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CLOUDY WEATHER, WITH OCCASIONAL SUNSHINE: CONSUMER LOANS, THE LEGISLATURE, AND THE SUPREME COURT OF JAPAN

Shigenori Matsui[†]

Abstract: The Supreme Court of Japan, despite its well-known passive and conservative stance towards constitutional adjudication, occasionally shows quite a creative and liberal attitude. Recently, the Supreme Court of Japan has shown this attitude in its development of pro-consumer jurisprudence involving consumer loan cases. This development is still more noteworthy because the Supreme Court of Japan ignored the legislature's intent to overturn its previous judgments and practically wiped out a statutory provision enacted by the legislature. As a result of this development, millions of consumers could demand refunds from consumer loan companies, and consumer loan companies went into serious financial troubles, triggering massive reorganization of the industry. This article outlines this development in the consumer loan cases, examines how the Supreme Court of Japan accomplished this result, and explores the reason why the Supreme Court of Japan decided to take such a bold action.

I. INTRODUCTION

Judges in the civil law tradition are supposed to interpret the provisions of a statute according to the people's will as embodied in the textual provisions. They are not making law, but simply following the command stipulated in the textual provisions.¹ Civil law judges become judges right after their professional training and remain on the bench until the mandatory retirement age. They are career judges and are in reality judicial bureaucrats working inside the judiciary.² Japanese judges, trained and equipped with judicial power in the longtime civil law tradition that dates back to 19th century, generally demonstrate a positivistic and bureaucratic attitude.

However, everyone knows that judges, even in the civil law tradition, often make law.³ Sometimes, they create judicial doctrines that are not

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¹ For a general description of the role of the judges in the civil law tradition, see MARY ANN GLENDON, PAOLO G. CAROZZA, & COLIN B. PICKER, *COMPARATIVE LEGAL TRADITIONS* 248-51 (3d ed. 2007).

² See Setsuo Miyazawa, *Administrative Control of Japanese Judges*, in *LAW AND TECHNOLOGY IN THE PACIFIC COMMUNITY* 263, 264 (Philip S.C. Lewis ed., 1994) (observing that judges are "virtually life-time employees of a national government bureaucracy called the judiciary.").

³ See MAURO CAPPELLETTI, *THE JUDICIAL PROCESS IN COMPARATIVE PERSPECTIVE* 53 (1989) ("[T]he problem of judicial creativity has emerged even in a growing number of civil law countries in contours no less dramatic than in the common law jurisdictions. Far from not being susceptible to comparative analysis, the problem is essentially the same in both legal families.").

anticipated by the legislature. And, sometimes, they create judicial doctrines that are contrary to legislative intent.

The Supreme Court of Japan, generally well-known for its passive and conservative attitude toward constitutional adjudication,⁴ occasionally shows judicial creativity. Such judicial creativity is most apparent in its establishment of anti-dismissal jurisprudence against employers. The Labor Standard Act mandates that employers provide thirty-day advance notice before dismissing employees or pay an average thirty-day salary before firing their employees, if such advance notice is not given.⁵ Thus, one may be tempted to believe that private companies could fire their employees if they paid a thirty-day average salary. But, in reality, the Supreme Court of Japan fashioned a jurisprudence that practically prohibits private companies from firing their employees without compelling reason, invoking the abuse of rights doctrine.⁶ Even when a company is in economic crisis, the courts will not allow companies to fire their employees unless the dismissal is unavoidable and there is no other alternative to save the company. As a result, it has become quite difficult to dismiss employees in Japan. The Diet, or national legislature, codified this jurisprudence into the Labor Contract Act.⁷ This example clearly shows that judges in Japan can and do create judicial doctrine without a basis in statutory provisions. General clauses of the Civil Code, such as a ban on abuse of rights,⁸ provide judges a convenient tool to create judicial doctrine. Moreover, this jurisprudence is politically quite liberal in the sense that it was meant to protect workers against the companies that employ them.

Recently, the Supreme Court of Japan showed a similar kind of judicial creativity in establishing a pro-consumer jurisprudence against consumer loan companies. This jurisprudence is remarkable because it was accomplished by ignoring the legislature's contrary intent. Although the Diet enacted a statutory provision in order to overturn a previous pro-consumer judgment, the Supreme Court of Japan ignored this legislative intent and practically wiped out the new provision. The judgments of the

⁴ SHIGENORI MATSUI, *THE CONSTITUTION OF JAPAN: A CONTEXTUAL ANALYSIS* 145-50 (2011); Shigenori Matsui, *Why Is the Japanese Supreme Court So Conservative?*, 88 WASH. U. L. REV. 1375 (2011).

⁵ Roudō kijunhō [Labor Standard Act], Law No. 49 of 1947, art. 20.

⁶ Saikō Saibansho [Sup. Ct.] Jan. 31, 1977, 268 Roudō HANREI 17 (2nd petty bench) (Kōchi Broadcasting Case). See generally Daniel H. Foote, *Judicial Creation of Norms in Japanese Labor Law: Activism, in the Service of—Stability?*, 43 UCLA L. REV. 635 (1996).

⁷ Roudō Keiyakuhō [Labor Contract Act], Law No. 128 of 2007, art. 16.

⁸ MINPŌ [CIV.C.], art. 1, para. 1 (private rights must conform to the public welfare); *id.* para. 2 (the exercise of rights and performance of duties must be done in good faith); *id.* at para. 3 (no abuse of rights is permitted).

Supreme Court of Japan had a tremendous impact on the consumer loan industry and consumer loan regulation. As a result of this pro-consumer jurisprudence, millions of consumers could now demand refunds from consumer loan companies. Consumer loan companies went into serious financial troubles, triggering massive reorganization of the industry. Moreover, these developments forced the Diet to amend the regulatory statute in order to introduce more demanding regulation against consumer loan companies. This pro-consumer jurisprudence is also highly liberal in that these judgments were meant to protect consumers against consumer loan companies.

This article shows how the Supreme Court of Japan accomplished this result by engaging in creative judicial law-making. Part II provides a background for the development of the pro-consumer jurisprudence by the Supreme Court of Japan. It outlines the statutory framework for limiting interest rates on consumer loans, the historical development of the consumer loan industry, and the response of the Supreme Court of Japan to the limitations on interest rates. We will see that despite a legislative compromise, which allowed consumer loan companies to collect higher interest rates while limiting the maximum interest rate, the Supreme Court of Japan came to ignore this compromise and wiped out the statutory provision in order to benefit consumers. Then, this article will examine the legislative response to the judgments of the Supreme Court of Japan and see how the legislature introduced new regulatory framework to control consumer loan companies. By introducing this comprehensive regulation, the legislature overturned the judgment of the Supreme Court of Japan and allowed the collection of higher interest by the consumer loan companies. The Supreme Court of Japan initially showed its willingness to accept this legislative judgment. But soon the Supreme Court of Japan came to ignore it and made this provision a dead letter.

Part III will examine how the Supreme Court of Japan could practically wipe out this new statutory provision, paying close attention to what kind of interpretive techniques were used by the Supreme Court of Japan to reach this result. Then Part IV examines the impact of those judgments and the 2006 amendments brought by the Diet in response to them. Specifically, it inquires whether these judgments were a blessing for consumers and whether they managed to solve the root problem of money borrowing in Japan. Finally, Part V summarizes the interpretive methodology used by the Supreme Court of Japan to illustrate how creative the court was and explores why it decided to take such a bold action. Although there is wide support for the development of this pro-consumer jurisprudence,

despite the contrary legislative intent, how such a development could be justified in a democratic country remains a question.

II. CONSUMER LOANS AND CONSUMERS

In order to understand the context for the development of the pro-consumer jurisprudence of the Supreme Court of Japan, we need to examine the background of consumer loan regulation in Japan. Formerly, although the maximum interest rate that consumer loan companies could charge was restricted by statute, consumer loan companies were allowed to collect higher interest rates—only the highest rates were criminally prohibited. The consumer loan industry grew into a major industry, taking advantage of this regulatory gap. The Supreme Court of Japan initially showed its willingness to accept this legislative compromise. However, it came to ignore this compromise and wipe out the statutory provision for the benefit of consumers. In response to this judicial development, the legislature introduced a new regulatory framework to control consumer loan companies. The legislature once again decided to allow consumer loan companies to receive a higher interest rate. The legislature apparently intended to overturn the judgments of the Supreme Court of Japan. The Supreme Court of Japan then showed its willingness to accept this legislative judgment.

A. “Gray Zone” Interest Rate

Like many Americans, Japanese people borrow money from banks, credit unions, and other financial institutions. Especially when they buy houses, they have to rely upon financial institutions for a loan. The loan is granted only after very careful review of the borrower’s financial situation. These financial institutions generally require mortgages on property as collateral, and require borrowers to sign assurance contracts with the assurance companies and to sign life insurance contracts to secure payment. The amount of money that consumers can borrow depends upon the financial capacity of the borrower and the value of their property as collateral.

The maximum interest rate that financial institutions can charge is stipulated in the Interest Rate Limitation Act of 1954.⁹ This act sets the maximum interest rate for a loan according to the amount of principal in Article 1, paragraph 1.¹⁰ If the principal amounts to less than 100,000 yen

⁹ Risokuseigenhō [Interest Rate Limitation Act], Law No. 100 of 1954, art. 1.

¹⁰ *Id.* art. 1, para. 1.

(1,000 USD with the exchange rate of 1 USD to 100 yen), the maximum interest rate is 20% per year. If principal amounts to more than 100,000 yen and less than one million yen (10,000 USD), the maximum interest rate is 18% per year. If the principal amounts to more than one million yen, the maximum interest rate is 15% per year. Any contract with an interest rate higher than the rate stipulated in this act is null and void.¹¹ Financial institutions must obey this limitation. However, this is a civil law statute and carries no criminal punishment against violation.

On the other hand, many people need financial assistance for everyday life or for business. For these people, loans from financial institutions are unavailable or unattractive. Most of them do not have any property to mortgage. Moreover, they need money more quickly. They cannot endure the financial institutions' long and complicated review of their financial situations. Furthermore, banks are not enthusiastic about consumer retail loans. Thus, the average individual must turn to consumer loan companies that are willing to provide loans without an elaborate review process and without the requirement to submit properties for mortgage. Many of these consumer loan companies were called "sala-kin" (finance for salaried workers) because most of their customers were salaried workers. All a customer had to do was provide a piece of identification, and the consumer loan company would be happy to lend money with minimal review (generally they would check whether the applicants were actually working at the company as they claimed). The amount of money they could receive was usually small, often less than 500,000 yen (5,000 USD) or one million yen. Customers were usually allowed to pay back the loan by monthly installment.

Because of the minimal review process, many consumers ended up failing to pay back their borrowed money. Moreover, the loans were largely unsecured loans. To make a profit, these consumer loan companies charged much higher interest rates, often higher than the rate stipulated in the Interest Rate Limitation Act. Even though a contract is null and void to the extent it charges higher interest rate, there is a provision in the Interest Rate Limitation Act that prevents consumers from requesting a refund if they paid the higher interest "voluntarily."¹² The consumer loan companies were thus allowed to charge a higher interest rate and collect payment.

The only limitation was the maximum interest rate stipulated in the Capital Subscription Act. This act established the maximum interest rate,

¹¹ *Id.*

¹² *Id.* art. 1, para. 2. This provision was later deleted in 2006. *See infra* note 135.

with a criminal punishment against violation.¹³ The maximum interest rate allowed was 109.5% in 1954, and it was cut down to 73% in 1983, 54.75% in 1986, 40% in 1991, and then 29.2% from 2000.¹⁴ If consumer loan companies charged an interest rate higher than this maximum interest rate, then the police could search their offices, arrest the managers, and prosecute them for a criminal law violation. As a result, on the surface of the statutes, consumer loan companies could charge an interest rate higher than the rate stipulated in the Interest Rate Limitation Act so long as the interest rate was lower than the maximum interest rate stipulated in the Capital Subscription Act. The legislature apparently made a compromise between business and consumer interests. The gap in interest rate regulation between the two acts is generally called the “gray-zone” interest rate.¹⁵

B. *Consumer Loans and Japanese Borrowers*

The modern consumer loan industry in Japan was a rather dubious one in the beginning.¹⁶ It started in the 1950s, and most of the loan companies were small companies, operating in small offices in city-center, high-rise buildings. Unlike financial institutions, which were subject to tight regulation by the Ministry of Finance and now by the Financial Services Agency, these consumer loan companies were once only subject to notification requirements and to regulation under the Act Concerning the Policing of the Loan Company of 1949.¹⁷ But in 1954, as part of an attempt at liberalization, this statute was abolished and consumer loan companies were left to be generally regulated by the Ministry of International Trade and Industry (“MITI”) (the predecessor of the current Ministry of Economy, Trade and Industry). As a result, the industry was not well regulated and many people suspected that these loan companies had some ties with illegal gang groups and were engaging in some suspicious activities. As we will see, in 1983, the Consumer Loan Company Act¹⁸ was enacted and the

¹³ Shusshi no ukeire, azukarikin oyobi kinritō no torishimari ni kansuru hōritsu [Act Concerning Regulation of Receipt of Subscription of Capital, Deposit, and Interest Rate], Law No. 195 of 1954, art. 5.

¹⁴ This provision was later amended in 2006 and the maximum interest rate was cut down to 20% per year. See *infra* note 136. For a history of change in the maximum interest rate regulation after the WWII, see Andrew M. Pardieck, *Japan and the Moneylender-Activist Courts and Substantive Justice*, 17 PACIFIC RIM L. & POL’Y J. 529, 540-42 (2008).

¹⁵ *Id.* at 543.

¹⁶ For a history of moneylenders and the usury regulation before WWII, see Pardieck, *supra* note 14, at 533-40.

¹⁷ Kashikingyōtō no torishimarini kansuru hōritsu [Act Concerning Policing of the Loan Company], Law No. 170 of 1949 (abolished in 1954).

¹⁸ Kashikingyōhō [Loan Company Act], Law No. 32 of 1983. Its original title was Kashikingyōno kiseitō nikansuru hōritsu [Act Concerning Regulation of Loan Company] but its title was amended to the

government introduced much stricter regulation by the Ministry of Finance (later regulated by the Financial Services Agency), but there still remained a striking difference between the regulation of consumer loan companies and the regulation of financial institutions.

Gradually, large corporations came to dominate the market and foreign financial institutions also entered the market. These large corporations adopted a media strategy to improve the industry's image. They hired many female customer service representatives, ran many television commercials, and attempted to create an image that the consumer loan companies are well-regulated, customer-friendly companies. Their strategy paid off and consumers gradually came to accept the consumer loan companies. Especially after the burst of the economic bubble in the early 1990s, an increasing number of consumers turned to consumer loan companies. Many consumers simply had to borrow money to survive because of the long-lasting economic stagflation.¹⁹

In the 2000s, the consumer loan industry became a booming business. Takefuji, Promise, Aiful, Acom, Lake, and others companies ran television commercials soliciting customers and competing to provide consumer friendly service. They advertised how easy it was to borrow money and assured customers that their privacy would be carefully protected. They opened offices in the most popular spots in the city and their offices were nicely decorated. They made it possible for customers to borrow money through ATM machines with minimum review. They even built shields to protect the privacy of customers entering the ATM office to ease consumer fears that they might be noticed by neighbors. Consumer loans became quite popular. It was estimated that fourteen million customers, one in nine of the total population, were borrowing money from these consumer loan companies.²⁰ It is no wonder that the consumer loan industry registered a huge profit.

Because the review process for borrowers was minimal, many consumers used to borrow money from multiple consumer loan companies, leading to huge amounts of debt with no prospect of paying the loans back. Some consumers had to borrow money in order to pay the higher interest of

current one from 2007. For a closer examination of the regulation introduced, *see infra* notes 36-42; Pardieck, *supra* note 14, at 552-54.

¹⁹ Pardieck, *supra* note 14, at 558; MARK D. WEST, LAW IN EVERYDAY JAPAN: SEX, SUMO, SUICIDE, AND STATUTES 225 (2005) (noting the significant increase of the consumer debt in the 1990s).

²⁰ FINANCIAL SERVICES AGENCY, TAJŪSAIMUSHATAISAKUHONBU YŪSHIKISHAKAIGI [CONFERENCE OF EXPERTS OF THE HEADQUARTER FOR COPING WITH HEAVILY-INDEBTED BORROWERS], TAJŪSAIMUSHAMONDAINO KAIKETSU NIMUKETA HOUSAKU NITSUITE [ON MEASURES TO COPE WITH THE ISSUES CONCERNING HEAVILY-INDEBTED BORROWERS] (Apr. 9, 2007).

the existing loans, increasing the total amount of their loan. The number of such deeply indebted consumers surpassed two million by 2006.²¹ Some companies began to use violent or threatening collection methods, forcing debtors to run away or commit suicide. The use of such violent and intimidating collection methods became widely known in 1999, when one employee of the loan company Nichiei demanded that the defaulting borrower sell his kidney or eyeball to pay off the loan.²² Regulation of the loan companies was tightened.²³ Nevertheless, consumer loan companies were willing to lend money even with additional risks of default in order to increase the number of loans. As a result, the consumer loan issue became a very serious social issue.²⁴

C. *The Response of the Supreme Court of Japan*

The Supreme Court of Japan initially showed its willingness to accept the compromise reached in the Interest Rate Limitation Act. In a 1955 ruling, the Supreme Court of Japan rejected the claim for a refund when the customer paid an interest rate higher than the rate prescribed by the Interest Rate Limitation Act without objecting.²⁵ In another case, a customer argued that a loan contract with an interest rate higher than the maximum prescribed in the Interest Rate Limitation Act was against “public order and good moral” as stipulated in Article 90 of the Civil Code,²⁶ and that the contract should be viewed as null and void as a whole. But the Supreme Court of Japan was not persuaded. It held that, in the absence of special circumstances, a contract with a higher interest rate could not be said to violate public order or

²¹ In 2006, it was reported that some 2.3 million borrowers were heavily in debt, in debt to five or more lenders, and 2.7 million were behind on payments and were in default. *Id.*; Pardieck, *supra* note 14, at 530.

²² Pardieck, *supra* note 14, at 560-61.

²³ In response, the maximum interest rate in the Capital Subscription Act was reduced from 40% to 29.2%. *See supra* note 14. The system of sharing credit information was also established by major loan companies, allowing the consumer loan companies to find out how much money the borrower was borrowing from other loan companies in total. CREDIT INFORMATION CENTER, *available at* <http://www.cic.co.jp/>. But it was only major loan companies that used this credit information and the use was not mandatory.

²⁴ Souichirou Kozuka & Luke R. Nottage, *Re-Regulating Unsecured Consumer Credit in Japan: Over-Indebted Borrowers, the Supreme Court, and New Legislation*, (Sydney Law School Research Paper No. 07/62, Sept. 2007) *available at* <http://ssrn.com/abstract=1019392>.

²⁵ Saikō Saibansho [Sup. Ct.] Feb. 22, 1955, 9 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 209 (3rd petty bench).

²⁶ MINPŌ [CIV. C.], art. 90.

good moral in and of itself.²⁷ This stance was affirmed again in 1962. The Supreme Court denied a borrower's claim for a refund when the borrower voluntarily paid back a higher interest rate under Article 1, paragraph 2 of the Interest Rate Limitation Act, and also denied the application of the excessive payment to the satisfaction of the principal, holding that such application would undermine Article 1, paragraph 2.²⁸

However, gradually, the Supreme Court of Japan came to protect borrowers against consumer loan companies. The Supreme Court of Japan held in 1964 that, although consumers could not request a refund when they paid the higher interest rate voluntarily, their payments had to be viewed as satisfying the principal, thus reducing the amount of principal.²⁹ Even when a customer paid money designated as a payment of interest, the Supreme Court of Japan said, an excessive interest rate beyond the rate stipulated in Article 1 of the Interest Rate Limitation Act was void and such a designation was meaningless and should be treated as if there were no designation at all.³⁰ This judgment was hailed as "the beginning of a newly assertive Supreme Court" for the protection of consumers.³¹ In 1968, when a consumer made a payment after he had already paid back the principal, believing that he still owed the money, the Supreme Court of Japan held that a consumer could request a refund as a remedy for unjust enrichment.³² Article 1, paragraph 2 is a provision, according to the Supreme Court of Japan, that assumes the remaining balance to be paid, and therefore this provision does not preclude a refund claim when the consumers paid off all the principal.³³ In other words, when the debtor pays an interest rate in excess of the statutory limit and when the debtor's payments satisfy the principal, then the debtor can demand a refund for amounts paid beyond the principal despite Article 1, paragraph 2. These judgments practically made Article 1, paragraph 2 a dead letter. These were clear examples of "judicial legislation."³⁴

²⁷ Saikō Saibansho [Sup. Ct.] Dec. 18, 1953, 7 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1470 (2nd petty bench); Saikō Saibansho [Sup. Ct.] Nov. 5, 1954, 8 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2014 (2nd petty bench).

²⁸ Saikō Saibansho [Sup. Ct.] June 13, 1962, 16 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1340 (grand bench).

²⁹ Saikō Saibansho [Sup. Ct.] Nov. 18, 1964, 18 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1868 (grand bench). The Supreme Court of Japan thus overruled its 1962 judgment. *Id.*

³⁰ *Id.*

³¹ Pardieck, *supra* note 14, at 545.

³² Saikō Saibansho [Sup. Ct.] Nov. 13, 1968, 22 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2526 (grand bench). *See* MINPŌ [CIV. C.] art. 703.

³³ Saikō Saibansho [Sup. Ct.] Nov. 13, 1968, 22 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2526 (grand bench).

³⁴ Pardieck, *supra* note 14, at 547.

In these judgments, the Supreme Court of Japan gave priority to the overarching legislative intent of consumer protection manifested in the Interest Rate Limitation Act. Interpreting the payment of interest in excess of the statutory limitation as satisfying the principal and thus reducing the amount of principal to be paid, said the Supreme Court of Japan, comports with the “primary legislative intent of the law to protect the borrower who was in economically disadvantaged position.”³⁵ The Supreme Court of Japan thereby ignored the compromise that the legislature made. The legislature, while limiting the interest rate in the Interest Rate Limitation Act, left the higher interest rate un-prohibited in the Capital Subscription Act (subject to limitations stipulated in that Capital Subscription Act) and allowed lenders to receive the payment of higher interest rates so long as the payment was voluntary under Article 1, paragraph 2 of the Interest Rate Limitation Act. These judgments, however, practically deprived Article 1, paragraph 2 of the Interest Rate Limitation Act of any meaning.

Moreover, the Supreme Court of Japan did not care about the parties’ contractual intent. Usually, consumers pay back loans through monthly installments and the amount of payment is clearly divided into payment towards the principal and payment towards the interest. Consumers thus know that they are paying towards a higher interest rate. Nevertheless, even when the debtor payment is designated as a payment of interest, that intent is disregarded by the Supreme Court of Japan. The payment of interest in excess of the statutory limit is now automatically viewed as satisfying the principal and any overpayment must be refunded when the payment has already satisfied the principal.

D. Loan Company Act and Article 43

In 1983, however, the Loan Company Act³⁶ was enacted to regulate consumer loan companies. This Act was meant to secure the proper operation of consumer loan businesses, thereby protecting the interests of the borrower and contributing to the proper administration of national life.³⁷ This act introduced a registration requirement for consumer loan companies with the prime minister or prefectural governor³⁸ and imposed an elaborate

³⁵ Saikō Saibansho [Sup. Ct.] Nov. 18, 1964, 18 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1868 (grand bench).

³⁶ Kashikingyōhō [Loan Company Act], Law No. 32 of 1983.

³⁷ *Id.* art. 1.

³⁸ *Id.* art. 3. Loan companies to be registered under this act include consumer loan companies (Shōhisha kin-yū or shōhisha loan) as well as business loan companies (Shōkō loan) and credit companies that lend money by using credit cards (if the customer buys some goods using credit card, this is shopping

governmental regulatory scheme. For example, under Article 17 of this act, a loan company was obliged to provide the customer with a written document stating the details of the contract—the name and address of the loan company, the date of the contract, the amount of the loan, the interest rate, the method of payment, the term and frequency of the payment, the penalty for default, and other information to be specified by the cabinet order—at the time of the conclusion of the contract.³⁹ Under Article 18, the loan company was obliged to provide written receipt stating the transaction, including: the name and address of the loan company, the date of the contract, the amount of the loan, the amount of receipt, how the received payment is apportioned to the principal and interest, the date of receipt, and other information to be specified by the cabinet order.⁴⁰ The payment collection method was also regulated. Harassment or invasion of privacy was prohibited in the collection of a loan.⁴¹ All of these regulations were enforced by the Ministry of Finance (now enforced by the Financial Services Agency).

In exchange for government regulation, Article 43 of this act deemed the payment of an interest rate higher than the rate stipulated in the Interest Rate Limitation Act as valid payment of interest under certain circumstances: the consumers must have paid the money voluntarily, the consumer loan company must have provided the written document showing the necessary information at the time of conclusion of consumer loan contract as stipulated in Article 17, and the consumer loan company must have provided a written receipt stipulated in Article 18 immediately when it receives a payment from the consumer.⁴² The registered consumer loan companies were thus expressly granted the right to receive the higher interest rate under this provision subject to limitation of the Capital Subscription Act. Apparently, the legislative intent behind this provision was to overrule the pro-consumer judgments of the Supreme Court of Japan.

Article 43 was not popular among lawyers. Many criticized it for allowing consumer loan companies to take advantage of the desperate economic situation of borrowers and charge higher interest rates—rates made illegal under the Interest Rate Limitation Act. In the 1980s and early 1990s, however, the Supreme Court of Japan seemed to accept the legislative judgment. It allowed loan companies to receive payments of excessive

credit and is not subjected to the Loan Company Act). Banks, credit unions and similar financial institutions are not subjected to this Act.

³⁹ *Id.* art. 17.

⁴⁰ *Id.* art. 18.

⁴¹ *Id.* art. 21.

⁴² *Id.* art. 43. This provision was deleted and replaced with another provision in 2006. *See infra* note 134.

interest rates, even when the consumer did not know that he or she was paying an excessively high interest rate.⁴³ It was not legally required that a debtor understand that he or she was paying an interest rate in excess of the statutory limit; the contract was not void to the extent that the higher interest rate was charged in order for the debtor to pay back it back “voluntarily.”⁴⁴ If the debtor made a payment with the understanding that it would be applied to interest, the Supreme Court of Japan held, that was sufficient to make the payment “voluntary,” and to enable the consumer loan company to enjoy the benefit of Article 43.⁴⁵

III. CONSUMER LOANS, THE LEGISLATURE, AND THE SUPREME COURT OF JAPAN

We saw that there used to exist a gap between the maximum interest rate allowed by the Interest Rate Limitation Act and the maximum interest rate prohibited by the Capital Subscription Act with criminal punishment. The consumer loan companies were permitted under Article 1, paragraph 2 of the Interest Rate Limitation Act to collect interest rates higher than the maximum interest rates allowed by the Interest Rate Limitation Act so long as the interest rate was lower than the maximum interest rate prohibited by the Capital Subscription Act. We also saw that the Supreme Court of Japan, initially showing willingness to accept this compromise, came to practically wipe out Article 1, paragraph 2 and deny consumer loan companies the ability to collect higher interest rates. However, the legislature responded to this development by introducing comprehensive regulation of consumer loan companies in the Loan Company Act and inserting the statutory provision, Article 43, to overturn the judgment of the Supreme Court of Japan—consumer loan companies were again allowed to collect higher interest rates. We also saw that at first the Supreme Court of Japan was willing to show deference to the new enactment.

Nevertheless, it did not take long for the Supreme Court of Japan to reverse this attitude. Once again, the Supreme Court of Japan came to adopt a highly pro-consumer stance. As we will examine more closely in this Part, the Supreme Court of Japan came to:

1. construe conditions for enjoying the benefit of Article 43 quite strictly;

⁴³ Saikō Saibansho [Sup. Ct.] Jan. 22, 1990, 44 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 332 (2nd petty bench).

⁴⁴ *Id.*

⁴⁵ *Id.*

2. view all additional payment other than payment to the principal as payment of interest;
3. deny the applicability of Article 43 when the loan company subtracted the higher interest at the time of loan;
4. construe the voluntariness requirement rigidly;
5. view payment of excessive interest as satisfying other loans;
6. allow customers to demand refunds from the loan companies when they paid back the principal;
7. impose the obligation to pay refunds with statutory interest rate;
8. extend the period before the statute of limitations precludes a refund claim; and
9. impose on the loan companies the duty to disclose the transaction history to customers.

The Supreme Court of Japan thus practically denied consumer loan companies the benefit of receiving payment of higher interest rates admitted under Article 43 and allowed millions of customers to demand refunds from consumer loan companies after they paid off all their loans. In other words, it essentially wiped out Article 43.

A. *Construing the Requirements for Enjoying Article 43 Strictly*

First, the Supreme Court of Japan interpreted the conditions attached to receiving payment from consumers literally and made it quite difficult for consumer loan companies to enjoy the benefits of Article 43. In 1999, the Supreme Court of Japan held that the written receipt requirement in Article 18 must be rigidly enforced. In that case, the customer wired funds for scheduled payments directly to the bank account of the loan company and later claimed that the payment of a higher interest rate should be construed to satisfy the principal despite Article 43. The consumer loan company argued that when the customer wired funds directly into their bank account, the requirement of written receipt should not apply and that the loan company should be allowed to enjoy the benefits of Article 43. The Supreme Court of Japan was not persuaded by the arguments of the consumer loan company.⁴⁶ Emphasizing that the written receipt must be issued immediately upon receiving each payment as stipulated in Article 18, the Supreme Court of Japan held that even when the customers wired their payment directly into the bank account of the consumer loan company, the

⁴⁶ Saikō Saibansho [Sup. Ct.] Jan. 21, 1999, 53 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 98 (1st petty bench).

consumer loan company had to follow all of the requirements strictly in order to enjoy the benefit of Article 43.⁴⁷

In another case, the Supreme Court of Japan held that the receipt must be provided “immediately,” as provided in Article 18.⁴⁸ Although the loan company in this case provided the written receipt after it received payment by wire transfer, this was sometimes more than twenty days after the receipt of payment. In a 2004 judgment, the Supreme Court concluded that the receipt was not provided immediately and denied the loan company the benefit of Article 43.⁴⁹

In another 2004 judgment, the Supreme Court of Japan held that, in order to enjoy the benefit of Article 43, all of the items designated in Article 17 must be included in the loan documents.⁵⁰ In this case, all the information was included except for a description of collateral. If there was a missing item, the Supreme Court of Japan held, Article 17 was not satisfied.⁵¹ The Supreme Court of Japan thus concluded that the consumer loan company could not enjoy the benefit of Article 43.⁵²

Furthermore, when the loan company preprinted all required disclosures in Article 18 at the time the loan was made, and provided the customer a series of bank transfer forms, together with each disclosure as required by Article 43, the Supreme Court of Japan did not allow the loan company to enjoy the benefit of Article 43.⁵³ Because the required information must be provided in written receipt immediately after the receipt of each payment, the Supreme Court of Japan held, anticipatory disclosures provided before the payment did not satisfy the requirement of Article 43.⁵⁴

The Supreme Court of Japan extended this philosophy of rigid interpretation to cases involving revolving loan contracts—a practice that was

⁴⁷ *Id.* The Consumer Loan Act, Article 18, paragraph 2, required the loan company to provide written receipt only upon the request of the customer when the customer wired payment to the bank account of the loan company. However, the Supreme Court of Japan construed Article 43 as overriding Article 18, paragraph 2, to require written receipt even when the customer did not ask for it. The consumer loan company was thus forced to provide the written receipt each time it received payment from the customer. *Id.*

⁴⁸ Saikō Saibansho [Sup. Ct.] Feb. 20, 2004, 58 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 475 (2nd petty bench).

⁴⁹ *See also* Saiko Saibansho [Sup. Ct.] July 9, 2004, 214 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 709 (2nd petty bench) (holding that written receipt delivered seven or ten days after the payment was not immediately issued).

⁵⁰ Saikō Saibansho [Sup. Ct.] Feb. 20, 2004, 58 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 475 (2nd petty bench).

⁵¹ *Id.*

⁵² *Id.*

⁵³ Saikō Saibansho [Sup. Ct.] Feb. 20, 2004, 58 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 380 (2nd petty bench).

⁵⁴ *Id.*

not anticipated at the time the Loan Company Act was enacted. When a borrower made a revolving loan contract, the borrower could borrow money up to the limit stipulated in the contract, and the borrower had a choice as to the payment amount, term, and frequency. Therefore, it was impossible to stipulate the amount of payment or the term and frequency of the payment in advance in the loan contract. The Supreme Court of Japan affirmed the necessity of strictly construing the Article 17 requirement.⁵⁵ Although the term and frequency of payment or the amount of payment could not be fixed at the time of the contract, the loan companies were obliged to provide the equivalent information, *i.e.*, the minimum amount of payment and the term and frequency of payment if the consumer decides to pay that minimum amount in the loan document as stipulated in Article 17.⁵⁶ The absence of such equivalent information prevented loan companies from enjoying the benefit of Article 43.

Furthermore, in its 2006 judgment, the Supreme Court of Japan did not allow even a minor exception to the disclosure requirement in the written receipt.⁵⁷ In this case, the customer borrowed three million yen (30,000 USD), repayable over five years at a 29% interest rate, and when the consumer fell behind in payment the loan company sued him to collect an outstanding balance of some 1.9 million yen (19,000 USD). The customer argued that payment of an interest rate higher than the interest rate stipulated in the Interest Rate Limitation Act should be viewed as satisfying the principal. The loan company countered that it could enjoy the benefit of Article 43.

The loan company in this case provided necessary documents at the time of the contract and also provided a written receipt every time it received payment disclosing almost all information required. However, the company indicated the customer's contract number and not the contract date. Since the contract number could be matched with the contract date, this might seem to be a harmless error. Nevertheless, the Supreme Court of Japan held that the loan company must strictly obey the exact requirements of Article 18 to enjoy the benefit of Article 43.⁵⁸ This mistake was fatal for the loan company, which could no longer enjoy the benefits of Article 43.

Indeed, this was not an error of the loan company. The loan company simply relied upon the Cabinet Order, which permitted the loan company to

⁵⁵ Saikō Saibansho [Sup. Ct.] Dec. 15, 2005, 59 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2899 (1st petty bench).

⁵⁶ *Id.*

⁵⁷ Saikō Saibansho [Sup. Ct.] Jan. 13, 2006, 60 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1 (2nd petty bench).

⁵⁸ *Id.*

substitute the contract number for the contract date. In other words, the loan company was merely following the government's instruction. The Supreme Court of Japan held, however, that the Loan Company Act simply delegated the power to add, by the cabinet order, additional information to be described in the receipt and was not meant to allow the substitution of listed items with others.⁵⁹ Since the loan company must obey the exact requirements of Article 18 to invoke Article 43, the Supreme Court of Japan concluded that this order exceeded the bounds of legal discretion conferred by the statute and is thus illegal.⁶⁰ As a result, it held that the Cabinet Order was invalid and that loan company could not rely upon this order to enjoy the benefit of Article 43.⁶¹

In 2006, the Supreme Court of Japan also held that if there was incorrect information or ambiguity in the loan contract then the loan company could not satisfy the requirement of Article 17, thus precluding the loan company from enjoying the benefit of Article 43.⁶² According to the Supreme Court of Japan, all the designated items specified in Article 17 had to be disclosed and that when they were not disclosed in an accurate and clear manner the requirements of Article 17 were not satisfied.⁶³ The loan contract's language in this case was incorrect with respect to the amount of the loan and was unclear to the extent that the contract described days when the lender would not make collection calls as "customary holidays when transactions are not made." The Supreme Court of Japan held that these errors and ambiguity left the requirements of Article 17 unsatisfied and thus prevented the loan company from enjoying the benefit of Article 43.⁶⁴

B. All Additional Payment Must Be Viewed as Payment of Interest

Second, the Supreme Court of Japan held that all the money the customer paid, other than for the payment for the principal, should be viewed as payment towards interest.⁶⁵

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* See also Saikō Saibansho [Sup. Ct.] Mar. 17, 2006, 219 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 927 (2nd petty bench).

⁶² Saikō Saibansho [Sup. Ct.] Jan. 24, 2006, 219 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 243 (3rd petty bench).

⁶³ *Id.*

⁶⁴ *Id.* See also Saikō Saibansho [Sup. Ct.] Jan. 24, 2006, 60 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 319 (3rd petty bench) (collection day and payment day were unclear); Saikō Saibansho [Sup. Ct.] July 13, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1980 (2nd petty bench) (amount of the payment to be made was incorrect).

⁶⁵ Saikō Saibansho [Sup. Ct.] July 18, 2003, 57 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 895 (2nd petty bench).

After the amendment to the Capital Subscription Act that reduced the maximum interest rate from 40% to 29.2%, many consumer loan companies came to substitute the higher interest rate with other charges, such as collection or guarantee fees, and claimed that the interest rate did not exceed the maximum rate. In one case, a consumer claimed a refund after paying because the interest plus the fees exceeded the limit prescribed in the Interest Rate Limitation Act. The Supreme Court of Japan upheld the argument of the customer and concluded that any payment other than payment to be applied to satisfy the principal should be viewed as payment of interest, regardless of whether these payments were charged as fees or other charges.⁶⁶ As a result, consumer loan companies are precluded from charging other fees to avoid the limitation on interest rate.⁶⁷

C. Denying the Applicability of Article 43 When Loan Companies Subtracted the Higher Interest at the Time of the Loan

Some loan companies subtract the higher interest rate at the time of taking out the loan. In Article 2, the Interest Rate Limitation Act stipulated that, when the interest was subtracted at the time of taking out the loan, all the money beyond the amount recalculated according to Article 1, based on the amount the borrower actually received as a principal, should be deemed to be applied to the principal.⁶⁸ The question was raised whether a consumer loan company that subtracted a higher amount of interest at the time of taking out the loan could still invoke Article 43 to receive a payment of a higher interest rate. In a 2004 judgment, the Supreme Court of Japan denied the applicability of Article 43 when the loan company subtracted the interest at the time of taking out the loan.⁶⁹ Article 43 of the Loan Company Act is, according to the Supreme Court of Japan, a special provision to Article 1, paragraph 1 of the Interest Rate Limitation Act.⁷⁰ It is not a special provision to Article 2 of the Interest Rate Limitation Act. Therefore, Article 43 of the Loan Company Act is not applicable when Article 2 of the Interest Rate Limitation Act is applied.⁷¹

⁶⁶ See also Saikō Saibansho [Sup. Ct.] Sept. 11, 2003, 210 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 617 (1st petty bench); Saikō Saibansho [Sup. Ct.] Sept. 16, 2003, 210 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 729 (3rd petty bench).

⁶⁷ See also Kashikingyōhō [Loan Company Act], Law No. 32 of 1983, art. 12-8, para. 2.

⁶⁸ Risokuseigenhō [Interest Rate Limitation Act], Law No. 100 of 1954, art. 2.

⁶⁹ Saikō Saibansho [Sup. Ct.] Feb. 20, 2004, 58 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 475 (2nd petty bench).

⁷⁰ *Id.*

⁷¹ *Id.*

D. *Construing the Requirement of Voluntariness Rigidly*

Moreover, the Supreme Court of Japan came to construe the word “voluntarily” strictly to deny the application of Article 43. The warning sign was given by the concurring opinion of Justice Shigeo Takii in a 2004 judgment.⁷² This case involved a loan contract with a clause that mandated the borrower pay back all of the remaining loan when he or she defaulted on one payment and a clause that mandated a much higher interest rate (40%, higher than the permissible maximum rate) when he or she defaulted. Because a consumer could not borrow money unless he or she agreed to this acceleration clause, Justice Takii argued, any payment made under this acceleration clause should not be viewed as being made “voluntarily.”

Justice Takii’s opinion did not attract support of the majority in 2004, but the majority adopted Justice Takii’s stance in their January 13, 2006 judgment.⁷³ In this case, an acceleration clause in the loan contract stipulated that, in the event of default, all of the remaining balance and interest was due immediately, with the penalty of a higher, 29.2% interest rate. According to the Supreme Court of Japan, Article 43 is an exception and must be interpreted strictly in light of the legislative intent to protect the interests of borrowers.⁷⁴ In order to decide whether the borrower had paid the interest “voluntarily,” the Supreme Court of Japan held that courts must examine whether there was coercion in fact.⁷⁵ When there was an acceleration clause, the Supreme Court of Japan reasoned, the borrower had to pay the excessive interest in order to avoid the penalty, and therefore any payment under this acceleration clause could not be said to be a payment of the borrower’s own free will in the absence of special circumstances.⁷⁶

Since this acceleration clause was included in almost all consumer loan contracts, this judgment practically excluded all benefit of Article 43 from all consumer loan companies.⁷⁷ This holding was a landmark in the history of pro-consumer jurisprudence of the Supreme Court of Japan.

⁷² Saikō Saibansho [Sup. Ct.] Feb. 20, 2004, 58 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 475 (2nd petty bench) (Takii, J. concurring).

⁷³ Saikō Saibansho [Sup. Ct.] Jan. 13, 2006, 60 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1 (2nd petty bench).

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ The day this judgment was handed down was indeed a “doomsday” for the consumer finance business in Japan. See James Johnson, *An Activist Supreme Court Does Not a Market Make: The Effect of Japanese Supreme Court Rulings on the Consumer Finance Industry*, 6 DARTMOUTH L.J. 16, 27 (2008). The Supreme Court of Japan affirmed this rigid attitude in the later judgments as well. See Saikō Saibansho [Sup. Ct.] Jan. 19, 2006, 219 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 31 (1st

The Supreme Court of Japan confirmed this demanding attitude toward voluntariness in its other 2006 judgment. In this case, the Supreme Court of Japan required clear evidence that the excessive interest was paid voluntarily.⁷⁸ In order to do this, the Supreme Court of Japan held that it was insufficient that the loan company did not violate laws that regulate collection methods with administrative or criminal penalties.⁷⁹ The courts must examine the totality of circumstances to ensure that the borrower paid the excessive interest of his or her own free will.⁸⁰ This holding placed the burden of proof on the loan company to prove that the borrower paid the excessive interest out of his or her own free will, and it was not sufficient to prove that the loan company obeyed all laws. This burden of proof is onerous for the loan company to carry. This will practically preclude all consumer loan companies from the benefit of Article 43, because it is practically impossible for the loan companies to prove by clear evidence that the borrowers “voluntarily” paid back higher interest.

E. Viewing Overpayment as Satisfying Other Loans

According to the Supreme Court of Japan, when the customer makes a payment towards excessive interest, that payment will be automatically applied to satisfy the principal. All the payments made after the principal is wiped out are overpayments. As we will see below, however, the Supreme Court of Japan came to view the overpayment as satisfying the principal of remaining loans and the principal of new loans taken out after the payment.

Many consumer loan companies conclude basic contracts with customers. Borrowers are able to borrow a series of loans under this basic contract up to the limit so long as that basic contract remains valid. Sometimes, when payments wipe out the principal of the original loan, the customer may have another loan under the same basic contract. Then it would be beneficial for the customer to argue that overpayment should be viewed as satisfying the other remaining loans based on the same basic contract. Sometimes, when the consumer pays back the original principal, there is no remaining loan but he or she might borrow money after the payment under the same basic contract. Then, it would be beneficial for the

petty bench); Saiko Saibansho [Sup. Ct.] Jan. 24, 2006, 219 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 243 (3rd petty bench); Saikō Saibansho [Sup. Ct.] Mar. 17, 2006, 219 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 927 (2nd petty bench).

⁷⁸ Saikō Saibansho [Sup. Ct.] Jan. 19, 2006, 219 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 31 (1st petty bench).

⁷⁹ *Id.*

⁸⁰ *Id.*

customer to claim that the overpayment should be applied to satisfy the principal of the new loan made after the payment. Sometimes, the consumer loan company repeatedly lends money without a basic contract to the consumer, and the consumer might have other loans when their payments satisfy the original loan or may take out a new loan after paying back the first loan. The consumer might want the loan company to apply the overpayments towards the satisfaction of the new or remaining loans.

When there is a basic contract to allow borrowers to repeatedly borrow and pay back money, the Supreme Court of Japan held in 2003 that borrowers generally prefer the reduction of the total amount of loan and do not prefer the existence of multiple loans.⁸¹ When the payment of excessive interest satisfies the principal and when there is an overpayment, the court concluded that payment must be presumed as satisfying the remaining outstanding loans based on the same basic contract, unless there is a special circumstance to indicate otherwise.⁸² In other words, this holding established a very strong presumption that the borrowers' intent was to apply the overpayment to the remaining loan in the absence of a contrary agreement in the contract.⁸³

What would happen if there was no other outstanding loan when the overpayment was made? There would be no other loan to be satisfied by the overpayment. However, the Supreme Court of Japan held in 2007 that the basic contract should be interpreted to allow the overpayment to be applied to the satisfaction of the other loan even if that loan is made after the overpayment.⁸⁴ This holding affirmed that the overpayment to the first loan under the basic loan contract should be viewed as satisfying the principal of the other remaining loans in the absence of contrary agreement.⁸⁵ If there is no remaining loan, the overpayment to the first loan would not be automatically applied to the new loan made after the payment.⁸⁶ But if there is an agreement to apply that overpayment to the new loan, then the overpayment must be viewed as satisfying the new loan.⁸⁷ In this case, the basic contract allowed the borrower to borrow money up to the prescribed

⁸¹ Saikō Saibansho [Sup. Ct.] July 18, 2003, 57 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 895 (2nd petty bench).

⁸² *Id.*

⁸³ *Id.* See also Saikō Saibansho [Sup. Ct.] Sept. 11, 2003, 210 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 617 (1st petty bench); Saikō Saibansho [Sup. Ct.] Sept. 16, 2003, 210 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 729 (3rd petty bench).

⁸⁴ Saikō Saibansho [Sup. Ct.] June 7, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1537 (1st petty bench).

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

limit and allowed the borrower to pay back monthly to the bank account of the loan company based upon the total balance of all remaining borrowings and interest rate calculated based on the balance. The Supreme Court of Japan accepted this finding of the lower court and found that the overpayment was supposed to be applied to all remaining balances in total, and there was an agreement to apply the overpayment to the new loan after the payment was made.⁸⁸

When there is no basic contract, however, the consumers have some difficulty, but there is hope. In a 2007 judgment, the Supreme Court of Japan held that in the absence of a basic contract each loan contract should be viewed as a separate contract precluding the satisfaction of the second loan by the overpayment to the first loan, absent special circumstances.⁸⁹ An exception can be made, however, when borrowings are repeated between the borrower and the loan company as if there was a basic contract, and either the second loan was already assumed at the time of the first loan or there was an agreement to view the overpayment to the first loan as satisfying the second loan. This judgment did not allow the borrower to apply the overpayment of the first loan to a different loan in the absence of basic contract. But if the borrower could prove that the second loan was a part of a single continuous loan or prove the existence of contrary agreement, then the borrower could apply the overpayment to the second loan.

Indeed, in another 2007 judgment, the Supreme Court of Japan viewed the ongoing contractual relationship between the loan company and the customer as a continuous transaction when the second loan was made three months after the payment to the first loan, even in the absence of the basic contract.⁹⁰ In this case, the loan company changed and added another loan every time the borrower increased its loan, and the second loan was made shortly after the first loan based on the same terms and conditions. The Supreme Court of Japan agreed that this was a part of a single consecutive transaction and the parties anticipated the subsequent loan at the time of the first loan and generally did not want the existence of multiple loans.⁹¹ Therefore, the Supreme Court of Japan concluded that there was an agreement to apply the overpayment of the first loan to satisfying the loan made after the payment.⁹² This holding made it possible for consumers to

⁸⁸ *Id.*

⁸⁹ Saikō Saibansho [Sup. Ct.] Feb. 13, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 182 (3rd petty bench).

⁹⁰ Saikō Saibansho [Sup. Ct.] July 19, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2175 (1st petty bench).

⁹¹ *Id.*

⁹² *Id.*

argue that, even in the absence of a basic contract, an overpayment of the first loan should be applied to the second loan even if the second loan was made after the overpayment to the first loan.

What would happen if the basic contract expired and there was another basic contract and a new loan after the payment? Could the consumer argue that the overpayment to the first loan should be applied to the new loan made under the new basic contract? The Supreme Court of Japan held that in such a case, the overpayment to the first loan should not be applied to the new loan made under the new second contract in the absence of special circumstances such as the contrary agreement.⁹³ Again, the customers had to prove that there was a contrary agreement to apply the overpayment of the first loan to the new, second loan, but at least this holding left room for the borrower to prove special circumstances existed.

Moreover, when the borrower borrows and returns money repeatedly under the basic contract and payment towards a higher interest rate on the first loan is to be applied to another loan under the basic contract, the principal of the new loan is to be calculated by adding the remaining balance of the principal of the first loan after applying the payment of higher interest to the principal and the amount of new loan.⁹⁴ The maximum interest rate should be calculated based on the amount of that new loan and, if the amount of the principal moves up to a higher amount, then the corresponding lower maximum interest rate would be applied and any higher interest rate would be void.⁹⁵ When the amount of principal moves down to a lower amount

⁹³ Saikō Saibansho [Sup. Ct.] Jan. 18, 2008, 62 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 28 (2nd petty bench). The Supreme Court of Japan listed the length of the first basic contract, the duration between the last payment under the first basic contract and a new loan under the second basic contract, the return of the contract document of the first basic contract, the validity of the ATM card to be used, the degree of contact between the loan company and the borrower after the last payment for the first basic contract and the conclusion of the second basic contract, the history leading to the conclusion of the second basic contract, and the difference in the terms and conditions of the loan between the first and second basic contract as factors to be considered to decide whether the first basic contract and the second basic contract should be viewed as a part of the single continuous transaction. *Id.* Therefore, the Supreme Court of Japan overturned the judgment of the lower court that held four basic contracts concluded between the loan company and borrower were parts of a single continuous loan contract because of the inclusion of the automatic extension clause in each contract and held that the court must also consider the length of period between the last payment of the previous loan and new loan. Saikō Saibansho [Sup. Ct.] July 14, 2011, 237 SAIKŌ SAIBANSHŌ SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 263 (1st petty bench). *See also* Saikō Saibansho [Sup. Ct.] Sept. 11, 2012, (3rd petty bench) (borrower concluded another contract with the loan company allowing mortgage on the property to pay off all remaining debts from the continuous loan under the previous basic contract, but the Supreme Court of Japan concluded that there was no continuity between the first basic contract and the second loan contract because of the differences in the nature of contracts).

⁹⁴ Saikō Saibansho [Sup. Ct.] Apr. 20, 2010, 64 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 921 (3rd petty bench).

⁹⁵ *Id.*

however, the same maximum interest rate rather than the higher maximum interest rate must be applied.⁹⁶

F. Allowing Customers to Demand a Refund

As explained above, the 1968 judgment of the Supreme Court of Japan held that customers could demand a refund for overpayment to remedy unjust enrichment if the payment towards excessive interest was applied to satisfy the principal and there remained no principal to be paid.⁹⁷ This holding made it possible for many customers who had already paid off all the loans with higher interest rates to claim a refund.

The statute of limitations for an unjust enrichment claim is ten years.⁹⁸ As discussed below, the Supreme Court of Japan handed down a judgment in favor of the borrower as to the starting date of this statute of limitations.⁹⁹ Nevertheless, many borrowers who had made overpayments more than ten years earlier could not claim a refund because of the statute of limitations. Some borrowers, relying on tort claims, insisted that their claim for a damage award should still be permitted because the statute of limitations for tort claims is twenty years.¹⁰⁰ They argued that the loan companies committed a tort when they received payments towards the excessive interest, knowing that those rates were violating the Interest Rate Limitation Act. The Supreme Court of Japan was not persuaded.¹⁰¹

The loan companies were surely committing a tort when they employed violent or intimidating methods of collection, or when their behaviors were extremely improper in light of the social conscience, such as when a lender dared to collect money knowing that there was no factual or legal basis for their loans, or when the lender, as a regular loan company, should have known that there was no factual or legal basis for their loans.¹⁰² But they did not commit a tort, the Supreme Court of Japan concluded, simply by receiving a voluntary payment for interest higher than the rate stipulated in the Interest Rate Limitation Act.¹⁰³ This holding, while rejecting tort liability of consumer loan companies in general, left room for claims that a consumer loan company had committed a tort when it received

⁹⁶ *Id.*

⁹⁷ *See supra* note 32.

⁹⁸ MINPŌ [CIV.C.], art. 167, para. 1.

⁹⁹ *See infra* notes 118-21.

¹⁰⁰ MINPŌ [CIV.C.], art. 724. The plaintiff must also file a tort action within three years of learning of the damage and offender. *Id.*

¹⁰¹ Saikō Saibansho [Sup. Ct.] Sept. 4, 2009, 63 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1445 (2nd petty bench).

¹⁰² *Id.*

¹⁰³ *Id.*

payments toward excessive interest rates and the requirements of Article 43 of the Loan Company Act were not satisfied.

What would happen if the loan company sold its business to another loan company and there was an explicit clause denying the transfer of any legal obligation arising from the loan business to the new loan company? Could the customer still claim that their payment of excessive interest to the previous loan company should be applied to the new loan concluded with the new loan company, or claim a refund for overpayment from the new company? The Supreme Court of Japan held that the scope of the transfer should be based upon the intent of the parties and, if there was such a clause in the contract, then the new loan company had no legal obligation to adopt the obligation of the previous loan company to refund overpayments.¹⁰⁴ However, this holding left room for the consumer to argue that, in some cases, the intent of the parties was to transfer to the new loan company the obligation to make a refund.¹⁰⁵

G. Imposing the Obligation to Pay a Refund with Statutory Interest Rate

Furthermore, the Supreme Court of Japan held that the consumer loan companies must return an overpayment at the statutory interest rate. As we already saw, the consumer loan companies must return an overpayment to remedy unjust enrichment under Article 703 of the Civil Code.¹⁰⁶ If the loan company is a bad-faith recipient (*i.e.* if they knew that they were receiving a payment without a legal reason), the company had to return the money at the statutory interest rate under article 704.¹⁰⁷ Consumer loan companies argued that they were not bad-faith recipients because they believed in good-faith that the payment was valid under Article 43 of the Loan Company Act,

¹⁰⁴ Saikō Saibansho [Sup. Ct.] Mar. 22, 2011, 236 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 225 (3rd petty bench). *See also* Saikō Saibansho [Sup. Ct.] July 7, 2011, 237 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 139 (1st petty bench); Saikō Saibansho [Sup. Ct.] July 8, 2011, 237 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 159 (2nd petty bench); Saikō Saibansho [Sup.Ct.], June, 29, 2012, 241 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 1 (2nd petty bench). It must be noted, however, the transfer could not be made unless the debtor gave consent or the debtor was notified (if the debtor filed objection, the transfer could not be made). MINPŌ [CIV. C], art. 466.

¹⁰⁵ For instance, if the contract between the parent company and its subsidiary indicated the intention of switching all the contract obligations between customers and its subsidiary with new contract between the same customers and parent company, then the parent company owes a legal obligation to make a refund. Saikō Saibansho [Sup.Ct.], Sept. 30, 2011, 237 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 655 (2nd petty bench). *See also* Saikō Saibansho [Sup. Ct.] June 29, 2012, (2nd petty bench).

¹⁰⁶ MINPŌ [CIV. C.], art 703.

¹⁰⁷ *Id.* art. 704.

while consumers argued that the loan companies must be viewed as bad-faith recipients because they knew that the higher interest rate was illegal.

The Supreme Court of Japan held in a 2007 judgment¹⁰⁸ that a consumer loan company that receives a payment towards an interest rate higher than the maximum rate stipulated in the Interest Rate Limitation Act should be presumed to be a bad-faith recipient who is obliged to make a refund at the statutory interest rate. Even though a loan company believed that it could enjoy the benefit of Article 43, that loan company is still presumed to be a bad-faith recipient, unless there are exceptionally compelling reasons for that loan company to have believed that it could enjoy the benefits of Article 43.¹⁰⁹

As a result of this holding, a loan company that fails to provide a written receipt as stipulated under Article 18 cannot claim not to be a bad-faith recipient to avoid paying a refund with statutory interest.¹¹⁰ The Supreme Court of Japan also held that if the loan company could not enjoy the benefit of Article 43, the loan company should have realized that the payments towards interest had to be applied to the principal and, if no principal was left, there was no legal reason to receive the payment and therefore the company should be viewed as a bad-faith recipient.¹¹¹ All consumer loan companies that received payment after payment toward the higher interest rate wiped out the remaining principal are thus bad-faith recipients who are obliged to make refunds at the statutory interest rate.

The Supreme Court of Japan affirmed this stance in 2011 with respect to a loan company that lent money under a revolving loan contract. Until its holding in 2005, the Supreme Court of Japan had never made it clear that, with respect to such revolving loan contracts, the loan company at least had to describe equivalent information—such as the minimum payment requirements and the term and frequency of the payments—to satisfy the requirement of Article 17 to enjoy the benefits of Article 43. The loan

¹⁰⁸ Saikō Saibansho [Sup. Ct.] July 13, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1980 (2nd petty bench).

¹⁰⁹ *Id.*

¹¹⁰ Saikō Saibansho [Sup. Ct.] July 13, 2007, 225 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 103 (2nd petty bench).

¹¹¹ Saikō Saibansho [Sup. Ct.] July 13, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1980 (2nd petty bench); Saikō Saibansho [Sup. Ct.] July 17, 2007, 225 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 201 (3rd petty bench). However, before the 2006 judgment that precluded the application of Article 43 when there was an acceleration clause mandating consumers to return all the balance immediately when he or she defaulted, the consumer loan companies could not anticipate that judgment and therefore could not be presumed to be a bad-faith recipient simply because of the inclusion of such clause in the loan contract. Saikō Saibansho [Sup. Ct.] July 10, 2009, 63 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1170 (2nd petty bench). *See also* Saikō Saibansho [Sup. Ct.] July 14, 2009, 231 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 357 (3rd petty bench).

company in this case argued that, since the loan company could not expect this holding until that time, the loan company that failed to satisfy the requirement should not be viewed as a bad-faith recipient. But the Supreme Court of Japan disagreed.¹¹² It noted that it was easy for the loan company to expect that holding and that there was no clear legislative intent to allow exceptions for revolving loan contracts.¹¹³ The Supreme Court of Japan thus concluded that there was no exceptionally compelling circumstance to allow the loan company to believe that it could enjoy the benefits of Article 43.¹¹⁴

As a result, consumer loan companies have to pay back refunds at the 5% statutory interest rate.¹¹⁵ Moreover, the consumer loan companies must pay that statutory interest rate from the time the overpayment was received.¹¹⁶

H. Delaying the Starting Date for the Statute of Limitations

The Supreme Court of Japan held that the statute of limitations for a refund claim starts from the end of the basic contract, not from the date of overpayment. As we already saw, the statute of limitations for an unjust enrichment claim is ten years,¹¹⁷ but there was a question as to when the statute of limitations starts to run. Consumer loan companies argued that the statute of limitations should start from the time of overpayment, because the consumers could demand a refund from the time of overpayment. But the Supreme Court of Japan disagreed.¹¹⁸ So long as the basic contract remained valid, it held, parties generally do not anticipate that the borrower will demand a refund upon each overpayment; rather, the parties will assume that the overpayment should be applied to the new loans made under the

¹¹² Saikō Saibansho [Sup. Ct.] Dec. 1, 2011, 238 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 189 (1st petty bench).

¹¹³ *Id.*

¹¹⁴ *Id.* Applying this holding to a case before the court, the Supreme Court of Japan found the loan company provided the equivalent information even before its 2007 holding but found that the borrower already paid all the principal by paying excessive interest and therefore the loan company was still a bad-faith recipient.

¹¹⁵ There was a dispute over whether the rate applicable to refunds should be a 5% statutory interest rate, stipulated in the Civil Code (MINPŌ [CIV. C.] art. 404), or a 6% statutory interest rate, stipulated in the Commercial Code (SHŌHŌ [COMM. C.] art. 514). However, the Supreme Court of Japan held that it should be a regular 5% statutory interest rate that should be applied. Saikō Saibansho [Sup. Ct.] Feb. 13, 2007, 61 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 182 (3rd petty bench).

¹¹⁶ Saikō Saibansho [Sup. Ct.] July 17, 2009, 2048 HANREI JIHŌ [HANJI] 9 (2nd petty bench); Saikō Saibansho [Sup. Ct.] Sept. 4, 2009, 231 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 477 (2nd petty bench).

¹¹⁷ MINPŌ [CIV. C.] art. 167.

¹¹⁸ Saikō Saibansho [Sup. Ct.] Jan. 22, 2009, 63 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 247 (1st petty bench).

basic contract, and that the borrower will only claim a refund for overpayment at the end of the series of continuous loans under the basic contract.¹¹⁹ It thus held that the statute of limitations should not start running until the time when parties no longer anticipate any new loan under the basic contract.¹²⁰ The Supreme Court of Japan thus concluded that, in the absence of special circumstances such as the existence of a contrary agreement, the statute of limitations runs from the date of the end of the series of transactions under the basic contract.¹²¹

As a result, even if more than ten years have passed since the time of overpayment, consumers are allowed to demand refund if the demand is made within ten years from the end of the basic contract. This holding made it possible for an even greater number of customers to claim refunds.¹²²

I. Imposing the Duty to Disclose Transaction History to Customers

Finally, the Supreme Court of Japan mandated that consumer loan companies disclose the history and details of a transaction to requesting customers. In its judgment in 2005,¹²³ the Supreme Court of Japan held that loan companies had an obligation to provide the transaction record under the good-faith requirement arising from the loan contract. Moreover, the loan company has a duty of disclosure so long as the company maintains the record, even if it is no longer mandated to keep it by statute.¹²⁴ The failure to disclose the transaction record is a tort that entitles a customer to recover damages.¹²⁵ As a result, the consumers could check the transaction record to find out whether they made overpayment, whether there remained other outstanding borrowing to be satisfied by the overpayment, and when the overpayment started. This holding significantly facilitated consumers' refund claims.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.* See also Saikō Saibansho [Sup. Ct.] Mar. 3, 2009, 230 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 167 (3rd petty bench); Saikō Saibansho [Sup. Ct.] Mar. 6, 2009, 230 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 209 (2nd petty bench).

¹²² Moreover, the Supreme Court of Japan held that the statutory interest starts to accrue from the date of overpayment even when there was an agreement to apply the overpayment to the satisfaction of new loan under the basic contract. Saikō Saibansho [Sup. Ct.] Sept. 4, 2009, 231 SAIKŌ SAIBANSHO SAIBANSHŪ MINJI [SAIBANSHŪ MINJI] 477 (2nd petty bench). Since under the holding of the Supreme Court of Japan a borrower is not supposed to claim refund under such an agreement until the end of the continuous transaction under the basic contract, there seems to exist some inconsistencies in this holding.

¹²³ Saikō Saibansho [Sup. Ct.] July 19, 2005, 59 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1783 (3rd petty bench).

¹²⁴ *Id.*

¹²⁵ *Id.*

IV. IMPACT OF THE JUDGMENTS OF THE SUPREME COURT OF JAPAN

What was the impact of these judgments of the Supreme Court of Japan? In this Part, we will see that these judgments had a significant impact on consumers and consumer loan companies and that they prompted the legislature to introduce the 2006 amendments to consumer loan regulation and bring in much tighter regulation of the industry. We will then examine whether this development was a blessing for Japanese consumers and consider whether this development successfully solved the root problems of borrowing money in Japan.

A. *Impact of the Judgments*

These holdings of the Supreme Court of Japan had a tremendous impact on the consumer finance industry.¹²⁶ It is true that not all judgments of the Supreme Court of Japan are in favor of the borrowers. Indeed, some dismissed the consumers' claims against consumer loan companies. Consumer advocates and lawyers criticized these judgments as not sufficiently protective of borrowers.¹²⁷ But at least as a result of these judgments, consumers were relieved of the obligation to pay higher interest rates and could even demand a refund from consumer loan companies if they paid unnecessary higher interest rates. Many lawyers and law firms took this opportunity to make quick money and solicited consumers to consult with them in order to file lawsuits against consumer loan companies.¹²⁸ The claims for refunds soared after these judgments.¹²⁹

These judgments of the Supreme Court of Japan were strongly supported by lawyers and the mass media.¹³⁰ Almost all lawyers and the

¹²⁶ These judgments "had a disastrous impact upon the financial condition of loan companies that had previously relied on an expectation of enforceability of their premium rate loan contracts" under Article 43. See Johnson, *supra* note 77, at 29.

¹²⁷ YAGETA LAW FIRM, TOKUSHUNA KEISAN: KEIYAKUKIRIKAE, SAIKENJŌTO NO BAAI [SPECIAL CASES: EXCHANGE OF DEBT AND TRANSFER OF CONTRACT], available at http://www.yageta-law.jp/site_debt/ksn/ksn06.html (criticizing the Supreme Court of Japan for its failure to admit the transfer of contract obligation to new companies).

¹²⁸ *Post kabarai bubblewa nandemoari: Kenzaikasuru bengoshikaino yuuutsuna genjitu [Everything Is Acceptable in the Post Overpayment Bubble: Emerging Depressing Reality of Lawyers' Society]*, DIAMOND ONLINE, (Mar. 13, 2012), <http://diamond.jp/articles/-/16546> (noting that the lawyers are scrambling to find next lucrative job because the bubble of overpayment cases is almost over).

¹²⁹ Pardieck, *supra* note 14, at 569.

¹³⁰ *Minashi bensaino tekiyounikansuru saikousaihanketsu nituiteno kaichouseimei [Statement of the President on the judgment of the Supreme Court of Japan concerning the Receipt of Higher Interest as Valid Payment]* NIHON BENGOSHI RENGOUKAI [JAPAN FEDERATION OF BAR ASSOCIATION], Feb. 3, 2006, available at http://www.nichibenren.or.jp/activity/document/statement/year/2006/060203_2.html.

mass media praised the bravery and wisdom of the Supreme Court of Japan in denying the receipt of higher interest rates and allowing refund claims from borrowers. They called for much tougher regulation on consumer loan companies.¹³¹

Some estimate that roughly five million borrowers would be able to seek refunds and it is estimated that the total amount of refunds to be paid by all the consumer loan companies will reach up to ten trillion yen (100 billion USD).¹³² Consequently, many consumer loan companies, overwhelmed by this sudden rise of refund requests, went into serious financial trouble. Many consumer loan companies registered red ink after these holdings.¹³³

B. *The 2006 Amendments*

The government responded to these holdings in 2006 by amending the Interest Rate Limitation Act, the Capital Subscription Act, and Loan Company Act.¹³⁴ These amendments deleted Article 1, paragraph 2 of the Interest Rate Limitation Act that had precluded a borrower from claiming a refund if he or she voluntarily paid back the higher interest rate.¹³⁵ The government removed the regulatory gap between the Interest Rate Limitation Act and the Capital Subscription Act and made the maximum interest rate of 20% the only maximum cap for loan companies.¹³⁶ The

¹³¹ TOKYO BENGOSHIKAI [TOKYO BAR ASSOCIATION], SHUSSIHŌ NO JOUGENKINRINO HIKISAGETŌWOMOTOMERU IKENSHO [OPINION CALLING FOR REDUCTION OF MAXIMUM INTEREST RATE IN THE CAPITAL SUBSCRIPTION ACT] (Nov. 7, 2005), available at <http://www.toben.or.jp/message/ikensyo/post-229.html>.

¹³² Press Release, Shihoshoshi houjin Shinjuku jimusho [Judicial Scribner Corporation, Shinjuku Branch], Yokohamachisai niyoru Takefuji motoshachoeno henkanhanketsuwo uke, sihoushoshi houjin shinjukujimushoga kabaraikin, shakkin mondaino muryousoudanmadoguchiwo Yokohamani kaisetsu [Judicial Scribner Corporation, Shinjuku Branch, Opened a Free Consultation Window on Overpayment and Debt Issues Based upon the Judgment of the Yokohama District Court Against Former President of Takefuji] (Aug. 6, 2012), available at <http://www.atpress.ne.jp/view/29142>.

¹³³ Johnson, *supra* note 77, at 30. Some foreign consumer credit companies pulled out from Japan or significantly reduced their business in Japan. *Id.*

¹³⁴ Kashikingyōno kiseitō nikansuru hōritsutō no ichibuwo kaiseisuru hōritsu [Act to Amend Parts of the Act Concerning Regulation of Loan Company and Others], Law No. 115 of 2006. For a history leading to these amendments, see Pardieck, *supra* note 14, at 569-76. For an outline of these amendments, see *id.* at 576-80.

¹³⁵ Risokuseigenhō [Interest Rate Limitation Act], Law No. 100 of 1954, art. 1.

¹³⁶ Shusshi no ukeire, azukarikin oyobi kinritō no torishimari nikansuru hōritsu [Act Concerning Regulation of Receipt of Subscription of Capital, Deposit and Interest Rate], art. 5, para. 2 (imposing a five year imprisonment and/or a fine of no more than ten million yen [100,000 USD] as a punishment). Everyone is prohibited from charging more than 109.5% interest rate by a five year imprisonment and/or a fine of no more than ten million yen, *id.* para. 1, and, if the loan companies concluded a contract with interest rate higher than 109.5%, then the punishment will be increased to ten years imprisonment and/or fine of no more than 30 million yen [300,000 USD], *id.* para. 3. Depending upon the amount of the principal, there is still a narrow gap between the maximum interest rate stipulated in the Interest Rate

government prohibited loan companies from charging interest rates higher than the rates stipulated in the Interest Rate Limitation Act¹³⁷ and deleted the old Article 43.¹³⁸ The government authorized the establishment of specified credit information management organizations to share credit information among registered loan companies.¹³⁹ The government also imposed a new obligation on loan companies to check the annual income of the customer¹⁴⁰ (using credit information obtained through specified credit information management organization),¹⁴¹ prohibited loan companies from lending money beyond the borrower's capability to pay back, and mandated that the total amount of a loan must not exceed one-third of the borrower's annual income.¹⁴²

It was remarkable that the legislature decided to delete Article 1, paragraph 2 of the Interest Rate Limitation Act and Article 43 of the Loan Company Act despite its past reluctance to deny loan companies the benefit of receiving voluntary payments of higher interest. The government, long dominated by the conservative Liberal Democratic Party ("LDP"), used to be reluctant to deny consumer loan companies the benefit of receiving payments for higher interest rates so long as their business activities conformed to the government regulations. Now, faced with the strong call for much tougher regulation from opposition parties such as the Democratic Party of Japan ("DPJ"),¹⁴³ backed by wide mass media support, the LDP government decided to delete these provisions.

These amendments took effect gradually. But they made it more difficult for consumer loan companies to lend money and make a profit.¹⁴⁴ Indeed, Takefuji, one of the largest consumer loan companies in Japan, had to file a bankruptcy proceeding because of the enormous demands for refunds and the slim possibility of making enough profit to pay all of the

Limitation Act and Capital Subscription Act. But since the loan companies are prohibited from charging interest rate higher than the rate stipulated by the Interest Rate Limitation Act, any violation is null and void and may be subject to administrative penalty.

¹³⁷ Kashikingyōhō [Loan Company Act], Law No. 32 of 1983, art. 12-8, para. 1.

¹³⁸ *Id.* art. 43 (replacing old article 43 with a different provision).

¹³⁹ *Id.* arts. 41-13 to 41-38.

¹⁴⁰ *Id.* art. 13, para. 1.

¹⁴¹ *Id.* art. 13, para. 2.

¹⁴² *Id.* art. 13-2. Also, the loan company was prohibited from receiving a life insurance payment from suicide when it is a recipient of an insurance payment arising from the insurance policy (*id.* art. 12-7).

¹⁴³ TOKYO METROPOLITAN ASSEMBLY, DEMOCRATIC PARTY OF JAPAN, SHUSSHŌ OYOBI KASHIKINGYOKISEIHŌ NOKAISEI NIKANSURU IKENSHO [OPINION ON AMENDMENT TO THE CAPITAL SUBSCRIPTION ACT AND ACT CONCERNING REGULATION OF LOAN COMPANY] (Mar. 30, 2006), available at <http://www.togikai-minsyuto.jp/html/teireikaihokoku/th18/1801ikensyo.htm#1801k04>.

¹⁴⁴ Finbarr Flynn & Takako Taniguchi, *Moneylenders in Japan Brace for Losses, Shakeout on New Rules*, BLOOMBERG, June 17, 2010, available at <http://www.bloomberg.com/news/2010-06-17/japan-consumer-lenders-brace-for-losses-closures-as-new-rules-take-effect.html>.

refunds after the amendments went into effect.¹⁴⁵ Other major consumer loan companies had to be rescued by major financial institutions and became members of the major financial groups.¹⁴⁶ The number of consumer loan companies that were allowed under these new regulations was significantly reduced.¹⁴⁷ The judgments of the Supreme Court of Japan and the 2006 amendments triggered a tremendous shrinking of the consumer loan industry and a massive reorganization.

C. *Blessing for Consumers?*

These holdings are surely a blessing for many consumers who had to pay back a higher interest rate. They no longer have to pay the higher interest and they can even demand a refund at the statutory interest rate from the consumer loan companies. Moreover, because of the 2006 amendments introduced by the Diet in response to judgments of the Supreme Court of Japan, many customers who are already deeply indebted will not be able to borrow any more money and there will be smaller number of over-indebted borrowers in Japan.¹⁴⁸

¹⁴⁵ Takefuji reported 433.6 billion yen [4.3 billion USD] in liabilities and would not be able to repay all the overpaid interest from borrowers estimated to exceed one trillion yen [10 billion USD]. See Takako Taniguchi & Takahiko Hyuga, *Takefuji Files for Bankruptcy Protection after Refunds*, BLOOMBERG, Sept. 28, 2010, available at <http://www.bloomberg.com/news/2010-09-27/takefuji-said-to-file-for-bankruptcy-today-amid-rising-interest-refunds.html>. Technically, it was a corporate reorganization application, but practically, it was an application for bankruptcy.

¹⁴⁶ Promise is now controlled by the Sumitomo Mitsui Financial Group Inc., led by the Mitsui Sumitomo Banking Corp., and Acom is now a unit of Mitsubishi-UFJ Financial Group Inc., led by the Bank of Tokyo-Mitsubishi UFJ, Ltd. These megabanks decided to enter into the consumer retail loan market by acquiring consumer loan companies. Aiful remains an independent consumer loan company, but had to go through a reconstruction procedure with all lenders and seriously cut down its service in order to avoid bankruptcy. *Aiful, jigyosaisei ADR ga seiritsu [Aiful, Reconstruction ADR Accomplished]*, REUTERS, Dec. 24, 2009, available at <http://jp.reuters.com/article/topNews/idJPJAPAN-13093520091224>. On the other hand, Lake was acquired by the Shinsei Financial and their business was transferred to the Shinsei Bank, Ltd., which could enter the retail consumer loan market without the statutory restrictions designed for consumer loan companies. *Shinseiginko, shouhishakin-yujigyouwo ginkouhontaide tenkai [Shinsei Bank, Offering Consumer Loan Service by the Bank Itself]*, REUTERS, July 20, 2011, available at <http://jp.reuters.com/article/domesticEquities4/idJPnTK046574520110720>.

¹⁴⁷ The number of registered loan companies significantly decreased to 2,677 in 2010, down from 47,504 in 1986. Atsushi Ohkawauchi, *Kaiseikashikingyohono kanzensekō womeguru ronten [Issues Concerning Full Implementation of the Amended Loan Company Act]*, 699 CHOUA TO JOUHOU 1, 8-9 (2011). In 2011, the number decreased further to 2,350. NIHON KASHIKINGYŌ KYOUKAI [JAPAN FINANCIAL SERVICES ASSOCIATION], HEISEI 23 NENDO NENJI HOUKOKUSHO [ANNUAL REPORT, 2011], available at http://www.j-fsa.or.jp/doc/material/white_paper/h23/chapter3.pdf (hereinafter cited as Association Report).

¹⁴⁸ It was estimated that the number of over-indebted borrowers who were borrowing money without security from more than five loan companies decreased to 727,000 in 2009. Ohkawauchi, *supra* note 147, at 5.

Does this mean that the Supreme Court of Japan finally won a battle against the Diet? Was the legislature now convinced that the Supreme Court of Japan was right and that it was better to preclude consumer loan companies from collecting higher interest rate? Or was the legislature reluctantly forced to concede that a more stringent approach must be adopted because of the devoted stance of the Supreme Court of Japan to protect weak consumers? Or were the politicians of the ruling LDP, who used to be supported by significant contributions from the loan companies, deciding to revise the consumer loan regulation for the benefit of the consumers in an attempt to win the popular support and the coming election? Or did the Financial Services Agency, formerly content with Article 43, grab this opportunity provided by the Supreme Court of Japan to accomplish their aim of reorganizing the consumer loan industry into the financial institutions they could more tightly regulate? Is this merely an attempt by the Financial Services Agency to expand its power, possibly to elevate the agency into a governmental department? Or is this an attempt by the Supreme Court of Japan to provide lucrative jobs for money-strapped lawyers? Definitely, the judgments of the Supreme Court of Japan were tremendously good news for lawyers who are now forced to make less money because of the stiff competition caused by the sudden increase of the number of lawyers after the introduction of new law school system in 2004. Was the legislative response merely a confirmation of this hidden motive of the Supreme Court of Japan?

Whatever reasons may exist for the government and legislature to accept those judgments of the Supreme Court of Japan, it is debatable whether, in the long run, these judgments and the 2006 amendments had a healthy impact on the consumer finance industry and consumers in general. It was not the regular consumer loan companies that created the more serious social issues. Rather, it was black market loan-sharks that illegally charged extremely high interest rates and employed illegal and violent collection methods, forcing consumers into a desperate situation and creating more serious social problems. These companies were not legally registered and usually did not have an established office. Gang members or organized crime groups (*yakuza*) are often deeply involved in the operation of such black market operations.¹⁴⁹ For those consumers who already had huge debt, they were the only organizations willing to lend money. Despite the efforts of the Diet to introduce stringent regulation and the efforts of the

¹⁴⁹ Pardieck, *supra* note 14, at 562; WEST, *supra* note 19, at 228-29.

police to crack down on them,¹⁵⁰ there were demands for them and it was hard to wipe them out.

The registered, regular consumer loan companies were not, therefore, serious troublemakers. However, by seriously restricting the regular consumer loan industry and reorganizing its members into major financial institutions, many consumers would probably face difficulty in finding a company willing to lend them money.¹⁵¹ The requirement to check the annual income of the borrower before lending money would definitely deprive many customers of the opportunity to borrow money. The potential customers most affected might be housewives, who could no longer borrow money based upon the income of their husbands. But many others, including small business operators who, for instance, need immediate money to pay salaries to their employees before receiving payment from clients or customers, would not be able to secure the loan.¹⁵² It is questionable whether depriving customers of the opportunity to borrow money from these regular consumer loan companies was really necessary.

There is also a question as to whether it was a wise policy to set the maximum cap on interest rates at 20% per year and to deprive many customers of the opportunity to borrow and pay back money even with a higher interest rate. Indeed, even before the 2006 amendments, most of the consumers who borrowed money with 29.2% maximum cap had no trouble returning the money back. Now, as a result of the judgments of the Supreme

¹⁵⁰ Of course, these loan sharks are violating the Capital Subscription Act and criminal penalties may be imposed. The regulation against unregistered loan sharks intensified and the criminal penalty against violation increased significantly in 2003. Kashikingyōno kiseitō nikansuru hōritsu oyobi shushino ukeire, azukarikin oyobi kinritō no torishimari nikansuru hōritsu no ichibuwo kaiseisuru hōritsu [Act to Amend Parts of the Act Concerning Regulation of Loan Company and Act Concerning Regulation of Receipt of Subscription of Capital, Deposit and Interest Rate] (Unregistered Loan Sharks Eradication Act), Law No. 136 of 2003. Their use of illegal collection methods can be also charged as a criminal code violation. Furthermore, loan contracts with extremely high interest rates may violate public order and good morality and would thus be wholly null and void. See Kashikingyōhō [Loan Company Act], Law No. 32 of 1983, art. 42, para. 1 (any loan contract with interest rate higher than 109.5% per year is void). Indeed, the Supreme Court of Japan held that a loan contract with such an extremely high interest rate is so unethical that the loan company could not seek a refund of the money it lent the consumer under a theory of unjust enrichment. Saikō Saibansho [Sup. Ct.] June 20, 2008, 62 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1488. When the customer sought damages against the loan company as a tort, the Supreme Court of Japan also held, the loan company could not offset that money and damages and subtract that money from the damages. *Id.*

¹⁵¹ The total amount of lending by loan companies decreased to 29.9357 trillion yen (299 billion USD) in 2010, compared to 54.5309 trillion yen (545 billion USD) in 1999, indicating a 45% decline in lending. Ohkawauchi, *supra* note 147, at 9. The ratio of conclusion of contract among the applicants at the four major loan companies in 2010 was 29.1% compared to 61% in 2005, indicating that fewer applicants are now approved for loans. *Id.* at 9-10.

¹⁵² It is estimated that among fourteen million customers as many as seven million customers would be refused loans. *Kaiseikashikingyōhōno hamon [Impact of Loan Company Act Amendment]*, REUTERS, June 18, 2010, available at <http://jp.reuters.com/article/topNews/idJPJAPAN-15877020100618>.

Court of Japan and the 2006 amendments, consumer loan companies cannot charge more than 20% and probably will not be willing to lend money unless they can make a profit with 20% maximum cap. As a result, many customers will simply be shut out from the consumer loan companies.¹⁵³ Was this really necessary?

Moreover, capping the maximum, total amount of loans at one-third the annual income of the consumer also raises a more controversial question of whether such a limitation is necessary. It is hard to find a country in the world having such an absolute total-amount limitation. Apparently, this limitation is to protect the vulnerable consumers from borrowing money beyond their capacity to pay back. But is there any special reason to believe that Japanese consumers need this kind of special protection compared with consumers in other countries? Moreover, even if such total amount limitation is necessary, there still remains a question as to whether it is actually appropriate to set the maximum cap at one-thirds of the annual income.¹⁵⁴

In addition to these questions, there is a more serious question: what would happen if those consumers who desperately need money cannot secure a loan from consumer loan companies? Indeed, there is a significant possibility that some of the consumers who are refused a loan from regular consumer loan companies might be forced to turn to the black market loan-sharks.¹⁵⁵ Simply limiting the maximum interest rate and imposing the maximum cap on the total amount of loan does not help those consumers who need money but who would not be able to secure a loan. Unless other kinds of help are available, perhaps some consumers might end up relying upon such illegal loan sharks. Otherwise, they might end up committing suicide from desperation, not because of over-indebtedness but because of the failure to secure a loan.

Thus, it is debatable whether the judgments of the Supreme Court of Japan and the subsequent 2006 amendments are an actual blessing for general consumers.

¹⁵³ Masatoshi Kinoshita, *Kashikingyōkiseihō kaisei wo meguru mondai* [Issues regarding the Amendment to the Act Concerning the Regulation of Loan Company], 7 HIROSHIMA HOUKADAIGAKUIN RONSHŪ 1, 14 (2011).

¹⁵⁴ *Id.* at 17.

¹⁵⁵ Johnson, *supra* note 77, at 31. Although the Financial Services Agency denies it, there are already some signs that indicate the sudden increase of customers who must turn to such illegal loan sharks. *Saishin detaga shimesu kin-ychōno shissei* [Most Recent Data Shows the Mistake of the Financial Services Agency], DIAMOND ONLINE, Oct. 31, 2011, available at <http://diamond.jp/articles/print/14645>; *Loan-Shark Lending Surge Feared in Japan*, BLOOMBERG, Aug. 8, 2012, available at <http://www.bloomberg.com/news/2012-08-07/loan-shark-lending-surge-feared-in-japan.html>.

D. *Roots of the Consumer Loan Issues*

The roots of the problem might lie in the Japanese people's attitude toward borrowing money and in the legal system that is intended to save the deeply-indebted borrowers.

Most people believe that when people borrow money they have to pay it back. It is a contract and as far as borrowing money is concerned this belief is widely shared, even when the interest rate is quite high. Borrowers know when an interest rate is quite high and agree to pay the money back together with that higher interest rate. How can borrowers then argue that the interest rate was too high after borrowing the money? This strong belief in the binding nature of the contract places tremendous pressure on the borrowers to pay back the money they borrowed, even if the interest rate is illegally high.¹⁵⁶

Furthermore, borrowing money from a loan company is something most people do not want revealed. It can be embarrassing, and therefore people want to hide the fact that they are borrowing. Most customers of loan companies do not want their neighbors, co-workers, and sometimes even other family members know about their borrowing. This sense of embarrassment has not changed even after consumer loans became commonplace. The fact that the loan company workers come to the house or workplace to collect the debt alone would be extremely embarrassing or terrifying to the borrowers, something most borrowers would want desperately to avoid.¹⁵⁷ This would make it hard for borrowers to seek help.

If a debtor is over-indebted and cannot pay back a debt, that debtor can definitely file a voluntary bankruptcy proceeding.¹⁵⁸ Then, the judge might relieve the debtor of the entire legal obligation to pay back the debt and the borrower could start a new life. Of course, filing a bankruptcy proceeding means that one's future financial credit will be seriously restricted. But if such a bankruptcy proceeding is quite easy, then the loan company would not lend money beyond the capacity of the borrower to pay back. The borrower will be granted a second chance. Nevertheless, in Japan the bankruptcy proceedings takes time and a filing of bankruptcy often means that the person is not capable of managing his or her own financial

¹⁵⁶ It is often said that the Japanese attitude toward contract is more flexible. There are debates as to whether this description is correct. See Michael Young, Masanobu Kato, & Akira Fujimoto, *Japanese Attitudes Towards Contracts: An Empirical Wrinkle in the Debate*, GWU LAW SCHOOL, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=363400. It appears that the general public view contract strictly binding when it comes to regular loan contract.

¹⁵⁷ WEST, *supra* note 19, at 252 (noting that for Japanese people, publicly revealing the fact of debt is itself shameful and to be avoided).

¹⁵⁸ *Hasanhō* [Bankruptcy Act], Law No. 75 of 2004.

matters—it is embarrassing not only to the person who filed a bankruptcy, but also to other family members or even relatives.¹⁵⁹ Filing bankruptcy is therefore something that one wants to avoid at all costs.¹⁶⁰

In other countries, a debtor can run away and there is a chance that moneylenders will not find him or her. But in Japan, there is a family registration system¹⁶¹ and a resident registration system,¹⁶² and every change of address must be registered. Without the registration, it is extremely difficult to live an ordinary life in Japan. These registrations used to be open to the public for inspection. Despite the recent efforts to restrict access to these registrations,¹⁶³ there is a high risk that creditors may find the new residence through this registration system.¹⁶⁴ Running away is quite difficult.

Some of the loan companies require joint surety in order to borrow money, although major loan companies do not. If the borrower cannot pay back the loan or run away, the loan companies can go after the joint surety, thus destroying the life of the person who became a joint surety.¹⁶⁵ In most cases, the joint surety is a friend, relative, co-worker, or boss. The borrower does not want to ruin the lives of these people who were kind enough to become the joint surety. These are reasons why some over-indebted borrowers ended up committing suicide in order to pay back their debts,

¹⁵⁹ WEST, *supra* note 19, at 248-49 (noting that the feeling of guilt for burdening or offending the parents or family by filing for bankruptcy because of huge debt may be one reason a debtor chooses suicide over filing for bankruptcy).

¹⁶⁰ *Id.* at 230-32. The number of voluntary bankruptcies gradually increased and reached 242,377 cases in 2002, the largest number yet. FINANCIAL SERVICES AGENCY, *available at* <http://www.fsa.go.jp/ordinary/karisugi/index.html>. The number of voluntary bankruptcy application gradually declined thereafter. There were 100,509 voluntary bankruptcy applications in 2011. *Trends in the Number of Bankruptcy Filing by Self-aggregation Supreme Court*, JAPAN FINANCE NEWS, <http://www.financenews.co.jp/b/main.html>. After the Diet enacted the Civil Rehabilitation Act in 1999 and made it available for individual debtors, an increasing number of debtors came to use this civil rehabilitation proceeding rather than the bankruptcy proceeding. See Minjisaiseihō [Civil Rehabilitation Act], Law No. 225 of 1999; See also WEST, *supra* note 19, at 256-62 (noting that the civil rehabilitation procedure could be more effective and less stigmatic).

¹⁶¹ Kosekihō [National Registration Act], Law No. 224 of 1947.

¹⁶² Juhmintouroukuhō [Resident Registration Act], Law No. 81 of 1967.

¹⁶³ *Id.* art. 11-2, para. 1.

¹⁶⁴ JUHMINTHYŌ NO UTSUSHINO KOUHUSEIDOTŌNO ARIKATA NIKANSURU KENTŌKAI [STUDY GROUP ON THE SYSTEM TO ALLOW REQUEST A COPY OF THE RESIDENT REGISTRATION], SOUMUSHO [MINISTRY OF INTERNAL AFFAIRS AND COMMUNICATION], HOUKOKUSHO [FINAL REPORT] (Feb. 2007), *available at* www.soumu.go.jp/main_sosiki/jichi_gyousei/c-gyousei/pdf/jyuminhyo_utusi_16.pdf (noting that the creditor has a legitimate reason to see the resident registration of the borrower in order to find the place of residence).

¹⁶⁵ NIHONBENGOSHIRENGOKAI [JAPAN FEDERATION OF BAR ASSOCIATION], HOSHŌSEIDONO KONPONTEKIKASEIWO MOTOMERU IKENSHO [OPINION CALLING FOR A FUNDAMENTAL CHANGE TO THE SURETY SYSTEM], *available at* <http://www.nichibenren.or.jp/activity/document/opinion/year/2012/120120.html> (notes that the surety system is one of the main reasons individuals are incurring huge debt and committing suicide, and calls for a ban on individual to become surety).

hoping that the life insurance payments would be sufficient to cover all the debts.¹⁶⁶

Consumer advocates, lawyers, and mass media blamed consumer loan companies for all of the tragic suicides. Because the consumer loan companies are willing to lend money and charge high interest rates, many borrowers ended up borrowing money beyond their capacity to repay and were forced to commit suicide.¹⁶⁷ There is a need, some argued, to lower the maximum interest rate, limit the total amount of the loan, and force consumer loan companies to follow these regulations.¹⁶⁸

This is exactly what was accomplished by the Supreme Court of Japan and by the Diet. Surely, the judgments of the Supreme Court of Japan force the consumer loan companies to obey the maximum interest rate. Surely lowering the maximum interest rate by the 2006 amendment will reduce the burden of borrowers and imposing the total amount limitation will reduce the number of over-indebted borrowers. It is noteworthy that the Supreme Court of Japan practically triggered all these changes by taking a leading role. But it is unclear whether these changes are sufficient to solve the root problem of money borrowing in Japan.¹⁶⁹

¹⁶⁶ In 2010, 31,690 people committed suicide and 7,438 people were believed to have committed suicide for economic and personal reason. See KEISATSUCHŌ [NATIONAL POLICE AGENCY], HEISEI 22 NENCHŪ NIOKERU JISATSUNO GAIYŌ SHIRYŌ [DATA CONCERNING THE SUICIDE IN 2010], <http://www.npa.go.jp/safetylife/seianki/H22jisatsunogaiyou.pdf>. Many tend to believe that the difficulty and stigma of bankruptcy proceeding is the main reason for debtors to choose suicide. *But see* WEST, *supra* note 19, at 236-54 (questioning the correlation between bankruptcy and suicide). The Japanese Commercial Code (SHŌHŌ [COMM. C.], art. 680) provides that the insurers need not pay insurance in suicide cases but Japanese life insurance contract normally excludes insurance payment for suicide only for one year after the contract. Therefore, those debtors who committed suicide after one year can expect that the insurance companies will pay the life insurance so that the surviving family does not have to worry about the debts. *Id.* at 260-61. In some cases, the loan companies carried the life insurance on the borrower and received the payment directly from the insurance company, even without telling the borrowers or their families. The Diet thus prohibited the loan company from receiving the insurance payment from suicide if it carried the life insurance on the borrower. See *supra* note 142.

¹⁶⁷ NIHONBENGOSHIRENGOUKAI [JAPAN FEDERATION OF BAR ASSOCIATION], SHUSSIHŌNO JOUGENKIRINO HIKISAGETŌWO MOTOMERU IKENSHO [OPINION CALLING FOR REDUCTION OF THE MAXIMUM INTEREST RATE IN THE CAPITAL SUBSCRIPTION ACT] (July 18, 2003), available at http://www.nichibenren.or.jp/library/ja/opinion/report/data/2003_32.pdf.

¹⁶⁸ *Id.*

¹⁶⁹ After the amendments fully took effect the government, led by the DPJ since 2009, established a project team to report on the full implementation of the amendments. The report made ten proposals in response to the criticisms, including a proposal to facilitate financial institutions to enter into consumer retail loan business, to provide safety net for consumers who need money, to provide loan for small business operators, and to call for much tougher enforcement of law against illegal loan sharks. FINANCIAL SERVICES AGENCY, KASHIKINGYŌSEIDO NIKANSURU PUROJEKUTOCHIMU HOUKOKU [REPORT OF THE PROJECT TEAM ON LOAN COMPANIES] (Apr. 2, 2010), available at <http://www.fsa.go.jp/policy/kashikin/pt.pdf>. On the other hand, the LDP, an opposition after 2009, proposed amendments to the amended Loan Company Act to change maximum interest rate to fluctuate with the prevailing interest rate with the maximum cap of 30% per year and eliminate the limit on lending beyond one-thirds of the annual income. *Jiminshouiga kashikingyohonado kaiseian* [LDP Subcommittee Proposed Amendments to the Loan

V. THE PASSIVE COURT AND LIMITS OF JUDICIAL CREATIVITY

A. *Interpretive Method Used by the Supreme Court of Japan*

In addition to their huge impact, the judgments of the Supreme Court of Japan in the consumer loan cases are also extremely noteworthy for their judicial creativity. They created a highly pro-consumer jurisprudence by ignoring the contrary legislative intent and rewriting the statute. This creativity is all the more striking because the Supreme Court of Japan generally takes a very passive and conservative attitude toward constitutional adjudication.

It is true that there was an inconsistency or gap between the Interest Rate Limitation Act and the Capital Subscription Act. It could be argued that this inconsistency or gap was a result of the legislative compromise. While limiting the interest rate one can use, the legislature might have believed that the consumer loan companies should be entitled to receive the voluntary payment of higher interest unless the interest rate exceeded the limit criminally prohibited. Apparently, however, the Supreme Court of Japan did not accept this compromise and employed a skewed interpretation, practically nullifying this compromise.

The Supreme Court of Japan must have faced a difficult dilemma when the legislature enacted the Loan Company Act and reintroduced the compromise. In exchange for the introduction of government regulation, the legislature decided to allow the consumer loan companies to receive the interest rate higher than the maximum interest rate stipulated in the Interest Rate Limitation Act as a valid payment subject to the limitation set by the Capital Subscription Act. Apparently, the legislative intent was to overrule the judgments of the Supreme Court of Japan. But once again, the Supreme Court of Japan practically overturned this legislative judgment and wiped out the compromise provision in favor of the consumers.¹⁷⁰

The interpretive techniques used are sometimes highly textual: the Supreme Court of Japan demanded that the requirements of Article 43 be strictly observed before the consumer loan company could enjoy the benefits of Article 43. As a result, the Supreme Court of Japan construed the

Company Act], REUTERS, May 23, 2012, available at <http://jp.reuters.com/article/businessNews/idJPTYE84M05Y20120523>. It appears that the LDP now regrets its 2006 amendment to the Loan Company Act. Since the LDP recaptured the government in December 2012, it will be interesting to see whether the new LDP government is willing to revise the Loan Company Act again.

¹⁷⁰ Pardieck, *supra* note 14, at 531 (these judgments “turned statutory law into dead law”); Kinoshita, *supra* note 153, at 8.

requirements of Article 17 and Article 18 utterly literally. Sometimes, however, purposive interpretation achieves the goal of protecting consumers—the Supreme Court of Japan applied the thrust of Article 43 to revolving loan contracts, requiring the description of the equivalent information in the contract document, as required by Article 17. The court also apparently wished to protect consumers when it denied the consumer loan company the benefit of Article 43 when there was an acceleration clause in a contract. The Supreme Court of Japan did not care much about the compromise the legislature made in designing the consumer protection measures.

The Supreme Court of Japan sometimes presumed the intent of the parties was to afford protection to borrowers. When there was a basic contract to allow repeated borrowing, the Supreme Court of Japan presumed that the parties intended to apply the overpayment for the first loan to the principal of the remaining second loan. Even when there was no outstanding loan at the time of the payment, still the Supreme Court of Japan assumed that there was an agreement to apply the overpayment to the principal of the future new loan. Sometimes, the Supreme Court of Japan allowed borrowers to prove special circumstances or contrary agreements while denying the remedy they requested in principle—borrowers could prove that the overpayment for the first loan should be applied to the second loan, even in the absence of the basic agreement. But other times it completely ignored the intent of the parties, as when the payment of an excessive higher interest rate was applied to the principal of the loan even when the borrower specified the payment was the payment of interest.

It is remarkable that, in those judgments, the Supreme Court of Japan relied heavily upon the overarching purpose of protecting the interests of borrowers of the Loan Company Act rather than invoking the general clauses of the Civil Code. Apparently, it felt that these general clauses are not appropriate, that they ignored the legislative provision. Instead, the Supreme Court of Japan believed that Article 43 is an exception in light of that overarching legislative goal and should be narrowly construed, to be eliminated if possible. This understanding led the Supreme Court of Japan to practically wipe out Article 43.

These judgments clearly show that the Supreme Court of Japan could, and indeed in some cases does, act quite creatively. Moreover, the judgments are highly liberal in the sense that they are meant to protect vulnerable consumers against powerful consumer loan companies. Despite its general passive and conservative stance toward constitutional

adjudication, these judgments show that the Supreme Court of Japan could adopt a very creative and highly liberal stance in non-constitutional cases.

B. What Has Made the Supreme Court of Japan Engage in Such Judicial Creativity?

Why could the Supreme Court of Japan believe that it should actively create such a pro-consumer jurisprudence, even by ignoring or disregarding the legislative intent? Surely, Justices of the Supreme Court of Japan knew horror stories of many consumers who were forced to run away, sell their organs to pay off their debt, or commit suicide. They must have been convinced that they must do something. Moreover, unlike lower court judges, who are appointed right after the professional training and remain on the bench until their retirement, not all of the Justices of the Supreme Court of Japan are career bureaucrats working inside the judiciary. Although by custom, six out of fifteen Justices would be appointed from lower court judges and two would be appointed from prosecutors, four would be appointed from practicing attorneys, two would be appointed from government bureaucrats and one from academia.¹⁷¹ Therefore, the Supreme Court of Japan could act more flexibly. Indeed, Justice Takii, who took a lead in the development of the pro-consumer jurisprudence, was a former attorney. But apparently, these judgments of the Supreme Court of Japan are also supported by Justices appointed from lower court judges and prosecutors. Moreover, in the consumer loan cases, it is the lower court judges that played a leading role in shaping the pro-consumer jurisprudence that ultimately led the Supreme Court of Japan to create its own pro-consumer jurisprudence.¹⁷² Lower court judges are generally more creative and more supportive to borrowers than the Supreme Court of Japan as a whole.

From the standpoint of financial stability, the increase of unsecured consumer loans and the existence of a huge number of deeply indebted consumers is surely a headache. But from the standpoint of consumer protection, the existence of illegal loan sharks and the use of violent and intimidating collection methods are more serious problems. Instead of imposing much tougher criminal penalties or strengthening the regulation of or enforcement against these illegal loan sharks, however, the Supreme Court of Japan chose to deny the benefit of receiving higher interest rates from regular consumer loan companies and forced the Financial Services

¹⁷¹ MATSUI, *supra* note 4, at 123-24.

¹⁷² Pardieck, *supra* note 14, at 554-56.

Agency and the Japanese Diet to adjust the maximum interest rate and limit lending beyond the capacity of the borrower to repay. Why did the Supreme Court of Japan decide to take this course?

Maybe the Supreme Court of Japan believed that it was unethical for consumer loan companies to take advantage of the loophole in the law to receive the higher interest. It might have believed that the courts must do something to relieve the financial burden of those borrowers who had to pay higher interest rates. Or it might have believed that the Supreme Court of Japan, as an ultimate guardian of justice and morality, must achieve justice even by ignoring the legislative compromise.

The judiciary does more than simply fill in legislative *lacunae*, Professor Andrew Pardieck remarked, and in the consumer loan cases we can find an example of judicial nullification.¹⁷³ “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.”¹⁷⁴ Pardieck thus argues that the concept of substantive justice remains firmly embedded in Japan¹⁷⁵ and that the courts viewed law “as a protective, regulative, paternalistic and now, above all, a paramount expression of the moral sense of the community.”¹⁷⁶ In this sense, the Supreme Court of Japan might have attempted to achieve what it believes to be substantive justice by creating a judicial doctrine that is contrary to the legislative intent.

Moreover, the judgments of the Supreme Court of Japan taught a lesson to average Japanese consumers regarding the necessity and desirability of seeking legal advice from lawyers and encouraged them to file litigation, thus providing for the first time in history of Japan actual incentive to file a suit for many citizens. As a result, claims for refunds and suits seeking refund as remedy for unjust enrichment soared. In this sense, the Supreme Court of Japan might have attempted to show justice to the public as well.

The Supreme Court of Japan might have believed that it must curb the stronger power of the consumer loan companies to protect the vulnerable borrowers, reflecting a value judgment in favor of the community. While adhering faithfully to the doctrinal constructs and language of the civil law tradition, Professor Haley pointed out:

¹⁷³ *Id.* at 532.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.* at 589.

¹⁷⁶ *Id.* at 586.

Japanese judges have fashioned the rules and adopted the doctrines in distinctive ways. Instead of expanding the rights of wives, tenants, and workers for their protection, the courts have rather restrained the rights of fathers and husbands, landlords, and employers to prevent their exercise in ways that seem abusive or overreaching In case after case throughout the century, Japanese judges have denied “rights” in order to ameliorate what they have perceived to be the injustice of property and contract enabling those with greater economic and social leverage to enlist the aid of the state against those with whom they dealt. Rather than developing new rights for the weak, Japanese courts constrained the old rights of the strong.¹⁷⁷

Moreover, Professor Haley argues that these rules and doctrines are meant to reinforce the community and have a strong “communitarian orientation.”¹⁷⁸ He goes on to point out:

Japanese scholars have introduced new theory and doctrines that in case after case enabled Japanese judges to shape the rules and principles of the codes to conform community. Japanese judges have discovered in their own community ways to ensure consistency in the law and, though self-policing, to maintain public trust and independence.¹⁷⁹

All these judgments of the Supreme Court of Japan may be explained as another example of restricting the stronger power to protect the weaker party, and they are also an attempt to enforce community values.

But in these cases, the Supreme Court of Japan practically reversed the judgment of the legislature and wiped out the compromise provision. However unpopular that provision might be, the question must be asked: was it appropriate for the courts to achieve justice, or even to reflect community values, by ignoring the legislative compromise?¹⁸⁰

¹⁷⁷ JOHN OWEN HALEY, *THE SPIRIT OF JAPANESE LAW* 204-05 (1998).

¹⁷⁸ *Id.* at 205, 211.

¹⁷⁹ *Id.* at 205.

¹⁸⁰ Professor Haley argues that the Justices of the Supreme Court of Japan shared the orientation of the community even in the constitutional adjudication:

[I]n my view, judges in Japan share the prevailing communitarian orientation of their society They also, I believe, accept the unstated premise that legislative and administrative decisions reflect a consensus among participants—not a simple majority As a consequence, judges are cautiously conservative. They adhere to precedent and endeavor to maintain, as best they can in a changing society, legal order that is predictable and consistent. Stability is a virtue, not a vice. They do not seek to be the catalysts of social change. They believe in democratic

Of course, these judgments of the Supreme Court of Japan can be characterized as judicial attempts to engage in a dialogue with the legislature. The Supreme Court of Japan may simply be throwing the ball back to the legislature to solve the social injustice. If the legislature was not happy with the judgments of the Supreme Court of Japan, it could overturn them and enact new statutes. In this case, however, the legislature was ultimately convinced that the Supreme Court of Japan was right and revised the statutes. It might be argued, therefore, that there is nothing wrong with the judicial attempt to overrule the legislative judgment and call for further reconsideration. The important question to ask in this characterization is: to what extent should one allow the Supreme Court of Japan to overturn a legislative judgment. In the consumer loan cases, the Supreme Court of Japan once stripped any meaning from Article 1, paragraph 2 of the Interest Rate Limitation Act and the legislature overturned the judgment and inserted Article 43 of the Loan Company Act. Nevertheless, the Supreme Court of Japan once again overturned the legislative judgment. The Supreme Court of Japan may be suggesting that it will not back off. This is hardly an attempt at dialogue.

It still remains to be seen whether the attempt of the Supreme Court of Japan was a success. But it is surely quite controversial whether the Supreme Court of Japan was justified in attempting to accomplish justice or to reflect community values even by ignoring the contrary legislative intent. When there is a social injustice, we cannot blame judges if they believed that they had to do something. The public also expects the judges to do justice. But they must remember one thing: judges simply cannot correct all social injustice. Moreover, this may not be the proper job for judges and they may not be the best persons to do this.

VI. CONCLUSION

Judicial creativity is not the hallmark of civil law judges. But judges could and indeed do act quite creatively in some cases. The judgments of the Supreme Court of Japan in the consumer loan cases showed that the Supreme Court of Japan is no exception. Despite its passive and conservative attitude toward constitutional adjudication in general, the

institutions and thus defer to the democratic institutions of governance while maintaining, indeed reinforcing in their priority of values, the rule of law.

Johan O. Haley, *Constitutional Adjudication in Japan: Context, Structures and Values*, 88 WASH U. L. REV. 1467, 1491 (2011). Apparently, however, those judgments of the Supreme Court of Japan ignoring the contrary legislative intent are not as deferential to the democratic institutions.

Supreme Court of Japan indicated in these cases its willingness to overturn the legislative judgments and rewrite the statute. If you are accustomed to cloudy weather almost every day, you will be delighted to see the occasional sunshine. But it is at least debatable whether we could enjoy the sunshine brought in the consumer loan cases, because it is still unclear that the judgments of the Supreme Court of Japan were really a blessing for consumers and it is debatable whether the Supreme Court of Japan was justified in wiping out the statutory provision ignoring the contrary legislative intent. It will also be interesting to see whether the Supreme Court of Japan is willing to show this kind of judicial creativity in other cases as well.