

Private Law Aspects of the New Bill on Electronically Registered Claims

A bill seeking to create a new type of monetary claim that can electronically accrue or be transferred is scheduled to be submitted to the Diet sometime this year. This new type of claim is expected to be used as an alternative to nominative claims and bills.



By **Nobuyoshi Inujima**
Nagashima Ohno & Tsunematsu

The creation of an electronically registered claim (ERC), which seeks to create a new type of monetary claim that can electronically accrue or be transferred, has recently been under discussion. The Legislative Council of the Ministry of Justice released the "Interim Draft Proposal regarding the ERC System" in August 2006. Consequently, based on public comment on the draft proposal, the Legislative Council released the "Outline Regarding the Private Law Aspects of the ERC System" in February 2007. The Legislative Council and the Financial Services Agency are now preparing the proposed legislation with the aim of having it approved during an ordinary Diet session this year. Although the proposed legislation has not been released, the ERC has received a lot of attention as a possible new means of funding and settling company accounts.

Definition and advantages of the ERC

The Interim Draft Proposal introduced the concept of the ERC, describing it as (i) a monetary claim that is separate from the claim that accrues directly from the legal relations, (ii) a claim that cannot accrue or be transferred, despite the intentions of the relevant parties, unless it is registered with an administrative organization, and (iii) a claim other than the existing types of claims such as nominative claims or bills. Under the Outline, the ERC is defined as a monetary claim that has to be registered to accrue.

The reason for creating the ERC is that both nominative claims and

bills have, by their nature, some drawbacks. For example, with bills there is the cost of printing and storage as well as the risk of loss or theft. Thus, while bills have been widely used in Japan for financing, the drawbacks have led to a recent decline in their use. With respect to nominative claims, they are not represented by written instruments and rules regarding the protection of *bona fide* purchasers and a cutoff of personal defences to promote a transfer of claims are not available. Therefore, in acquiring nominative claims, the existence, content and attribution of the claims must be carefully examined, at some cost.

As is clear from the above, the ERC will accrue or be transferred through electronic registration and a written instrument, such as a bill, is not necessary. Therefore, the cost and risk arising from the use of a written instrument is eliminated and, with a centralized registry, it will be easier to check for the existence, content and attribution of the claim. Also, as

the ERC is separate from the claim that accrues directly from the causal legal relations, and because the defences that may arise from such causal legal relations are personal defences, in principal, the obligor cannot claim this defence against the assignee of an ERC. Furthermore, *bona fide* purchasers are protected under the ERC system. Because of these features, we may say that the ERC has high liquidity.

As stated above, as the ERC is a new type of claim that will make it possible to avoid the drawbacks of nominative claims and bills, users may choose the claim best suited to their needs (i.e., nominative claims, bills or ERCs).

Characteristics of the ERC

(i) General

The accrual and transfer of an ERC will be effective upon registration. There has been debate as to whether (i) an application for such registration may be made only by the obligor (or assignee) or must be made also by the creditor (or assignor), and (ii) whether there must be an agreement between the obligor (or assignee) and the creditor (or assignor) in addition to an application for registration. In the Interim Draft Proposal, all four combinations of these two factors, described in the table below, were submitted as possible plans.

This has been one of the most-watched issues. Those who plan to use the ERC mainly as an alternative to bills insist that ERCs should

Guidelines for Submitting Applications		
	(i) Who should submit the application for registration?	(ii) Is an agreement necessary, in addition to an application?
Plan A-1	Both the creditor (or assignor) and the obligor (or assignee).	Yes.
Plan A-2	Both the creditor (or assignor) and the obligor (or assignee).	Yes, but an application doubles as an agreement.
Plan B-1	Both the creditor (or assignor) and the obligor (or assignee).	No.
Plan B-2	Either the creditor (or assignor) or the obligor (or assignee).	No.

be accrued easily only by obligors (or assignees) without any action of creditors (or assignors). However, this view has been criticized because, without any action by the creditors (or assignors), there is a risk that obligors (or assignees) will register the payment conditions or defenses that are favourable to them. After discussion, the Outline (i) required both obligors (or assignees) and creditors (or assignors) to apply for registration and (ii) did not require an agreement between them in addition to an application for registration.

(ii) Accrual of the ERC

As stated above, as registration is necessary for the accrual of an ERC, an application for registration is required. The important thing to note with this application is that the matters that may be registered are not limited as strictly as those that may be included in bills. Therefore, it is possible to register a broad range of matters, both in content and in volume, as long as such registration follows the operating rules of the administrative organization.

The purpose of this flexibility is to make the ERC available for syndicate loans or housing loans, which usually have many atypical clauses such as those regarding the rate-setting method, payment method, event of default, covenants, etc.

This flexible treatment is welcome news, as under the book-entry transfer system for bonds, whose purpose is to make paperless transactions possible, the matters that can be registered are limited, and it is not clear how bonds with many atypical clauses are to be handled.

(iii) Registered guarantee

Under the Outline, the registered guarantee is defined as a guarantee of the obligations regarding the ERC and has to be registered to accrue.

It is an important aspect of the ERC system that the registered guarantee is independent of the guaranteed obligation. Even if the registered obligor of the registered guarantee does not assume such obligation because of the nullity or rescission of the application

for registration, the registered guarantee will not be affected. The reason why this independence is adopted for registered guarantees is because those who purchase a guaranteed ERC usually rely on the credibility of the guarantor. Thus, in order to improve the security of transactions, the registered guarantee should be valid regardless of the validity of the guaranteed obligation. In this respect, the registered guarantee is very different from the normal guarantee provided under the *Civil Law*, which is affected by the effectiveness of the guaranteed obligation. However, this independence under the ERC system does not apply to retail consumer guarantees because of the overriding public policy of consumer protection.

(iv) Transfer of the ERC

(a) Cutoff of Personal Defence. As a general principle, a cutoff of personal defence is applied to ERCs to improve the security of transactions. However, the Interim Draft Proposal contained two possible exceptions to this general principle. The first proposed exception (Plan A), which was based on the bill system, allowed the obligor to raise personal defences against the assignee when the assignee received the ERC knowing that the transfer would harm the obligor. The second proposed exception (Plan B) allowed the obligor to raise personal defences against the assignee only when such defenses are registered, whether or not the assignee knew that the transfer would harm the obligor.

Plan B has merit for the assignee because the scope of the personal defences that may be raised by the obligor would be clear from the register. On the other hand, it has been pointed out that the obligor might register any and all matters in the fear that he may not be able to raise personal defences even against an assignee who knows that the transfer of the ERC would harm the obligor. After this discussion, the Outline adopted Plan A.

(b) Protection of Bona Fide Purchasers. The registered creditor is deemed to have valid rights under the ERC. Therefore, those who purchase an ERC, having trusted such registration, should be protected from the viewpoint of the transaction's security. Those who are registered as an assignee of an ERC may acquire such ERC unless the party knows that the assignor had no rights under the ERC or was ignorant of such fact through gross negligence under the ERC system's *bona fide* purchaser rule.

(c) Special Treatment for Retail Consumers. If the obligor of an ERC is a retail consumer, rules regarding the cutoff of personal defences are not applied and, if the assignor of an ERC is a retail consumer, rules regarding the protection of *bona fide* purchasers are not applied. This is to avoid putting retail consumers in a disadvantageous position compared to their treatment with respect to nominative claims.

(v) Extinction of an ERC

(a) *Treatment as Valid Payment.* Payment to the registered creditor of an ERC (who does not have the right to receive such payment) will be treated as valid, unless those who paid know such registered creditor has no right to receive payment or are ignorant of such fact through gross negligence.

(b) *Registration of Payment.* When payment is made with respect to an ERC, the registration of such payment may be made in order to avoid duplicate payments, but such registration is not a precondition for the extinction of an ERC. Some might argue that an ERC should not be extinguished unless a registration of payment is made. However, adopting this position would allow the creditor to demand payment, despite such payment having already been made, simply because the registration was not made. If the registration is not completed, the fact that such payment was made would not be treated as a material defence, but a personal defence. Therefore, it would not be a threat to the security of the transaction.

It is a general principle that the registration of payment has to be made by the creditor who receives payment, but with the consent of all creditors, the obligor could make such registration. Also, in order to make the registration of payment and payment at the same time, those who make the payment may request the creditor to give consent to making such registration against payment.

About the author

Nobuyoshi Inujima is a partner at Nagashima Ohno & Tsunematsu specializing in financial transactions involving structured finance, asset finance and syndicated loans. He graduated with an LL.B. from the University of Tokyo (1996) and with an LL.M. from Duke University School of Law (2003). He is admitted to practice law in Japan (1998) and in New York (2004). Mr. Inujima worked at Debevoise & Plimpton in New York as a foreign associate from 2003 to 2004. He can be reached at nobuyoshi_inujima@noandt.com.

NAGASHIMA OHNO & TSUNEMATSU

A Leading Law Firm in Japan

Areas of Practice:

- Administrative Law and Regulation
- Antitrust
- Arbitration and Dispute Resolution
- Asset Acquisition
- Banking
- Bankruptcy and Dissolution
- Capital Market Transactions
- Civil
- Commercial
- Communications and Media
- Corporate
- Corporate Reorganization
- Debt Issues
- Employment and Pension
- Entertainment
- Finance
- Franchises and Distributorships
- Information Technology
- Insurance
- Intellectual Property
- International Finance
- International Law
- Investment Trusts
- Joint Ventures
- Leasing
- Lending
- Licensing
- Mergers and Acquisitions
- Pharmaceuticals
- Product Liability
- Quasi-Judicial Proceedings
- Real Estate and Development
- Securities and Derivatives
- Securities Transactions
- Securitizations
- Tax
- Telecommunications
- Trade Regulation

Year Established: 2000

Number of Lawyers: 259 (as of February 1, 2007)

Languages Spoken: Japanese, English, Chinese, French and German

Contact Persons: Hisashi Hara, (Ms) Yuko Tamai (Dai-ichi-Tokyo Bar Association)

Kioicho Building, 3-12, Kioicho
Chiyoda-ku, Tokyo 102-0094, Japan

Tel: +81 3 3288 7000

Fax: +81 3 5213 7800

Web: <http://www.noandt.com/>

Email: info@noandt.com