



Euler Hermes

# Collection Profile Japan

## Collecting in Japan

- The payment culture in Japan is excellent with only a minority of invoices remaining unpaid thanks to strong cultural particularities. However, excessive DSO and significant payment disparities may be observed from one sector to another.
- Although domestic courts tend to be fairly efficient in delivering timely decisions, tribunals are time consuming, expensive and complex. Therefore, conducting well-orchestrated pre-legal collection actions is essential.
- Similarly, collecting debt from insolvent debtors is overall a challenging exercise and, even though insolvency proceedings could yield dividends, these would spread over years and generate significant costs.

## Collection complexity



## Complexity relating to

Notable → Severe

	Notable	Severe
Payments	\$ \$ \$ \$	
Court proceedings	⚖ ⚖ ⚖ ⚖	
Insolvency proceedings	↘ ↘ ↘ ↘	



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## General information

### Availability of financial information

Financial information is fairly available in Japan. Data may be obtained through various private providers, and listed companies disclose their financials on a quarterly basis. Unlisted companies however have no obligation to publish their financials.

Euler Hermes collects data from various sources and allocates each company a grade reflecting its financial health and how it conducts business. Grades represent a core of our knowledge and analyses, and help clients identify and avoid risk. Data is continuously monitored to offer the most up-to-date information to support management decisions.

### Main corporate structures

Liability for business debts is determined by legal structures, which may be described as follows:

- Sole Proprietorship is available for small businesses managed by an individual and for which no commercial structure is necessary. In this case, the owner is held liable for all business debts. Two or more individuals may also decide to share ownership and responsibilities through Commercial Partnerships (Go-meï Gaisha), in which case the partners may be jointly and individually liable for the actions of the other partners. Limited Liability Partnerships (Go-shi Gaisha) alternatively offer limited liability to the partners.
- Limited Liability Companies (Godo Kaisha, GK) regulated under the Companies Act of 2005 are the most favored legal entities since they require no minimum capital funds while the partners' liability is limited to their contribution. Joint-Stock Corporations (Kabushiki Kaisha, KK) are used for larger structures and require a minimum capital amount (JPY 1, to be increased to JPY 10 million within five years of incorporation) which must be divided into tradable shares. In these entities, the shareholders' liability is limited to the value of their shares.
- Foreign companies may settle in Japan through Representative Offices which are not allowed to generate income and thus merely act as liaison or market research offices. Branch Offices are more common even though such entities are not separate from the parent company's legal structure and thus offer no liability limitations. For this reason, subsidiaries tend to be set up through Limited Liability Companies.

### Regulatory environment

Japan has a Civil Law system in which the courts are not bound by precedents but nonetheless tend to take major decisions of the Supreme Court as guidelines. Justice is rendered through a multitude of Summary Courts (438 in total) at the local level, 50 District Courts (Chiho Saibansho), eight High Courts (Fukuoka, Hiroshima, Osaka, Nagoya, Sapporo, Sendai, Takamatsu, Tokyo) acting as Appellate Courts, and a Supreme Court acting in last resort.

Claims above JPY 1.4 million and litigation involving real properties must be brought before District Courts. District Courts furthermore have jurisdiction over disputes over design rights and trademark rights, but the Tokyo and Osaka District Courts are given the exclusive jurisdiction over disputes arising from, patent rights, utility model rights, etc.



### Days Sales Outstanding (DSO):

While there is a variance in DSO from one sector to another, the average is 69 days.



## Getting Paid

### Days Sales Outstanding (DSO)

The payment culture in Japan is excellent and only a minority of invoices remain unpaid thanks to strong cultural particularities, not to mention the fact that a debtor failing to pay twice over six months may be banned from the banking system.

Having said this, although payments ought to take place within 30 days on average, terms may extend to 60 days and while there is a variance in DSO from one sector to another, the average is 69 days.

In practice, only 45% of transactions are paid according to the terms negotiated by the parties and delays of up to 10 days may be observed.

### Late payment interest

The law allows charging interest on late payment to the debtor as the latter is deemed responsible for the failure to abide by its contractual obligations (Civil Code, Book III Claims, Article 404, 412, 419). Thus, the Commercial Code allows a 6% legal interest rate to be applied to a claim arising from commercial transactions between companies or between companies and individuals.

In fact, late payment interest may even be included into the principal if payment is still in arrears after one year, provided that a notice to pay has been sent to the debtor (Civil Code Article 405).

### Debt collection costs

Similarly, the law allows compensation to be claimed for damage arising as a result of late payment, however it is necessary for the contract to include a provision as to which compensation ought to be paid and how (Article 412 of the Civil Code).

### Ownership protection

Although the Japanese Civil Code does not consider this possibility, Japanese courts have admitted the right of a seller to retain ownership over goods until the debtor has paid the invoice in full, as long as a written agreement has been concluded between the parties. Retention of Title (RoT) provisions are thus fairly common in supply contracts.

Japan also recognizes a statutory Right of Retention (ryuchi-ken), which is different from RoT provisions insofar as it allows a creditor to retain a property owned by the debtor until the latter is released from its obligation to pay.

It should be added that, insofar as notaries have the authority to authenticate contracts, these are often given the same value as final and enforceable court decisions. Therefore, it is essential to carefully consider how contracts ought to be drafted.

### Payments

The majority of domestic transactions in Japan are conducted on open account, which means that the goods are shipped and delivered before payment is due. Domestic deals are alternatively paid through promissory notes (Yakusoku Tegata) because these may be used as enforceable debt recognition titles if left unpaid, however bills of



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exchange (kawase tegata) are not common in practice.

Bank transfers (furikomi) are among the most popular payment means for international transactions as they are fast, secured, and supported by an increasingly developed banking network internationally and domestically. Export transactions are usually guaranteed through Export Credit Insurance, which helps minimize the risk of sudden or unexpected customer insolvency. Euler Hermes' worldwide network of risk offices monitors the financial well-being of customers and grants them a specific credit limit up to which clients may trade and claim should something go wrong. Alternatively, Standby Letters of Credit (a bank guarantees the debtor's credit quality and repayment abilities) are often used in relation to export shipment transactions because they constitute reliable guarantees which can be triggered as a 'payment of last resort' if the client fails to fulfil a contractual commitment. Also, use of irrevocable and confirmed Documentary Letters of Credit (a debtor guarantees that a certain amount of money is made available to a beneficiary through a bank once certain terms specifically agreed by the parties have been met) is increasingly relied upon.

One in five transactions are paid in advance and down payments may be negotiated with local partners.



## Collecting overdues

### Amicable action

#### Negotiating

Negotiation and pre-legal collection efforts always ought to be considered in the first instance since conducting legal action in Japan is complex, and it is essential to be aware of the debtor's activity and solvency status: if the company is not in business anymore or if insolvency proceedings have been initiated, it generally becomes impossible to enforce a debt.

It must be emphasized that there are no specific procedures for the collection of debts in Japan. Therefore, although domestic courts tend to be fairly efficient in delivering timely decisions, tribunals are often unavoidable, time-consuming and expensive (all documents must be translated to Japanese). In such circumstances, it is essential to consider the elements of proof available before considering initiating legal action.

### Legal action

#### Ordinary proceedings

The collection process often starts with the sending of a registered Demand Letter (Naiyo Shomei) to the debtor in order to request payment of the principal and interest.

When the debt is certain and undisputed, a fast-track procedure aiming at obtaining a Demand for Payment (Tokusoku Tetsuzuki) may be initiated. Court clerks usually render a Payment Injunction (Shiharai Meirei) within a week (under the former procedure, Summary Courts used to render Orders within three to six months). Any contestation by the debtor formulated within two weeks, however, leads to bringing the claim before courts through ordinary legal action. The parties are bound by no obligation to cooperate prior to the ordinary judicial process and, although the court may allow a party to request that the other party (or a third party) provides documents in its possession, there are no penalties for non-compliance.

When the debt does not exceed JPY 300,000 (about EUR 2,100), a Small Claims procedure may also be initiated before the Summary Courts, which shall render a decision on the day set for oral argument, otherwise the procedure would also lead to ordinary litigation. Ordinary legal action would usually commence when amicable collection has failed. The creditor would file a claim (sojo) with the District Court which would then serve the defendant with a summons to appear. The court has authority to decide on delays, but failure of the debtor to bring a defense is considered as an approval of the facts of the claim. Hearings are then organized in order to examine evidence and hear third-party experts. In practice, the courts furthermore tend to provide opportunities for negotiations and the parties often reach a compromise.

Otherwise, the courts may award remedies in the form of a declaratory judgment (kakunin hanketsu), of specific performance (kyufu hanketsu), of damages, etc. The court however has no authority to award punitive damages.

#### Necessary documents

Power of Attorney (issued by representative directors, if any, or directors authorized by the company to do so), copy of company registry for defendant company, and documents showing details of the claim (originals if possible).

#### Time limitations

Article 522 of the Commercial Code provides that although a five years' time limitation is applied to a claim arisen from a commercial transaction, if a period for prescription shorter than five years is provided by other laws or ordinances, such provisions shall apply. In other words, claims must be brought to courts within five years, but exceptions would apply.

#### Provisional measures

Upon request, provisional measures in the form of preliminary injunctions may be awarded against the debtor under the Civil Provisional Remedies Act of 1989 to preserve the status quo pending a final and enforceable judgment. Courts usually award provisional attachment orders (kari-sashiosae) to prevent the respondent from disposing of its assets or to protect evidence (shoko hozen) but the claimant must first demonstrate that irreparable harm is likely to occur unless the precautionary measure is granted. In emergency situations, interim measures may occasionally be obtained on a same-day basis, but the courts would order the creditor to provide counter-security on costs in order to protect the debtor from irresponsible action. The courts would often take such decisions ex parte (without the parties being present) but the respondent may object or request revocation of the interim order through separate procedures (respectively 'hozen Igi' and 'hozen torikeshi'). Hence, this kind of appeal does not suspend the precautionary order.

#### Lodging an appeal

The defeated party may, within two weeks of notification of the judgment, lodge an appeal against the decision rendered by

#### Collection @ Euler Hermes

It is always advised to attempt collection prior to any legal action in order to maximize chances of successful recovery and avoid legal costs and delays. Our key principle is to collect in close proximity to the debtor, using a series of letters, emails and phone calls in the local debtor language. Our World Collection Network of Euler Hermes offices and external providers are experts in professional trade debt collection and negotiation, ensuring positive outcomes while retaining important client relationships. Euler Hermes can handle the complete collections process from amicable, pre-legal action through to judgment and enforcement.



District Courts in first instance. Appeal proceedings would then be conducted by the High Courts, which are competent to deal with errors of fact or law. Similarly, decisions rendered by the High Court in the second instance may be appealed against before the Supreme Court, but the latter would only consider procedural mistakes, misinterpretation or any other contravention of the law or Constitution clearly influencing the judgment, etc.

#### **Enforcing court decisions**

Enforcement may commence once a judgment is final (i.e. if no appeal is lodged within two weeks). If the debtor fails to satisfy judgment on a claim for payment of money, compulsory enforcement would be organized through (i) execution against Real Property (an application is made to court and an Execution Court issues a commencement order for a compulsory auction); (ii) execution against movables (an application is made to the Marshal Court and an execution is commenced through a seizure of the subject matter); and (iii) execution against a claim (an application is made and a compulsory execution is commenced through an order of seizure, i.e. an attachment order, by an execution court).

#### **How long could legal action take?**

The Lawsuit Expedition Law No. 107 of 2003 stipulates that decisions made in the first instance must be rendered within a maximum of two years but in practice, simple claims brought before District Courts may take one year while complex ones could require more time. Appeal proceedings may for instance take an additional ten months.

It is difficult to say whether courts would require more time to deal with claims involving a foreign party than to deal with claims involving domestic parties only. However, it should be noted that all documents must be translated, which often extends proceedings.

#### **How much could this cost?**

As a general rule, the defeated party may be required to pay court fees and annex costs, but in practice the successful party's costs would remain uncompensated for. Indeed, although legally recoverable, recuperating such costs requires too many formalities and the process is overall complicated and time consuming. Court costs normally consist of an application fee (calculated based on claim amount) and of postage stamp expenses (JPY 5~6,000 per defendant). On average, the legal costs would cost around 15% of the debt.

#### **Litigation @ Euler Hermes**

Should legal action be necessary, Euler Hermes can provide support throughout the legal process from judgment to enforcement via our World Collection Network of Euler Hermes offices and external providers. Legal action can often be complicated and expensive, so you will be informed of all costs prior to any action and advised on which route is best to take.



## Alternatives to legal action

### Alternative Dispute Resolution methods (ADR)

As in most countries, Alternative Dispute Resolution methods in Japan would include conciliation, mediation and arbitration (chusai, as defined by Act No 138 of 2003, based on the UNCITRAL Model Law on International Commercial Arbitration of 1985). However, the Law on the Promotion of the Use of Alternative Dispute Resolution of 2004 only entered into force in 2007, therefore ADR is not widespread and, since courts are fairly reliable, formal litigation remains the most frequent method to settle large commercial disputes. ADR, it should be added, is normally only possible when the parties have considered such a possibility in their contract.

### Foreign forums

Using a foreign tribunal is not necessary as domestic courts are fairly reliable. Nonetheless, Japanese law permits the parties to a contract to, by mutual agreement, choose the law applicable to this contract, and select the court that will have jurisdiction over disputes. As a result, domestic courts generally respect the parties' written agreement to solve their business disputes in a foreign forum (i.e. under a foreign law or before a foreign court), unless of course Japanese law provides exclusive jurisdiction to Japanese courts (usually in relation to consumer and labor matters). It is however essential that the agreement be characterized by an international connection (for example, one party has elected domicile in another country, or the place of execution is located abroad), and that a jurisdiction clause is drafted to this effect.

### Enforcing foreign awards

Enforcing foreign orders in Japan is usually time consuming, expensive and haphazard. As in most countries, the foreign decision must first be recognized by Japanese courts through an exequatur procedure in order to become enforceable (Article 118 of the Code of Civil Procedure). The court would for instance verify whether the decision is final and enforceable in the issuing jurisdiction, whether the parties benefited from a due process of law and whether enforcement would be incompatible with Japanese public policy. In addition, the reciprocity factor implies that, unless the issuing country has a reciprocal recognition and enforcement treaty with Japan, the foreign decision would not be enforced by domestic courts.

Japan is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. Therefore, domestic courts also ought to recognize and enforce decisions rendered through international arbitration proceedings.



## Handling insolvent debtors

Insolvency in Japan is both a matter of cash flow and balance sheet. In other words, a debtor would be deemed insolvent once unable to pay its debts as they fall due, but also when the business' assets fail to compensate for its liabilities. A debtor is also punished by having their bank transactions suspended after dishonoring bills.

Insolvency proceedings normally take place before the District Courts but various proceedings coexist. Whatever the proceedings, the court must decide on a time period (up to four months) during which the creditors may file their claims.

In practice, collecting debt from insolvent debtors is most challenging: the dividend rate is on average less than 10 % of the claim amount under the bankruptcy proceedings and could reach 15% to 20 % of the amount of the claim under the corporate rehabilitation proceedings.

### Insolvency proceedings

#### Out-of-Court proceedings

Several out-of-court mechanisms aiming at providing companies in difficulty with fresh cash are relied upon. Out-of-Court Multi-Financial Creditors Workout guidelines were established in 2001 by the National Bankers' Association, the Federation of Managers' Association and other relevant associations. In addition, the Revised Industrial Revitalization Law of 2007 provides for Business Reorganization by Alternative Dispute Resolution (BRADR) proceedings. A private sector organization (Japan Association of Turnaround Professionals, JATP) furthermore recommends neutral third-party experts in charge of leading such workouts in a fair and independent manner. Unanimous consent by creditors is required for the out-of-court reorganization plans to be accepted.

#### Restructuring the debt

On one hand, Civil Rehabilitation proceedings (under the Civil Rehabilitation Act of 1999) may be initiated upon demand of the debtor. The latter files a petition with the court in order to obtain a preservation measure under which the payment of debts to unsecured creditors is temporarily prohibited. A supervisor is nominated and assets may be frozen until the debtor becomes solvent again.

On the other hand, Corporate Rehabilitation proceedings (under the Corporate Reorganization Act of 2002) aim at negotiating a rehabilitation plan with all creditors to allow continuation of the debtor's economic activity. During this phase, all management prerogatives are transferred to a court-appointed supervisor while a moratorium is put in place to protect the debtor company from any enforcement claim. Recently, however, the courts have introduced a debtor-in-possession principle allowing directors to remain in power during the proceedings. In certain situations, involuntary reorganizations proceedings may also be commenced upon demand of a creditor owing a debt equivalent to at least 10% of the company's capital.

#### Winding up proceedings

Bankruptcy under the Hasan-ho law n°75 of 2004 aims at obtaining cash from the sale of the debtor's assets and may occur upon request



of the debtor (voluntary liquidation) or of the creditors (involuntary liquidation). A liquidator is normally appointed by the court to sell the company's assets and distribute the proceeds to the various creditors on a pro rata basis.

A special liquidation procedure may also be conducted for very complex insolvency situations. Bankruptcy proceedings rather designate liquidation adapted to individual persons.

#### Priority rules

Priority rules normally apply while distributing the proceeds to the creditors. Fresh cash providers during reorganization proceedings would typically be considered as owning a preferential claim. They would thus have priority over general unsecured claims. Tax claims are also considered as preferential claims.

#### Cancellation of suspect transactions (clawback)

Administrators and liquidators in reorganization and liquidation proceedings alike are normally entitled to request the court to cancel certain transactions concluded prior to the insolvency proceedings. In particular, any measure taken by the debtor deemed detrimental to the creditors would typically be void (unfair loans, inappropriate debt repayment, suspect disposal of assets, fraudulent transactions, gratuitous acts, etc.). The law however provides no precise suspect periods during which these transactions may be considered doubtful.

#### How long could insolvency proceedings take?

Bankruptcy proceedings take two to three years on average, versus up to ten years for corporate rehabilitation proceedings.

#### Insolvency @ Euler Hermes

Euler Hermes works closely with debtors, creditors and lawyers to provide support during insolvency and restructuring processes. With many options available when it comes to insolvency action, we can offer advice on which option is most suitable.



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