higher than the prevailing market rate of recent years, the Code does not have any adjustment mechanism.

The Amendment lowers the statutory interest rate to three percent per year and introduces a mechanism to review and adjust the statutory rate every three years as necessary.

#### Rules on Standard General Terms and Conditions

The Code currently does not have any provision on “general terms and conditions” (yakkan), which are generally used for mass-market agreements, such as insurance, public transportation, and mobile phone agreements. Such general terms and conditions are usually prepared by a service provider and applied to each agreement with individual users, while the contents of the terms and conditions are not explicitly discussed or agreed upon between the parties in advance. In contrast, the basic principle of the Code premises a mutual agreement between the parties to create a binding contract. The rules on general terms and conditions are not prescribed by the current Code despite the frequent use of the terms and conditions in practice.

The Amendment sets forth new provisions on “standard” general terms and conditions, which are applicable to standardized transactions. The new rule provides for (1) the definition of “standard general terms and conditions”; (2) the requirements by which each provision of the standard general terms and conditions is deemed agreed upon between the parties and incorporated into the agreement, even if a customer is not aware of each provision; (3) exemption from such deemed agreement; and (4) requirements for amendment of the agreement without obtaining individual consent from each customer by amending provisions in the standard general terms and conditions.

“Standard general terms and conditions” mean a set of rules prepared by a service provider to be the provisions of an agreement for “standardized transaction,” which the service provider conducts with many and unspecified customers to provide typical services. It must be reasonable for both parties that the whole or part of the service is standardized, for which it is natural to use the same set of rules for many customers in a uniform manner, and it is reasonable for the customers to accept such pre-fixed terms and

conditions without individual negotiation. For example, a “form” of a contract is generally not viewed as the standard general terms and conditions because such form is usually just a starting point of negotiation for further adjustment by the parties, unless such form is reasonably expected to be used for a standard transaction without any amendments.

Any provision that harms customers one-sidedly against the principle of good faith and fair dealing, in light of the type and nature of the transaction or the prevailing market practice, is excluded from the deemed agreement, i.e., such provision does not form part of the agreement.

#### Requiring Notarization for Individual Business Loan Guaranties

Under the current Code, an individual may enter into a guaranty agreement with a creditor if the agreement is made in writing. With respect to loans for small to medium-sized enterprises (SMEs), a relative or friend of the business owner is often requested to be a guarantor. It is problematic that such relative or friend tends to enter into a guaranty agreement for a business loan without careful consideration of the potentially severe consequences and associated risks because, when the debtor of the loan defaults, this type of guaranty sometimes results in subsequent bankruptcy of the guarantor.

The Amendment requires confirmation of the contents of the guaranty agreement by a notary public when an individual (except for the business owner, directors, or executive officers or co-owner of the principal debtor) guarantees a business loan in order to minimize the risk of an unexpected outcome, such as bankruptcy or other financial difficulties of an individual.

#### Unifying Terms for Statutes of Limitations

The statute of limitations for a claim under the Code currently varies depending on the type of claim. For example, the statute of limitations of a claim is generally 10 years. However, there are several exceptions on the length, such as one to three years for certain types of claims. Such shorter terms for exempted claims do not necessarily have a rational explanation and do not represent actual transaction practices.

The Amendment abolishes such classification and shorter terms, and adopts five years as the basic statute of limitations term for claims.

#### **Incorporating Unwritten Rules and Interpretations**

There are several matters that the Code does not address, while certain rules are formed through case law or generally accepted practices. The following examples of new provisions under the Amendment make such unwritten rules known to the public.

1. A claim that is expected to accrue in the future may be assigned or collateralized;
2. Any legal acts conducted by a person without sufficient mental capacity due to, for example, severe dementia or other grounds are null and void; and
3. A security deposit for leased premises must be returned to the tenant at the end of the lease after deducting any unpaid rent, i.e., the tenant is not responsible for wear and tear or aging degradation of the leased property.

## Schedule

The Amendment will be implemented within three years after promulgation and is expected to go into effect in 2020.

## End Note

The purpose of this GT Alert is to provide a general overview of the Amendment by raising a limited number of examples. It is not intended as a comprehensive and detailed analysis of all provisions included in the Amendment. Therefore, if you would like additional information on the Amendment that may affect your business with a Japanese entity or your business in Japan, please contact your Greenberg Traurig attorney.

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