Fact Sheet
Credit Management in Japan

Nakagawa & Yamakawa Law Office

Commercial Department
Royal Danish Embassy, Tokyo

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Introduction

This Fact Sheet provides an overview on the specific subject of credit management in the jurisdiction of Japan.

We will deal with basics on the subject especially from the aspects of applicable laws and regulations, judicial proceedings, and usual business practices. We hope readers will find it a useful lead to start further research necessary for their own business needs.

Kindly note that this Fact Sheet is intended as a general overview and discussion of what credit management is typically like in Japan. The information provided here was accurate as of May 2018, however, the law may have changed since this date. This Fact Sheet is not intended to be, and should not be used as, a substitute for taking legal advice in any situation. It is not possible to provide comprehensive advice on the matters that may apply in your particular circumstances. We therefore recommend that you seek legal advice with counsel before taking any further action.

Should you have any queries regarding the matters dealt with in this Fact Sheet, please do not hesitate to contact us. We would welcome any question as we are committed to readily supporting your business in the Japanese market.

1. How to obtain information on Your (Potential) Japanese Business Partners

Concerning credit management, you may want to start with collecting accurate information about your Japanese partners or debtors. Usually, Japanese businesses are registered and run as a stock corporation known as *Kabushiki Kaisha (K.K.)*. It is a commonly used company form permitted under the Companies Act of Japan.

Commercial Register	In the jurisdiction of Japan, companies are registered pursuant to the Commercial Registration Act with the Commercial Registry in the Legal Affairs Bureau. You can obtain a certificate of the commercial register of your partner or debtor companies by making an application at your closest registration office. As for the print edition of the certificate of the registered matters, they charge JPY 600 per copy, in principle. Details of the registered matter of a *K.K.* include: • Name of corporation; • Head office address; • Registered number; • Date of incorporation; • Branch office(s) if any; • Stock of shares; • Paid-in capital; and • The company's director(s) and other officers.

	Please note, however, that the information from this official source is available only in the Japanese language. Translation may be necessary.

Financial Status	It is mandatory for a *K.K.* to publicize its balance sheet, or at least the summary thereof, without delay after the conclusion of the ordinary general assembly of shareholders every business year. The balance sheet may provide you with the most basic information on the financial status of your debtor. There are three (3) ways of the public notice: 1. The official gazette; 2. The daily newspaper; and/or 3. The online publication. Each *K.K.* chooses the method of public notice and the choice is registered with the commercial registry. This means you can check up on the certificate of the registered matters available from the legal affairs bureau.

The above is related to the official sources. You may also find further information through company websites or by engaging credit status investigation services providers to know more of your business counterparts.

2. How to Start Business with Japanese parties

Foreign businesses who wish to enter the Japanese market often choose to appoint distributors or sales agents to provide their goods and services to customers and users in Japan.

Traditionally, Japanese businesses tend to be less willing to enter into a written contract with detailed provisions than in most other countries. Nonetheless, to avoid any misunderstanding or possible dispute, the conventional wisdom is applicable also in Japan; it is generally beneficial to set out terms and conditions in writing.

Many foreign businesses come to realize that there may be gaps between them and their Japanese counterparts in terms of perceptions or ways of thinking in the course of contract negotiation – even on basic issues. Where there may be language barriers, it is beneficial to settle agreed terms in writing so that both parties' understanding of the matters are clear and any misunderstandings clarified.

3. How to Protect Your Interests in Your Contracts

Below, we will deal with selected topics concerning how you may protect your interests, more specifically, your pecuniary receivables from your Japanese business counterparts.

To execute a legally binding contract, save in exceptional cases, it is not mandatory to use a stamp or chop to seal the contract document, though Japanese businesses customarily use their stamps, affixing the seal impressions to effectuate their agreements. As per Paragraph 4 of Article 228 of the Civil Procedure Act, a document except for ones drawn up by the public authorities shall be presumed to be true and correct reflection of a person's genuine intent, if the person affixes either of his/her signature or seal impression with the documents. Thus, your signed contract will in principle be treated equally as the one affixed with a relevant seal impression.

Setting forth proper payment conditions	We believe that there is nothing special or unique to the Japanese market in respect of the importance of setting forth proper conditions of your payment. Payment due date is one of such contractual terms that you may see in virtually every sales or services contract. If you intend to conclude sales or distribution agreements, other typical payment conditions that may be mentioned include the delivery of trade related documents, notably the shipping documents such as a bill of lading.

Choice of payment methods	Whether domestic or cross-border, most transactions of selling goods or providing services are paid by way of telegraphic transfer into a designated bank account. Particularly in cases of international trades, please be sure to

	set out the currency for your payments, and other details relating to applicable exchange rates as the need be. If the governing law of your transactions is the Japanese laws, the general principle is that costs arising out of payment including bank telegraphic transfer fees shall be borne by the party who is liable to pay unless otherwise agreed upon in your contract. When it comes to cross border sales, from time to time you may not be certain if your purchaser maintains sufficient solvency margin to make its promised payment. In such cases, it is common in Japan to require your purchaser to use payment methods other than cash to secure your collection. Letters of Credit are generally regarded as ways of assuring your payments if they are issued by any of the commercial banks operating in Japan. If you allow your purchaser to pay the purchase price for your products or articles by check, it is common and safe to ensure that the check is issued by a bank whose credit status is sound and solid, with the bank itself being designated as the payer of the amount shown thereon.

Title Reservation	A typical way of protecting sellers' business interests with a view to collecting accounts receivable from other parties is by incorporating a reservation of title provision in your contract.

	A reservation of title provision is a clause that reserves the seller's title to the goods until those goods are fully paid. It imposes a duty of care in respect of the goods on the buyer and purports to entitle the seller to retrieve the sold goods in the buyer's possession and to recover any unpaid amounts should the buyer become in default of payment. Many sales contracts contain such title reservation clause. However, it is often the case with the seller that it turns out to be practically difficult to recover its delinquent accounts by enforcing the reserved title to the sold goods. This is primarily because the sold goods are no longer within the seller's control and it is unlikely that the buyer would allow the seller to collect or otherwise dispose of them. Preplanning is important if you wish to make the most of your reserved title and collect your debt successfully.

Suspension of Supply Termination of Contract	There are some indirect mechanisms, which are widely employed in sales or distribution contracts with a view to assuring the collection of the vendors' receivables. First, it may be worth incorporating a right to suspend your supply. Under the laws of Japan, once you accept purchase orders and agree to deliver your products according to respective delivery due dates, you will continuously be

	bound by the obligation to deliver these orders pursuant to the delivery dates even if the purchaser may become delinquent for any part of the payments or show a sign of non-payment. To be released from due delivery, you need to have incorporated a provision that enables you to suspend your supply despite any ordered deliveries in cases where the purchaser likely fails to pay. Secondly, it may be worth incorporating a right to terminate your contract to help ensure due performance on the part of your counterparty. At present, there are no legislative act specifically designed to directly regulate and limit your contractual right to terminate your distribution or sales agent contract or agreement. However, the general tendency of Japanese courts' rulings is to protect business interests of distributors and sales agents whose businesses largely depend on your supply. If not careful, exercising your termination right may be invalidated or denied. This could particularly happen in cases where your distributor or sales agent may have a reasonable expectation for their existing business with you to continue. To ensure that you may terminate your contract without hindrance under the laws of Japan, the pertinent part of your contract should be written with care so that it explicitly states that the contract will expire at a certain point in time, and may be terminated in the event of certain termination

	causes. The key consideration is that the terms of your contract should not allow the other party to reasonably expect that the contract will continue on and on or will always be renewed as a matter of course.

Liquidated Damages for Payment Delinquency	One of the important elements to prompt your counterparty to make necessary payments to you on or before the payment due dates without delay is liquidated damages imposed on the payment delinquency. The higher the amount of this pecuniary sanction is arranged, the more likely your Japanese distributors or sales agents will be urged to meet the deadlines, if they rationally calculate the sum they may be charged as a result of their delayed payment. To determine the amount of the liquidated damaged for delayed payment, the Japanese laws provide a certain prescribed rate per annum at which the damages shall accrue on the unpaid amount for the duration of the delay in question. Previously, the rate applicable to the payment arising out of commercial transactions used to be a fixed rate of six percent (6%) per annum under the Commercial Code, whilst other payment liabilities were governed by another fixed rate of five percent (5%) per annum under the Civil Code. The latest Civil Code reform has made a change to these

	rates, however. After the legislative change, Japan will have a floating rate subject to adjustment on a yearly basis. For the initial year of the newly introduced legislation, it is going to be three percent (3%) per annum. This rate will be applied indiscriminately regardless of the nature of payments. The new law has already been promulgated in June 2017, but has yet been effectuated as of May 2018 in regard to calculation of the applicable rate. Please note that the rates explained above are to set the standard for damages arising out of delayed payments. It is not only permissible but also widely seen to set by mutual agreement of contractual parties any higher rates for calculation of damages, for instance ten percent (10%) per annum. Not to mention, your contract may contain other schemes of liquidated damages such as a lump sum payment type of indemnity. The legal limitation on how you may stipulate liquidated damages in your contract is defined by a doctrine established by previous court rulings. The Japanese courts have made it clear that your entitlement to liquidated damages shall be denied to the extent that the amount of damages may be deemed excessive. The rationale of the denial of your entitlement is that such an excessive penalty amount should be against the public policy.

Personal Guarantee	In connection with obtaining personal guarantee to assure your collection of receivables, the joint surety and the bank guarantee are probably most classic means coming to your mind. Of these two (2) means, we will briefly touch on the joint surety for your information. You may establish the joint surety by causing a person other than the party who may actually or potentially owe a liability to you to execute an agreement in writing which sets forth to the effect that the person shall be jointly and severally liable for any and all liabilities of the principal party. Usually, for the joint surety of your counterparty, you may wish to choose somebody from effective owners or beneficiaries of the party in cases where it is a mid- or small-sized business enterprise, or from the party's parent company if it is one of the subsidiaries belonging to a large corporate group controlled under a holding company. The caveat to which your attention should be drawn in obtaining the surety is about formalities of surety agreement required by the law. As hinted above, no agreement creating the surety's liability shall be effective and in force if it is not made in writing. In addition to that, the latest Civil Code reform in June 2017 introduced a set of fresh stipulations which will regulate the scope of liability which the surety may bear and, notably, how the surety agreement shall be executed. The regulations are restrictive especially in case of

	a natural person undertaking the revolving guarantee, that is, a guarantee covering a certain specific scope of obligations without identifying each of them. In such case, after the newly introduced laws take effect and come into force, you may be required to execute the surety agreement with the notary public involved as so laid down in the revised code. If you see a possibility to obtain a personal guarantee, it would be beneficial and prudent to seek advice from your lawyer for further details of the regulations in advance before negotiating with your counterparts.

Statutory Liens	Like many other major jurisdictions, the Japanese laws provide for several sorts of statutory liens. One example is the statutory lien over movables sold by you, to which you are entitled as the seller of them. As this is a statutory grant for the seller of goods or other tangible movable assets, you do not need to make any agreement in your contract to be entitled to the pertinent statutory lien. The problem lies within the practicality in the phase of the enforcement of such statutory liens. To effectively exercise your liens granted over your sold goods, you must be able to identify them in the storage of your purchaser's warehouse, discerning them from other unrelated articles, and file an application before the competent court for attachment.

	Considering costs to be incurred in relation to monitoring and tracing the whereabouts of your sold goods after the sales, and for implementation of necessary court procedures, statutory liens are mostly viewed as an inefficient way of pursuing the collection of your receivables. At least we could say that meticulous pre-planning is essential to create a workable scheme of recovering your unpaid amounts through statutory liens.

Dispute Resolution Clause	It is meaningful to discuss pros and cons of dispute resolutions before Japanese courts, and of those by arbitration in comparison. First, the Japanese judiciary as a whole has a high degree of judicial integrity. Judges of Japanese courts adhere to the fundamental principle of maintaining the neutral viewpoint, and try to treat both sides of litigants in an unbiased manner. We believe you could count the Japanese courts as one of the reliable options for dispute resolution. Second, the Japanese court proceedings are relatively quick and smooth as compared to those in other jurisdictions of the major advanced countries and regions including the United States. Third, except for criminal felony cases or non-adjudicative civil proceedings such as mediation, the Japanese court proceedings do not adopt a jury system, or even involve any

	layperson as a member of the tribunal. All court adjudications are to be rendered by properly-trained career judges, and in Japan you do not have to be worried about the level of uncertainty or arbitrariness which you may have for court decisions in other jurisdictions where there is a jury system. Fourth, the demerit for Danish businesses to select a court of Japan as a dispute resolution forum is that the language used in the proceedings shall all be Japanese. Translation will be required and it is recommendable to have a skilled translator to assist you in developing your litigation strategy. In contrast to the court proceedings as discussed above, in arbitration, you may be able to use non-Japanese languages including English, if you and your counterparty consent thereto in the arbitration agreement. As is often said, flexibility in terms of procedural matters is an appealing point for choosing arbitration. In Japan, arbitration has not been used much. The country does not boast a track record of arbitration, and statistics show that the number of commercial arbitration cases filed is low but trending upward recently. Although the change may only be gradual, we expect some increase of businesses choosing commercial arbitration in Japan.

Governing Law	It is understandable that you wish your home country's law

	to be the governing law of your transactions. Familiarity is certainly one of the important factors in selecting the applicable laws to reduce the risk of uncertainty involving your business conducts. Consider for a moment where your business in Japan is successful and begins to expand its scale, and you have multiple local partners and other business connections. The business management may become more complicated for you by then, and you may want to consult with attorneys-at-law admitted in Japan for advice on local matters including contracts you have entered into with your partners. It may turn out to be troublesome and difficult to find a lawyer who is able to readily provide you with the legal advice you may need, if the governing law of your contracts are designated to be those not familiar to the lawyer, for example, the laws of the Kingdom of Denmark. Selecting the Japanese laws as the governing law for your business dealings in Japan is thus an option, which is worth thinking about in view that it could be that you are more likely to obtain advice from local lawyers more smoothly than otherwise. It may be even helpful in saving legal costs for your business in Japan.

4. In Case of Non-Payment

We will below provide you with a brief sketch of steps you may take to address circumstances where you unfortunately do not receive your payment even if payment due date arrives.

Demand Notice / Warning Letter	It is not a common practice in Japan to immediately engage with a defaulting party through court proceedings or alternative dispute resolution mechanisms such as arbitration. In the event that your Japanese counterparty fails to perform its obligation, in most cases, you may wish to first draw up and send a notice in writing, prompting the due performance of its obligation. Usually, such notice includes terms to warn the recipient of potential further measures to be taken if the breach is not cured within a period, which you may set out and designate in the notice. Your warning would send a stronger message and should expectedly be more effective if the notice is given through an attorney-at-law qualified to practice in Japan acting for and on behalf of you, or through the Commercial Department at the Royal Danish Embassy in Tokyo. Often a payment demand notice is sent by mail in the form of the contents-certified mail. This is a mailing services provided by the Japan Post by which you can track the delivery status online and have certified the contents of what

	you have written. The record of the delivered message of the contents-certified mail is available from the Japan Post, and you may use it as evidence later in the event of litigation or arbitration. As for legal services fees and costs for the mailing services, please consult with your attorney-at-law beforehand. In cases where you request the Commercial Department at the Embassy in Tokyo to issue a demand notice for you, the Department normally works on a time-charge basis and the cost you may incur depends on the actual time spent.

Provisional Attachment / Other Interim Measures	In some cases, especially when the other side of the parties to your contract is at the brink of insolvency, time may not permit you to wait for such other party's voluntary action to make due payment, because it is at risk of losing its financial capacity to fulfill the outstanding liability to you. To preserve and secure the collection you are entitled to, you would need to resort to immediate actions through the competent court. A provisional attachment is a preservative, interim measure for protection that you may rely on to temporarily freeze assets belonging to the property of a party who is liable to pay to you. If your provisional attachment is successful, you will be able to recover the unpaid amount in priority from the assets under the provisional attachment after, and on the

	condition that you are eventually determined entitled to the payment. If you have the right to require the other party to deliver goods or services or to render some specific performance, there are various types of interim measures for protection, collectively referred to as the provisional disposition, available under the Civil Preservation Act of Japan. For instance, if you intend to claim the title and ownership to a residence in possession of your counterparty and you see an imminent risk of such residence to be sold to or otherwise be disposed of in favor of a third party, you may choose to file an application for the provisional disposition for the prevention of transfer.

Mediation	Before filing a lawsuit, it may be beneficial to consider trying a less confrontational approach to facilitate dialogue with your counterparty, with a view to reaching an amicable resolution for your dispute. The mediation is one of the options you may like to choose. In fact, though it depends on cases of course, the mediation administered by the Commercial Department of the Embassy in Tokyo often turns out to be helpful to make a meaningful progress to finding a solution for your dispute with your Japanese counterparts. With the involvement of an experienced mediator from the Department, the process

	often works positively, if not always entirely successfully in favor of you. The courts of Japan also provide the mediation procedure. The appealing point of this is that once you successfully reach a settlement with the other party, the agreed terms of the settlement as kept in court record will be given the legal effect substantially equivalent to that of a final, binding court judgment.

Civil Lawsuit	The Japanese civil litigation system is in principle composed of three instances: you file your complaint before the competent District Court, and elevate the case to the High Court in the event of appeal, and to the Supreme Court if the final appeal is sought. The Supreme Court is the highest judicial body of Japan, and it accepts only limited matters as prescribed in the Civil Procedure Act such as matters raising a constitutional challenge and matters involving a court ruling *a quo* contradictory to the established Supreme Court precedents.

Attorneys' Fees for Legal Proceedings	Under the laws of Japan, except for cases where the claim of your damages derive from a tort, there is no rule or principle that the prevailing party is entitled to be compensated for costs relating to its attorneys' fees by the losing side. This means that, regardless of whether the result of your lawsuit is favorable to you or not, you need to bear your own

	attorneys' fees incurred in pursuit of your claim in most situations of your debt collection. Court orders of a judgment include those pertaining to "litigation costs" determining who shall bear same, but the costs as referred to in the orders mean: filing charges of the complaint; postage for service; travel allowance for a witness; and such other procedural related ones. Attorneys' fees are out of scope as such.

5. Compulsory Civil Execution

Below, we will briefly explain compulsory measures to collect your unpaid amount of credit through court civil execution procedures in the jurisdiction of Japan.

To apply for the compulsory civil execution, it is necessary to obtain a proper enforceable title of obligation. The most typical format of enforceable titles of obligation is the authenticated copy of the final and binding judgment of court. The authenticated copy of the record of settlement before court is another example of enforceable titles of obligation.

In order to materialize your rights and interests, you will file the application for the civil execution with the execution court whose jurisdiction may extend to the asset from which you intend to collect your unpaid amount. For instance, if you

aim at a land lot as the target for seizure, the competent court will be the District Court whose territorial jurisdiction covers the location of the land.

Assets often targeted for the attachment are, to name a few, immovables such as land lots and buildings, valuable movables such as automotive and factory equipment. Other targeted assets are the defaulting party's credits or accounts receivable from a third party, for instance a deposit of funds in a bank account and monthly paid salary from employers.

In case of immovables, the standard way of civil execution is the compulsory auction, where the execution court will arrange that the attached real estate items be sold through a public auction. The court will grant permission of sale to the highest bidder on each item and the sales proceeds paid will go to the recovery of your unpaid accounts.

As for movable assets, setting aside some exceptions including registrable assets in particular automobiles, the first step for implementing the civil execution is to obtain the possession of the assets. Therefore, the target assets must be located and identified as such, so that the court execution officer may visit the location and physically take control of the assets.

With respect to credits and accounts receivable, as they are intangible and not visible, it is often the case that it is necessary to investigate whether or not there actually exist such credits or accounts receivable in the first place, and how you can identify them as the subject of attachment if any such potential asset may

exist.

One way of searching this category of assets is to make an inquiry to banks to confirm whether they have bank accounts under the name of the obligor or not. The obstacle is that banks operating in Japan are protective about their clients' information and it is unlikely that they will disclose the bank account details in any way. However, if you have obtained the enforceable title of obligation and the bank is requested by your Japanese counsel through a formal process called the bar association's inquiry to disclose such information, it may be possible. The bar association's inquiry is a privilege and only available for attorneys-at-law, so please consult with your lawyer if the need may arise.

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Contacts for further information and questions:

Hiromitsu YAMAKAWA
Takunori YAMAMOTO
Attorneys-at-Law
Nakagawa & Yamakawa Law Office

Thomas Højlund CHRISTENSEN
Head of Commercial Department
Royal Danish Embassy, Tokyo