Contract Law Reform in Japan and the UNIDROIT Principles

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I. – REFORM OF THE JAPANESE CIVIL CODE: HOW IT STARTED

1. The present situation

In October 2009, the Minister of Justice consulted the Legislative Council, an advisory body to the Minister of Justice, about revising that part of the Civil Code pertaining to the law of obligations, with a particular focus on the subject of contracts.

In its Consultation No. 88, the Minister of Justice noted that, in view of the need to respond to the social and economic changes that had taken place since the enactment of the Civil Code and in order to make the law easier for the public to understand, the provisions of the Law of Obligations in the Civil Code, being the basic private law code, stood in need of revision, with particular emphasis on the provisions governing contracts since these were intimately relevant to the daily lives and economic activities of the people. The Minister of Justice accordingly requested the Legislative Council to present a basic policy for reform.

A Working Group on the Civil Code (Law of Obligations) was accordingly established in November 2009, and work on reforming the Japanese contract law has been progressing ever since. This will be the first drastic revision since the Civil Code was enacted in 1898, an interval of more than 110 years. The deliberation process is being made public on the Ministry of Justice's English-language website.[1]

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1 <http://www.moj.go.jp/ENGLISH/ccr/CCR_00001.html>.

In this paper, I would like to introduce the current status of the reform project, paying special attention to the role played by the UNIDROIT Principles of International Commercial Contracts (hereinafter: the UNIDROIT Principles.

2. A brief history of the Japanese Civil Code

First, it may be useful briefly to sketch the history of the Japanese Civil Code (hereinafter: "JCC") as background to the discussion thereafter.

After Japan opened up to the outside world in 1868, the new Government's first political priority was to abrogate the unequal treaties signed by the Tokugawa Shogunate in the 1850s under pressure from the Western powers. These insisted on the introduction of a Western-style legal system as a prerequisite for revising the treaties. In order to promote prompt codification of the basic laws, French Professor Gustave Emile Boissonade, among others, was commissioned by the new Government to draft both the Civil Code and the Penal Code. Professor Boissonade spent ten years drafting a Civil Code, which was finally promulgated in 1890, being basically a Japanese translation of the "Boissonade Draft". However, the fledgling Code met with fierce opposition and its enforcement was eventually suspended. While this dispute was later compared to the dispute between Anton Friedrich Justus Thibaut and Friedrich Carl von Savigny in Germany by Nobushige Hozumi, one of the drafters of the JCC, the cultural and political context was not the same. However, the disputes had something in common to the extent that they represented a form of emotional resistance to the imposition of a French-style code on a heterogeneous culture.

After a law was enacted to suspend enforcement of the Civil Code (now referred to as the "Old Civil Code") for a period of four years , three Japanese scholars were commissioned to revise the Old Civil Code. Two of these, Masaakira Tomii and Kenjiro Ume,[2] held a doctoral degree from Lyon University, while Nobushige Hozumi held the title of barrister at the Middle Temple in London. When they were appointed as drafters, Hozumi was thirty-seven years old, Tomii thirty-four, and Ume thirty-two. They were indeed the best and brightest in a youthful, modern Japan. Although two of them had studied law in France and one in England, they paid considerable attention to the development of the Civil Code in Unified Germany, work on drafting which had already started while they were still in Europe. Hozumi and Ume spent a

2 Kenjiro UME is the author of *De la transaction en droit romain et dans l'ancien droit français*, Paris (1889). The author's name was written as "Oumé Kendjirō" in the French version.

year in Berlin before returning to Japan. In fact, the first and the second drafts of the German Civil Code exerted a strong influence on the work of the three drafters, and as a result, the structure of the JCC was akin to the German Civil Code (to be precise, it was the same as the Civil Code of Saxony) and its provisions came almost half from Germany and half from France.

One of the main features of the JCC was that it contained only half the number of provisions of both the French and German Civil Codes, and the wording of each provision was often too simple to provide sufficient guidelines for adjudication. This was because, first, since Japan had been forced to introduce Western-style modern codes in some haste in order to bring about the revision of the unequal treaties, there was not enough time to discuss detailed rules. Second, while it was possible to import detailed rules from Europe, there was a risk that they might not have been suited to Japanese society. Third, it was not realistic to extract detailed rules from the customs of Japanese society since Japan was undergoing rapid change in pursuit of modernisation. The drafters therefore decided simply to set forth the basic principles, so that lawyers would be able to adapt them to the circumstances of Japanese society through flexible interpretation. This was indeed judicious drafting policy at that time.

However, such a simple Civil Code could not provide sufficient norms for adjudication. In order to fill the gaps, German legal doctrines, which were held in high esteem at the time, began to be imported extensively hard upon the enactment of the JCC, and they were systematically construed as interpretive theories of the provisions of the JCC. Hence, the curious situation arose where provisions originating in French law were interpreted using German legal doctrines. Voluminous judicial decisions adjudicated in a Japanese context but based on such imported provisions and doctrines accumulated over a century. In a sense, Japan became situated at a crossroads of comparative law.

3. Motives for reform

As mentioned in the Minister of Justice's Consultation No. 88, the major motives for reform are twofold.

The first motive is the modernisation of the contract law part of the JCC. For example, with respect to the prescription system that originates in French law, there is room for improvement, as was demonstrated by the 2008 reform of the French Civil Code. As to the system of the assignment of claims, which likewise has its origins in French law, modernisation is necessary to meet the contemporary demands of corporate finance. Moreover, the JCC does not

have the concept of a standard terms contract. Besides these major points, there are many other areas for which modernisation is required.

The second motive is to improve the Code's transparency. In the century or so since the Code came into force, a massive volume of case law has grown up around the texts of the Code, so that most of the relevant civil law rules are now found outside the Code. Hence calls to improve the transparency of the Code by incorporating established judicial precedents into the Code, *i.e.*, re-codification.

4. Legislative procedure of the Civil Code

The procedure for the current contract law revision involves neither the scholarly "*Gutachten*" as used in Germany, nor the commissioning of a draft from a specific scholar, as in the Dutch Civil Code revision. Instead, a common legislative procedure operates under the jurisdiction of the Ministry of Justice.

In the revision of the Civil Code in Japan, the Minister of Justice consults the Legislative Council, which is the Minister's advisory panel, and the Legislative Council submits an outline draft to the Minister of Justice upon concluding its deliberations. A bill is prepared along with the report by the Ministry of Justice for submission to the Diet by cabinet decision. Hence it is the Legislative Council of the Ministry of Justice that performs the most important role in the bill-making process. The consultation on the revision of the contract law took place on 28 October 2009.

The Legislative Council of the Ministry of Justice generally sets up a working group for each separate topic. For the contract law reform, a Working Group on the Civil Law (Law of Obligations) was established, consisting of over forty members: eighteen scholars, four attorneys from the Japan Federation of Bar Associations, four judges, three industry representatives, one representative from the Japanese Trade Union Confederation, one from a consumer organisation, one from the Cabinet Legislation Bureau, five from the Ministry of Justice, and several officials from the other Ministries concerned. With a body of this scale, consensus-building is not easy. Although, in principle, decisions are adopted by majority, the Council seeks to work as much as possible through consensus-building, aiming for unanimous decisions.

When the Ministry of Justice first announced it would be inquiring into the need for Civil Code reform in 2006, civil law scholars were quick to respond. Three groups voluntarily organised themselves and each started to draft a reform plan. All three groups later published their own proposals. The largest of these groups, made up of thirty-five leading professors of civil law,

commercial law and civil procedure law, was named the "Civil Code (Law of Obligations) Reform Commission" (hereinafter: the "Reform Commission"). After intensive deliberations over a period of two and a half years, the Reform Commission made public its draft, entitled the "Basic Reform Policy" (BRP), in April 2009, together with a detailed commentary for each proposal in five volumes totalling 2,438 pages. The BRP sparked lively debates on contract law reform among practising lawyers as well as business people.

The fact that a sweeping draft of such completeness, with detailed commentaries, was published at the initial stage of the reform process by a group of scholars had both positive and negative aspects. One positive aspect was that an ideal reform plan could be pursued by excluding political compromises and without pressure from interest groups. Among the negative aspects was that the drafters' prominent scholarly status gave the impression that the reform was being led by scholars, raising concerns among practising lawyers and in business circles that the reform might not reflect the demands of business in real life. Quite a few practitioners harboured negative feelings towards the reform without actually having looked at the scholars' plans in detail.

In fact, however, the Legislative Council's Working Group is not bound by any proposals previously presented by any scholars' groups, and it has been at pains to consider ideal reform plans freely and flexibly, giving due consideration to all the requests expressed and to existing proposals.

II. – THE IMPACT OF COMPARATIVE LAW AND THE UNIDROIT PRINCIPLES

One of the drafters of the JCC wrote that the JCC is the fruit of comparative law.[3] Indeed, the drafters took extensive note of the Civil Codes – or their drafts – of many countries including France, Germany (the first and second drafts), Prussia (ALR), Saxony, Austria (ABGB), the Netherlands, Italy, Portugal, Switzerland (OR), Graubünden, Thuringia, Montenegro, Spain, Belgium (Civil Code and its draft), the United Kingdom, India and the United States of America (New York (draft), California). Nevertheless, they mainly transplanted the French Civil Code and the first and second drafts of the German Civil Code into Japan. The current reform would show how French and German seeds planted in a Japanese garden took root and blossomed. It would be interesting in dynamic comparative law terms to focus on the diachronic transformation of civil law in Asia transplanted from Europe.

3 Nobushige HOZUMI, Lectures on the new Japanese Civil Code: as material for the study of comparative jurisprudence, Tokyo (1912).

As stated above, the main reason for the reform is the modernisation and improved transparency of the JCC. The UNIDROIT Principles provide models of modern contract law provisions and are a rich source of inspiration. On the other hand, there are some cases in which solutions other than those offered by the UNIDROIT Principles are intentionally being proposed in Japan. Although the legislative JCC reform process still has a long way to go, I would like to introduce some aspects of the current stage of deliberations.

1. Codification of case law

The first goal of the current reform is to incorporate established judicial precedent into the statutory provisions and to improve the transparency of the Code. Interestingly, the established rules in the case law produced in the course of resolving domestic conflicts in Japan often coincide with the results achieved by the comparative legal studies that are crystallised in the UNIDROIT Principles. This might suggest that contract law, suited to free economic activity, be it in the East or in the West, is converging.

For instance, the rule on "negotiation in bad faith" in Article 2.1.15 of the UNIDROIT Principles, the rule on "gross disparity" in Article 3.2.7(1) & (2), and the rule on "hardship" in Articles 6.2.2 and 6.2.3 are very close to the rules established by judicial precedent in Japan. While the business community has reacted negatively to these rules on the grounds of the risk of abuse, the fact that they have already been stipulated in the UNIDROIT Principles lends great force to the claim that these rules have universal relevance.

Besides these rules, there are others for which the JCC has no provisions, but which Japanese judicial precedent has established as case law, and for which the UNIDROIT Principles do have provisions; such as the rules on "force majeure" in Article 7.1.7(1) & (4), the rule on "repair and replacement of defective performance" in Article 7.2.3, the rule on the assignment of "future rights" in Article 9.1.5 and the rules on "plurality of obligees" in Article 11.2.1 *et seq*.

2. Clarification of the rules

The second goal of the reform is to clarify some of the more obscure rules in the Code. Here, the UNIDROIT Principles act as an indicator showing model rules that are the outcome of comparative legal study.

(1) In the area of the battle of forms, where the JCC provisions are interpreted as being premised on the so-called "last shot principle" in which the form sent at the very end prevails, this seems to lack clarity and the results

of the principle do not appear to be appropriate. Therefore, consideration is being given to a rule whereby a contract is presumed to be concluded on the basis of the agreed terms and of standard terms that are common in substance, as is stipulated in Article 2.1.22 of the UNIDROIT Principles.

(2) The categorisation of the concept of obligation by means of "*obligation des moyens*" and "*obligation de résultat*" is useful particularly in the context of the service contracts that are such a dominant feature of our modern society. As the JCC does not have sufficient provisions for service contracts, consideration is being given to provisions corresponding to Article 5.1.4 (Duty to achieve a specific result and Duty of best efforts) and Article 5.1.5 (Determination of kind of duty involved) of the UNIDROIT Principles.

(3) While the JCC has no provision on the anticipatory non-performance stipulated in Article 7.3.3 of the UNIDROIT Principles, judicial precedents have dealt with this problem flexibly by recognising frustration. However, the introduction of a corresponding provision is currently being examined.

(4) In addition, the transfer of obligations stipulated in Article 9.2.1 *et seq.*, and assignment of contracts stipulated in Article 9.3.1 *et seq*. of the UNIDROIT Principles are examples of provisions not laid down in the JCC, and consideration is being given to the introduction of such provisions, paying serious attention to the UNIDROIT Principles.

3. Modernisation

The third goal of the reform is to modernise the obsolete provisions in the JCC. The UNIDROIT Principles are referred to as an indicator of the models of modernisation achieved through comparative legal study. To quote some examples:

(1) Article 7.4.9(2) of the UNIDROIT Principles, which provides interest for failure to pay money, provides for three different interest rates depending on the circumstances. On the other hand, the statutory rate of interest in Japan is still fixed at 5% for civil obligations and 6% for commercial obligations, despite the fact that they were set at the end of the 19th century at a time when Japan had only just started its transformation into a modern State. Here, inspired by the rule of the UNIDROIT Principles, consideration is being given to the adoption of an interest rate that changes in accordance with some form of index.

(2) Article 7.4.13 of the UNIDROIT Principles, which provides for the effect of the agreement with respect to the amount of compensation for non-performance, allows for the reduction of the agreed sum when it is grossly excessive. The JCC only has a form of control provided by a general public

order clause; the courts are not allowed to reduce the agreed sum. However, since the provisions of the UNIDROIT Principles evidence the results of comparative legal study, consideration is being given to the introduction of a rule allowing for a reduction in the agreed amount in accordance with the UNIDROIT Principles.

(3) While the general limitation period provided for by the JCC is ten years, the JCC has a number of short-term extinctive prescriptions for specific occupations that originated in the French Civil Code. However, there is no rational reason for the survival of short-term extinctive prescriptions for specific occupations, and a proposal is therefore being made to abolish them and provide for both a general limitation period and a maximum limitation period. There is no doubt that this proposal was inspired by Article 10.2 of the UNIDROIT Principles. Yet the outcome of the deliberations is not clear, since there is strong opposition to shortening the general limitation period.

(4) As to the modernisation of the prescription system, the rule on the modification of limitation periods by the parties (Article 10.3) and the rule on suspension by judicial proceedings, etc. (Articles 10.5-10.7) in the UNIDROIT Principles will continue to inspire the discussions of reform as model rules of a modern prescription system.

4. Rules deviating from the UNIDROIT Principles

After serious deliberation, the drafters of the new rules are considering rules that differ from the UNIDROIT Principles in respect of some topics.

(1) Force majeure in monetary obligations

Article 7.1.7 of the UNIDROIT Principles, which sets forth a rule on exemption in cases of force majeure, stipulates that this rule does not prevent a party from exercising its right to request interest on money due (paragraph (4)). According to Article 7.4.9(1) (Interest for failure to pay money), a creditor of a monetary obligation is entitled to interest on the unpaid sum of money from the time when payment is due to the time of payment, whether or not the non-payment is excused. The JCC has substantially the same rule. Article 419(1) of the JCC stipulates that "the amount of the damages for failure to perform any obligation for the delivery of any money shall be determined with reference to the statutory interest rate; provided, however, that, in cases where the agreed interest rate exceeds the statutory interest rate, the agreed interest rate shall prevail." Paragraph (3) of that same Article stipulates that "the obligor may not raise the defence of force majeure with respect to the

damages referred to in paragraph (1)." However, after the devastating earthquakes in 1995 and 2011, Japanese lawyers learned that there are cases where a delay in the payment of a monetary obligation should be excused. A new provision to that effect is now being proposed.

(2) Long-term contracts

With respect to so-called long-term contracts, the UNIDROIT Principles have a provision on "restitution with respect to contracts to be performed over a period of time" (Article 7.3.7). However, after careful consideration, the UNIDROIT Working Group decided not to include any provisions on the termination of long-term contracts. In the Japanese trading community, long-term trade relationships are predominant and there is a wealth of judicial precedent that deals with them, in light of which a proposal was made to incorporate the rules established in the case law on the termination of long-term contracts into the statutory provisions. A pivotal issue is whether the rules respecting the continuity of contracts (the principle of *favor contractus*) should be stipulated in the Code. In-depth discussions will continue until a final decision is made by the Working Group of the Legislative Council.

(3) Assignment of a right to the payment of a monetary sum

Article 9.1.9(1) of the UNIDROIT Principles provides that the assignment of a right to the payment of a monetary sum is effective notwithstanding an agreement limiting or prohibiting such an assignment. On the other hand, Article 466 of the JCC for its part provides that the assignment of a right is ineffective provided the obligee and obligor have made an agreement prohibiting such assignment, unless the assignee did not know of the assignment. Indeed, it seems excessive that an agreement between the obligee and obligor can deprive a right of its alienability, as is suggested in the above provision of the UNIDROIT Principles. However, such an agreement might be reasonable to the extent of determining the party to whom the obligor should make payment. The BRP is now proposing a provision to the effect that the assignment of a right is effective among the parties other than the obligor even if the assignee knew about the agreement. As a result, the assignee cannot claim payment from the obligor if it knew about the agreement, but the assignment will still be effective vis-à-vis subsequent assignees. This rule is expected to balance protection of the debtor with the use of the assignment of receivables for the purpose of finance, such as securitisation and asset-based-lending (ABL). Extensive discussions will continue on the validity of this proposal.

(4) Successive assignments of a right

As to the rules on successive assignments of a right, two systems coexist in Japan. The first is basically the same as the system adopted in French law and is close to Article 9.1.11 of the UNIDROIT Principles. Article 467(1) of the JCC provides that "the assignment of a claim may not be asserted against the obligor or any other third party, unless the assignor gives a notice thereof to the obligor or the obligor has acknowledged the same." Paragraph (2) of that same article provides that "the notice or acknowledgement set forth in the preceding paragraph may not be asserted against a third party other than the obligor unless the notice or acknowledgement is made using an instrument bearing a fixed date." The second system is a registration system available as an alternative when a legal person makes an assignment.

The BRP proposes to unify these two systems on the assignment of receivables by creating a new registration system, in an attempt to meet the contemporary demands of corporate finance in respect of the assignment of receivables. However, the controversy as to whether or not a convenient, simple registration system capable of achieving such a purpose can be constructed still continues.

(5) Suspension of limitation period through negotiations

The UNIDROIT Principles contain no provisions on the suspension of the running of the limitation period through negotiations. However, the possibility of such a provision is now being discussed in Japan.

(6) Settlement and release of joint and several obligors

Article 11.1.6 of the UNIDROIT Principles reads that the release of one joint and several obligor, or settlement with one joint and several obligor, discharges all the other obligors for the share of the released or settling obligor, unless the circumstances indicate otherwise. Article 437 of the JCC is basically the same, although it does not explicitly mention settlement. However, in Japanese practice, it is frequently observed that an obligee releases one joint and several obligor on the understanding that the release will not affect other co-obligors. The BRP proposes to set forth a default rule to that effect.

III. – CONTESTED ISSUES IN THE CONTRACT LAW REFORM

In the reform of the Japanese contract law, the major issues currently under dispute, other than those dealt with above, are the following.

1. Detailed rules or a simple principle?

As stated above, the JCC has a relatively small number of provisions and the wording of each provision is often very simple. For example, it is not rare for only an exceptional rule to be stipulated without stating the principle against which the exception is to be applied. This is unhelpful to readers . Clearly, the drafters did not have ordinary citizens in mind but assumed that the Code would be read by elite lawyers with extensive knowledge of Western legal science.

In the current reform, efforts are being made to improve the transparency of the Code and to enable ordinary citizens to understand the rules applied to them. However, since Japanese lawyers are so accustomed to the century-old tradition that most of the important rules can be found in the case law or interpretive theories, some practitioners believe the status quo to be more flexible and equitable than a Code with detailed rules could ever be. They insist that such a basic law as the Civil Code should not contain too much detail. Here, there is political conflict as to whom the Civil Code addresses, as well as aesthetic discord over the appearance of the Civil Code.

2. Status of consumer law

An issue closely related to the above-mentioned clash is the treatment of consumer rules. The BRP proposed the introduction of a consumer concept into the Civil Code in order to reflect the reality of a modern civil society, and to stipulate very general consumer rules in the Code. However, there is strong opposition to incorporating consumer concepts into the Code not only from industrial circles, concerned about their negative impact on economic activity, but also from scholars in favour of consumer protection, who argue that expeditious amendments may be obstructed if consumer rules are stipulated in the Civil Code. The fact that the contract law in the Civil Code has not been revised for more than a century seems to be a sensitive issue for them. They take the view that, since Japan already has a Consumer Contract Law, consumer rules should be incorporated into this law and the broader aim should be for a grand Code of Consumer Law on the lines of the "*Code de la consommation*" in France. Here, we have a confrontation over the ideal style of Civil Codes in contemporary society.

3. Materialisation of the good faith principle

One of the traits of adjudication in Japan is that general clauses, such as those on good faith, are used flexibly and frequently. Often, a new rule that cannot be found in the statutory text will be created by applying the good faith provision. It is fair to say that this phenomenon was promoted because several of the JCC's provisions did not provide the necessary rules. However, another factor that promoted the frequent use of the good faith principle was the Japanese tradition of preferring reconciliation through negotiation and solutions through mediation to formal dispute resolutions through lawsuits. Not only the parties concerned but also judges tend to prefer a flexible solution taking account of specific circumstances to the mechanical application of formal rules.

The BRP proposed turning the rules generated by judicial precedent through the application of the good faith principle into statutory provisions. Some of these rules correspond to the rules in the UNIDROIT Principles, such as "bad faith negotiation". Industrial circles, however, appear averse to the frequent use of a concept that leaves so much to the discretion of the court, and even some judges have taken a critical stand because the ambiguous decision-making criteria create difficulties for them. The differences in attitude towards the style of the legal provisions reflect the conflict in the legal consciousness on the ideal form of the legal provisions. Some people believe that a legal provision should be as specific and clear a "rule" as possible. Other people insist that a provision should be a "standard", allowing for discretionary decision-making, and thus promoting more equitable dispute resolution.[4]

IV. – FUTURE PROSPECTS

A devastating earthquake in north-eastern Japan on 11 March 2011 cast a shadow over the Civil Code reform process. Procedures calling for public comment on the interim report of points at issue in the contract law reform had originally been scheduled to commence in mid-April, upon which the reform would embark upon the second stage of deliberations on the basis of the results obtained. Because of the earthquake, a delay of at least a few months now seems likely.

4 This dualism in the legal consciousness brings to mind Duncan KENNEDY in his renowned article, "Form and Substance in Private Law Adjudication", 89 *Harvard Law Review* (1976), 1685.

After the second stage of deliberations, which aims at completing the interim draft, the Ministry of Justice will again invite public comment on the draft. Based on the outcome of that survey, a final report containing the draft bill will be prepared and submitted to the Minister of Justice. How long all this will take is not yet possible to predict. The Legislative Council has not yet set a deadline for its deliberations, so as to allow ample time for careful discussion. Personally, I am convinced the process will take at least several more years. In any case, the reform of the contract law of the JCC may serve as one model for future worldwide unification of contract law, given that the results stand at a crossroads of comparative law including French, German, and Anglo-American law. And as far as comparative law is concerned, the UNIDROIT Principles will continue to play an important role as the crystallisation of comparative legal study.