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JAPAN AND THE MONEYLENDERS— ACTIVIST COURTS AND SUBSTANTIVE JUSTICE

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Abstract: Problems with sub-prime loans roiled financial markets worldwide in 2007 and brought renewed attention to predatory lending practices by loan brokers in the United States. Questionable lending practices, however, plague consumer financial markets worldwide, including one of the largest, found in Japan. This Article addresses the Japanese response to systemic problems in its consumer finance market. Over the last forty years, the judiciary has led and the Diet followed. Most recently, in 2006, the Supreme Court handed down a series of decisions that turned the single most important earnings driver for the consumer finance industry into dead letter law. The Diet followed with legislative revisions. Both actions have imposed restrictions unheard of in the United States and drastically reshaped the financial industry in Japan. This Article analyzes these recent changes and places them in context. Doing so offers more than description and a point of comparison. It provides a window into the evolution of Japanese private law. It provides evidence that challenges the conventional wisdom on Japan. The Japanese judiciary is neither weak nor ineffectual. It is not limited to following the dictates of the Liberal Democratic Party or bureaucracy or filling in legislative lacuna. It has not limited itself to activism in the service of stability or community. In private law matters, it has come to act aggressively: repeatedly invalidating black letter law and providing substantive as opposed to procedural justice. This work shows the Japanese judiciary has not evolved into a monolithic bureaucracy, but one often driven by activist lower courts. The historical context and discussion of recent developments in consumer finance law offers insight into legal changes affecting the Japanese financial markets today, as well as the evolution of the role of law and the rule of law in Japan.

I. INTRODUCTION

Even with the uptick in Japan's economy,[1] after fifteen years of recession and stagnation, the numbers are still pretty bleak. In 2006, one in every nine Japanese, one in every seven adults, was indebted to a lender

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[1] *See, e.g.*, Patrick Barta, *Markets Brace for Impact Of Japan's Growing Hunger*, WALL ST. J., May 16, 2006, at C1; Sebastian Moffett & Phred Dvorak, *Rising Sun: After Long Decline, Japan's Economy Is Stirring to Life*, WALL ST. J., Nov. 10, 2003, at A1; Andrew Morse, *Japan Data Bolster Case For Growth*, WALL ST. J., Aug. 15, 2005, at A11; Akane Vallery Uchida & Andrew Morse, *Land Prices in Japan Reverse Slide*, WALL ST. J., Mar. 23, 2007 at A5.

reporting to the Federation of Credit Bureaus of Japan.[2] Out of a population of approximately 127 million people,[3] over 22 million were registered with the federation, including 14 million currently in debt, double that from 1991.[4]

The majority of Japan's borrowers are temporary workers and pensioners.[5] Most remain in debt for 6.5 years; approximately 30% remain in debt for ten years or more.[6] In 2006, approximately 2.3 million borrowers were classified as heavily in debt, in debt to five or more lenders,[7] and 2.7 million were behind on payments to consumer finance companies and in default.[8]

Actual numbers then and now are likely much worse. Government statistics from 2005 showed over 14,000 money lenders registered with either the central or a local government and only 2079 members of the Federation of Credit Bureaus.[9] In other words, a large number of lenders are not using established credit bureaus and their borrowers are not included in the above statistics.[10]

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[2] Utsunomiya Kenji, *Kashikingyō Kisei no Kadai—Shōhisha no Tachiba Kara*, 1319 JURISTO 13, 19 (2006).

[3] STATISTICS BUREAU, JAPAN MINISTRY OF INTERNAL AFFAIRS AND COMMC'N, STATISTICAL HANDBOOK OF JAPAN 8 (2007), *available at* http://www.stat.go.jp/English/data/handbook/c02cont.htm (last visited Mar. 5, 2007); Statistics Bureau, Population Estimates: Monthly Report, Nov. 1, 2007 (Final Estimates), http://www.stat.go.jp/english/data/jinsui/tsuki/index.htm (last visited May 9, 2008).

[4] *Shōhisha Kinyū, Seigenhō Kosu Risoku: "Hai-iro Kinri" Jisshitsu Hitei*, ASAHI SHINBUN, Jan. 14, 2006, at 43; Utsunomiya, *supra* note 2, at 13.

[5] Utsunomiya, *supra* note 2, at 19.

[6] *Id.* at 17.

[7] Akemi Nakamura, *Will Lending Law Revision Put Brakes on Debt-Driven Suicide?*, THE JAPAN TIMES, Dec. 13, 2006; Utsunomiya, *supra* note 2, at 14.

[8] Utsunomiya, *supra* note 2, at 14.

[9] *Id.*; Zenkoku Shinyō Jōhō Senta-Rengoukai, Zenjōren Tōkei, http://www.fcbj.jp/data/figures/index.html (last visited Mar. 25, 2007).

[10] Straight comparisons with the United States are difficult. The Federal Reserve in its most recent 2004 survey of consumer finance offers statistics per family instead of per individual. The share of families carrying debt was 76.4%; however, 47.9% of this total was debt secured by a primary residence, i.e. a home mortgage. Brian K. Bucks et al., *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, Fed. Res. Bull. (2006), at A26, 30-31, *available at* http://www.federalreserve.gov/pubs/bulletin/2006/financesurvey.pdf. Credit cards are another primary source of debt: in 2004, 46.2% of families carried a median credit card balance of $2200. Distressed debt indicators for 2004 showed 12.2% of families carrying income to debt ratios of over 40% and 8.9% of families delinquent on at least one debt payment. *See id.* at A35. Non-business bankruptcy filings trended upward from 1996 through 2006, spiked in 2005, and then plummeted in 2006 because of the changes brought about by the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act. American Bankruptcy Institute, 2006 Bankruptcies Fall to Lowest Levels Since 1980s (Apr. 17, 2007), http://www.abiworld.org/AM/Template.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=46645; American Bankruptcy Institute, Annual Business and Non-business Filings by Year 1980-2006 (Aug. 16, 2007), http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=46621. Payday lending in the United States offers an additional point of comparison. The industry did not exist before the 1990s, and by 2004 estimates

Most borrowers borrow down, starting with mainstream consumer finance companies, and after exhausting their credit with those sources, moving to the mid-size and small consumer finance companies, and then the black market.[11] Many file for bankruptcy, 184,422 in 2005, sixteen times more than in 1990.[12] Many attempt to disappear or "run away under the cover of night" (*yonige*). The numbers are hard to believe, but some estimate as many as 100,000 each year.[13] Interviews show that many wind up homeless.[14] Others resort to suicide.[15] In 2005, 32,522 committed suicide, including 7756 for economic reasons, a slight improvement from the high in 2003.[16] In comparison, the number of fatalities from traffic accidents in Japan is below 7000.[17]

In December 2006, the Japanese Diet acted, but they did not act in response to these numbers. The numbers peaked in 2003.[18] They acted in response to the Japanese Supreme Court. In the first three months of 2006, the Supreme Court handed down six decisions interpreting Japan's usury laws and the laws regulating the consumer finance industry.[19] All of them overturned lower court decisions for the lender; the combination of them turned statutory law into dead letter law.[20] The bureaucracy and the Diet

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suggested there were over 22,000 payday lenders nationwide with a loan volume of over $40 billion. Joe Mahon, *Banking on the Fringe*, FEDGAZETTE (July 2004), *available at* http://www.minneapolisfed.org/pubs/fedgaz/04-07/banking.cfm#. Industry analysts have estimated that about 5% of the U.S. population has taken out payday loans at some point; many become chronic borrowers, with surveys suggesting over 40% both roll over their loans and borrow from multiple lenders. *See* Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. Q. 8, 14, 19-21 (2003), *available at* http://www.ccc.unc.edu/documents/CC_Payday_lending.pdf.

[11] Utsunomiya, *supra* note 2, at 19. *See* Akemi Nakamura & Mayumi Negishi, *Consumer Lenders' Dirty but Open Secret*, THE JAPAN TIMES, May 18, 2006.

[12] Utsunomiya, *supra* note 2, at 14; Kinyūchō, *Kashikingyō Seido Nado ni Kansuru Kondankai no Kaisai ni Tsuite*, TŌKEI SHIRYŌ NADO, http://www.fsa.go.jp/news/newsj/16/kinyu/f-20050427-2.html (last visited Mar. 12, 2007).

[13] Utsunomiya, *supra* note 2, at 15-16.

[14] *Id.*

[15] For a discussion suggesting a causal link between suicide and insolvency law, see MARK D. WEST, LAW IN EVERYDAY JAPAN: SEX, SUMO, SUICIDE AND STATUTES 223-65 (2005).

[16] Utsunomiya, *supra* note 2, at 15-16; Kinyūcho, *Kashikingyō Seido Nado ni Kansuru Kondankai no Kaisai ni Tsuite*, TŌKEI SHIRYŌ NADO, http://www.fsa.go.jp/news/newsj/16/kinyu/f-20050427-2.html (last visited Mar. 12, 2007).

[17] *Japan to Tackle High Suicide Rate*, BBC NEWS, June 15, 2006, http://news.bbc.co.uk/go/pr/fr/-/2/hi/asia-pacific/5082616.stm.

[18] *See infra* text accompanying notes 361-362.

[19] *See infra* text accompanying notes 318-339. Blackstone noted that money lent on contract for compensation "is called *interest* by those who think it legal, and *usury* by those who do not so." WILLIAM BLACKSTONE, 2 COMMENTARIES *454. This Article uses the term without intending any such distinction but rather to describe the practice of lending money at a high rate of interest. According to *Black's*, usury is defined as "[h]istorically, the lending of money with interest" and today as "the charging of an illegal rate of interest" or "[a]n illegally high rate of interest." BLACK'S LAW DICTIONARY 1580 (8th ed. 2004).

[20] *See infra* text accompanying notes 318-339.

played catch-up and when they caught up with legislation in 2006, they came down relatively hard on usury and the money lending industry in Japan. Henceforth, for the finance companies in Japan, there are new interest rate caps, new duties imposed on the lenders, and increased criminal penalties; for the consumer, there is less credit. [21]

The new legislation is the latest addition to a history of legislative and judicial efforts to regulate money lending in Japan that stretches back over eight hundred years.[22] Like usury law in the West, these efforts provide an opportunity to examine an evolution in legal norms governing a basic transaction that remains fundamentally unchanged: lending money at interest. An examination of that evolution in Japan shows, in a microcosm, the history and evolution of private law in Japan: 1) from an early, well-developed policy and practice of micro-managing private law for public purposes, 2) to a private law regime embracing "freedom of contract" and judicial restraint, 3) to a paternalistic conception of private law driven by the judiciary.[23]

This new legislation, when placed in context, shows that the Japanese judiciary, an institution often characterized as conservative and ineffectual, can and does act as a "liberal" and decisive force within Japanese society. Judicial activism is not limited to "activism in the service of stability," or even activism in the service of community.[24] The judiciary does more than simply fill in legislative lacunae.[25]

In the areas of usury law and consumer finance in Japan, instead of jury nullification, one finds judicial nullification. The judiciary has rejected attempts by the bureaucracy and Diet to legislatively revise judicially established norms. It has cast itself as an arbiter of societal norms and, through a technical application of the law, imposed substantive as opposed to procedural justice. In this area of private law, the judiciary has driven the bureaucracy and Diet. In this area of the law, the judiciary has radically

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[21] *See infra* text accompanying notes 411-456.

[22] *See, e.g.*, ONO SHŪSEI, RISOKU SEIGENHŌ TO KŌJO RYŌZOKU 208 (1999); 1 JOHN HENRY WIGMORE, LAW AND JUSTICE IN TOKUGAWA JAPAN 120 (1969).

[23] In the civil law tradition, "[l]aw is divided up into clearly delimited fields. Public law and private law . . . are treated as inherently different and clearly distinguishable." JOHN HENRY MERRYMAN, THE CIVIL LAW TRADITION 63, 68, 91 (2d ed. 1985).

[24] *See* Daniel H. Foote, *Judicial Creation of Norms in Japanese Labor Law: Activism in the Service of – Stability?*, 43 UCLA L. REV. 635, 638 (1996). *See also* JOHN OWEN HALEY, THE SPIRIT OF JAPANESE LAW 124 (1998).

[25] *See* John O. Haley, The Japanese Judiciary: Maintaining Integrity, Autonomy and the Public Trust (Aug. 23, 2003) (unpublished paper), *available at* http://law.wustl.edu/higls/papers/lectures/2003-3HaleyJapaneseJudiciary.html#_ftnref3).

changed the governing legal norms, which, in turn, in 2006 radically changed the financial markets in Japan.

Finally, this legislation, placed in context, shines light on a Japanese society that is still coming to terms with the bursting of the Japanese economic bubble fifteen years ago.[26] Fifteen years of painful economic restructuring has changed the balance of power. The 2006 legislative process suggests there are increasingly powerful younger members of the Liberal Democratic Party ("LDP") responsible to a constituency stretching beyond traditional business interests, and increasingly large, but often muted, foreign stakeholders.

This Article will examine each of these points. Part II will examine the legislative and judicial history of interest rate restriction laws as well as the judicial precedent that preceded the 2006 legislation. It will briefly examine the law governing money lending found in the Tokugawa era (1603-1867), followed by the legislative reforms that accompanied the Meiji Reformation, and the decisions from the Great Court of Cassation, imperial Japan's highest court. Part II will focus though on the legislation and caselaw that followed the end of World War II and preceded the changes in 2006. Part III will examine the impetus for the the 2006 legislative reforms, the outlines of the new lending laws, and the aftermath, including the restructuring of the consumer financial markets in Japan. Part IV will seek to place this discussion in a broader context. Discussion of whether Japanese law permits 12% or 15% interest or whether the Japanese courts deem certain payments "construed interest" or not, without more, would scarcely justify the paper and ink expended. Part V argues that there is more; that usury law, as dry as it sounds, offers broad insights into the role of law and the rule of law in Japan.

II. LEGISLATIVE AND JUDICIAL HISTORY

A. The Tokugawa Era

Usury laws in Japan date back at least to the Kamakura Dynasty (1185-1336).[27] There was not a total prohibition against lending money at interest, as seen in Western Europe, but abundant records detail prohibitions

[26] In 1989 the Tokyo Stock Exchange had a market value of $4.3 trillion and was the largest in the world having surpassed even that of the New York Stock Exchange. In 1991 the Bubble burst and by 1995 the market value of the Tokyo exchange had declined to $3.6 trillion, or roughly 60% of the New York Stock Exchange. *See Sekai no Shuyō Kabushiki Shijō*, ASAHI SHINBUN, Oct. 8, 1996, at 13; Shinichi Terada, *Lending Legislation Reforms Spell Industry Shakeout*, THE JAPAN TIMES, Dec. 14, 2006, *available at* http://search.japantimes.co.jp/print/nb20061214a2.html.

[27] 1 WIGMORE, *supra* note 22, at 120.

on interest due on bills of exchange.[28] Records from the Muromachi Period (1336-1573) detail more inclusive interest rate restrictions: interest rates on all money loans were capped at 5% per month.[29]

The records from both of these periods, however, are spotty. It was not until after the Warring States Period (1467-1583), the subsequent unification of Japan, and the beginning of the extended rule of the Tokugawa Shogunate (1603-1867) that we see a comprehensive treatment of usury law. The Tokugawa Shogunate created an extensive body of law, both judicial precedent and administrative orders, which wholly endorsed government restriction of money lending at interest.[30]

Early on, the Tokugawa government established a maximum interest rate of 20% per annum with criminal penalties assessed on rates over 30%,[31] and for pawnbrokers a graduated scale from 36% to 20% decreasing with the size of the loan.[32] They fiddled with those numbers incessantly, capping interest rates at one point at 5%, at another point declaring the "proper rate" 15%, and later 12%.[33] The government would also ex post adjust interest rates.[34] In 1729, it reduced interest rate charges to 5% on all outstanding loans concluded between 1702 and 1729, noting that after the recoinage of gold and silver in the Genroku Period (1688-1704) the price of grain advanced considerably and then fell, but "the interest on loans and pledges remains the same as before, to the great embarrassment of the people."[35]

Despite considerable barriers to litigation,[36] cases relating to money lending were widely adjudicated and the procedures for such suits well

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[28] *See id*.

[29] ONO, *supra* note 22, at 208.

[30] At the same time, John Locke, Jeremy Bentham, and Sir William Blackstone were writing in defense of usury and England was moving towards the abolition of its usury laws. *See* Carl F. Taeusch, *The Concept of "Usury" the History of an Idea*, 3 J. HIST. IDEAS 291, 306, 310 (1942). *See also* BLACKSTONE, *supra* note 19, at *454-56.

[31] Nishimura Nobuo, *Shin Risoku Seigenhō Hihan (1)*, 29 MINSHŌHŌ ZASSHI (No. 6) 387, 389 (1954); ONO, *supra* note 22, at 201.

[32] In 1692, the Tokugawa Shogunate promulgated regulations for pawnbrokers restricting interest rates to 36% for loans up to 100 mon, 28% for loans under 2 ryō; 24% for loans under 10 ryō; 20% for loans up to 100 ryō; and less than 20% for loans over 100 ryō. Nishimura, *supra* note 31, at 398.

[33] *See* 3 WIGMORE, *supra* note 22, at 256-62; 333-34; Nishimura, *supra* note 31, at 398.

[34] *See* 3 WIGMORE, *supra* note 22, at 256, 259.

[35] *Id.* at 256.

[36] Apart from the "didactic conciliation" mandated by the Tokugawa authorities and documented by Professor Henderson, Professor Wigmore notes "one of the reasons why the mercantile classes resorted so little to the courts in their disputes was the necessity of humiliating themselves so deeply in their quest for justice—of crawling, for instance, on hands and knees from the door of the court to the judgment room." 1 WIGMORE, *supra* note 22, at 41. *See also* DAN FENNO HENDERSON, CONCILIATION AND JAPANESE LAW: TOKUGAWA AND MODERN (1965).

established.[37] The numbers, however, periodically threatened to overwhelm the courts. At one point, the Chamber of Decisions, Tokugawa Japan's highest court, complained that money actions have "increased to such an extent that, if we are to try all of them, as we do now, the court days of the Chamber . . . will be occupied with those actions exclusively . . . [and] the morale of the Chamber may degenerate."[38] No self-respecting samurai-magistrate could tolerate listening to money suits all day, and the Council of State responded by limiting the dates on which money suits would be heard.[39]

The magistrates also sought to limit practice before the courts by creditors, citing "many vicious practices":

> [T]he creditor sometimes sends to court some person skilled in litigation [to represent him], pretending that this man is his dependent relative or servant. . . . Again, some instigate unfounded suits for some petty arrearage against country people, knowing that the latter, even when they have no recollection of the claim, would rather pay some proportion of it in settlement than undertake the expense of coming to the city to defend the suit. Moreover, we hear that sometimes a person takes advantage of the poverty or ignorance of another, and in lending him money takes an instrument of land pledge, stipulating usurious interest, and afterwards alters the arrangement into a contract of renting.[40]

The magistrates argued and the Council of State agreed that this conduct—skilled representation, extorted settlements, and fraud—could not be stopped absent penalty. They proposed that a litigant falsely putting forward a person skilled in litigation be punished.[41]

The Chamber of Decisions employed other means to regulate actions involving the lending of money at interest. It periodically dismissed all of them.[42] It issued "private settlement orders" in 1719 and again in 1797, noting in the latter that borrowing money "originates as a matter of private arrangement between the parties, and hence there is no necessity for

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[37] *See* CARL STEENSTRUP, A HISTORY OF LAW IN JAPAN UNTIL 1868, 108-19, 147 (1991); 3 WIGMORE, *supra* note 22, at 7-8, 43-47.

[38] 3 WIGMORE, *supra* note 22, at 54.

[39] The negative response to this kind of suit was "[a] not unnatural notion of samurai." *Id.* at 54 n.6.

[40] *Id.* at 19.

[41] *See id.*

[42] *See id.* at 1-2.

undertaking and judging disputes of that sort."[43] Actions on money suits "must necessarily mean lack of sincerity in both the borrower and lender."[44] Orders stipulated that the parties were to carry out their obligations with a "true sense of their mutual duties," and those who did not would be "punished severely."[45]

The Tokugawa rulers were aware of the consequences of intervention. In 1842, a town magistrate argued that "the failure of debtors to repay their borrowings has recently become so frequent that . . . the circulation of money is at present very sluggish."[46] The magistrate argued that private settlement orders "injuriously affected" money circulation and caused men to become "more and more self-willed and shameless," borrowing money with the intent to delay payment.[47] "In seeking to cure these evils and that of the inactive circulation of money," reform of the laws was necessary "so as to facilitate legal proceedings as much as possible and give the creditor a guarantee that he shall obtain satisfaction without fail."[48]

In 1843, the Council of State adopted regulations to do just that, providing for regular court hearings and imprisonment for failure to pay, execution of property and liability for any remaining debts, penalties for secreting property, and no statute of limitations.[49] In less than a year, however, the Council again dismissed all money suits, deciding that "out of compassion" for the heavy debt loads and "unfortunate condition" of numerous families of the military gentry they would change the regulations.[50] The Tokugawa government again dismissed all pending money suits.[51] Interest rates remained capped at 12% per annum until the beginning of the Meji Reformation.[52]

B. The Meiji, Taisho, and Pre-World War II Showa Eras

The Meiji Reformation brought major changes. After a brief civil war, the Tokugawa government fell, and, on January 3, 1868, the Meiji Emperor was "restored."[53] The Meiji government initially decreed that the

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[43] *Id.* at 1-3, 324-25.
[44] *Id.*
[45] *Id.* at 324-25, 334.
[46] *Id.* at 321-23.
[47] *Id.*
[48] *Id.*
[49] *Id.* at 323-47; ONO, *supra* note 22, at 214.
[50] 3 WIGMORE, *supra* note 22, at 333-34.
[51] *Id.*
[52] *Id.*; ONO, *supra* note 22, at 201.
[53] MERYLL DEAN, JAPANESE LEGAL SYSTEM 61 (2d ed. 2002). Scholars suggest the Meiji Restoration came about "as a unifying political force through the inter-related political processes of 'revival

Tokugawa era laws would continue to apply.[54] However, in 1871 the Great Council of State (*dajōkan*), an institution surviving from the imperial court,[55] issued Order No. 31, abolishing Tokugawa usury restrictions and declaring that, henceforth, parties to a civil contract were free to set their own interest rates.[56]

This freedom was short-lived.[57] In 1877, the Meiji government reintroduced comprehensive interest rate restrictions, albeit without any criminal penalties.[58] By Order No. 66, the Council promulgated the Interest Rate Restriction Act ("Meiji IRRA") and, in doing so, established a regulatory paradigm that continues today.[59] Article 1 divided interest rates on money loans into those established by law and those established by contract.[60] For the latter, Article 2 permitted interest rates up to 20% per annum on loans under ¥100, up to 15% on loans between ¥100 and ¥1000, and up to 12% on loans over ¥1000. Interest payments in excess of these limits were "void before the court" (*saiban jo mukō*).[61] Interest otherwise denominated, including "appreciation fees" and "thanks money," were "void before the court."[62] Liquidated damages provisions were subject to reduction by the court to reflect actual damages.[63]

Debate regarding freedom of contract lasted longer. The French legal scholar Gustave Emile Boissonade de Fontarabie arrived in Japan in 1873,[64] and his draft of the Civil Code specifically contemplated interest rate restrictions.[65] The Codification Investigation Committee's debate over Boissonade's draft in toto was perfunctory, but debate over his interest rate

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of monarchal government' (ōsei fukkō), 'return of the people and land to the emperor' (hanseki hōkan), and 'abolition of fiefs and establishment of prefectures' (haihan chiken)." Ken Mukai & Nobuyoshi Toshitani, *The Progress and Problems of Compiling the Civil Code in the Early Meiji Era*, *in* 1 LAW IN JAPAN 25, 31 (Dan Fenno Henderson trans., 1967).

54 ONO, *supra* note 22, at 202-03 (quoting Minbukan Futatsu No. 506 of June 4, 1869).

55 Mukai & Toshitani, *supra* note 53, at 28 note c.

56 ONO, *supra* note 22, at 203 (quoting Dajōkan Fukoku No. 31 of Jan. 18, 1871); Nishimura, *supra* note 31, at 389.

57 Nishimura, *supra* note 31, at 389.

58 *Id*. at 389, 391. For further discussion of law without sanctions in Japan, see John O. Haley, *Sheathing the Sword of Justice in Japan: An Essay on Law Without Sanctions*, 8 J. JAPANESE STUD. 265, 272 (1982).

59 Dajōkan Fukoku 66 of September 11, 1877 [Great Council of State Order No. 66 of 1877], http://dajokan.ndl.go.jp/SearchSys/index.pl (follow "検索画面へ" hyperlink; enter"利息制限法" in the"法令名" field and "66" in the "法令番号等" field; follow "検索実行"). (last visited Feb. 14, 2007) [hereinafter Meiji IRRA].

60 *Id*. art. 1.

61 *Id.* art. 2.

62 *Id.* art. 4.

63 *Id.* art. 5.

64 ONO, *supra* note 22, at 215 n. 20.

65 *Id.* at 216-17.

provision lasted for two days.[66] Opponents argued that Boissonade's draft was paternalistic and counter to the philosophy of freedom of contract that underlay the new Civil Code; it would restrict finance and harm borrowers.[67] In the end, both the 1890 Civil Code first promulgated and the 1896 Civil Code later adopted offered the exact opposite of Boissonade's draft.[68] The parties were free to establish interest rates in excess of the default rate by agreement, and remedies in the case of any illegal charges were limited to a refusal to pay the same.[69] Opponents of Boissonade's draft followed this victory with proposals in May and June 1895 to abolish the Meiji IRRA, but were unsuccessful.[70] The Civil Code, as revised, and the Meiji IRRA, as earlier established, represented a compromise.[71] The result is that the current Civil Code provides a general rule of freedom of contract, establishes a legal interest rate that acts as a default, and is silent with regard to interest rate restrictions.[72] The current IRRA operates as a special law within this framework.[73]

This tension between a newly espoused freedom of contract and legislative restrictions on money lending was reflected in the judicial decisions of the imperial courts. The issue that confronted the Tokugawa magistrates, whether to allow the parties to structure their own transactions or interfere, remained, but the judicial decisions now reflected a distinct bias towards the former. The Great Court of Cassation, a high court based on the French model established in 1875,[74] applied the Meiji IRRA where necessary and limited its application where possible.

The court early on addressed whether interest rate restrictions were applicable to non-monetary loans, and it repeatedly said no.[75] Courts began

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[66] *Id.* at 218.

[67] *Id.*; Ōkawa Sumio, *Meiji Minpō no Hensan to Risoku Seigen Hō*, 6 RITSUMEIKAN RONSHŪ 102, 103, 112 (2003).

[68] For an explanation of the Civil Code controversy, see JOHN OWEN HALEY, AUTHORITY WITHOUT POWER: LAW AND THE JAPANESE PARADOX 75-77 (1991); Mukai & Toshitani, *supra* note 53, at 25; Richard W. Rabinowitz, *Law and the Social Process in Japan*, 10 TRANSACTIONS OF THE ASIATIC SOCIETY OF JAPAN (3d Series) 11 (1968).

[69] ONO, *supra* note 22, at 218.

[70] *Id.* at 219, 230. Opponents of the law called it an "empty act" (tohō) at odds with basic economics and the evolution of law from restriction to freedom. Proponents argued the law remained necessary providing a remedy, at the court's discretion, for immoral behavior. *See* Ōkawa, *supra* note 67, at 104-05, 111.

[71] ONO, *supra* note 22, at 219, 230.

[72] *Id.* at 221.

[73] *Id.*

[74] HALEY, *supra* note 68, at 69.

[75] 4 DAIHAN MINROKU 30 (Great Ct. of Cassation, Feb. 17, 1898); 9 DAIHAN MINROKU 101 (Great Ct. of Cassation, Oct. 22, 1901); 13 DAIHAN MINROKU 716 (Great Ct. of Cassation, June 26, 1907); 27 DAIHAN MINROKU 939 (Great Ct. of Cassation May 18, 1921); Nishimura, *supra* note 31, at 391.

emphasizing that the law was "in contravention of the principle of freedom of contract," and though perhaps necessary to prevent harm arising from unreasonable profits, not to be expanded.[76] When the courts found the statute applicable, they were required to interpret the "void before the courts" language in Article 2, and refused to enforce lenders' claims to excessive interest charges not yet paid.[77] At the same time, they rejected borrowers' claims for refund of excessive interest paid so long as it was "voluntarily paid."[78] Other courts focused on the agreement of the parties with the same result. According to a 1909 decision, if "it had been paid based on the agreement of the parties," it was not amenable to a claim for refund.[79] If a contract calling for illegal interest was made and illegal interest voluntarily paid, then it was not only the creditor but also the debtor who had engaged in an illegal act.[80]

In 1919, with the end of World War I and poor economic conditions,[81] the government lowered the maximum interest rate in the Meiji IRRA to 15%.[82] Yet the courts continued to conservatively interpret the act. In a 1921 case, the court affirmed, where the debtor has agreed to pay "without any reservation . . . they cannot demand the return of the payment made in excess."[83] The courts would closely examine whether at the time of payment the party "registered any objection" to the usurious interest rate.[84] Debtors routinely made the argument that interest rates in excess of the caps were void as against public policy, and the courts routinely rejected it.[85] In the absence of inappropriate or "cruel circumstances," such contracts could exist within the "range of the freedom of contract."[86]

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[76] 24 DAIHAN MINROKU 67 (Great Ct. of Cassation, Jan. 28, 1918). *See also* ONO, *supra* note 22, at 242.

[77] Nishimura, *supra* note 31, at 391; Ōkawa, *supra* note 67, at 102, 103.

[78] Nishimura, *supra* note 31, at 391; Ōkawa, *supra* note 67, at 102, 103.

[79] 15 DAIHAN MINROKU 649 (Great Ct. of Cassation, July 3, 1909). *See also* ONO, *supra* note 22, at 248.

[80] 8 DAIHAN MINROKU 134 (Great Ct. of Cassation Oct. 25, 1902).

[81] *Risoku Seigen Mondō*, YOMIURI SHINBUN, Mar. 15, 1919, at 2.

[82] *See* Risoku Seigenhō [Interest Rate Restriction Act (Amendment)], Law No. 59 of 1919. *See also* Nishimura, *supra* note 31, at 397; ONO, *supra* note 22, at 221. The Diet reduced the top rate to 15% on loans below ¥100, 12% on loans between ¥100 and ¥1000, and 10% on loans over ¥1000. ONO, *supra* note 22, at 221.

[83] 27 DAIHAN MINROKU 475 (Great Ct. of Cassation, Mar. 5, 1920). *See also* ONO, *supra* note 22, at 254.

[84] ONO, *supra* note 22, at 255-57.

[85] 3281 HŌRITSU SHINBUN 9 (Great Ct. of Cassation, May 23, 1931); 4 HŌGAKU 1568 (Great Ct. of Cassation, Apr. 26, 1935). *See also* ONO, *supra* note 22, at 290-91.

[86] 10 DAIHAN MINSHŪ 69 (Great Ct. of Cassation, Feb. 13, 1931); ONO, *supra* note 22, at 255, 290-91.

While courts were loath to expand the scope of the law, as with the Tokugawa courts, they did not countenance attempts to circumvent it. The statute is silent as to discounted interest, defined as prepaid interest subtracted from the loan proceeds provided to the debtor.[87] Where the borrower received ¥1480 on a loan of ¥4300, the Court of Cassation found the borrower received an economic benefit from only the money received and, as a result, no contractual debt arose with regard to the deducted interest and fees.[88] Subsequent courts agreed explaining that to hold otherwise "would allow evasion" of the Meiji IRRA.[89] The courts had little difficulty reaching a similar conclusion regarding "compensation fees" paid for loans, deeming them construed interest.[90] Investigative fees which were in reality "means by the creditor to obtain monetary profits in excess of the interest rate restrictions" were also "void before the court."[91]

Scholars have argued the courts' focus on the agreement of the parties and voluntary payment literally took the teeth out of the law.[92] These cases suggest the courts were not willing to countenance creditors evading the statute, but they were not willing to extend the protection of the statute further.

C. The Post-World War II Showa and Heisei Eras

World War II brought substantial changes to the money lending industry. In 1939, the Diet adopted the Finance Industry Control Regulation which, under the jurisdiction of the Metropolitan Police Department, created a licensing system for the lending industry, prohibited misleading advertising, and required written loan contracts.[93] In the midst of the turmoil and high interest rates after the war, the new government issued a Price Control Order in 1946 and adopted the Temporary Interest Rate Adjustment Act in 1947.[94] The former prohibited excessive profits.[95] The latter allowed

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[87] Meiji IRRA, *supra* note 59.

[88] 9 DAIHAN MINSHŪ 49 (Great Ct. of Cassation, Jan. 28, 1930).

[89] 10 DAIHAN MINSHŪ 1159 (Great Ct. of Cassation, Dec. 3, 1931); 14 DAIHAN MINSHŪ 1211 (Great Ct. of Cassation, May 8, 1935). *See also* ONO, *supra* note 22, at 265-66.

[90] 2051 HŌRITSU SHINBUN 20 (Great Ct. of Cassation, Oct. 5, 1922). *See also* ONO, *supra* note 22, at 266.

[91] 15 DAIHAN MINSHŪ 1843 (Great Ct. of Cassation, Oct. 23, 1936). *See also* ONO, *supra* note 22, at 268.

[92] Nishimura, *supra* note 31, at 391.

[93] Kinyūgyō Torshimari Kisoku [Financial Industry Regulation], Metropolitan Police Order No. 29 of 1939; ONO, *supra* note 22, at 221.

[94] Bukka Tōsei Rei [Price Control Order], Order No. 118 of 1946, *available at* http://law.e-gov.go.jp/htmldata/S21/S21CO118.html (last visted at Mar. 23, 2007) [hereinafter Price Control Order]; Rinji Kinri Chōseihō [Temporary Interest Rate Adjustment Act], Law No. 181 of 1947, *available at*

the Minister of Finance to establish a Japan Banking Policy Committee to set maximum interest rates that varied by region and type of financial institution.[96]

The government followed with the Money Lending Industry Self Regulation Development Act which established local self regulatory organizations.[97] Membership, however, was voluntary and less than 10% of the registered money lenders joined.[98] In response, the government enacted in 1949 the Money Lending Industry Control Act.[99] This new law required advance registration by commercial money lenders with the Ministry of Finance and the submission of business practice reports detailing interest rates charges.[100] If those interest rates rates exceeded 50 *sen* per day, the Ministry of Finance routinely rejected the report and, in doing so, attemped to impose a de facto interest rate cap of 182.5% per annum.[101]

Interest rates rose rapidly during the period from 1946 through 1949, from approximately 50% to over 200%.[102] They were followed by "the Dodge Line," harsh anti-inflationary measures drafted by Joseph Dodge, economic advisor to Supreme Commander of Allied Powers.[103] Deflation and recession followed, businesses were forced into bankruptcy, unemployment increased, and workers went on strike protesting layoffs at Japan Steelworks, Toshiba, and other major companies.[104] Letters to the legal advice columnist of the Yomiuri Newspaper touched repeatedly on borrowing money.[105]

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http://law.e-gov.go.jp/htmldata/S22/S22HO181.html (last visited Mar. 23, 2007) [hereinafter Temporary Interest Rate Adjustment Act].

[95] Price Control Order, *supra* note 94, art. 10.

[96] Temporary Interest Rate Adjustment Act, *supra* note 94, arts. 2, 3.

[97] Kashikingyōsha no Jishu Kisei no Jochō ni kansuru Hōritsu [Money Lending Industry Self Regulation Development Act], Law No. 170 of 1949, http://hourei.ndl.go.jp/SearchSys/frame/haishi_top.jsp (last visited Mar. 25, 2007).

[98] ONO, *supra* note 22, at 222.

[99] Kashikingyō Torishimarihō [Money Lending Industry Control Act], Law No. 170 of 1949.

[100] ONO, *supra* note 22, at 222.

[101] Nishimura, *supra* note 31, at 397.

[102] TAKAFUSA NAKAMURA, A HISTORY OF SHŌWA JAPAN, 1926-1989, 295 (Edwin Whenmouth trans., 1998).

[103] Dodge's economic plan prioritized balancing the budget by stemming the flow of funds from the government to the private sector, stopping subsidies, and halting lending by the Reconstruction Finance Bank. *Id.* at 297.

[104] *See id*. at 299.

[105] *Dokusha Hōritsu Sōdan: Kaizanmae no Bira Senjutsu, Kyōsei Rōdou, Kōri no Shakkin ni Nayamu*, YOMIURI SHINBUN, Dec. 8, 1948, at 2; *Hōritsu Sōdan: Kōrikashi Kara no Shakkin Kashikin to Kaisha no Hasan*, YOMIURI SHINBUN, Apr. 8, 1950, at 3; *Hōritsu Sōdan: Shakkin no Kinri shinhōritsu ni Yoru Katei ha*, YOMIURI SHINBUN, July 31, 1954, at 5.

In 1954, the Diet responded with a new Interest Rate Restriction Act ("IRRA")[106] as well as the Acceptance of Investment, Money Deposits and Interest Rates Regulation Act ("Investments, Deposits, and Interest Rates Act").[107] Both were aimed at what the newspapers described as "street finance companies" and "vague moneylenders" that had arisen in the aftermath of World War II.[108] Both laws continue to govern the consumer finance industry in Japan today.

The latter, as its unwieldy title suggests, sought to regulate three separate areas of finance. It restricted the acceptance of investments and money deposits to licensed financial institutions.[109] The law offered a direct response to the upheaval caused by postwar pyramid schemes such as the "Conservation Economics Club," which offered a five year, ¥2 million return on an investment of ¥10,000 and gathered 15,000 investors and ¥450 million before filing for bankruptcy.[110]

With regard to interest rates, it capped them as well as brokerage commissions on loans.[111] Article 4 capped commissions at 5% of the loan amount and deemed any money received by a broker "to be a commission regardless of its designation."[112] The new act added criminal penalties to lending money at usurious rates. Article 5 provided for imprisonment up to three years and/or a fine up to ¥3 million for lending rates in excess of 30 *sen* per day, or 109.5% per year.[113]

The new IRRA revised the private law restrictions. The Ministry of Justice explained that, given currency values, continued application of the Meiji era interest rate and yen range structure would be "remarkably

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[106] Risoku Seigen Hō [Interest Rate Restriction Act], Law No. 100 of 1954, *available at* http://law.e-gov.go.jp/htmldata/S29/S29HO100.html (last visited Jan. 25, 2007) [hereinafter IRRA]. The new law came into effect June 15, 1954, abolishing and replacing the Meiji IRRA. *Id.* supp. provision 1-2, *translated in* [STATUTE VOL.] DOING BUSINESS IN JAPAN pt. 4, at app. 4B-2 (Zentaro Kitagawa ed., 2007).

[107] Shusshi no Ukeire, Azukarikin oyobi Kinri nado no Torishimari ni kansuru Hōritsu [Acceptance of Investments, Money Deposits and Interest Rates Regulation Act], Law No. 195 of 1954 [hereinafter Investments, Deposits, and Interest Rates Act]. The law abolished its predecessor, the Money Lending Industry Self Regulation Development Act No. 170 of 1949. *See* Shusshihō *available at* http://law.e-gov.go.jp/htmldata/S29/S29HO195.html (last visited Jan. 25, 2007).

[108] *Machi no Kinyū Torishimarihō Kokkai he Teishutsu*, YOMIURI SHINBUN, Mar. 2, 1954, at 3; *Seiritsu Shita Shuyō Keizai Hōritsu*, YOMIURI SHINBUN, June 5, 1954 at 4.

[109] Investments, Deposits, and Interest Rates Act, *supra* note 107, arts. 1-2. The Law also prohibited loans made by employees of financial institutions for the benefit of themselves or a third party other than the financial institution. *Id*. art. 3.

[110] The "Conservation Economics Club" prompted calls for new regulation and a fraud conviction for its managers. Kimura Mitsue, *Shusshihō to Shōhisha Hogo*, 240 HŌGAKU KYŌSHITSU 16 (2000).

[111] Investments, Deposits, and Interest Rates Act, *supra* note 107, art. 4

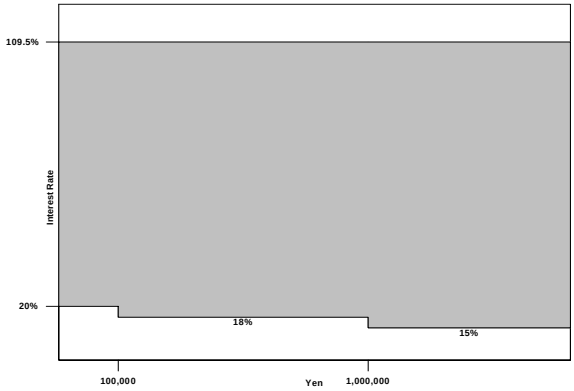
[112] *Id.*

[113] *Id.* art. 5.

irrational" and contribute to a tendency for the law to be ignored.[114] The new IRRA increased the ceilings on the three interest rate caps, and it explicitly incorporated the exception recognized by the pre-war judiciary validating "voluntary" payment of interest in excess of the caps.[115]

Article 1 of the 1954 IRRA capped maximum interest rates where the principal is less than ¥100,000 at 20% per annum; where the principal is between ¥100,000 and ¥1 million at 18%; and where the principal is ¥1 million or more at 15%.[116] "The agreement on interest shall be null and void with regard to the portion which is in excess."[117] Pursuant to Paragraph 2, however, "where the debtor has voluntarily paid a portion in excess . . . he may not demand the refund thereof."[118] Scholars argued the revisions should have been limited to adjusting the limits to account for the new currency values.[119]

Gray Zone Lending After 1954



The gap between the top 20% civil cap and 109.5% criminal cap left plenty of room for "voluntary payments."[120] Consumer finance companies, not surprisingly, lent money at rates within this range, in a practice that came to be known as "gray zone lending."[121]

The statute also explicitly addressed "discounted interest" and "construed interest." Discounted interest or prepaid interest "shall be deemed to have been allocated to the payment of the principal."[122] Money

[114] Ministry of Justice, Civil Affairs Section, Explanation of the Interest Rate Restriction Act, *quoted in* Nishimura, *supra* note 31, at 395.

[115] Nishimura, *supra* note 31, at 393.

[116] IRRA, *supra* note 106, art. 1.

[117] *Id.*

[118] *Id*. art. 1, ¶ 2.

[119] Nishimura, *supra* note 31, at 394.

[120] Suit was filed against the government under the National Compensation Act alleging that the government was negligent in failing to eliminate this gap between the IRRA and the Investment, Deposits, and Interest Rates Act. The claim was rejected. *See* 492 HANREI TAIMZU 115 (Fukuoka D. Ct, Dec. 22, 1982).

[121] Kinyūchō, Karisugi·Tajū Saimu ni Go Chūi, http://www.fsa.go.jp/ordinary/karisugi/index.html (last visited Jan. 27, 2007); *Gure-zon-no Kinri*, ASAHI SHINBUN, Jan. 14, 2006, at 43.

[122] IRRA, *supra* note 106, art. 2.

received by the creditor in connection with the loan, other than for principal or expenses "in concluding the contract" or "performing obligation-duties," will be deemed interest regardless of whether construed as an investigation fee, discount charge, commission, or other.[123] Finally, the new statute restricted the liquidated damages permitted in a loan to no more than two times the rates prescribed in Article 1.[124]

The Diet, in effect, incorporated the prewar holdings of the Great Court of Cassation that defined "discounted interest" and "construed interest," as well as the early court doctrine regarding payments "voluntarily made." The latter doctrine, now statutory law, continued to significantly limit the substantive effect of the statute.[125]

The new Japanese Supreme Court made few changes. In a 1955 decision, it reviewed illegal interest rate charges of 120% and found:

> It goes without saying that a creditor cannot demand payment of contractually designated interest in excess of any interest rates provided in the [IRRA] in an action at law. However, with regard to the portion already paid without objection by the debtor, one cannot make claims for repayment of this amount, or claim that the apportionment of this payment was inappropriate.[126]

The Supreme Court found that such interest rates were not, despite the IRRA, ipso facto void as against public policy. To find a violation of Article 90 of the Civil Code required "special circumstances" where the lender took advantage of a borrower who "was in dire straits, rash, or inexperienced in order to gain strikingly excessive profits."[127]

The lower courts were less constrained. While prewar cases focused on the statutory language "void before the court," postwar courts quickly focused on the language "voluntarily paid." Postwar courts split with regard to whether payments voluntarily made in excess of the interest-rate caps should be applied to the remaining principal of the loan. Some courts said no, including a 1955 Sapporo High Court decision that foreclosed on the

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[123] *Id*. art. 3.

[124] *Id*. art. 4.

[125] Nishimura, *supra* note 31, at 393-98.

[126] 9 MINSHŪ (No. 2) 209 (Sup. Ct., Feb. 22, 1955), *available at* http://www.courts.go.jp/hanrei/pdf/1CA44DBFC4EB83E849256A8500316587.pdf.

[127] 11 MINROKU (No. 9) 1479 (Sup. Ct., Sept. 5, 1957), *available at* http://www.courts.go.jp/hanrei/pdf/36E79C2819B11F8249256A8500316450.pdf.

borrower's ST deluxe men's bicycle.[128] Others said yes, finding that any interest payments in excess of the caps, voluntary or not, should be applied to the remaining principal.[129] These courts found the payments similar to prepayment of interest, which pursuant to Article 2 reduced the amount of principal; they focused on the intent of the statute to "protect the economically disadvantaged borrower."[130]

The Supreme Court followed, slowly. In a May 1962 decision, it overturned a lower court applying liquidated damages that exceeded the interest rate caps to the principal of the loan.[131] The Court found the contractual provision void and the voluntary payment made on a "non-debt," but it held that the borrower was not permitted to demand application of the excess payments to the remaining principal of the loan, because this "would have the same economic effect as receiving a refund."[132] Even if the intent of the statute was to "protect the economically disadvantaged borrower from usurious financing rates," applying excess interest payments to the principal of the loan in this case would "give rise to a remarkable inequality of treatment" with those for whom no principal remained.[133]

In the next two years, ten new members were appointed to the Supreme Court, and the Supreme Court changed its mind.[134] In 1964, the Supreme Court sitting en banc handed down a decision that scholars hailed as the beginning of a newly assertive Supreme Court.[135] The defendant had borrowed at interest rates up to 36% and argued that the payments made in excess of the statutory caps should be applied to the principal.[136] The arguments were familiar, and the lower courts declined to do so. The

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[128] 223 HANREI JIHŌ 23, 24 (Sapporo High Ct., Feb. 29, 1955). *See also* 7 KAKYŪ MINSHŪ 392 (Nagoya High Ct., Feb. 20, 1956); 118 HANREI TAIMUZU 64 (Sendai High Ct., Jan. 26, 1959); 103 HANREI TAIMUZU 41 (Kōmatsu High Ct., Mar. 10, 1960); 10 KAKYŪ MINSHŪ 173 (Sendai High Ct., Dec. 27, 1960).

[129] 81 HANREI TAIMUZU 64 (Hiroshima High Ct., Apr. 3, 1958); 94 HANREI TAIMUZU 48 (Nagoya High Ct., June 13, 1959); 234 HANREI JIHŌ 18 (Tokyo High Ct., July 12, 1960).

[130] 227 HANREI JIHŌ 21, 23 (Tokyo High Ct., May 30, 1960). *See also* 232 HANREI JIHŌ 27, 28 (Tokyo D. Ct., July 8, 1960).

[131] 16 MINSHŪ (No. 7) 1340 (Sup. Ct., June 13, 1962), *available at* http://www.courts.go.jp/hanrei/pdf/8D0E90E93A7C633649256A85003161B9.pdf.

[132] *Id.*

[133] *Id.*

[134] Awaji Takahisa, *Risoku Seigenhō Ihan ni Taisuru Saikōsai Hanketsu no Hitotsu no Handan*, 22 HŌRITSU HIROBA (No. 3) 10, 13 (1969). Following a fairly standard pattern, four judges, three prosecutors, two attorneys, and a law professor were appointed. Saibansho, Saikōsaibansho Hanji Ichiranhyō, http://www.courts.go.jp/saikosai/about/saibankan/hanzi_itiran.html (last visited Aug. 15, 2007).

[135] 18 MINSHŪ (No. 9) 1868 (Sup. Ct., Nov. 18, 1964), *available at* http://www.courts.go.jp/hanrei/pdf/6FDED3E81EC2B66B49256A85003124E0.pdf; Ono Shūsei, *Kashikingyō ni Matsuwaru Saikin no Saikōsai Hanrei no Hōri*, 1319 JURISITO 26 (2006); Chihara Yōko, *Saikōsaibanrei no Kiseki Seiri*, 1106 HANREI TAIMUZU 14, 16, 24 (2003).

[136] 18 MINSHŪ 1868 (Sup. Ct., Nov. 18, 1964), *available at* http://www.courts.go.jp/hanrei/pdf/6FDED3E81EC2B66B49256A85003124E0.pdf.

Supreme Court acknowledged its earlier decisions, but now found that "when the borrower has voluntarily paid interest and liquidated damages on a cash-based consumption loan contract in excess of the restrictions" that portion should be applied to the remaining principal. The Court found Article 1 was a mandatory provision and any excess interest rate charges "void":

> As a result, even where a borrower makes payment designating it as payment of interest and liquidated damages, with regard to the excess portion, that designation is without meaning, and, as a result, it is treated as if there was no designation at all.[137]

Where unpaid principal remained, now, pursuant to the default provisions of the Civil Code, excess interest would be applied to that principal.[138] Where earlier courts searched for the parties' intent, now, that intent "is without meaning" and "treated as if there was no designation."[139]

For the first time, the Supreme Court prioritized consumer protection: "interpreting the debtor's voluntary payment of amounts in excess of the restrictions as payment towards the remaining principal comports with the primary legislative intent of the law to protect the borrower who occupies an economically disadvantaged position."[140] Any other interpretation justified by an inequality of result would "abandon the protection of borrowers with principal outstanding and violate the legislative spirit of this law."[141]

The Court's concern with unequal treatment of borrowers was short-lived. Four years later, the Supreme Court explicitly allowed claims for refund.[142] Plaintiff had borrowed at an interest rate of 84%, defaulted, and the defendant foreclosed on property pledged as collateral. The plaintiff sued for return of the property and a refund of interest and penalties paid. The lower court refused to award damages, but the Supreme Court reversed:

> [W]hen a borrower has voluntarily paid interest or liquidated damages in excess of the law's designated interest rates, a demand for the refund of that excess portion cannot be made. However, this provision is, as a matter of course, premised on principal existing on a cash-based consumption loan. Where

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[137] *Id.* The courts looked to the statute and, reasoning by analogy, found payment of excess interest was like prepayment of interest and applied to the principal. *Id*.

[138] *Id.*

[139] *Id.*

[140] *Id.*

[141] *Id.*

[142] 22 MINSHŪ 2526 (Sup. Ct., Nov. 13, 1968), *available at* http://www.courts.go.jp/hanrei/pdf/DDEC3536DC70EC1349256A8500312311.pdf.

> principal on the loan does not exist, it cannot give rise to interest or liquidated damages, and, as a result, it is not possible for there to be an excess payment of interest or liquidated damages.[143]

In other words, where the principal had been paid and the borrower continued to voluntarily pay interest and liquidated damages, the payment is made on a "non-debt," the IRRA is not applicable, and "a claim for repayment based on unjust enrichment will be recognized."[144] Scholars argued that the Supreme Court had engaged in "judicial legislation" declaring paragraph 2 of Articles 1 and 4 of the IRRA deadletter.[145] They called the decision "groundbreaking" and a clear attempt at "social ordering" by the Supreme Court.[146]

Throughout the remainder of the 1960s and 1970s, the courts repeatedly upheld borrower's claims for unjust enrichment and awarded damages refunding gray zone interest rates charges. In their decisions, the courts continued to emphasize the inequality between the creditor and borrower, focus on substance over form, and ignore the parties' stated intent.[147]

A second 1968 Supreme Court decision illustrates their willingness to ignore the plain language of the contract.[148] The parties had entered into multiple loan contracts and contractually designated the apportionment and order of payment, but the court found: "with regard to . . . the amount in excess of the restrictions for which no obligation exists, that agreement is meaningless."[149] At this point, the Court was willing to flatly ignore the explicit intent of the parties. It addressed the issue sua sponte, as "a legal issue," finding no need to wait for argument or special pleading from the parties.[150]

A 1977 Supreme Court decision illustrates their interest in substance over form.[151] The Court found the lender lent ¥11.5 million to a borrower

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[143] *Id.*
[144] *Id.*
[145] Awaji, *supra* note 134, at 10, 13-14.
[146] *Id.*
[147] 23 MINSHŪ 2137 (Sup. Ct., Nov. 25, 1969), *available at* http://www.courts.go.jp/hanrei/pdf/C0F5BC0BF304870C49256A850031228D.pdf; 24 MINSHŪ 298 (Sup. Ct., Apr. 21, 1970), *available at* http://www.courts.go.jp/hanrei/pdf/5C454C208038E7F149256A8500312269.pdf.
[148] 22 MINSHŪ (No. 10) 2257 (Sup. Ct., Oct. 29, 1968), *available at* http://www.courts.go.jp/hanrei/pdf/644EF2748FEC1ADC49256A8500312318.pdf.
[149] *Id.*
[150] *Id.*
[151] 31 MINSHŪ (No. 4) 449 (Sup. Ct., June 20, 1977), *available at* http://www.courts.go.jp/hanrei/pdf/CA1573B0BBD85C4949256A8500312086.pdf.

but required the borrower maintain ¥6 million on deposit. In doing so, the lender violated Article 19 of the Antimonopoly and Fair Trade Act and "engaged in an unfair business practice."[152] The Supreme Court found "in reality" a loan to "the economically vulnerable appellant" of no more than ¥5.5 million and recalculated interest charges based on this, subject to the restrictions set out in the IRRA.[153]

With these decisions, the Supreme Court began to enforce a "legislative intent" to protect the borrower and, in doing so, to ignore the parties' stated intent. Along the way, they invalidated the "voluntary payment" sections of the IRRA.[154] According to one practitioner, after 1964, the Supreme Court came to "prioritize the objective application" of the Act.[155]

The decisions did little though to stem growing problems, widely reported in Japanese newspapers, with the burgeoning consumer finance industry. With banks focused on secured business loans and uninterested in unsecured consumer loans, consumer finance companies started cropping up in the 1950s and increased rapidly in the 1960s.[156] *Sara-kin*, an abbreviation for "salaryman financing" or unsecured consumer loans, continued to grow throughout the 1970s and the 1980s.[157] Finance companies introduced automatic teller machines ("ATM") to dispense cash loans to registered users.[158] "One call lending" allowed new borrowers to complete loans over the telephone and have the money transferred to the customer's bank account the same day.[159] New ATMs followed that could screen new borrowers allowing them to borrow any time of the day or night, without the

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[152] *Id.* According to Article 19 of the Antimonopoly and Fair Trade Maintenance Act, "No entrepreneur shall engage in unfair business practices." Shiteki Dokusen no Kinshi oyobi Kōsei Torihiki no Kakuo ni kansuro Hōritsu [Antimonopoly and Fair Trade Maintenance Act], Law No. 23 of 2003, art. 19, *translated in* [STATUTE VOL.] DOING BUSINESS IN JAPAN pt. 7, at app. 7A-23 (Zentaro Kitagawa ed., 1999).

[153] 31 MINSHŪ (No. 4) 449 (Sup. Ct., June 20, 1977), *available at* http://www.courts.go.jp/search/jhsp0010?action_id=first&hanreiSrchKbn=02.

[154] ONO, *supra* note 22, at 284.

[155] Chihara Yōko, *Saikōsaibanrei no Kiseki Seiri*, 1106 HANREI TAIMUZU 14, 16 (2002).

[156] Terada, *supra* note 26; *Bōri Sarakin Yurusanu, Kisei Hōan Konkokkai ni Teishutsu he Yoyatō Gōi—Jōgen Kinri Dankai Sage*, NIKKEI (Yūkan), Mar. 20, 1982, at 7; *Bōryoku Toritate ha Haijo—Tōnai no Kashikingyōsha, Jishu Kisei Tsukuru*, NIKKEI, Apr. 9, 1982, at 23; Kaho Shimizu & Mayumi Negishi, *Aggressive TV Commercials Paid Off—Perhaps Too Much*, THE JAPAN TIMES, May 18, 2006.

[157] Shōhisha Kinyū Shinyō Kyōyo Zandaka (Shōwa 56–Heisei 14), *available at* http://www.stat.go.jp/data/chouki/14.htm (last visited Mar. 22, 2008); Zaimukyoku Kankei no Kinyū Kikan, *available at* http://www.mof.go.jp/zaimu/50nenn/020402.htm (last visited Mar. 22, 2008).

[158] *Shōhisha Kinyū Kakusha, Madoguchi Kikaika Rasshu—CD·ATM o Shinzōsetsu, Raishun 200 Dai Taisei*, NIHON KEIZAI SANGYŌ SHINBUN, Apr. 22, 1982, at 12.

[159] *Denwa Ippon De Sugu Yūshi—Shinshu no Sarakin Hirogaru Ippō, Ukeru Tegarusa, Higeki mo Fueru*, NIKKEI (Nishibu Chōkan), Apr. 9, 1983, at 17.

embarrassment or inconvenience of going to a finance company.[160] Consumer loans up to ¥300,000 required only an identification card and self-declaration of income.[161]

Along with easy credit came harsh collection tactics.[162] In 1976, the National Police Agency took the unusual step of publicly requesting the Ministry of Finance investigate and adopt regulatory measures to address the problems associated with the economic downturn in the 1970s and bad-faith, high interest lending practices.[163] Consumer interest groups formed to advocate legislative reform.[164] Local bar associations formed study groups,[165] and the Japan Federation of Bar Associations proposed legislation.[166] Opposition parties submitted bills in the Diet to regulate the industry.[167]

Newspapers, even the conservative *Nihon Keizei Shinbun*, began publishing accounts of *sara-kin* financing destroying families; overwhelmed borrowers fleeing their homes; borrowers committing suicide; borrowers killing their children and themselves; housewives arrested for burglarizing department stores to repay consumer debt; and debtors setting fire to their homes to collect the insurance and repay consumer loans.[168] Of the fifty-four debt-related suicides recorded in Fukuoka Prefecture in 1982,

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[160] *See* Shimizu & Negishi, *supra* note 156; *see also* Nakamura & Negishi, *supra* note 11.

[161] Utsunomiya, *supra* note 2, at 16. Unsecured loans are generally offered for individuals in amounts up to ¥300,000 and for small businesses in amounts up to ¥500,000. The terms of the loan vary, but are often advertised as ranging from one month to five years, payment by monthly installment. All contain acceleration clauses and liquidated damages; many require a guarantor. *See, e.g.*, Promise, Shōhin Naiyō, Kaiin Kiyaku, https://cyber.promise.co.jp/Pcmain;jsessionid=0001Tr8toqbPA6lcTkbVBzT8Q6G:2 (last visited Apr. 30, 2007); Acom, AC Kain Kiyaku, Kashitsuke Jōken Hyō, http://pr.acom.jp/def/?p1=afvc003 (last visited Apr. 30, 2007); Takefuji, ¥Shop, http://www.takefuji.co.jp/shop/karitai/ad693_main.html?ad=p000693%83g%83%89%83t%83B%83b%83N%83Q%81%5B%83g (last visited Apr. 30, 2007).

[162] *Bōri Sarakin Yurusanu, Kisei Hōan Konkokkai ni Teishutsu he Yoyatō Gōi—Jōgen Kinri Dankai Sage*, NIKKEI (Yūkan), Mar. 20, 1982, at 7; *Bōryoku Toritate ha Haijo—Tōnai no Kashikingyōsha, Jishu Kisei Tsukuru*, NIKKEI (Chōkan), Apr. 9, 1982, at 23.

[163] *Akushitsu Sarakin, Hōchi Dekinu—Keisatsuchō, Ōkurashō ni Kisei Kyōka Yōsei*, NIKKEI (Chōkan), Dec. 22, 1976, at 19.

[164] *Shōhisha Kinyū Kyōkai, Sarakin Riyōsha Hogo ni Kujōshorii nado Setchi*, NIKKEI (CHŌKAN), Dec. 29, 1976, at 8.

[165] *Ōsaka Bengoshikai, Sarakin Mondai o Kenkyū—Hōsei no Shian Tsukuri he*, NIHON KEIZAI SANGYŌ SHINBUN, July 28, 1977, at 9.

[166] *Sarakin, Nichibenren ga Kiseian—Menkyōsei Dōnyū ya Rishi Seigen*, NIKKEI (CHŌKAN), Aug. 3, 1978, at 22.

[167] *"Sarakin" Hōkisei no Ugoki - Eigyō Teishi nado Gyōsei Kainyū, Kōmeitō, Konkokkai ni Hōanteishutsu*, NIKKEI (CHŌKAN), May 7, 1977, at 6.

[168] *Kokumin Seikatsu Shinbukai, Sarakin Kisei de Chūkan Hōkoku—Shōhisha Shinyō Hogohō o, Kōkinri nado Hadome*, NIKKEI (Chōkan), Sept. 9, 1978, at 22; *Keishichō, Nenmatsu Hikae Akushitsu Kinyū 34 Gyōsha Tekihatsu*, NIKKEI (Yūkan), Nov. 27, 1981, at 15; *Okūsan, Otonari Made Sarakin Higeki ga – Kigaruni Karishimi ni*, NIKKEI (Nagoya Chōkan), Apr. 4, 1983, at 21; *Sarakingyōhō no Settei o Isoge*, NIKKEI (Chōkan), Apr. 9, 1983, at 2.

approximately 80% were attributed to problems with *sara-kin*.[169] The police made mass arrests of lenders violating the law and pointed to links to organized crime.[170] The stories of "debtor's hell" and "salaryman finance tragedies" mounted and so did the pressure on the Japanese government to act.

In 1978, as discussions between the ministries over a regulatory framework dragged on, the Ministry of Finance worked on a bill that would cut the then current public law caps of 109.5%.[171] They issued administrative guidance to the Japanese Federation of Consumer Finance Associations to clarify interest disclosures and begin providing detailed receipts.[172] The Prime Minister followed, directing the administrative agencies to submit to the next session of Diet a comprehensive legislative proposal.[173] In two months, the Ministry of Finance had draft legislation that created a licensing system for lenders, reduced maximum interest rates, and added administrative oversight.[174]

The bill was never submitted to the Diet.[175] LDP proposals barred borrower claims for refund of interest charges in excess of the IRRA caps where "the borrower paid the interest voluntarily," an addition reversing the Supreme Court and strongly opposed by the opposition parties.[176] The LDP's legislation "miscarried" in 1979, and again in 1980, 1981, and 1982.[177] Over the course of eight sessions of parliament, bills were

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[169] *Sarakin Higeki, Yūkōgata kara Seikatsugata he—Kyūshū Kakuchi de Kensū Kyūzō, Hōritsu Sōdan 3 Wari*, NIKKEI (Nishibu Chōkan), Apr. 16, 1983, at 17.

[170] *Keishichō, Akushitsu Sarakin 25 sha Tekihatsu—Mise no Shina Katte ni Shobun no Rei mo*, NIKKEI (Yūkan), Nov. 25, 1978, at 11; *Keishichō, Nenmatsu Hikae Akushitsu Kinyū 34 Gyōsha Tekihatsu*, NIKKEI (Yūkan), Nov. 27, 1981, at 15; *Tōkyō·Himonyasho, Geppu Hanbaiten Kara 2 Okuen Sashu no Shufu Guru-pu o Taihō—Sarakin no Hensai ni Komari*, NIKKEI (Yūkan), Feb. 24, 1982, at 15.

[171] *Ōkurashō, Sarakin Kisei he Hōritsu Kaisei o Kentou—Kinri no Jōgen wo Hanbun ni?*, NIKKEI (CHŌKAN), Aug. 22, 1978, at 1.

[172] *Ōkurashō, Sarakin o Kyōroku ni Gyōsei Shidō—Nenritate Demo Hyōji, Kōrikisei to 2 Dan Kamae*, NIKKEI (CHŌKAN), Aug. 23, 1978, at 3.

[173] *Sarakin Kisei Hōan, Jiki Kokkai Seiritsu Hakare—Shushō Shiji*, NIKKEI (Yūkan), Oct. 20, 1978, at 1; *Ōkurashō, Sarakin Kisei he Shusshi Hō Kaisei no Genan—Tōrokusei · 3 Nen Kōshin*, NIKKEI (Chōkan), Dec. 12, 1978, at 3.

[174] *Id.*

[175] *Seifu, Sarakin Kisei no Kashikingyou Kise Hōan no Kokkai Teishutsu Dannen, Giin Rippou Machi he*, NIKKEI (Chōkan), Mar. 13, 1979, at 9.

[176] *Sarakin Kisei Hōan, Ōtsume de Nankō—Jiminan ni Yatō Ni no Ashi, Chōka Kinri no Atsukai ga Shōten ni*, NIKKEI (Chōkan), May 10, 1979, at 3; *Sarakin Kisei Hō, Yoyatō no Iken Chōsei Nakō—Gure-zo-n ga Sōten, Saishū Ketsuron ha Raishu Ikōka*, NIHON KEIZAI SANGYŌ SHINBUN, May 10, 1979, at 10.

[177] *Sarakin Kisei Hōan, Jimintō Tandoku Demo Kokkai Teishutsu he—Zaisei Bukai de Hōshin Katameru*, NIHON KEIZAI SANGYŌ SHINBUN, May 17, 1979, at 10; *Kashikingyō Kisei Hōan, Keizoku Shinsa ha Hisshi—Yoyatō 'Gure-zo-n" de Tairitsu*, NIHON KEIZAI SANGYŌ SHINBUN, June 11, 1979, at 9; *Jimin, Sarakin Kisei Hōan Saiteishutsu o Kimeru*, NIKKEI (Chōkan), Mar. 15, 1980, at 4; *Kashikingyō Hōan no Kaitei Machikoshi he—Kinri Kisei Nuki no Hōan Shingi, Ōkura no 'Matta" de Tekkai*, NIHON

introduced and either defeated or withdrawn for further review.[178] Opposition parties also objected to LDP proposals that would reduce maximum interest rates to 54.75% rather than 36.5%.[179] Small and medium lenders, then lending at 70% to 80%, opposed any reduction and "possessed vote getting power that the LDP could not ignore."[180]

The LDP then proposed to reduce interest rates over time, lowering the maximum interest rate to 40.0004% "at a future date" and keeping the "voluntary payment" provisions. [181] They admitted the law would overturn Supreme Court precedent but argued that it balanced the need for borrower protection with the need to improve an unstable business environment for lenders.[182] Opposition parties and the Japan Federation of Bar Associations argued the proposal was a sop to industry, would increase problems, and turn the IRRA into a "shell."[183] After six years of debate, the LDP gathered enough support for the proposed regulatory structure to overcome opposition to the interest rate provisions. The bill passed, as proposed, in 1983.[184]

With this, the Diet revised the Investments, Deposits, and Interest Rates Act and enacted the third and final piece of legislation that regulates the consumer finance industry today, the Money Lending Industry Regulation Act.[185] The Diet revised the former by amending Article 5 to reduce the interest-rate levels at which criminal penalties would attach "in instances where moneylending is conducted as a business."[186] The maximum interest rates would be reduced in stages, from 109.5% to 73% in

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KEIZAI SANGYŌ SHINBUN, Nov. 11, 1981, at 9; *Bōri Sarakin Yurusanu, Kisei Hōan Konkokkai ni Teishutsu He Yoyatō Gōi—Jōgen Kinri Dankai Sage*, NIKKEI (Yūkan), Mar. 20, 1982, at 7.

[178] *Sarakin Kiseihō Seiritsu Kankin, Akushitsugyōsha Haijo ni Kōka—"Kinri" no Kaizen Mada Mada*, NIKKEI (Chōkan), Apr. 16, 1983, at 7.

[179] *Sarakin no "Tsuke" Itsumade—Kisei Hōan, Mata mo Ryūzan?*, NIKKEI (Chōkan), Apr. 15, 1982, at 3.

[180] *Id.*

[181] *"Myōyomi" no Kashikingyō Kiseihō—Jōgen Nenri 40.004%, Ōkura ha Seiritsu ni Muke-Maru*, NIHON KEIZAI SANGYŌ SHINBUN, May 11, 1982, at 12.

[182] *Id.* ("This law is momentous as it seeks to overturn Supreme Court precedent setting out a right of demand return of interest. It will improve the unstable business conditions facing lenders, and at the same time protect borrowers. It must be passed this session of the Diet.").

[183] *Nichibenren, Sarakin Kisei Hōan de Jimintō·Shakai ni Ikensho—Higaisha Fuyasu Osore*, NIKKEI (Chōkan), July 23, 1982, at 3; *Nichibenren nado, Sarakin Hōan Hihan*, NIKKEI (Chōkan), Apr. 20, 1983, at 31 (A law like this is likely to enlarge the usury pot (*nabe*), and is clearly tilted towards protecting the interests of industry.").

[184] Kashikingyō no Kisei nado ni Kansuru Hōritsu [The Money Lending Industry Regulation Act], Law No. 32 of 1983, *available at* http://law.e-gov.go.jp/htmldata/S58/S58HO032.html (last visited Jan. 15, 2007) [hereinafter Money Lending Industry Regulation Act], *translated in* [STATUTE VOL.] DOING BUSINESS IN JAPAN, *supra* note 152, pt. 7, app. 7C; *Sarakin Kisei Hōan Sanin de Kaketsu, Shūin he*, NIKKEI (Yūkan), Apr. 20, 1983, at 1.

[185] Money Lending Industry Regulation Act, *supra* note 184.

[186] *Id.* art. 5, ¶ 2.

three years, to 54.75% in five years, and to 40.004% at an undetermined future date.[187] Supplementary rules carved out exceptions for "daily installment lenders," who "for the time being" could continue to lend at rates up to 109.5%.[188] By this point the largest consumer finance companies were lending at rates below 50% and were largely unaffected.[189]

These revisions were limited in comparison to the newly enacted Money Lending Industry Regulation Act. The 1983 law imposed comprehensive regulation on the industry.[190] Article 3 required money lenders operating in one jurisdiction to register with the governor's office and those operating in multiple jurisdictions to register with the Ministry of Finance.[191] Registration could be refused based on a finding of previous violations of the laws regulating the money lending industry.[192] Unregistered money lenders were prohibited from operating, and registered

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[187] *Sarakin Kiseihō no Seiritsu, Akushitsugyōsha Tsuihō he*, NIKKEI (Chōkan), Apr. 29, 1983, at 11; ONO, *supra* note 22, at 236.

[188] Supplementary Rule Nos. 8-10 addressed "daily installment lenders" (*nippu kashikingyōsha*) lending to designated small-scale industries engaged in the production and sale of goods. Repayment periods were required to be over 100 days in length, with the lender collecting in person at the debtor's home or place of business. The intent was to facilitate loans to small business by allowing payments from daily sales receipts, with the higher collection costs justifying the higher rates. Lenders were required to make collection rounds on over 70% of the payment days in order to qualify for the higher interest rate. *See* ONO, *supra* note 22, at 238-40; Kinyūchō, Kashikingyōsha Kankei no Hōrei ni Tsuite, http://www.fsa.go.jp/ordinary/chuui/hourei.html (last visited Jan. 26, 2007). Lenders would advertise "one phone call/immediate lending" and "borrow ¥100,000 and pay only ¥1000 a day." *Hikake Kinyū, Jōken Kibishiku: Saikōsai Handan Akushitsu Kōri Haijo ni Michibiku*, ASASHI SHINBUN, Jan. 25, 2006, at 2. Supplementary Rule Nos. 14 & 15 provided additional exceptions for pawn brokers and "telephone subscription loans." NTT traditionally charged a substantial subscription fee for the installation of telephone service, and "telephone subscription loans" were secured by that subscription. The principal amount of the loan could not exceed an amount specified by ordinance and tied to the cost of purchasing the subscription and installing the line. *See* ONO, *supra* note 22, at 238-40.

[189] *Sarakin Kiseihō Seiritsu he—Akushitsugyōsha ha Eigyō Teishi, Sarakin Nabe Bōshi niha Genkai*, NIKKEI (Chōkan), Apr. 27, 1983, at 5.

[190] *Sarakin Kiseihō Seiritsu Kankin, Akushitsugyōsha Haijo ni Kōka—"Kinri" no Kaizen Mada Mada*, NIKKEI (Chōkan), Apr. 16, 1983, at 7. According to Article 1, "[t]he purpose of this Act is to establish a registration system for those engaged in the business of lending money, to set forth necessary restrictions on such businesses . . . and to protect interest of those in need of loans." Money Lending Industry Regulation Act, *supra* note 184, art. 1.

[191] Money Lending Industry Regulation Act, *supra* note 184, art. 3. Registration requires detailing: 1) the trade name, designation, and address; 2) for legal entities, the names and addresses of officers; 3) for designated employees, the names and addresses of such employees; 4) for minors, the name and address of the legal representative; 5) the names and locations of the places of business or offices; 6) the types and methods of business; and 7) if other businesses are performed, the types of such businesses. *Id*. Subsequent amendments added requirements for the listing of a designated principal at each office and contact information, including the office phone number, for any offices or places of business to be listed in advertisements or loans solicitations. *Id*. art. 4. The 2003 amendments required confirmation of the applicant's identity, additional capital requirements and prohibitions on affiliation with organized crime. Kinyūchō, Kashikingyōsha Kankei no Hōrei ni Tsuite, http://www.fsa.go.jp/ordinary/chuui/hourei.html (last visited Jan. 26, 2007).

[192] Money Lending Industry Regulation Act, *supra* note 184, art. 6, ¶ 5.

money lenders prohibited from operating at undisclosed places of business.[193] Unregistered lenders were now subject to criminal penalties of up to three years imprisonment or a fine of up to ¥3 million.[194]

The Money Lending Industry Regulation Act also required investigation of the borrower's credit worthiness and prohibited loan contracts likely to exceed his or her ability to repay the loan, but assigned no penalty for violation.[195] The Act prohibited collection practices that amounted to coercion (*ihaku*) or which "disturbed the peace of private life or work,"[196] and for these violations imposed criminal penalities of up to six months imprisonment or a fine up to ¥1 million.[197]

It also detailed new documentation requirements. Lenders were required to disclose at their place of business information regarding interest rates, the method and period of payment, number of installments, and other information designated by ordinance.[198] The Act required advertisements to include the interest rate and other information designated by ordinance, and also prohibited any representation considered false or misleading.[199]

Pursuant to Article 17, lenders concluding a loan contract must "without delay" provide the borrower with written documentation clearly disclosing the terms of the loan contract.[200] Pursuant to Article 18, when the borrower makes a payment, the lender "must promptly provide to the borrower receipt documents for each payment." [201] The Act gave the Prime

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[193] *Id.* art. 11, ¶¶ 1, 3.

[194] *Id.* art. 47, ¶ 2.

[195] *Id.* arts. 13, 36; *Sarakin Kiseihō no Seiritsu, Akushitsugyousha Tsuihō he*, NIKKEI (Chōkan), Apr. 29, 1983, at 11.

[196] Money Lending Industry Regulation Act, *supra* note 184, art. 21. Subsequent revisions gave specific examples including collection, absent justifiable reason, between the hours of 9 p.m. and 8 a.m., telephone or visits to the borrower's place of work, and also prohibited the use of or sale of debt to members of organized crime. *See* Kinyūchō, Kashikingyōsha Kankei no Hōrei ni Tsuite, http://www.fsa.go.jp/ordinary/chuui/hourei.html (last visited Jan. 26, 2007).

[197] Money Lending Industry Regulation Act, *supra* note 184, art. 48.

[198] *Id.* art. 14.

[199] *Id.* arts. 15, 16.

[200] *Id.* art. 17. The loan contracts must include: 1) the tradename, designation, and address of the moneylender; 2) the date of execution of the contract; 3) the amount of the loan; 4) the interest rate on the loan; 5) the method of repayment; 6) the period for repayment and number of installments; 7) where there is a liquidated damages provision, the amount thereof; and 8) other items as designated by Ministry of Finance Ordinance. *Id.* art. 17 ¶ 1, items 1-8.

[201] *Id.* art. 18. These receipt documents must contain: 1) the tradename, designation name, and address of the moneylender; 2) the date of execution of contract; 3) the amount of the loan; 4) the amount received and its apportionment to interest, principal or damages; 5) the date of receipt of payment; and 6) any other items designated by the Ministry of Finance. *Id.* art. 18 ¶ 1, items 1-6. Additional disclosures are required by ordinance including: 1) words indicating receipt of payment; 2) the moneylender's registration number; 3) the borrower's name, commercial name, and registration number if any; 4) if a third party other than the borrower or guarantor made payment, that person's name, trade name, and/or registration number if any; and 5) the remaining amount of the loan after payment. Enforcement

Minister and prefectural governors power to suspend a registered lender's business for up to one year where the lender violates the disclosure and collection provisions and to cancel the lender's registration where the circumstances are either particularly grave or a suspension order is violated.[202]

At the same time, Article 43 rolled back the judicially developed norms of the 1960s.[203] Prior to the 1983 legislation, approximately 30,000 borrowers a year restructured or eliminated debt pursuant to the standards established by the Supreme Court.[204] Article 43 now provided that where the borrower "voluntarily paid interest" in excess of the maximum interest rates and the borrower received the necessary documentation, that payment would be "deemed a valid payment of interest on the debt."[205] The articulated rationale was that moneylenders as registered entities were now subject to strict regulation, and Article 43 was intended to protect and encourage "good-faith lenders" by allowing them to charge higher interest rates.[206] Proponents also argued that if debtors were able to demand a refund of excess interest rate payments, transactions would lose their certainty, and it would lead to an increase in black-market moneylending.[207]

The provision was enormously unpopular within the scholarly community and the Japanese bar; they had opposed it from the start, without effect.[208] In contrast, the judiciary opposed this change to great effect. There were no sweeping pronouncements, but there was a slow, incremental restriction of the Article's application.

Early on, lower courts held that Article 43 of the Money Lending Industry Regulation Act voids the intent of the IRRA and "is applicable only where the conditions imposed are strictly met."[209] Those conditions included the lender proving 1) it acted as a registered moneylender "engaged in the business"; 2) the borrower paid the money "voluntarily as interest"; and 3) the lender provided all of the proper documents.[210]

Regulations for the Money Lending Industry Regulation Act, *as revised by* Cabinet Order 39, Apr. 11, 2006, art. 15, ¶ 1, items 1-5.

[202] Money Lending Industry Regulation Act, *supra* note 184, arts. 36-37.

[203] Ono, *supra* note 135.

[204] *Sarakin Kiseihō Seiritsu he—Akushitsugyōsha ha Eigyō Teishi, Sarakin Nabe Bōshi niha Genkai*, NIKKEI (Chōkan), Apr. 27, 1983, at 5.

[205] Money Lending Industry Regulation Act, *supra* note 184, art. 43 ¶ 1. The same prescription applies to liquidated damages. *Id.* art. 43 ¶ 3.

[206] ONO, *supra* note 22, at 240-41.

[207] *Id*.

[208] *Id*. at 327-28.

[209] 168 MINSAI SHIRYŌ 48 (Kōmatsu Summary Ct., Sept. 27, 1985).

[210] 1327 KINYŪ HŌMU JIJŌ 29, 33 (Tokyo D. Ct., Oct. 11, 1991); ONO, *supra* note 22, at 328.

With regard to money paid "voluntarily as interest," by 1985 summary courts were refusing to apply Article 43 where the lender failed to prove the borrower's "expression of intent to designate the payment as an interest payment."[211] Courts apportioned the money paid by the debtor to the principal, damages, and interest within the caps.[212] Later district courts held that "it is appropriate to require active intent" by the borrower to designate the payment voluntarily made as interest or damages in order to make an otherwise invalid debt valid.[213]

The courts also focused on the documentation requirements.[214] Where the lender failed to disclose all the items required in Article 17 when the loan was consummated, or where the documents contained mistakes or omissions, however slight, the courts refused to apply Article 43. A 1988 Kyoto court rejected an Article 43 claim by a lender charging interest rates of 73%.[215] The court held that "all items" must be properly disclosed for Article 43 to apply and that did not happen where one loan contract disclosed the interest per day rather than per annum and a second failed to disclose the lender's registration number.[216] Other courts rejected application of Article 43 where the umbrella loan document miscalculated the minimum payment necessary to repay a ¥200,000 loan over a two-year time period.[217] Other courts refused to apply Article 43 where the lender receipts incorrectly identified certain charges as "handling fees" instead of interest.[218]

Lower courts applied the Article 18 documentation requirements with the same vigor.[219] Article 18 requires that the lender provide the borrower with a receipt containing certain disclosures "promptly" on receipt of each payment.[220] Paragraph 2 provides an exception: where payment is made by electronic transfer, the receipt is required "only upon request of the person making the payment."[221] The courts, however, routinely held that even with electronic payment and regardless of demand by the borrower, where the

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[211] 168 MINSAI SHIRYŌ 48, 51 (Kōmatsu Summary Ct., Sept. 27, 1985).
[212] *Id.*
[213] 1327 KINPŌ 29, 33 (Tokyo D. Ct., Oct. 11, 1991). *See also* 897 HANREI TAIMUZU 213 (Nagoya D. Ct., May 30, 1995).
[214] ONO, *supra* note 22, at 335.
[215] 1318 HANREI JIHŌ 106, 108-09 (Kyoto D. Ct., Aug. 19, 1988).
[216] *Id.*
[217] 1290 HANREI JIHŌ 131, 136-37 (Akita D. Ct., Mar. 14, 1988).
[218] 1250 HANREI JIHŌ 70, 73 (Tokyo D. Ct., Oct. 3, 1986).
[219] ONO, *supra* note 22, at 360.
[220] Money Lending Industry Regulation Act, *supra* note 184, art. 18. *See supra* note 201 listing the required disclosures.
[221] *Id.* ¶ 2.

lender did not promptly provide a receipt containing all of the required disclosures after each payment, they would not apply Article 43.[222] Courts summarily rejected Article 43 claims where the lender did not offer proof they supplied the Article 18 documents.[223] Courts demanded proof sua sponte when the borrower failed to appear in court.[224] The courts found the Article 18 documentation requirements to be part of a process justifying the "voluntary payment" of an otherwise invalid debt.[225]

The first appellate decision addressing Article 18 requirements rejected arguments that the borrower had contractually agreed to accept an electronic bank transfer receipt in lieu of the Article 18 receipts.[226] According to the Osaka High Court, it is only when the "lender strictly complies with the procedures" set out in Article 17 and Article 18 that they are entitled as a "special privilege" to charge otherwise invalid interest rates.[227] "It is possible for the commercial lender, at the time of the loan, to use its superior position to force agreement to the substitution of simpler documentation."[228] To allow this would defeat the purpose of the statute: to provide both evidence of payment in the event of a subsequent dispute and also "cause the borrower to clearly understand the costs associated with the debt and apportionment of the repayment."[229]

When Article 18 documents were provided, substantial compliance was not enough. From "the standpoint of consumer protection," all of the disclosures specified by law were required.[230] Descriptions in the receipt of payments apportioned to "money advanced" were not specific enough.[231] Article 18 receipts omitting the lender's address and registration number precluded Article 43 application.[232]

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[222] 1152 HANREI JIHŌ 158, 159 (Kyoto Summary Ct., Aug. 8, 1984); 1187 HANREI JIHŌ 121, 123 (Sasebo Summary Ct., July 23, 1985); 1318 HANREI JIHŌ 106, 109 (Kyoto D. Ct., Aug. 19, 1988); 705 HANREI TAIMUZU 175, 176 (Osaka High Ct., Mar. 14, 1989).

[223] 1152 HANREI JIHŌ 158, 159 (Kyoto Summary Ct., Aug. 8, 1984).

[224] 1187 HANREI JIHŌ 121, 123 (Sasebo Summary Ct., July 23, 1985).

[225] 1318 HANREI JIHŌ 106 (Kyoto D. Ct., Aug. 19, 1988); 1152 HANREI JIHŌ 158 (Kyoto D. Ct., Aug. 8, 1984); ONO, *supra* note 22, at 363.

[226] 705 HANREI TAIMUZU 175 (Osaka High Ct., Mar. 14, 1989).

[227] *Id*. at 176.

[228] *Id*.

[229] *Id*. Absent demand, failure to provide Article 18 documentation would not result in criminal penalty, but it would preclude a creditor from making claim for gray zone interest charges pursuant to Article 43. *See* 652 HANREI TAIMZU 246, 249-50 (Osaka D. Ct., Sept. 26, 1986).

[230] 705 HANREI TAIMZU 175 (Osaka High Ct., Mar. 14, 1989).

[231] 1250 HANREI JIHŌ 70 (Tokyo D. Ct., Oct. 3, 1986).

[232] 168 MINSAI SHIRYŌ 58 (Sapporo Summary Ct., Nov. 29, 1985).

The courts also focused on the "voluntariness" of the payments. When a loan contract required discounted interest payments, a Tokyo District Court found:

> [U]nder circumstances where absent prepayment of interest financing will not be received, payment by the debtor cannot be said to be voluntary. . . . As a result, even if prepayment of interest is done by agreement, it is appropriate to find that it is not subject to application of Article 43.[233]

The court ignored the parties' agreement, found the prepayment terms imposed, and found no "voluntary" repayment as a result.

An Osaka District Court examined the Article 43 requirements and found all the requirements met, save one.[234] The court refused to apply Article 43 holding:

> In order for the condition of voluntariness to be met, it is reasonable to interpret that the borrower must be aware that the interest and penalty payments they are making exceeded the restrictions set out in the [IRRA], and while aware of that voluntarily make payment. [235]

The court required proof of the borrower's subjective knowledge of the IRRA restrictions and, absent that, found no "voluntary" payment. [236]

The Osaka High Court pulled back from these aggressive attempts to protect borrowers and reversed.[237] In 1990, the Supreme Court affirmed its decision.[238] The Supreme Court found the purpose of the moneylending industry law was to secure the appropriate functioning of the industry, and to "protect the interests of the suppliers of capital."[239] Where the contract documentation and receipt documentation complied with the intent of the law, that was sufficient: "[I]t is not required that the borrower understand that the amount paid exceeded the interest or anticipatory damages limitations set out in [the IRRA] or that the contract, as to the portion in

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[233] 748 HANREI TAIMZU 170 (Tokyo D. Ct., Dec. 12, 1990).

[234] 854 KINHAN 12 (Osaka D. Ct., Feb. 27, 1987). The defendant was a moneylender, registered with the Osaka city government, engaged in the business of making consumer loans. The payments made by the plaintiff were made pursuant to the contract. At both the time of the loan and at each payment, defendant provided the plaintiff borrower with the proper loan documentation. *Id*.

[235] *Id.*

[236] *Id.*

[237] 854 KINHAN 10 (Osaka High Ct., Sept. 18, 1987).

[238] 44 MINSHŪ 332 (Sup. Ct., Jan. 22, 1990), *available at* http://www.courts.go.jp/hanrei/pdf/2F4A8370CA2DF46749256A8500311ECB.pdf.

[239] *Id.*

excess, was void."[240] The Court found that if the plaintiff made the payment with the understanding it would be applied to interest and penalties, this payment was made "of their own free will," and this was sufficient to apply Article 43 to validate gray zone lending.[241]

The Supreme Court endorsed a flexible interpretation of the Article 43 requirements, and was roundly criticized by the bar and by legal scholars.[242] It was the Court's last such decision. Shortly thereafter, in 1991, Japan's economic bubble collapsed. The stock and real estate markets collapsed, and, while that proved a disaster for the banks, it was a "boon for consumer finance."[243] Those who could no longer obtain bank loans after the value of their landholdings and other collateral fell turned to the finance companies and, thereafter, the courts.[244]

Despite the 1990 Supreme Court decision, the lower courts continued to restrictively interpret the lending laws.[245] A Tokyo District Court again found that regardless of agreement by the parties, where it was plain that absent prepayment of interest refinancing would not occur, "it cannot be said that payment was voluntary."[246] Later high courts agreed.[247] Other courts examining discounted interest found that the law contemplated "the actual payment of cash," and where "the defendant did not receive tender of cash payment for interest, they would not receive application of Article 43."[248]

The courts continued to focus on documentation. A Nagoya District Court found that, despite mistakes, the documents "if read carefully were sufficient for the average person to understand the terms of the contract" and sufficient to apply Article 43.[249] The Nagoya Appellate Court disagreed, finding that "the contract documents must be sufficiently comprehensive, clear and concrete to allow the borrower to correctly understand the nature of the debt and be able to reference the documentation in formulating a

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[240] *Id.*

[241] *Id.* Earlier decisions found payments made by the borrower with full knowledge that they were in excess of the amount required under the IRRA not voluntary where they were made to stop harsh collection tactics or to prevent foreclosure. 1255 HANREI JIHŌ 30, 32 (Yokohama D. Ct., May 6, 1987); 1308 HANREI JIHŌ 131, 134 (Tokyo D. Ct., June 28, 1988).

[242] 854 KINHAN 10, 11 (1987); Ono, *supra* note 135.

[243] Terada, *supra* note 26.

[244] *See id*.

[245] Ono, *supra* note 135.

[246] 748 HANREI TAIMUZU 169, 172 (Tokyo D. Ct., Dec. 10, 1990). *See also* 1624 HANREI JIHŌ 116 (Tokyo D. Ct., Feb. 21, 1997); 1657 HANREI JIHŌ 102 (Fukuoka D. Ct., Feb. 26, 1998).

[247] 1747 HANREI JIHŌ 104 (Tokyo High Ct., July 24, 2000).

[248] 1700 HANREI JIHŌ 84, 86 (Osaka D. Ct., Mar. 30, 1999). *See also*, 897 HANREI TAIMUZU 213 (Nagoya D. Ct., May 30, 1995).

[249] 1600 HANREI JIHŌ 103 (Nagoya High Ct., Oct. 23, 1996).

repayment plan."[250] In that case, the document was difficult to understand, and the defendant was "a large-scale money lender with a nationwide business operation, and the development of documents setting forth the disclosure contents outlined above . . . cannot be thought of as overly difficult."[251]

The lower courts after the Supreme Court's 1990 decision adopted "a strict posture" holding that the items enumerated in Article 17 must be included in toto for Article 43 to apply.[252] Some held that the disclosures must be contained on one sheet of paper, and where they were not, refused to apply Article 43.[253] An appellate court held that "where it is made clear" that the Article 17 disclosures are supplemented in a separate document, "as an exception," that will satisfy Article 17.[254] However, the court still refused to apply Article 43 because, in that case, it was not made clear enough.[255] Where a lender offered revolving credit, both the umbrella contract and subsequent loan documents taken together must satisfy all the requirements of Article 17.[256] According to some courts, the statutorily required disclosure of "the amount of the loan" required a detailed accounting of the principal, interest and damages from any outstanding loans.[257]

Some courts found that, regardless of documentation, repayment made by the borrower via ATM or electronic bank transfer could not be "voluntary."[258] While the Supreme Court held that it was not necessary for the borrower to understand that they were paying excess interest charges, lower courts could still hold that a borrower must be able to understand what portion of the payment would be applied to interest and penalties.[259] Courts held payments made in person would allow the borrower, if dissatisfied with the apportionment of the payment to interest and penalties, to promptly complain and refuse or withdraw payment. "In contrast, payment when made by standard methods using an ATM, does not allow the user to know beforehand the amount of money that will be allotted to interest and

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[250] *Id*. at 106.
[251] *Id*.
[252] 1052 KINHAN 49, 52 (Tokyo D. Ct., Jan. 1, 1998).
[253] *Id*.
[254] 1128 KINHAN 41, 44 (Tokyo High Ct., Jan. 25, 2001).
[255] *Id*.
[256] 1463 HANREI JIHŌ 144, 148 (Fukuyama D. Ct., Oct. 10, 1992).
[257] *Id*.
[258] 1624 HANREI JIHŌ 116 (Tokyo D. Ct., Feb. 21, 1997).
[259] *Id*. at 121.

damages pursuant to the contract."[260] As a result "it cannot be recognized as voluntary payment of interest."[261]

In 1999, the Supreme Court examined Article 18.[262] It acknowledged that when a borrower voluntarily pays interest in excess of the statutory caps, that excess may be deemed repayment of valid interest-rate charges pursuant to Article 43:

> However, even when this payment is [electronically deposited] to a lender's account or savings account, absent special circumstances, it is reasonable to find that the lender on confirmation of receipt of this payment must immediately provide to the borrower, each time, a document as prescribed in Article 18 paragraph 1.[263]

In other words, the Supreme Court required lenders provide detailed receipts for each payment made by ATM or it would not recognize gray zone interest rates. Commentators argued that with this decision the Supreme Court affirmed the strict interpretation seen in the lower courts.[264]

This decision came as finance companies again assumed the spotlight. As banks stopped lending to businesses in the early 1990s, the finance companies continued, with some specializing in business or *shōkō* loans. Ninety-nine out of 100 companies in Japan are small or medium sized businesses,[265] and by 1999 they were collectively borrowing ¥14 trillion from non-bank sources.[266] Of that, ¥8 trillion came from finance companies, including the two largest business loan companies, Nichiei Co. and Shōkoh Fund.[267] Both loan companies were favorites of foreign investors. Japan funds had begun targeting Shōkoh Fund with its average growth rate of 39% per year.[268] Nichiei Co. was 30% owned by foreign investors and had listed on the Frankfurt Stock Exchange.[269]

Nichiei Co. had also engaged in unsavory collection tactics. Business loans were offered without collateral for amounts up to ¥10 million, but they

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[260] *Id.*
[261] *Id.*
[262] 53 MINSHŪ (No. 1) 98 (Sup. Ct., Jan. 21, 1999) *available at* http://www.courts.go.jp/hanrei/pdf/F684A8C2883573E849256E3900267EA3.pdf.
[263] *Id.*
[264] Ono, *supra* note 135.
[265] Phred Dvorak, *Heat for Japan's Small-Business Lenders—Some Firms Face Charges of Strong-Arm Tactics; Demand is Still Strong*, WALL ST. J., Nov. 9, 1999, at A21.
[266] *Id.*
[267] *See id.*
[268] Margaret Boitano, *A Japan Fund Snaps Up Finance Concerns*, WALL ST. J., June 1, 1999, at C25.
[269] Dvorak, *supra* note 265, at A21.

required a guarantor.[270] In October 1999, one such guarantor filed suit against Nichiei Co. alleging, inter alia, that its loan collectors had demanded the guarantor sell an eyeball or kidney to raise money to repay the loan.[271] A few weeks later, the Metropolitan Police Department arrested the former employee,[272] and the Financial Services Agency ("FSA") started an investigation into *shōkō* lending practices.[273]

There was little tolerance for such tactics. While Nichiei Co. and Shōkoh Fund were growing by leaps and bounds in the late 1990s, the rest of the economy was undergoing "shock therapy" with record bankruptcies, record unemployment, and continuous restructuring announcements.[274] The FSA sanctioned Nichiei Co.,[275] and the Diet enacted new legislation.[276]

The drafters acknowledged the December 1999 legislation was rushed, left issues unresolved, and they provided for re-evaluation of the legislation three years hence.[277] In the interim, the LDP and its coalition partners enacted mandatory disclosure requirements for loan guarantors and mandatory notices to guarantors when providing additional financing.[278] They added new regulations regarding collection practices vis-à-vis loan guarantors and increased the penalty provisions.[279] Revisions to the Investments, Deposits, and Interest Rates Act reduced the interest rates at which criminal penalties would attach from 40.004% to the current 29.2%, and the IRRA was revised to lower the limits on liquidated damages to 1.46

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[270] *See* Suzuki Masanori, *Kashikingyō no Kisei nado ni Kansuru Hōritsu no Ichibu o Kaisei Suru*, 1571 KINYŪ HŌMU JIJŌ 32 (2000); *Cracking Down on Loan Sharks*, THE JAPAN TIMES, Nov. 10, 1999.

[271] Dvorak, *supra* note 265; Utsunomiya Kenji, *Karirugawa ga Seikatsu Dekiru Kinri Made Hikisage o*, ASAHI SHINBUN, Apr. 9, 2005, at b2.

[272] *Cracking Down on Loan Sharks*, *supra* note 270.

[273] *FRC Unit to Probe 'shoko' Lenders*, THE JAPAN TIMES, Nov. 6, 1999.

[274] Kinyūchō, *Kashikingyō Seido nado ni Kansuru Kondankai no Kaisai ni Tsuite, Tōkei Shiryō nado*, http://www.fsa.go.jp/news/newsj/16/kinyu/f-20050427-2.html (last visited Mar. 12, 2007); Bill Spindle, *Japan Inc.'s Overhaul Gathers Steam, Opening Opportunities for Foreigners*, WALL ST. J., May 6, 1999, at A19. The unemployment rate reached 4.8% in March and for the first quarter alone there were over ninety major restructuring announcements. *Id*.

[275] Kinyū Kantokuchō, Kinyū Kantokuchō no Ichinen (Heisei 11 Jimunendōban), *available at* http://www.fsa.go.jp/p_fsa/news/newsj/f-20000627-0/20000627a.pdf (last visited Mar. 24, 2008); Kinyū Kantokuchō Nyu-zu Reta- (Feb. 2000), *available at* http://www.fsa.go.jp/p_fsa/letter/18/l18_001.html (last visited Mar. 24, 2008); Gillian Tett, *Nichiei Prepares for Penalties*, THE FINANCIAL TIMES, Jan. 20, 2000, at 32.

[276] Kashikingyō no Kisei nado ni Kansuru Hōritsu no Ichibu o Kaisei Suru Hōritsu, [Act Partially Amending the Money Lending Industry Regulation Act], Law No. 155 of 1999 [hereinafter Law No. 155 of 1999]; Suzuki, *supra* note 270, at 32.

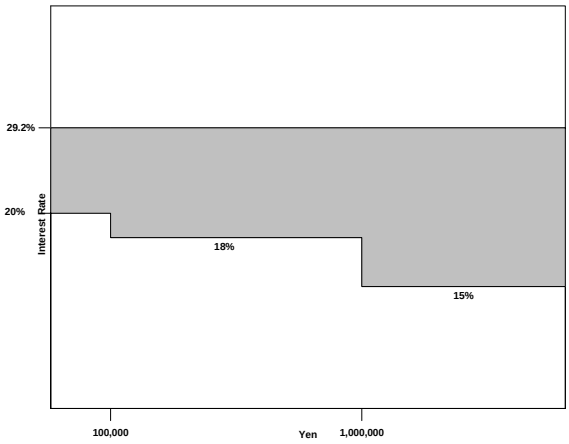
[277] Law No. 155 of 1999, *supra* note 276; Suzuki, *supra* note 270, at 35; Nyu-su Saizensen — Shōshisha Kinyū—Kashikingyouhōkaisei demo nao Nokoru Ooku no Mondai, SHŪKAN TŌYŌ KEIZAI, Sept. 30, 2006.

[278] Law No. 155 of 1999, *supra* note 276.

[279] *Id.*; Ono, *Risoku Seigen Hōri no Aratana Tenkai (Ue)*, 1776 HANREI JIHŌ 172 (2002).

times the maximum IRRA rates.[280] The new legislation reduced the gap and gray zone lending but did not eliminate it.

Gray Zone Lending Post 2000



In 2003, just as the lending laws were to be re-evaluated, consumer finance again found its way into the limelight. On June 14, 2003, a sixty-one year old cleaning company worker, his wife, and her eighty-one year old brother jumped in front of a Japan Railways train.[281] Their suicide note detailed their debts and described how debt collectors had called the house every night and threatened to "get it from their neighbors."[282] They had decided to "apologize with [their] lives."[283]

The suicide note again focused media attention on the finance companies, particularly the black market lenders. While most "legal" money lenders are registered, comply to a lesser or greater degree with the regulations and lend in the gray zone, black-market money lenders either operate without registration or register and operate outside the established regulatory framework.[284] Commentators estimated the victims of black-market or illegal lending practices numbered anywhere from 120,000 to over 1 million people.[285] Statistics maintained by the National Police Agency, showed that organized crime was heavily involved in black-market lending.[286]

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[280] Ono, *supra* note 279; *Keizai Juku—Dai 24 Kai—Tajū Saimusha Mondai niha Kinri Seigen Igai de Kaiketsu Subeki Da*, SHŪKAN TŌYŌ KEIZAI, Oct. 14, 2006, at 13.

[281] *Yami Kinyū, Bakkin Saidai 1 Okuen: Chōkōri Mukō no Hōkō*, ASAHI SHINBUN, June 27, 2003, at 42; *Lenders Sent Up for Borrower Suicides*, THE JAPAN TIMES, Jan. 13, 2007, *available at* http://search.japantimes.co.jp/print/nn20070113a8.html; WEST, *supra* note 15, at 223.

[282] *See* WEST, *supra* note 15, at 223.

[283] *Id.* In January 2007, the Osaka District Court sentenced to prison the four loan sharks it found responsible for the suicides. Three were sentenced to four years and fined ¥500,000. A fourth was sentenced to three years and fined ¥300,000. The judge found that defendants' "crimes were vicious, cruel and persistent. The harsh tactics forced the victims to kill themselves." *Lenders Sent Up for Borrower Suicides*, *supra* note 281.

[284] *Yami Kinyū Taisaku Hō Seiritsu He*, ASAHI SHINBUN, July 2, 2003, at 42.

[285] *Id.*

[286] *Id.*

Arrests of Organized Crime Members Violating Public Lending Laws[287]

Year	1997	1998	1999	2000	2001	2002	2003
Arrests for violation of the Money Lending Industry Regulation Act/Organized crime members arrested	46/23	56/33	56/38	41/22	64/20	52/23	130/63
Arrests for violation of the Investment, Deposit and Interest Rate Restriction Act/ Organized crime members arrested	57/19	60/25	80/17	57/26	76/31	68/25	258/77

In 2003, the police arrested Susumu Kajiyama, the "king of the black-market lenders" and a couple of his twenty-one "presidents."[288] Together, they oversaw a black-market lending operation run by the Yamaguchi crime family that included approximately 1000 offices and brought in profits of ¥10 billion annually.[289] The investigation showed that consumer finance had become a principle source of funding for organized crime in Japan.[290] It also showed that Kajiyama had organized black-market lending operations as part of an intentional strategy during the economic stagnation of the 1990s to move from traditional sources of funds to income sources that targeted the general public.[291] During this time, black-market lenders began direct-mail advertising to large numbers of distressed borrowers and those that had filed for bankruptcy.[292] Police investigations showed employees soliciting loans with interest rates over a thousand times the legal rate and working in offices constructed from karaoke boxes in order to muffle the sounds of their

[287] Keisatsuchō, *Heisei 18 Nendo Jōhanki no Bōryoku Jōsei*, http://www.npa.go.jp/toukei/index.htm#bouryokudan (last visited Mar. 22, 2007).

[288] *Yami Kinyū Jiken:Kasashita no 2 Shachō Tekihatsu*, ASAHI SHINBUN, Nov. 5, 2003, at 31. *See also 'King of Sharking' on Wanted List*, THE JAPAN TIMES, Aug. 6, 2003; Mayumi Negishi, *'Loan Shark King' Plea Held Till Mob Probe Ends*, THE JAPAN TIMES, Nov. 6, 2003.

[289] *Yami Kinyū Jiken, supra* note 288, at 31; Negishi, *supra* note 288. *See also 'King of Sharking' On Wanted List, supra* note 288.

[290] *Yami Kinyū Jiken, supra* note 288, at 31.

[291] Utsunomiya, *supra* note 2, at 18-19; *Karirugawa ga Seikatsu Dekiru Kinri Made Hikisage o*, *supra* note 271. For a discussion of traditional sources of funds for organized crime in Japan, see Curtis J. Milhaupt & Mark D. West, *The Dark Side of Private Ordering: An Institutional and Empirical Analysis of Organized Crime*, 67 U. CHI. L. REV. 41, 66-73 (2000).

[292] Utsunomiya, *supra* note 2, at 18-19.

collection calls.[293] Lenders would go to the debtors' homes, threaten to reveal their debts to their neighbors, and, absent payment, drive around the debtor's house broadcasting the debt over a megaphone.[294]

A little over a month following the Osaka suicides the Diet revised the consumer lending laws.[295] In July 2003, the Diet passed the Black Market Finance Countermeasures Act[296] to address the problems associated with unregistered money lenders and illegal collection practices.[297] The Act raised the criminal penalties for unregistered lenders to a maximum of five years imprisonment and ¥10 million in fines.[298] Japanese courts suspend most sentences under three years, so this meant that actual time would now be served.[299]

The Act increased the registration requirements and precluded registration by those associated with organized crime.[300] It increased basic capital requirements for registration to ¥30 million for individuals.[301] It prohibited advertising or loan solicitation by unregistered lenders, applied the collection provisions to unregistered lenders, and raised the fines associated with unregistered lending and illegal collection practices.[302] The Act also banned advertisements listing only cell phone numbers, misleading advertisements, and solicitions aimed at borrowers without an ability to repay.[303]

The new law set out examples of prohibited collection practices designed to coerce or oppress the borrower including collection during the hours from 9 p.m. to 8 a.m. "without a justifiable reason," and telephone calls or visits to the borrower's work place or other places apart from the home. The legislation prohibited demands for repayment from third parties other than a guarantor without express permission from the borrower.[304] It

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[293] *Hōtei no 8200 Bai de Kōrikashi*, ASAHI SHINBUN, Apr. 7, 2005, at 25.

[294] WEST, *supra* note 15, at 257.

[295] *Yami Kinyū, Bakkin Saidai 1 Okuen: Chōkōri Mukō no Hōkō*, ASAHI SHINBUN, June 27, 2003, at 42.

[296] Kashikingyō Kiseihō Oyobi Shusshihō no Ichibu Kaiseihō [Act Partially Amending the Money Lending Industry Control Act and Investment, Deposits and Interest Rates Act], Law No. 136 of 2003.

[297] Kinyūchō, Yamikinyū Taisakuhō ga Seiritsu Shimashita, http://www.fsa.go.jp/ordinary/yamikin (last visited Jan. 26, 2007); Kinyūchō, Yamikinyū Taisakuhō no Pointo—Ihōna Kinyū Gyōsha ni GoChūi, http://www.fsa.go/jp/ordinary/chuui/yami_leaf/index.html (last visited Jan. 26, 2007).

[298] ¥30 million for legal entities. *See* Kinyūchō, Yamikinyū Taisakuhō no Pointo, *supra* note 297.

[299] *Id.*; *Yami Kinyū Taisaku Hō Seiritsu he*, ASAHI SHINBUN, July 2, 2003, at 42. Kajiyama was ultimately fined ¥5.1 billion and sentenced to prison for six and a half years. Masami Ito, *'Loan Shark King' Faces Payback*, THE JAPAN TIMES, Nov. 18, 2005.

[300] *Yami Kinyū Taisaku Hō Seiritsu he*, *supra* note 299.

[301] *Id.*

[302] *Id.*

[303] *Id.*

[304] *Id.*

prohibited demands for pension documents and other "inappropriate means" of loan maintenance and collection.[305] The legislation prohibited the employment or assistance of any person associated with organized crime or assignment of debt to the same, and it required for the first time the placement of a trained compliance officer at each place of business.[306]

The law provided that where a lender "engaged in the business of lending" loaned money at an interest rate in excess of 109.5%, that loan contract was invalid, in toto, and the borrower need not pay any interest whatsoever.[307] Criminal penalties for loans made in excess of the designated interest rates were raised to a maximum of five years imprisonment and ¥10 million in fines.[308]

The Supreme Court followed in 2003 with a trilogy of decisions that reduced the fees that finance companies could charge. Each decision found that loan guarantee fees paid by the borrower to a loan guaranty company wholly-owned by the lender would be construed as interest received by the lender, and subject to the rate restrictions in the IRRA.[309] Each decision found that where a borrower voluntarily pays interest on one loan in excess of the IRRA caps, that excess, after paying off the principal of the loan, will be applied as payment on other outstanding loans, and the lender "cannot obtain interest during the contractually designated period on this principal."[310]

The Supreme Court handed down three decisions in 2004 involving financing companies' small business or *shōkō* loans. In each case, the Supreme Court reversed lower court decisions finding for the lender. In a February 2004 decision, the Supreme Court agreed with those lower courts that had found that Article 43 had no application where the interest payments had been discounted by the lender.[311] The court also found the requirements of Article 43 "should be strictly interpreted" and that "all of the items" designated in Article 17 must be included in the loan documents. Where any item was missing, including in this case a description of the collateral,

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[305] *Id.*

[306] *Id.*

[307] *Id.*

[308] *Id.* Monetary penalties for lending by legal entities (as opposed to natural persons) at illegal rates rose to up to ¥30 million and for legal entities operating as unregistered legal entities to up to ¥100 million. *Id.*

[309] 57 MINSHŪ 895 (Sup. Ct., July 18, 2003), *available at* http://www.courts.go.jp/hanrei/pdf/6F301B5DBAF5424049256E4C00267DCE.pdf; 1841 HANREI JIHŌ 95, 98-99 (Sup. Ct., Sept. 11, 2003); 1841 HANREI JIHŌ 100, 101 (Sup. Ct., Sept. 16, 2003).

[310] 57 MINSHŪ 895 (Sup. Ct., July 18, 2003).

[311] 58 MINSHŪ 475 (Sup. Ct., Feb. 20, 2004), *available at* http://www.courts.go.jp/hanrei/pdf/F46BB5D2AD0905B149256EDE0026A893.pdf.

Article 43 would not apply. Article 18 receipt documents must be provided "immediately after payment," and, in this case, where the receipts were sent twenty days after payment, Article 43 would not apply.[312] A second decision in February 2004 found that the lenders sending Article 18 receipt documents and the bank's electronic payment forms *prior* to the payment date would not satisfy Article 43.[313] In July 2004, the Supreme Court ruled that mailing the Article 18 documents within seven to ten days was insufficient.[314]

In 2005, the Supreme Court resolved a split among the lower courts finding that while there was no statutory requirement for a lender to disclose a borrower's transaction history, the borrower had a right to demand the same.[315] The court imposed on the lender a "good faith duty" to disclose the borrower's transaction history and found where they violated that duty such action constituted tortious conduct.[316] In 2005, the Supreme Court again found that the requirements of Article 17 "must be interpreted strictly" and where a "revolving credit" contract precluded disclosure of each item required by Article 17, the lender was not absolved from its duty to disclose but required to "disclose information corresponding to those items."[317]

Finally, in the first three months of 2006, the Supreme Court handed down a series of decisions that effectively ended gray zone lending. In a January 13, 2006 decision, the Court examined the acceleration and penalty provisions found in most loan contracts.[318] The provisions were standard: in the event of default, payment of the remaining principal and interest were due immediately, with penalties, and with interest on this sum payable at 29.2%.[319] The Supreme Court overturned a lower court decision in favor of

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[312] *Id.*

[313] 58 MINSHŪ 380 (Sup. Ct., Feb. 20, 2004), *available at* http://www.courts.go.jp/hanrei/pdf/3D7B1186BF8B8E6849256EDE0026A8FD.pdf.

[314] 1163 HANREI TAIMUZU 113, 115 (Sup. Ct., July 9, 2004). In 2004, the Diet also passed the Illegal Pension Mortgage Financing Countermeasures Act which revised the Money Lending Industry Act to prohibit advertisement and solicitation of loans from pensioners and others receiving public assistance. The act prohibited lenders from demanding or holding a pension card, cash card or bank book for a direct deposit bank account for public funds that the law prohibits from being assigned, mortgaged, or garnished. Kinyūchō, Ihō Nenkin Tanpō Yūshi Taishakuhō ga Seiritsu Shimashita, http://www.fsa.go.jp/ordinary/nenkintanpo/index.html (last visited Jan. 26, 2007).

[315] 59 MINSHŪ 1783 (Sup. Ct., July 19, 2005), *available at* http://www.courts.go.jp/hanrei/pdf/8896E167CC0672B2492571240026991F.pdf.

[316] *Id.*

[317] 59 MINSHŪ 2899 (Sup. Ct., Dec. 15, 2005), *available at* http://www.courts.go.jp/hanrei/pdf/3D7AF1922EE8579E492570D8002696FB.pdf.

[318] 1205 HANREI TAIMUZU 99 (Sup. Ct., Jan. 13, 2006); *Shōhisha Kinyū, Seigenhō Kosu Risoku "Hai-iro Kinri" Jisshitsu Hitei*, ASAHI SHINBUN, Jan. 14, 2006, at 43.

[319] 1205 HANREI TAIMUZU 99, 103 (Sup. Ct., Jan. 13, 2006).

the lender declaring that the acceleration clause made the payment of the gray zone interest coerced rather than voluntary.[320]

Article 43 was "an exception" that in light of the intent of the statute to "protect the interests of the borrower" should "be strictly construed."[321] In determining whether "interest was voluntarily paid," the Court would look at whether there was "coercion in fact."[322] The Court found that where there was a liquidated damages and acceleration clause borrowers would pay the excess interest to avoid the penalties; as a result, absent special circumstances, "it cannot be said that the borrower paid the portion of interest in excess of the rate restrictions of their own free will."[323]

A January 19 decision quickly followed affirming this holding and addressing collection practices.[324] The Court would require clear evidence that the excess interest was paid voluntarily, and, with regard to collection practices, that meant more than proof the lender did not violate laws that could result in administrative or criminal penalties.[325] The courts would look at the "totality of the circumstances" and whether the borrower paid the excess interest rate charges "of their own free will."[326]

On January 24, 2006, the Court handed down two additional decisions, both reversing lower courts finding for the lender.[327] Both targeted "daily installment lenders."[328] The Court found in the first January 24 decision that the Article 17 documentation requirements were not met.[329] According to the Court, all designated items must be disclosed, and "when they are not disclosed in a manner that is accurate and clear, the conditions for applying Article 43 paragraph 1 are not met."[330] The Court found the language in the contract inaccurate when "moneys received" by the borrower was not in fact the money tendered by the lender but included a balance from previous loans.[331] The Court found the contract language was unclear where it described days when the lender would not make collection

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[320] *Id.* at 104.
[321] *Id*. at 105.
[322] *Id*.
[323] *Id*.
[324] 1205 HANREI TAIMZU 106, 107 (Sup. Ct., Jan. 19, 2006).
[325] *Id*.
[326] *Id*.
[327] 1205 HANREI TAIMUZU 85 (Sup. Ct., Jan. 24, 2006); 1205 HANREI TAIMUZU 93 (Sup. Ct., Jan. 24, 2006).
[328] 1205 HANREI TAIMUZU 85; 1205 HANREI TAIMUZU 93. *See supra* note 188 defining "daily installment lenders."
[329] 1205 HANREI TAIMUZU 85, 85, 91.
[330] *Id*. at 91.
[331] *Id*.

calls as "customary holidays when transactions are not done."[332] Daily installment lenders "must meet in fact" all of the conditions imposed by statute in order to charge the higher interest rates.[333] The Court's second January 24 decision reiterated that where there was the threat of liquidated damages and acceleration, payment in excess of the IRRA caps was not voluntary, and so long as the borrower paid the interest and principal recognized by law there was no default. [334] With these decisions, Japanese scholars talked of a "substantive change in the jurisprudence" of the Court.[335]

Finally, in Febuary and March 2006, the Supreme Court again reversed lower courts finding for the lender. In a February decision, the borrower had borrowed money pledging property as collateral, defaulted, and entered into a sales agreement with a buy-back option for the same parcel. The option expired, the lender sought to evict, and the Supreme Court found the contract "was not a true sales contract with a buy-back option." [336] The Court found there was no evidence of intent to transfer and construed the contract, in substance, as a loan contract subject to the legal prescriptions on foreclosure.[337] In a March decision, the Supreme Court again strictly interpreted the requirements of Article 18 and struck down a Cabinet Order.[338] While the statute permitted the Cabinet to order disclosures in addition to those enumerated in the statute, the Cabinet Order had permitted the substitution of "the contract number" for "the date of contract" in the lender's receipt documents. This "exceeded the bounds of discretion provided in the law and as such is an illegal regulation." The Supreme Court reversed the lower court, found the Article 18 documentation requirements not met, and found Article 43 inapplicable.[339]

In the first three months of 2006, the Supreme Court handed down six decisions involving finance companies. Each reversed a lower court finding for the lender. Each strictly construed the documentation requirements and narrowly construed the provisions in Article 43 permitting lending at gray zone interest rates. Taken together, they eliminated gray zone lending.

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[332] *Id.*

[333] *Id.* at 92-93.

[334] 1205 HANREI TAIMUZU 93, 96-97 (Sup. Ct., Jan. 24, 2006).

[335] Ono, *supra* note 135, at 33.

[336] 60 MINSHŪ 480 (Sup. Ct., Feb. 7, 2006), *available at* http://www.courts.go.jp/hanrei/pdf/42065DA885C6CC074925710E0026977A.pdf.

[337] *Id.*

[338] 1408 SAIJI 6 (Sup. Ct., Mar. 17, 2006), *available at* http://www.courts.go.jp/hanrei/pdf/20060405100221.pdf.

[339] *Id. See also* 1205 HANREI TAIMUZU 99, 104 (Sup. Ct., Jan. 13, 2006).

III. THE 2006 LEGISLATION

A. The Legislative Process

After the Supreme Court's January decisions, claims for the refund of interest charges spiked.[340] First hundreds, then thousands of people filed suit.[341] The industry had already begun to lose in the lower courts and lobbying to raise or abolish interest rates caps.[342] The Supreme Court decisions sealed their fate in the courts and made it difficult for the Diet to raise interest rates.[343] The consumer finance companies began mediating cases instead of trying them, and by February 2006, estimates for fiscal year 2005 payments exceeded ¥500 billion.[344] The Japanese Association of Certified Public Accountants called for the industry to book a one time charge for all associated losses.[345] The share prices of the four main consumer finance companies plunged.[346] The consumer finance companies' "honeymoon relationship" with the banking industry was over.[347]

The lending laws regulating the consumer finance industry had long been seen as "Diet legislation."[348] The result, according to one FSA official, was that the administrative agencies were not proactive, "though they shared a bed, they had different dreams (*dōshō imu*)."[349] That changed after the 2006 Supreme Court decisions. The FSA followed the January decisions announcing in February its plan to eliminate gray zone lending "in response to the current trend established by the Supreme Court in its de facto rejection of gray zone interest rates."[350] The FSA also announced plans to establish a

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[340] *Mitsugetsu Magarikado: Shōshisha Kinyū, te 4 sha Kabuka Kyūraku*, ASAHI SHINBUN, May 5, 2006, at 7.

[341] *Gure- Zo-n Kinri—Higashi Nihon Kurejetto Aite Tori, Saimusha ga Issei Teiso/Iwate*, MAINICHI SHINBUN, Sept. 28, 2006 at 1; *1,800 Debtors Sue to Get Loan Overcharges Back*, THE JAPAN TIMES, Nov. 14, 2006, *available at* http://search.japantimes.co.jp/print/nn20061114b1.html; *Kabarai Henkan 500 Oku Yen: Shōhisha Kinyū 4 sha, Hai-Iro Kinri Seigen de Fue*, ASAHI SHINBUN, Feb. 26, 2006, at 3.

[342] *Hai-Iro Kinri Tettai he, Hōteki Mujun Kaishō Isogu, Shihō Handan ga Atooshi*, ASAHI SHINBUN, Feb. 22, 2006, at 11.

[343] *Id.*

[344] *Kabarai Henkan 500 Oku Yen: Shōhisha Kinyū, te 4 sha, Hai-Iro Kinri Seigen de Fue*, ASAHI SHINBUN, Feb. 26, 2006, at 3.

[345] *Id.*

[346] *Mitsugetsu Magarikado, supra* note 340; Yuka Hayashi, *Japan's Lending Crackdown May Hurt Foreign Consumer-Finance Investors*, WALL ST. J, Dec. 13, 2006, at C1.

[347] *Mitsugetsu Magarikado*, *supra* note 340, *Kinyū, Ōte 4 sha Kabuka Kyūraku*, ASAHI SHINBUN, May 5, 2006, at 7.

[348] *Hai-Iro Kinri Tettai he, Hōteki Mujun Kaishō Isogu, Sihō Handan ga Atooshi*, ASAHI SHINBUN, Feb. 22, 2006, at 11.

[349] *Id.*

[350] *Kashikingyō: "Hai-iro Kinri" Tettai He: Kinyūcho Hōkaisei Hoshin, Saimusha o Kyūsai*, ASAHI SHINBUN, Feb. 22, 2006, at 43.

new comprehensive Consumer Credit Law, and, as a temporary measure, to revise its rules to prohibit the use of acceleration clauses incorporating interest penalties at gray zone rates and to introduce regulations to reduce excessive lending.[351] The latter included investigation and documentation requirements of the borrower's ability to repay the loan without jeopardizing their ability to live or requiring a pledge of their home as collateral.[352]

The FSA also stepped up enforcement. In April 2006, the FSA shut down Aiful Corporation as a sanction for systemic loan collection abuses, all 1,700 branches for three days and five branches for twenty to twenty-five days.[353] Aiful had been found attempting to collect on a loan completed with a borrower diagnosed with dementia, harassing borrowers demanding repayment, and demanding that borrowers obtain money from third parties to repay loans.[354] In one instance, an Aiful employee dragged a borrower out of his apartment and forced him to borrow money from a nearby liquor store to make a loan payment.[355] Reports of consumer finance company employees telling borrowers to kill themselves so the company could collect the life insurance also surfaced.[356] In short order, eighty-one banks announced they were reconsidering their capital and working relationship with Aiful.[357]

Reports of overwhelming numbers of Japanese indebted to consumer finance companies increased pressure for reform.[358] The FSA released documents showing one in every seven Japanese adults indebted to a lender reporting to the Federation of Credit Bureaus.[359] Reports showed disturbing

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[351] *Id.*

[352] *Kajō Kashitsuke Kisei Kyōka, Kinyūchō, Hensai no Kyōhi Kinshi*, ASAHI SHINBUN, Mar. 6, 2006, at 43. Violation of these new requirements would result in "administrative guidance" with further penalties to await the grant of additional statutory authority from revision of the lending laws. *Id.*

[353] Kanako Takahara, *FSA Orders Suspension of Aiful*, THE JAPAN TIMES, Apr. 15, 2006; Natsuo Nishio & Yoshio Takahashi, *Industry News: Japan Hands 3-Day Supension to Retail Lender Amid Inquiry*, WALL ST. J., Apr. 15, 2006, at B6. *See also* Mariko Yasu, *Despite Loss, Lenders Gain Some Friends*, THE INTERNATIONAL HERALD TRIBUNE, Sept. 8, 2006, at 14.

[354] Takahara, *supra* note 353; Nishio & Takahashi, *supra* note 353, at B6.

[355] Nakamura, *supra* note 7.

[356] *Id.*

[357] *81 Kinyū Kikan: Aiful to Teikei Minaoshi, Ro-n ya Senden Jishuku*, ASAHI SHINBUN, May 5, 2006, at 43. Aiful took loan applications on behalf of banks, guaranteed bank loans, and collected on bank loans in default. *Id*.

[358] Kinyūchō, Kashikingyou Seido Nado ni Kansuru Kondankai no Kaisai ni Tsuite, Tōkei Shiryō Nado, Apr. 27, 2005, http://www.fsa.go.jp/news/newsj/16/kinyu/f-20050427-2/2-1.pdf (last visited Mar. 12, 2007); Utsunomiya, *supra* note 2, at 19.

[359] Utsunomiya, *supra* note 2, at 19.

trends in filings for bankruptcy and in the numbers of financially related suicides.[360]

Bankruptcy in Japan: Individual Filings[361]	
1990	11,273
1991	23,288
1992	43,144
1993	43,545
1994	40,385
1995	43,414
1996	56,494
1997	71,299
1998	103,803
1999	122,741
2000	139,280
2001	160,457
2002	214,638
2003	242,357
2004	211,402
2005	184,422

Suicide in Japan: Financially Related Suicides & Composite Numbers[362]		
1990	1,272	21,346
1991	1,660	21,084
1992	2,062	22,104
1993	2,484	21,851
1994	2,418	21,670
1995	2,793	22,445
1996	3,025	23,104
1997	3,556	24,391
1998	6,058	32,863
1999	6,758	33,048
2000	6,838	31,957
2001	6,845	31,042
2002	7,940	32,143
2003	8,897	34,427
2004	7,947	32,325
2005	7,956	32,552

Those numbers told only part of the story. While there is a stigma associated with bankruptcy in Japan, suicide has been described by some as "honorable."[363] FSA documents showed that the consumer finance companies took advantage of this: for fiscal year 2005, seventeen consumer finance companies received a combined ¥4.3 billion in suicide policy payouts on approximately 4,908 borrowers.[364]

A deliberative council (*shingikai*) established by the FSA pursuant to the 2003 revisions had been meeting for a year and on April 21, 2006

[360] *Id.* at 14-15; Kinyūchō, *supra* note 358; WEST, *supra* note 15, at 219. Japan continues to have one of the highest suicide rates among industrialized countries, a rate approximately twice per capita that found in the US. *Japan to Tackle High Suicide Rate*, *supra* note 17.

[361] Kinyūchō, *supra* note 358; Utsunomiya, *supra* note 2, at 14.

[362] Kinyūchō, *supra* note 358; Keisatsuchō, Heisei 17 Nenjū ni Okeru Jisatsu no Gaiyō Shiryō, http://www.npa.go.jp/toukei/index.htm (last visited Mar. 20, 2007).

[363] WEST, *supra* note 15, at 249, 257.

[364] Kinyūchō, Heisei 18 Nen 3 Gatsuki Shōhisha Shinyō Dantai Seimei Hoken Jisseki, Oct. 6, 2006, http://www.fsa.go.jp/news/18/20061006-1/01.pdf; Nakamura, *supra* note 7.

published its midterm report.[365] They recommended eliminating gray zone lending by lowering interest rates, adding administrative penalties for excessive lending, requiring lender participation in credit reporting agencies, and establishing a counseling system for distressed borrowers.[366]

The LDP quickly followed suit with their own recommendations. In July 2006, the finance committees for the LDP and Kōmeitō jointly announced their "Basic Framework Regarding Revision of the Moneylending Industry."[367] The LDP committee acknowledged a split among its members but concluded that new legislation should abolish gray zone lending and reduce the 29.2% public law caps imposing criminal penalties to the civil law maximum of 20% found in the IRRA.[368]

This time the consumer finance industry protested loudly.[369] Industry advocates argued that "many borrowers would be shunted out of the legal markets, and, as a result, not only will many borrowers be forced into economic ruin, but they will be susceptible to the coercive measures of the black market lenders."[370] They argued that reductions in the interest rate caps would both increase black market lending[371] and adversely affect the entire economy.[372] With the proposed interest rate reductions coming on top of the Bank of Japan's move from a zero interest rate policy, as many as 4400 small and medium sized lenders would go bankrupt.[373] For the large consumer finance companies, a 5% reduction in interest rates would result in a loss of ¥500 million in revenue for each.[374] Industry representatives

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[365] Nomura Shūya, *Kashikingyō kisei no Arikata*, 1319 JURISTO 2 (Sept. 15, 2006).

[366] *Id.*; *Jōgen Kinri 15%-20% ni, Kinyūcho no Yūshikisha Kon Hōanka, Nanko Mo*, ASAHI SHINBUN, Apr. 19, 2006, at 3; *Kashikingyō Kisei Hō Kaiseian Jigyousha Riyousha kara Higeki*, FUJI SANKEI BIJUNESU AI, Oct. 1, 2006, at 2.

[367] LDP, Kashikingyō Seido nado no Kaikaku ni Kansuru Kihonteki Kangaekata, http://www.jimin.jp/jimin/seisaku/2006/pdf/seisaku-020.pdf (last visited Mar. 7, 2007); Nomura, *supra* note 365, at 2.

[368] LDP, *supra* note 367; Nomura, *supra* note 365, at 2.

[369] Nomura, *supra* note 365, at 2; Ishii Tsuneo, *Kashikingyō Seido Kaikaku no Hōkō to Eikyō ni Tsuite—Kashikingyōkyōkai no Kangaekata*, 1319 JURISTO 22 (2006).

[370] Ishii, *supra* note 369, at 22.

[371] The argument has been made before. In 1572, Reverend Thomas Wilson, citing Italian jurist Andreas Alciatus, argued that strict prohibitions against usury led to a system of lending money only by "the woorst of men, suche as care not for laws and are past al shame." Taeusch, *supra* note 30, at 306 (quoting THOMAS WILSON, A DISCOURSE UPON USURY 345 (Tawney ed., 1925) (1572)). *See also* 2 BLACKSTONE'S COMMENTARIES, *supra* note 19, at *456.

[372] Ishii, *supra* note 369, at 22.

[373] *Id.* at 23.

[374] *Jōgen Kinri 15%-20% ni, Kinyūcho no Yūshikisha Kon Hōanka, Nanko mo*, ASAHI SHINBUN, Apr. 19, 2006, at 3; *Kashikingyō Kisei Hō Kaiseian Jigyōsha Riyōsha kara Higeki*, FUJI SANKEI BIJUNESU AI, Oct. 1, 2006 at 2; *81 Kinyū Kikan: Aiful to Teikei Minaoshi, Ro-n Ya Senden Jishuku*, ASAHI SHINBUN, May 5, 2006, at 43.

predicted restructuring of close to 30,000 employees.[375] Researchers predicted a reduction in Japan's gross domestic product of over ¥2 trillion.[376]

The LDP then proposed lowering the caps from 29.2% to 20% three years after the law went into effect and adding a special ordinance permitting interest rate charges up to 28% for five years. In effect, the LDP proposed a delay of nine years before any real reduction. The LDP also proposed limiting loans to new borrowers to ¥500,000 per year or ¥300,000 per six months, requiring investigation of the borrower's ability to repay loans over ¥1 million, and increasing criminal penalties.[377] At the same time, however, they sought increases in the IRRA caps so that interest rates of up to 20% could be charged on loans up to ¥500,000, 18% charged on loans up to ¥5 million, and 15% on loans in excess of ¥5 million.[378] In other words, the LDP proposed a 2% increase in the caps applicable to most consumer loans and a 3% increase on larger loans up to ¥5 million.

There was a backlash from the opposition parties, as expected.[379] The Japan Federation of Bar Associations and consumer interest groups also protested.[380] The Bar argued that the spike in lending by organized crime that led to the 2003 legislation was the result of a conscious strategy implemented in the mid-1990s and not the result of the previous reductions in the interest rate caps.[381] They pointed to interest rates cuts from 54.75% to 29.2% during the fifteen years from 1991-2006 and, at the same time, the number of borrowers doubling.[382] They argued that the LDP proposal was unmitigated "industry protection."[383]

Outside the LDP, sympathy for the consumer finance industry was limited. Financial numbers for Takefuji, Acom, Promise and Aiful stood in stark contrast to the statistics released for personal bankruptcies and

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[375] Ishii, *supra* note 369, at 24.

[376] *Id*.

[377] *Ihan Gyōsha ni Keijibatsu Kōkinri Tokurei, Kojin wa Saichō 5 nen Seifu, Kashikingyōkiseikyoukaan o Teiji*, FUJI SANKEI BIJUNESU AI, Sept. 6, 2006.

[378] *Id.*

[379] *Kashikingyō Kisei no Seido Minaoshi Iken Shūyaku Mochikoshi Jimin, Tokureikikan 3 nen no Hōkō*, FUJI SANKEI BIJUNESU AI, Sept. 12, 2006, *available at* http://www.business-i.jp/print/article/2006091200333a.nwc; *Kashikingyō Kisei de Minaoshi Tokurei 2nen, 25.5% de Kecchaku Jimin Gōdō Kaigi de Kecchaku*, FUJI SANKEI BIJUNESU AI, Sept. 16, 2006, *available at* http://www.business-i.jp/news/sou-page/news/200609160028aq.nwc; *Kashikingyō Kisei, Jimin ga Kecchaku Yotōnaini Ondosa Hōan Seiritsu nao Hai-Iro*, FUJI SANKEI BIJUNESU AI, Sept. 16, 2006.

[380] *Risoku Seigenhō "Riage" ni Hanpatsu Kashikingyō seido no Minaoshi "Jimintōan ha Gyōsha Hogo"*, TOKYO SHINBUN, Oct. 5, 2006, at 10.

[381] Utsunomiya, *supra* note 2, at 18-19.

[382] *Id.* at 19.

[383] *Id.*

suicides.[384] The 2004 numbers disseminated by the FSA showed the four main consumer finance companies borrowing from the banks at less than 2% and lending at 27% to 29%.[385] Each had over ¥1 billion in outstanding loans and over two million outstanding loan accounts.[386] Each had before tax operating profits of approximately ¥1 billion.[387] The top four consumer finance companies all ranked in the top forty companies in Japan in terms of declared taxable income, with Acom just below Sharp Corp. and Takefuji just above Japan Tobacco.[388]

For the first time, there was also a backlash within the LDP.[389] Older LDP members argued the proposal would "deal a mortal blow" to the consumer finance industry and decrease the credit available to consumers.[390] Younger LDP members argued in response that only the elimination of gray zone lending would address the growing problems of a class of borrowers that has arisen not as a result of profligate spending but a result of the unemployment and bankruptcies that occurred throughout the 1990s.[391]

Less than two weeks after its initial proposal, the FSA submitted a new proposal to the LDP. The new proposal maintained the increases in the IRRA caps, but scaled back the special ordinance provisions from five years to two and reduced the special rate from 28% to 25.5%.[392] Masusumi Gōtōda, a young LDP member appointed by the Prime Minister to the Cabinet as a Director of Financial and Economic Policy, resigned his position in protest calling this compromise proposal "the worst possible

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[384] Kinyūchō, *supra* note 358; NTA, *Heisei 15 Nendo Kessan Daihōjin no Shinkoku Shotoku Jōi 50sha Juni Hyō*, http://www.nta.go.jp/kohyo/press/press/2004/0410-07/01.htm (last visited Feb. 25, 2008).

[385] Kinyūchō, *supra* note 358; NTA, *Heisei* 15, *supra* note 384; Ustunomiya, *supra* note 2, at 16. As of June 2006, the average bank lending rate was 1.63%. Ustunomiya, *supra* note 2, at 16. For the five years up until July 2006, the central bank's short-term interest rate was zero, as of March 2007 it is 0.5%. Yuka Hayashi, *Japanese Addiction: Currency Bets—Small Investors, Acting 'Like an Enormous Hedge Fund,' Help Push the Yen Around*, WALL ST. J., Mar. 9, 2007, at C1.

[386] Kinyūchō, *supra* note 358.

[387] *Id.*

[388] *Id.* In 2002, Takefuji ranked 11th in terms of declared income, followed by Acom at 12th, Aiful at 20th, and Promise at 21st. NTA, Heisei 12 Nendo Kessan Daihōjin no Shinkoku Shotoku Jōi 50sha Juni Hyō, Jan. 9, 2001 http://www.nta.go.jp/kohyo/press/press/2001/0109/01.htm.

[389] *Nyu-su Saizensen—Shōshisha Kinyū—Kashikingyouhōkaisei demo nao Nokoru Ooku no Mondai*, SHŪKAN TŌYŌ KEIZAI, Sept. 30, 2006.

[390] *Id.*

[391] *Id.*; *Keizai Juku—Dai 24 Kai—Tajū Saimusha Mondai niha Kinri Seigen Igai de Kaiketsu Subeki Da*, SHŪKAN TŌYŌ KEIZAI, Oct. 14, 2006, at 13.

[392] *Kashikingyō Kisei de Minaoshi Tokurei 2nen, 25.5% de Kecchaku Jimin Gōdō Kaigi de Kecchaku*, FUJI SANKEI BIJUNESU AI, Sept. 16, 2006; *Keizai Juku—Dai 24 Kai—Tajū Saimusha Mondai niha Kinri Seigen Igai de Kaiketsu Subeki Da*, SHŪKAN TŌYŌ KEIZAI, Oct. 14, 2006, at 13.

outcome." [393] In media interviews, he blasted the LDP for twenty years of indifference and strong ties to the consumer finance industry. He disclosed that the first proposals for reform were from industry factions within the LDP and were intended to eliminate the caps.[394] He argued the LDP proposals flew in the face of the council report and vowed to continue to protest "as a single party member." [395]

Industry had not requested the special ordinance.[396] Worried about the combined hit from lawsuit related losses and reduced revenue from the proposed interest rate reductions, they opposed the elimination of the gray zone lending.[397] They were not alone. The U.S. Department of Treasury and U.S. financial companies strongly criticized the proposed reforms.[398]

Citigroup and General Electric Co. were active operators in Japan's ¥20 trillion consumer finance industry.[399] The finance division of General Electric had purchased Honobono Reiku, the sixth largest lender in the consumer finance industry, in 1998.[400] The Citigroup subsidiary CFJ purchased Deikku Aiku in 2003, then the fifth largest lender in the industry.[401] Foreign investors owned 20% to 34% of the stock of Aiful, Promise, and Acom.[402] Takefuji, the largest finance company, had listed on the London Stock Exchange in 2000, and, by 2006, foreign investors owned 56% of its voting stock.[403] Takefuji sought to reassure investors with full-page advertisments in the *Wall Street Journal* promoting its "voluntary efforts towards a sound consumer finance market." [404] It also announced an increase in its annual dividend to over 5%.[405] The foreign lobby argued

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[393] *Gōtōda Masuzumi (Shūingiin) "Kashikingyō Kisei hō" Kaisei o Meguri, Kinyū Tantou Seimukan Jinin no Shinso wo Gekihaku "Honenuki" no Kaiaku ha Tetteiteki ni Hihan shi, Saigo made Tatakaimasu"*, KEIZAIKAI, Oct. 17, 2006.

[394] *Id.*

[395] *Id.*

[396] *Kashikingyō Kisei, Jimin ga Kecchaku Yotōnaini Ondosa Hōan Seiritsu nao Hai-Iro*, FUJI SANKEI BIJUNESU AI, Sept. 16, 2006.

[397] *Id*.

[398] Yamanaka Izumi, *Sarakin Kisei ni Igi Ari*, NEWSWEEK [NIHONGOBAN] Sept. 20, 2006, at 45; Hayashi, *supra* note 346, at C1.

[399] Both companies lobbied against lowering the ceiling for interest charges. Justin Baer & Mariko Yasu, *Citigroup to Shut 80% of Consumer-Loan Units in Japan (Update4)*, BLOOMBERG, Jan. 8, 2007 (on file with Journal).

[400] Yamanaka, *supra* note 398, at 45.

[401] *Id.*

[402] *Id.*

[403] *Id.*

[404] *Takefuji, Japan's Leading Consumer Finance Co.-Facts and Figures*, WALL ST. J., Nov. 27, 2006, at A9.

[405] *Id.*

legislation should strengthen the regulation of illegal practices and the black-market moneylenders, but interest rates should be left to the markets.[406]

By the end of October, the debate was over, and the special ordinance calling for a ceiling of 25.5% on small short-term loans was withdrawn.[407] The Cabinet formalized a bill on October 31, 2006 for submission to a special session of the Diet.[408] It would lower interest rates ceilings within three years, limit loans to borrowers, as well as implement stricter procedural requirements including a ban on lenders taking out life insurance policies on borrowers that covered suicide.[409]

B. An Outline of the 2006 Legislation

Announcements by both Takefuji and Aiful in November of their first ever net loss were followed by Acom and Promise posting losses as a result of the set-asides to pay claims, but that made no difference.[410] On December 20, 2006, the Diet passed Law No. 115 of 2006.[411]

The legislation is to be implemented in four stages.[412] The first stage took effect January 2007 and, pursuant to Article 1, immediately raised the criminal penalties in the Money Lending Industry Regulation Act for unregistered moneylenders to a maximum of ten years imprisonment and/or a fine of ¥30 million.[413] At the same time, the Investments, Deposits, and Interest Rates Act was revised to establish the same penalties for receipt of or demand for payment of interest in excess of 109.5% per annum.[414]

Article 2 sets out changes to take place within a year of promulgation.[415] It expands the conditions under which the FSA can refuse

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[406] Yamanaka, *supra* note 398, at 45.

[407] *Cabinet OKs Bill to Cap Lender Rates, End Suicide Insurance*, THE JAPAN TIMES, Nov. 1, 2006, *available at* http://search.japantimes.co.jp/print/nb20061101a3.html.

[408] *Id.*

[409] *Id.*

[410] *Borrower Reimbursment Charge Pushes Takefuji into First-Ever Loss*, THE JAPAN TIMES, Nov. 2, 2006, *available at* http://search.japantimes.co.jp/print/nb20061102a3.html; Terada, *supra* note 26.

[411] Kashikingyō no Kiseinado ni Kansuru Hōritsu nado no Ichibu o Kaisei Suru Hōritsu [Act Partially Amending the Money Lending Industry Regulation Act], Law No. 115 of 2006, *available at* http://www.fsa.go.jp/common/diet/165/01/hou/index.html (last visited Feb. 14, 2007) [hereinafter Law No. 115 of 2006]. *Upper House Passes Bill to Lower Loan Rate Caps*, THE JAPAN TIMES, Dec. 14, 2006, *available at* http://search.japantimes.co.jp/print/nb20061214a1.html (last visited Dec. 14, 2006); Hōrei Enkaku Ichiran, http://hourei/ndl/go/jp/SearchSys/Search (last visited Feb. 14, 2007)

[412] *See* Kinyūchō, Kashikingyō no Kisei nado ni Kan suru Hōritsu nado no Ichibu o Kaisei suru Hōritsuan Yōmō, http://www.fsa.go.jp/policy/kashikin/index.html (last visited Jan. 26, 2007); *see also* Kinyūchō, Kashikingyōhō nado Kaisei no Gaigyō, http://www.fsa.go.jp/policy/kashikin/index.html (last visited Jan. 26, 2007).

[413] Law No. 115 of 2006, *supra* note 411, art. 1.

[414] *Id.* art. 6.

[415] *Id.* art. 2.

to accept the registration of a lender to include those circumstances where the applicant has not developed the necessary business structure to appropriately engage in the moneylending industry and where the applicant is recognized to have engaged in other businesses contrary to the public interest.[416] The Article requires that the moneylender or its agent establish systems to appropriately handle information relating to prospective borrowers, and it prohibits the use of false or misleading information or the omission of material information regarding the contract.[417]

Article 2 prohibits lenders from taking out life insurance policies on borrowers that payoff in the event of suicide, and requires the borrower's consent to otherwise conclude life insurance contracts that name the lender as a beneficiary.[418] It requires the lender "to make efforts" to introduce prospective borrowers who are found in need of assistance to credit counseling services.[419] It adds a suitability provision, requiring lenders to conduct their business in a manner that does not lead to "unsuitable solicitation" that disadvantages prospective borrowers in light of the borrower's knowledge, experience, finances, and purpose for entering into the loan contract.[420]

Article 2 imposes a duty on the lender to provide additional written disclosures to joint guarantors and in contracts establishing a line of credit.[421] It states that a lender may not refuse a borrower's request to examine transaction records absent clear evidence the request is made for improper purposes.[422] It requires disclosures to the borrower explaining the compulsory foreclosure provisions that arise with the completion of a notarized contract.[423] The Article requires advance disclosure of the total

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[416] *Id.*

[417] *Id.*

[418] *Id.*

[419] *Id.*

[420] *Id.* A few states in the United States have begun to debate a suitability standard for lenders as a result of rising subprime default rates. North Carolina currently requires mortgage brokers to "secure a loan that is reasonably advantageous to the borrower," Pennsylvania has proposed rules requiring lenders assess whether the borrower will be able to repay the loan, and proposed legislation in Iowa would require mortgage brokers to place customers in loans that are in "the best interests of the borrower." Federal banking regulators have also proposed guidelines for lenders issuing adjustable-rate mortgages to subprime borrowers. Ruth Simon, *Debating Standards for Mortgage Lenders, Subprime Defaults Prompt Calls for New Rules Ensuring That Loans Suit Borrowers*, WALL ST. J., Mar. 8, 2007, at D1.

[421] Law No. 115 of 2006, *supra* note 411, art. 2.

[422] *Id*.

[423] *Id*. Notarization in Japan establishes documentary and substantive authenticity. A notarized contractual obligation for the repayment of money allows its holder to move directly to the enforcement state of the proceedings in court. Michael K. Young & Constance Hamilton, *The Legal Profession*, *in* JAPAN BUSINESS LAW GUIDE, ch. 7, ¶7-900 (Mitsuo Matsushita ed., CCH Australia Ltd. 1988), *reprinted in*

amount of principal and interest necessary to repay the loan.[424] It also now restricts collection calls and home visits during the day, absent a justifiable reason, where the borrower has made a request regarding the time for repayment. It prohibits the lender from remaining at the borrower's home or place of business after the borrower has requested that the lender leave the premises.[425]

Article 2 of the 2006 legislation also strengthens administrative oversight providing for administrative orders when deemed necessary to protect the interest of the borrower, or to change or reform designated business practices.[426] Where lending practices violate the law or administrative dispositions, the lender's registration may be canceled or an order issued suspending all or a portion of the lender's business or removing its directors.[427] All moneylenders must now provide regular business reports, and either belong to a self regulatory industry association licensed by the Prime Minister's Office, or submit to "appropriate supervision" by the government based on the business practice guidelines established by the association.[428]

Within one and one-half years of enforcement of the Article 2 requirements, Article 3 increases the basic capital requirements for the moneylending industry to an amount established by cabinet order not below ¥20 million and begins an examination system for the compliance officers within the finance companies.[429] During this stage, a system of designated credit reporting agencies, licensed by the Prime Minister's Office, is to be established,[430] replacing the current hodge-podge of organizations with voluntary membership and limited information sharing.[431] Regulations are

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CURTIS J. MILHAUPT ET AL., THE JAPANESE LEGAL SYSTEM: CASES, CODES, AND COMMENTARY 46, 54 (2006).

[424] Law No. 115 of 2006, *supra* note 411, art. 2.

[425] *Id.*

[426] *Id.*

[427] *Id.*

[428] The self-regulatory organization must establish business practices approved by the Prime Minister's Office that include provisions relating to the prevention of excessive lending; minimum payments to be made under umbrella contracts establishing a line of credit; provisions relating to the contents, methods, and frequency of advertisements; provisions relating to solicitation; and provisions relating to the provision of counseling services. It is to establish bylaws for the assessment of penalties for members that violate these regulatory provisions, including the restriction or suspension of rights of membership, and expulsion from the self-regulatory decision. *Id*.

[429] *Id.* art. 3. *See also* Kinyūchō, Kashikingyōhō nado Kaisei no Gaiyō, http://www.fsa.go.jp/policy/kashikin/index.html (last visited Jan. 26, 2007).

[430] Law No. 115 of 2006, *supra* note 411, art. 3.

[431] Kinyūchō, *supra* note 358; Nomura, *supra* note 365, at 7. There currently are four principle credit bureaus: 1) the Federation of Credit Bureaus of Japan consists of approximately 2300 full-time consumer finance companies who are members of 33 different information centers called STARS, as well as credit

to be promulgated regarding the sharing of information among the credit reporting agencies, mandatory membership by lenders, and licensing and approval of the agencies.[432]

Finally, within two and one-half years of enforcement of the Article 2 provisions, Article 4 provides that lenders are required to have at each place of business a registered compliance officer who has passed the examination administered by the Prime Minister's Office, and the cabinet order is to be revised to require basic operating capital in excess of ¥50 million.[433] The conclusion of contracts along with the receipt or demand for payment of interest charges in excess of the IRRA caps will be prohibited. Prior to completing the contract, the lender will be required to investigate the customer's ability to repay the loan, and, if the prospective borrower is an individual, obtain a credit history from a designated credit information agency. The lender is then prohibited from completing loan contracts for amounts that exceed the borrower's ability to repay.[434] Where the lender offers a loan in excess of ¥500,000 or a loan that results in debt loads in excess of ¥1 million, the lender must also obtain proof of annual income.[435] Absent other designated liquid assets, the lender is then prohibited from lending an amount either individually or in conjunction with other lenders that exceeds one-third of the customer's annual income.[436] Where a contract establishes a line of credit, the lender will be required to establish monitoring systems to regularly obtain credit information from a designated credit information agency regarding repayment ability. The lender must then limit additional financing so that the total outstanding loans held by the borrower does not exceed one-third of their annual income.[437]

At this point, Article 43, which provides for "voluntary payment" of interest charges in excess of the statutory maximums, will be abolished and

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associations, credit card companies, and bank affiliated moneylenders; 2) CIC Corporation offers services to approximately 750 members consisting primarily of credit associations, credit card companies, and guarantee companies; 3) the National Bank Individual Credit Information Center has approximately 1500 member banks, bank affiliated credit card companies; and 4) CCB Corporation has about 500 members across the banking, credit card company, and moneylending industries. The result is that information regarding consumer debt is fragmented and an individual consumer's overall debt-level very difficult to assess. Nomura, *supra* note 365, at 7.

[432] Nomura, *supra* note 365, at 7. The Prime Minister's office is also to establish rules for the supervision of these agencies including reporting requirements, on-site investigation provisions, business practice improvement orders, and removal of designation provisions.

[433] Law No. 115 of 2006, *supra* note 411, art. 4. *See also* Kinyūchō, Kashikingyō Hō nado Kaisei no Gaiyō, http://www.fsa.go.jp/policy/kashikin/index.html (last visited Jan. 26, 2007).

[434] Kinnyūchō, *supra* note 433.

[435] *Id.*

[436] *Id.*

[437] *Id.*

along with it "gray zone lending."[438] In conjunction with this, Article 5 provides for the IRRA's revision to include special rules regulating the apportionment of payment where the borrower and lender have entered into multiple lending contracts, and anticipatory damages on default are to be limited to 20%.[439] Special rules will also incorporate any guarantee fees paid with the interest rate charged, subjecting both to the maximum interest rate restrictions.[440]

When these amendments take effect, Article 7 of the 2006 law will also amend the Investments, Deposits, and Interest Rates Act to lower interest rates caps on commercial moneylenders from 29.2% to 20%.[441] The special ordinances permitting higher interest rates from lending by "daily installment lenders" will be abolished.[442] The law concludes by mandating that the government make efforts to develop comprehensive policies to address the problem of distressed borrowers and provides for review of the act within two and a half years after enforcement of all its provisions.[443]

C. The Fallout from the 2006 Supreme Court Cases and Legislation

Shortly after the passage of the 2006 law, the Prime Minister's Office established a Distressed Borrowers Task Force.[444] It charged the task force with developing a counseling program for borrowers, "a social safety net," improving financial and economic education, and strengthening regulation of black-market lenders.

Citigroup boosted loan-loss reserves by $375 million and announced that it would shut about 80% of its consumer finance branches and 100 loan machines in Japan.[445] Acom followed suit announcing it would cut 700 jobs and close 135 outlets to reduce costs.[446] GE announced it would review its

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[438] Kinyūchō, Kashikingyōhō Kaiseihō ni Tsuite, http://www.fsa.go.jp/policy/kashikin/index.html (last visited Jan. 26, 2007); Kinyūchō, Kashikingyōhō nado Kaisei no Gaiyō, http://www.fsa.go.jp/policy/kashikin/index.html (last visited Jan. 26, 2007).

[439] Law No. 115 of 2006, *supra* note 411, art. 5.

[440] *Id*.

[441] Kinyūchō, Kashikingyōhō Kaiseihō ni Tsuite, *supra* note 438; Kinyūchō, Kashikingyōhō nado Kaisei no Gaiyō, *supra* note 438. Lenders lending at interest rates above the individual IRRA caps but less than 20% established by the Investment, Deposit, and Interest Rate Restriction Act, though not subject to criminal penalty, will be subject to administrative action. Kinyūchō, Kashikingyōhō nado Kaisei no Gaiyō, *supra* note 438.

[442] Law No. 115 of 2006, *supra* note 411, art. 7. The special ordinance for "telephone subscription loans" will also be abolished. *Id*.

[443] *Id*. at Supplemental Rules.

[444] Kinyūchō, Kashikingyōhō Kaiseihō ni Tsuite, *supra* note 438; Kinyūchō, Kashikingyō no Kisei nado ni Kansuru Hōritsu nado no Ichibu o Kaisei Suru Hōritsuan Yōmō, *supra* note 415.

[445] Baer & Yasu, *supra* note 399.

[446] *Id.*

business in Japan "to determine the best way forward."[447] Foreign investors announced the legislation was "very clearly the worst-case outcome for the consumer finance industry."[448]

While lawyers and activists applauded the legislation, critics continued to argue that it will adversely affect the broader economy by restricting consumer spending and cause a flood of new bad loans when credit dries up for borrowers servicing debt or, worse yet, cause an increase in black-market lending.[449] The American Chamber of Commerce in Tokyo suggested the legislation would lead to a "large constriction in the supply of credit, undercutting the current economic recovery."[450] Standard & Poor's estimated that the changes will cut outstanding loans at consumer finance companies in half from then current levels of ¥14.2 trillion, and if 80% of these loans were presumed to be used for consumption, national consumption would drop 2% cutting gross domestic product ("GDP") by 1.1%. [451]

Quarterly reports for the first part of 2007 suggest that credit has dried up for consumers presenting the greatest credit risk. For the four largest finance companies, average loan completion rates and outstanding loan balances are down almost 10%.[452] Quarterly profits trended up due to cost cutting, restructuring, and reduced payouts on claims, but payouts on claims are expected to rise again.[453] The Supreme Court recently held that borrowers may demand interest from the consumer finance companies, at the legally prescribed rate of 5%, on all illegal gray zone interest payments made to the finance companies.[454] The borrowers have now become the creditors, earning interest on money unwittingly loaned to the finance companies. Most recently, Promise, the third largest finance company, announced its intention to merge with Sanyō Shinpan Finance, the fifth largest.[455] Other companies are reported to have begun shifting resources to

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[447] Hayashi, *supra* note 346, at C1.
[448] *Id*.
[449] Terada, *supra* note 26.
[450] Hayashi, *supra* note 346, at C1.
[451] *New Law to Halve Consumer Loans: S&P*, THE JAPAN TIMES, Jan. 19, 2007, *available at* http://search.japantimes.co.jp/print/nb20070119a9.html.
[452] *Shōhisha Kinyū 4 Sha Sagaru "Seiyakuritsu"*, ASAHI SHINBUN, Aug. 4, 2007, at 9.
[453] *Id*.
[454] *Consumer Lenders Ordered to Pay Interest on Refunds*, THE JAPAN TIMES, July 14, 2007, *available at* http://search.japantimes.co.jp/mail/nn20070714a6.html.
[455] *Shōhisha Kinyū 4 Sha Sagaru "Seiyakuritsu"*, ASAHI SHINBUN, Aug. 4, 2007, at 13.

Korea where interest rates are currently capped at 66% and industry regulation less severe.[456]

IV. BROADER IMPLICATIONS

If the GDP numbers are anywhere close to accurate, the legislation will measurably harm the Japanese economy, and reports already show that it has measureably reduced credit, as expected. Which raises the question: why did the legislation pass? The question is answered by returning to the immediate events that preceded it: years of recession, growing unease with "the debt problem," an activist Japanese Supreme Court, and younger members of the LDP with enough clout to pass legislation providing relief to consumers but antithetical to industry and efficient markets.

A. The Tokugawa Era

The question can also be answered in a broader context. This is not the first time the Japanese have adopted legislation that constricts the supply of credit. In 1842, a Tokugawa magistrate protested such restrictions.[457] His recommendations for reform were adopted and almost immediately replaced by substantive limitations on interest rates and litigation.[458] The same question arises there: why would the Tokugawa Shogunate repeatedly issue orders dismissing all money suits and repeatedly adjust interest rate caps from 20% to 5%, knowing this was harmful to the broader economy?

Self-interest is one simple answer.[459] It motivated both procedural and substantive regulation. As rulers and arbiters, the Tokugawa made procedural modifications seeking efficiency, and they invalidated "charges under various names" and incomplete loan instruments seeking compliance.[460] More importantly, they sought to protect their base. The Tokugawa rulers sat at the apex of a military class of landowners and bureaucrats who were prohibited from engaging in commerce but required to live according to their station.[461] They were heavily in debt and when the Council of State and Chamber of Decisions made collection difficult,

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[456] *Kankoku Mezasu Kashikingyōsha*, ASAHI SHINBUN, Aug. 3, 2007, at 12; *Ihō Kinri Tajū Saimu Toraburu Zōka*, ASAHI SHINBUN, Aug. 3, 2007, at 12.

[457] *See supra* text accompanying notes 46-48.

[458] *See supra* text accompanying notes 49-51.

[459] Professor Ono describes the orders as a policy measure to preserve the feudal system. ONO, *supra* note 22, at 209-10.

[460] 3 WIGMORE, *supra* note 22, at 5-6, 259, 334.

[461] *See, e.g*, Dan F. Henderson, *Some Aspects of Tokugawa Law*, 27 WASH. L. REV. 85, 92-96 (1952); Harold G. Wren, *The Legal System of Pre-Western Japan*, 20 HASTINGS L.J. 217, 220-222 (1968-1969).

dismissed all lawsuits, and retroactively reduced interest rates on money loans, they protected their own.[462] They demonstrated "compassion" for the "pecuniary difficulties" of the military gentry, with full recognition that they were "injuriously affecting" the circulation of money.[463]

The ruling class engaged in an ongoing attempt to substantively manage the market without stifling it.[464] They sought to impose a substantively fair price, no more than fair consideration for money lent.[465] If recoinage of gold and silver caused an increase in grain prices, that would justify higher interest rates.[466] Conversely if those grain prices fell, interest rates should as well, or the government would decree it so.[467] In repeatedly adjusting interest rates ex post there was little concern demonstrated for procedural fairness and great concern for "fair consideration." The Tokugawa Shogunate served those in power by substantively managing the market.

Confucian-inspired paternalism offered both a justification for regulating the money markets as well as guiding principles in doing so.[468] One sees a fundamentally public law regime wherein civil litigation was both disfavored, and yet commonplace.[469] "Didactic conciliation"[470] occurred within the shadow of "didactic litigation," with the government using the civil litigation process to enforce a private order outside the courts.[471] That order dictated that "the lending and borrowing of money originates as a matter of private arrangement between the parties, and hence there is no necessity for [the court's] undertaking and judging disputes of that sort."[472] It decreed that the parties were to carry out their obligations with a "true sense of their mutual duties" or be punished severely.[473]

Confucian paternalism explains not only the government's conception of its role in private law disputes and its expectations of the parties, but also its willingness to move beyond self-interest. Tokugawa magistrates sought to prohibit representation by "person[s] skilled in litigation," in order to prevent "unfounded suits" for "petty arrearage against country people" and

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462 STEENSTRUP, *supra* note 37, at 146.
463 3 WIGMORE, *supra* note 22, at 333-334; Wren, *supra* note 459, at 220.
464 *See supra* text accompanying notes 31-52.
465 *See supra* text accompanying notes 34-35.
466 *Id.*
467 *Id.*
468 *See, e.g.*, HALEY, *supra* note 68, at 52-55.
469 *Id.* at 57-58.
470 1 DAN FENNO HENDERSON, CONCILIATION AND JAPANESE LAW 4-5, 56.
471 *See supra* text accompanying notes 40-45.
472 3 WIGMORE, *supra* note 22, at 324.
473 *Id.* at 324-25, 334.

suits where "a person takes advantage of the poverty or ignorance of another."[474] At the same time, they granted special privileges to the blind as creditors[475] and, in doing so, again moved beyond simply protecting those in power.

Usury law in Tokugawa Japan evidenced substantive regulation stemming from both self-interest and at least an intent to incorporate the "reciprocal ethical duties of benevolence" required of those in power and discussed in the literature.[476] Both influence practice today.

B. The Meiji, Taisho, and Pre-World War II Showa Eras

The Meiji Reformation marked a fundamental shift from substantive regulation of contract to freedom of contract. In terms of private law and usury law, that shift appeared early on in pronouncements by the Great Council of State and the Codification Committee.[477] Both adopted a "new" philosophy of freedom of contract.[478] Boissonade's proposals codifying continued paternalism were vigously debated and rejected.[479] The interest rate restrictions from the Meiji IRRA remained but only as a compromise.[480]

The nineteenth century cases from the Great Court of Cassation defined that compromise.[481] Professor Kawashima in his writings on litigiousness in Japan noted that disputes between a usurer and debtor exist in a "social vacuum," and "[s]ince the Meiji era . . . , long before industrialization was under way, official statistics have shown a surprisingly large number of cases involving claims of this sort."[482] The courts resolved this surprising large number of cases by restrictively interpreting the applicability of the IRRA.[483] They found the IRRA inapplicable to non-monetary loans, liquidated damage provisions in monetary loans, and in

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[474] *See supra* text accompanying notes 40-41.

[475] The blind were divided into different ranks, with money lending one of the chief occupations of those in the privileged classes. 3 WIGMORE, *supra* note 22, at 12, n.7. According to Professor Ono, they were granted a monopoly on high interest rate lending by the Tokugawa Shogunate as a welfare measure. ONO, *supra* note 22, at 202.

[476] *See* HALEY, *supra* note 68, at 22, 41. "By truthful service to their lord and by displaying benevolence to those they administer," those that rule generate good karma. *Id*. at 41. "The government [*kami*] is selfless." J. Mark Ramseyer, *Oko v. Sako: Kyōgen and Litigation in Medieval Japan*, *translated in* 25 LAW IN JAPAN 135, 137 (1995).

[477] *See supra* text accompanying notes 55-56.

[478] *See supra* text accompanying notes 55-56.

[479] *See supra* text accompanying notes 64-70.

[480] *See supra* text accompanying notes 71-73.

[481] *See supra* text accompanying notes 75-92.

[482] Takeyoshi Kawashima, *Dispute Resolution in Contemporary Japan*, *in* LAW IN JAPAN: THE LEGAL ORDER IN A CHANGING SOCIETY 41, 45-46 (Arthur Taylor von Mehren ed., 1963).

[483] *See supra* text accompanying notes 75-80.

some cases commercial loans.[484] The court followed these cases in the early twentieth century by repeatedly invoking the principle of freedom of contract in defense of their rejection of borrower's claims.[485] Both were accompanied by a shift in focus from the intent of the government to the intent of the parties. In these cases, the courts focused on "the agreement of the parties" and rejected claims of unjust enrichment where the interest was "voluntarily paid."[486] The courts rejected claims that loans were void as against public policy absent "cruel circumstances."[487]

Japanese scholars describe a conservative court narrowly interpreting the law.[488] There is arguably more to it. During this period, the court evolved from a public law centered organ of the state to a separate judiciary sitting as arbiters of private disputes. This shift from public to private was accompanied by an evolution from a substantive conception of justice to a formal one. With few exceptions, private law now focused on the intent of the parties and the freedom of those parties to structure their relationship, without regard for state interests and limited concern for the public welfare.[489]

Scholars describe a similar evolution in the United States during the eighteenth and nineteenth centuries: from a substantive conception of justice to a formal one, one that implemented purely "legal" rules that served new interests in a market economy.[490] According to Professor Horwitz, by the mid-1800s in the United States the early anti-commercial legal doctrines found in the common law had been undermined "and the legal system had almost completely shed its eighteenth century commitment to regulating the substantive fairness of economic exchange."[491]

> Law, once conceived of as protective, regulative, paternalistic and, above all, a paramount expression of the moral sense of the community, had come to be thought of as facilitative of

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[484] *See supra* text accompanying notes 75-80.
[485] *See supra* text accompanying notes 83-86.
[486] *See supra* text accompanying notes 75-80.
[487] *See supra* text accompanying notes 83-86.
[488] *See supra* text accompanying note 92.
[489] The exceptions include Meiji decisions limiting third party rights under property law and Taisho decisions developing the abuse of rights doctrine. *See* 14 DAIHAN MINROKU 1276 (Great Ct. of Cassation, Dec. 15, 1908); 4 DAIHAN MINSHŪ 670 (Great Ct. of Cassation, Nov. 28, 1926). Such decisions, however, focused on balancing the rights of the individual parties as opposed to developing notions of substantive justice as seen with the post-World War II Supreme Court. E-mail from Nobuhisa Segawa, Professor of Law, Hokkaido University School of Law (May 20, 2007) (on file with the author).
[490] Morton J. Horwitz, *The Rise of Legal Formalism*, 19 AM. J. LEGAL HIST. 251, 256-57 (1975). *See* Morton J. Horwitz, *The Historical Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 917 (1974).
[491] Horwitz, *The Rise of Legal Formalism*, *supra* note 490, at 251.

> individual desires and as simply reflective of the existing organization of economic and political power.[492]

The statement is an apt description of what occurred in Japan during the late nineteenth and early twentieth century, but it is not a perfect fit. The law was never perceived of as a paramount expression of the moral sense of the community. It was conceived of as a paramount expression of the moral sense of the Tokugawa Shogunate, but it was regulative and paternalistic.[493] With the Meiji Reformation that conception of law changed. The judiciary would interpret substantive regulation such as the IRRA narrowly.[494] The focus shifted to individual desires and the agreement of the parties, as reflected in the contract.[495] The courts' conception of civil justice evolved to more closely reflect and facilitate economic power.

C. The Post-World War II Showa and Heisei Eras

What is perhaps most remarkable about this evolution is that, in contrast to the United States, Japan shifted back. The Meiji Reformation and importation of Western legal ideas helped to develop a new conception of private law. The end of World War II and the rise of an independent Supreme Court resulted in a second transformation where the courts again committed to enforcing substantive legal standards and the fairness of economic exchange, albeit with a far less heavy hand than their Tokugawa predecessors and with different beneficiaries.[496]

The courts have come once again to view law as a protective, regulative, paternalistic and now, above all, a paramount expression of the moral sense of the community. Now, Professor Horwitz's description is entirely apt. The Japanese courts explicitly voice this when they invoke the "consensus of society" (*shakai tsūnen*) or "sense of society" (*shakai kannen*) in formulating norms and deciding civil law cases.[497] While some dismiss this as a "hortatory device," as Professor Haley notes, what is significant is that "judges themselves still feel bound by what they themselves discern as the community norm."[498]

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[492] *Id.*

[493] *See supra* text accompanying notes 31-52.

[494] *See supra* text accompanying notes 75-86.

[495] *See supra* text accompanying notes 75-86.

[496] *See supra* text accompanying notes 126-154, 209-263, 309-339.

[497] The expression of "the sense of society" or "consensus of society" is among the most frequently used standards in Japanese judicial opinions. *See, e.g.*, HALEY, *supra* note 24, at 157; Foote, *supra* note 24, at 644; Andrew M. Pardieck, *The Formation and Transformation of Securities Law in Japan: From the Bubble to the Big Bang*, 19 UCLA PAC. BASIN L.J. 1, 77 n.376 (2001).

[498] *Id.*

Within the civil law sphere, there has been a movement back from a formalistic conception of justice, one limited to ensuring procedural fairness. After the appointment of ten new post-war Supreme Court justices between 1962 and 1964, the Supreme Court, prompted by the lower courts, changed.[499] It became increasingly assertive, enforcing a substantive conception of fairness, through very formalistic reasoning.[500] The 1954 IRRA codified the "voluntary payment" doctrine adopted by the Great Court of Cassation and limited substantive application of the act.[501] The Supreme Court in 1964 and 1968 effectively nullified that legislative pronouncement.[502] They reasoned first by analogy that payment of interest beyond the caps was similar to discounted interest and would reduce the amount of principle.[503] Once that debt on the principal was extinguished, payment was made on a "non-debt" and subject to claims of unjust enrichment.[504] At this point, the court began to explicitly acknowledge a need "to protect the economically disadvantaged borrower."[505]

An LDP driven by industry interests and the Diet rolled back this new judicial doctrine in 1983 legislation, to counter what one Japanese scholar described as "social ordering" by the Supreme Court.[506] The lower courts immediately began to limit this new legislation, and, after 1990, the Supreme Court uniformly agreed.[507] The courts left the cries for equity, fairness, and debtor protection to the Japanese bar and consumer groups, but through strictly "legal" interpretations of narrow aspects of the law the Supreme Court changed the whole and changed it drastically.[508]

The courts found Article 43 from the 1983 legislation validating gray zone interest rate charges applicable only "where the conditions imposed are strictly met."[509] The courts strictly interpreted what it meant for the borrower to "voluntarily pay interest" and for the lender to provide all the required disclosures.[510] For the latter, "from the standpoint of consumer protection," that meant "all items" accurately disclosed without exception.[511]

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[499] *See supra* text accompanying note 134.
[500] *See supra* text accompanying note 135.
[501] *See supra* text accompanying notes 116-119.
[502] *See supra* text accompanying notes 135-146.
[503] *See supra* text accompanying notes 135-146
[504] *See supra* text accompanying notes 135-146.
[505] *See supra* text accompanying notes 134-142.
[506] Awaji, *supra* note 134, at 10, 13-14.
[507] *See supra* text accompanying notes 209-339.
[508] *See supra* text accompanying notes 209-339.
[509] 168 MINSAI SHIRYŌ 48 (Kōmatsu Summary Ct., Sept. 27, 1985). *See supra* text accompanying notes 208-263, 307-339.
[510] *See supra* text accompanying notes 128-130, 211-263, 310-339.
[511] *See supra* text accompanying note 230.

The courts would not countenance a lender using "its superior position" to force acceptance of less.[512] The courts found it was not that difficult for a "large-scale money lender with a nationwide business operation" to comply with the disclosure requirements.[513] The courts sought to "cause the borrower to clearly understand the costs associated with the debt."[514] For the borrower, voluntary payment of interest meant payment that was not coerced *in fact* by the threat of liquidated damages or default. The courts would look not only at whether there was compliance with the minimum standards established by criminal and administrative regulation, but at the "totality of the circumstances" in determining whether the borrower paid excess interest charges "of their own free will."[515] In doing so, the courts are defining substantive justice, establishing substantive rather than procedural standards.

The Supreme Court exercised its discretionary power to review sixteen consumer finance cases in eight years, six in 2006, finding each contained important issues involving the interpretation of law.[516] All of them restrictively interpreted the lending laws; all of them found for the borrower. In 2003, when the Supreme Court held that guarantee fees paid to guarantee companies wholly owned by a lender shall be construed as interest charged by the lender, they were imposing substantive restraints rather than acknowledging legal forms separating ownership.[517] In 2004, when the Supreme Court held that Article 18 documents must be provided concurrently with or immediately after payment—not twenty days later, not ten days later, and not before—they imposed a substantive restraint on electronic transactions between the lender and borrower.[518] In 2005, when the Supreme Court interpreted "good faith" to require the lender disclose the borrower's transaction records and imposed tort liability for failure to do so, they substantively regulated the relationship.[519] In 2006, when the Supreme Court refused to apply Article 43 where there is coercion *in fact*, where the borrower may have felt obliged to pay the excess interest charges to avoid

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[512] *See supra* text accompanying note 227-228.

[513] *See supra* text accompanying note 251.

[514] *See supra* notes 229.

[515] *See supra* notes 324-326.

[516] *See supra* text accompanying notes 318-339. The Supreme Court accepts civil appeals as a matter of right involving allegations of violation of the Constitution or one of six defined procedural illegalities. The Court may accept discretionary appeals involving important issues involving the interpretation of law. Supreme Court of Japan, Outline of Civil Suit in Japan, http://www.courts.go.jp/english/proceedings/civil_suit.html#ii_b_3 (last visited Feb. 28, 2007).

[517] *See supra* text accompanying notes 309-310.

[518] *See supra* text accompanying notes 311-314.

[519] *See supra* text accompanying notes 315-317.

incurring penalities, they nullified Article 43.[520] The Court eliminated any exception to the IRRA and substantively applied the interest rate caps.[521] When the Supreme Court invalidated the Cabinet Order permitting substitution of "the contract number" for "the date of the contract," it enforced a substantive interpretation of the statute that facilitated to the greatest extent possible the borrower's understanding of his debt.[522]

At this point, in 2006, the LDP and the Diet followed suit. The younger members of the LDP championed the substantive restrictions imposed by the Supreme Court and, despite the best efforts of industry and free market advocates, passed legislation that added both substantive and procedural protections for the borrower.[523] Gray zone interest lending was eliminated.[524] The interest rate caps were lowered.[525] Lenders will now have a duty, enforced by administrative sanction, to ensure the borrower does not borrow too much, no more than one-third their annual income.[526]

Why didn't the LDP and the Diet simply increase penalties for illegal collection tactics? Scholars have argued that "what Japan really needs is facilitation of finance by legitimate institutions to drive the mob out of business."[527] Industry has argued that legislative reform should strengthen the regulation of illegal practices within the industry.[528] A review of the cycles of reported abuse, public outcry, and then legislation suggests that tens of thousands of Japanese are not commiting suicide and fleeing into the night because some nice young man in a suit and tie knocked on their door and respectfully asked them to repay the money they owe. They commit suicide and flee into the night because there are employees calling from karaoke boxes screaming that they pay the money back, because there are employees demanding payment from family and friends, because there are employees demanding they sell an eye to repay their loan.

All of these ills are corrected by ensuring fair process not adjusting interest rates. The Japanese, however, continue to adjust interest rates, and the reason is that substantive justice remains important in Japan. While it may have been abandoned in the United States in the nineteenth century, the concept of substantive justice remains firmly embedded in Japan in the

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[520] *See supra* text accompanying notes 322-323.
[521] *See supra* text accompanying notes 316-337.
[522] *See supra* text accompanying notes 318-339.
[523] *See supra* text accompanying notes 340-409.
[524] *See supra* text accompanying notes 411-443.
[525] *See supra* text accompanying notes 411-443.
[526] *See supra* text accompanying notes 411-443.
[527] WEST, *supra* note 15, at 264.
[528] *See supra* text accompanying notes 399-400.

twenty-first century.[529] That in turn leads to a greater acceptance of and demand for substantive regulation. The scandals resulting in new legislation arise as a result of the consumer finance companies and black market lenders' harsh collection tactics. The bureaucracy, Diet, and judiciary address the issue by drafting new law as new abuses are uncovered, but they are not willing to stop with procedure. There is a demand for substantive justice that leads them to adjust interest rates, adjust maximum penalties and liquidated damages, and, in the case of the judiciary, invalidate statutory provisions that allow creditors beyond those points.[530]

V. CONCLUSION

In looking at usury law in Japan, the lenders and the borrowers each have a story to tell: from the blind lenders and indebted samurai in Tokugawa Japan, to Susumu Kajima the "king of the black market money lenders" in post Bubble Japan, and the elderly family that "apologized" for their debt by jumping in front of a train. The ruling authorities, from the Tokugawa Shogunate, Meiji Oligarchy, and pre-World War II governments to the LDP after the war have also left their mark; some were for, others against, and most beholden to the consumer finance industry.

At the same time, the story of usury law in Japan is in many respects a story about the judiciary. Starting in the Edo period we see judges who did not see themselves as judges: judges who disfavored commerce and disfavored litigation; judges who passed judgment as a necessary evil, and refused to pass judgment as a matter of policy. The Meiji Reformation changed that by creating a professional judiciary that followed the Civil Code model and possessed a fundamentally transformed view of private law, litigation and litigants. Commerce was no longer disfavored, nor was litigation to the same degree, but the judiciary had adopted a view of private ordering that limited their role. Within the courts, private law as opposed to public law was fundamental, but among unrelated parties so was freedom of contract. Finally, in the years since World War II, the Japanese judiciary has come to exercise enormous influence in the realm of private law, far more than in public or administrative law, and it no longer limits itself to discerning the intent of the parties or seeking to enforce procedural fairness in the market.

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[529] *See supra* text accompanying notes 134-158, 318-339, 489-501.

[530] The Japanese response is a conscious response. There is a debate in the context of usury laws, and in other areas, over the extent to which the Japanese government should play a paternalistic role, particularly the lives of low income and young members of society. Nomura, *supra* note 365, at 10.

The courts have rejected to a far larger degree than found in the United States deeply ingrained notions of freedom of contract and rule by and for the market place. They have found as their raison d'etre leveling the playing field in areas of Japanese society that have escaped the attention of the bureaucracy and legislature or, more often, where vested interests have tied the hands of the bureaucracy and legislature. Usury regulation in Japan provides an example of the postwar judiciary's repeated willingness not only to go against the grain, but to hand down decisions that negate legal norms established by the bureaucracy and the Diet.

In looking at writings on the Japanese judiciary, one sees an evolution that does not necessarily reflect this activism. The Japanese judiciary was long viewed "as by far the least influential, much less dangerous, branch" of the Japanese government.[531] Scholars wrote about the dearth of Supreme Court decisions challenging the constitutionality of legislation and administrative actions.[532]

They were followed by increased attention to the Japanese judiciary's role as "agents of legal change" working to preserve relationships.[533] They limited community ostracism,[534] explusion from the family[535] and contested divorce.[536] They restrictively interpreted lease contracts permitting eviction[537] and unilateral termination of a business relationship[538] or an employment relationship.[539] According to this scholarship, "[t]he effect is less . . . to protect the weak against the strong than to prevent unilateral rupture and, in so doing, to confirm community."[540]

Later work noted that judicial activism was not limited to the service of stable relationships and community. The courts have developed broad-ranging judicial norms governing the resolution of disputes involving traffic

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[531] HALEY, *supra* note 24, at 90.

[532] *See, e.g.*, Hiroshi Ito, *Judicial Review and Judicial Activism in Japan*, 53 LAW & CONTEMP. PROBS. 169, 178-79 (1990) ("Japan is a bureaucratic state in which high-ranking administrators shape and reshape many public policies. Courts have been very willing to defer their judgment to that of bureaucrats and politicians. . . . [T]he judicial and legal culture, social conditions, and the configuration of the governing power in Japan are not conducive to judicial activism.").

[533] HALEY, *supra* note 24, at 90, 123-24.

[534] *Id.* at 124.

[535] *See* J. MARK RAMSEYER, ODD MARKETS IN JAPANESE HISTORY 80-108 (1996).

[536] Taimie L. Bryant, *Marital Dissolution in Japan: Legal Obstacles and Their Impact*, 17 LAW IN JAPAN 73, 74 (1984).

[537] HALEY, *supra* note 24, at 140-147.

[538] *Id.* at 151. Courts have limited termination rights in contractual relationships including franchisor-franchisee relationships. Kenji Kawagoe, *Keizokuteki Keiyaku no Shuryrō*, 345 NBL 26 (1986).

[539] Foote, *supra* note 24, at 636-39.

[540] HALEY, *supra* note 24, at 124. "[T]he courts tend to avoid intervening to impose or to enforce external standards—even those of the community at large—to reform the terms of the contract." *Id.* at 147.

accidents,[541] bankruptcy,[542] and securities law.[543] More than maintaining relationships, the courts balance the rights and duties of the parties. In most of these cases, the courts have moved to fill a perceived void in public law and to provide remedies most suited to a determination of the rights and liabilities of private actors.[544]

This work again shows judicial activism that does not maintain a relationship or social structure. While most transactions between borrowers and consumer finance companies are part of an ongoing relationship, there is no "relationship" to preserve. The parties are antagonistic,[545] and when the courts repeatedly recognize the right of the borrower to a set-off and thereafter claims for unjust enrichment, they extract the borrower from that relationship. This work also shows, contrary to earlier pronouncements, that the judiciary exists not simply to fill "lacunae left by legislative and administrative inaction"[546] but works, at times, in an antagonistic relationship with the bureaucracy and the Diet. The courts in adjudicating private law disputes do not necessarily "enforce" or "reflect the policy preferences of the LDP,"[547] but at times the exact opposite. Examining the pattern of legislation and judicial response in the area of usury law suggests that the courts have set out to limit and then nullify those LDP sponsored provisions that they found unsuitable. In this area of the law, the courts have focused on applying substantive justice, not LDP policy, and demonstrated an intent to protect the weak from the strong, not to confirm community.[548]

At the same time, this area of the law shows that the courts are not necessarily uniform and do not necessarily march in lockstep with the

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[541] Daniel H. Foote, *Resolution of Traffic Accident Disputes and Judicial Activism in Japan*, 25 LAW IN JAPAN 19, 24, 26 (1995) ("[T]he automobile accident standards serve as . . . one of the foremost examples of conscious and deliberate judicial activism in Japan.").

[542] Kent Anderson, *The Cross-Border Insolvency Paradigm: A Defense of the Modified Universal Approach Considering the Japanese Experience*, 21 U. PA. J. INT'L ECON. L. 679, 733, 765-79 (2000).

[543] *See* Andrew M. Pardieck, *The Formation and Transformation of Securities Law in Japan: From the Bubble to the Big Bang*, 19 UCLA PAC. BASIN L.J. 1 (2001).

[544] Haley, *supra* note 25; Pardieck, *supra* note 543, at 81.

[545] *See* Nakamura & Negishi, *supra* note 11.

[546] Haley, *supra* note 25.

[547] J. Mark Ramseyer & Eric B. Rasumsen, *Skewed Incentives: Paying for Politics as a Japanese Judge*, 83 JUDICATURE 190, 191, 195 (Jan.-Feb. 2000). *See also* J. MARK RAMSEYER & MINORU NAKAZATO, JAPANESE LAW: AN ECONOMIC APPROACH 18 (1999); J. Mark Ramseyer & Eric B. Rasumsen, *Judicial Independence in a Civil Law Regime: The Evidence from Japan*, 13 J. L. ECON. & ORG. 259, 283-284 (1997); J. Mark Ramseyer, *The Puzzling (In)dependence of Courts: A Comparative Approach*, 23 J. LEGAL. STUD. 721, 725-726 (1994).

[548] In commenting on this Article, Professor Levin has suggested "we may want to disaggregate preservation of relationships from preservation of community . . . the courts' primary lawmaking concern is not about relationships per se, but is about community, that is protecting the economically vulnerable worker, tenant, and borrower." E-mail from Mark Levin, Associate Professor of Law, University of Hawai'i School of Law (Aug. 18, 2007) (on file with the author).

Supreme Court. Judges are "virtually life-time employees of a national governmental bureaucracy called the judiciary,"[549] but that national governmental bureaucracy, at least in the area of usury law, has responded to and not driven the judges in the lower courts. The modern Supreme Court has, with few exceptions, followed the lead of the lower courts in adopting liberal positions that respond to the perceived needs of Japanese society.

In doing so, it has functioned as a remarkably democratic institution, not in terms of bureaucratic structure, but in terms of how normative rules are created and what those rules are: grants of far greater power to the individual borrowers than recognized by the Diet or bureaucracy. That power takes the form of increasing recognition of private rights of action and far more expansive remedies than contemplated by statute.

In this context as well, the courts' treatment of usury law is part of a broader trend. The courts, followed by the Diet, have increasingly recognized new private rights of action.[550] In the context of usury law, the courts repeatedly recognized private rights of action denied in the statutes, first in 1964, then in 1968, and again in 2006.[551] With other consumer contracts, the courts began voiding consumer transactions in the 1990s that violated administrative regulations.[552] The Diet followed in 2000 enacting the Consumer Contract Act codifying new private rights of action.[553] Following years of lower court and then Supreme Court decisions, the Diet enacted in 2000 the Financial Product Sales Act recognizing a private right of action for the broker's breach of the "duty to explain."[554]

In 2004, the Diet revised a law regulating telephone, home, and catalogue sales (*tokushōhō*) to incorporate new civil remedies including a cause of action for rescission and damages.[555] Following years of lower court and then Supreme Court decisions, the Diet revised the Commodities Exchange Act in 2004 to clarify the brokers' "duty to explain" and provide for civil compensation for breach of that duty.[556] In 2004, the Diet revised the Securities Exchange Act to strengthen civil liability provisions and add a presumption of causation between breach and damages in certain

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[549] Setsuo Miyazawa, *Administrative Control of Japanese Judges*, 25 KOBE U. L. REV. 45, 46 (1991).

[550] Ishitoya Yutaka, *Shōhisha Torihiki ni Okeru Minji Ru-ru to Gyōsha Ru-ru no Kōsaku*, 827 NBL 18 (2006).

[551] *See supra* Part II.C.

[552] Ishitoya, *supra* note 550, at 19.

[553] *Id.* at 18. Over 150 reported decisions have addressed the Consumer Contract Act since its enactment. *Id*.

[554] Pardieck, *supra* note 543, at 1, 53-74.

[555] Ishitoya, *supra* note 550, at 20.

[556] *Id.* at 21.

circumstances.[557] In 2006, the Japanese Diet overhauled all of the laws regulating financial products and passed the Investment Services Act.[558] This new law recognizes multiple private rights of action.[559] In short, the 2006 Supreme Court decisions regarding interest rate restrictions and the subsequent revision of the lending laws are part of a much broader trend that has and will continue to change the relationship between the Japanese and the courts. As suggested by Japan's treatment of usury law and the consumer finance industry, the increasing recognition of private rights of action means that civil litigation, the judiciary, and its conception of substantive justice will play a large role in Japan in the years to come.

[557] *Id.* at 21.
[558] *Id.*
[559] *Id.*