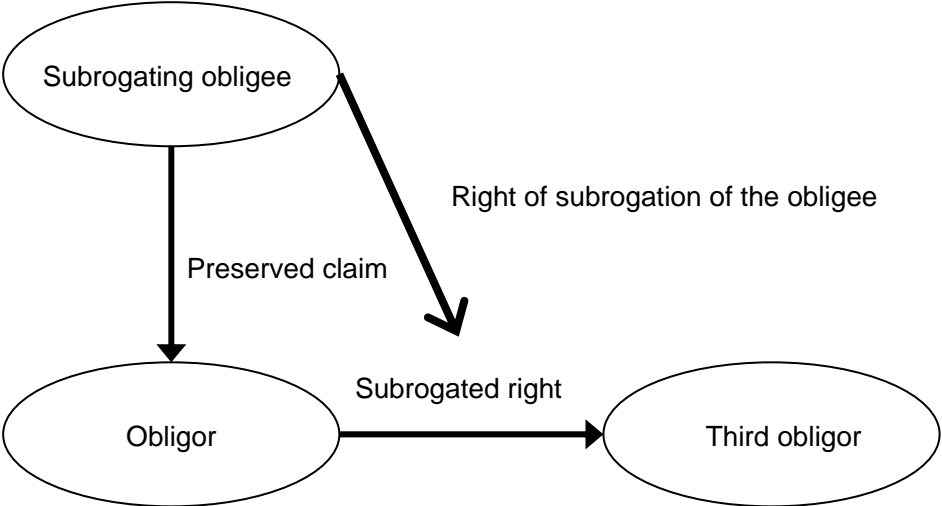


Items to be discussed for the Civil Code (law of obligations) reform (2)

Part I. Right of subrogation of the obligee

[Note] In this “Part I. Rights of subrogation of the obligee,” the following terms are used:

- “Subrogating obligee” :The obligee exercising the right of subrogation
- “Obligor” :The obligor of the preserved claim which the subrogating obligee possesses
- “Third obligor” :The opposing party to the right which the subrogating obligee exercises subrogation (subrogated right)



1. General discussion

There are theoretical criticisms on the existence of the system itself of the right of subrogation of the obligee. (See, 2(1)) On the other hand, while the right of subrogation of the obligee is originally the system to preserve the nonexempt property of the obligor, in practice it is used as an easy measure to collect claims (see, 2(3) and 3). It is also used as a measure to satisfy the purpose of non-monetary claims (specified claims), which is unrelated to preservation of nonexempt property. (See, 4) Therefore, there is a gap between the original purpose of the system and its real function.

In addition, the current Civil Code has only one article, Article 423, on the right of subrogation of the obligee, and case law theories and theories for interpretation make up the lack of detailed written regulations as to requirements and effects (see, 5), the

status of the third obligor (see, 6), and subrogation action (see, 7). Based on such situation, what kind of issues should we consider in reviewing the whole provisions on the right of subrogation of the obligee?

(Related issues) “Subrogation right in the original form” and “subrogation right in a diversion form”

While there are various views on the purpose of the system of the right of subrogation of the obligee, it is generally accepted that the original purpose of the system is to preserve nonexempt property of the obligor. (In the following, the term “subrogation right in the original form” is used as to the right of subrogation of the obligee which is exercised for this original purpose.)

The applied situation is different depending on subrogation rights in the original form or in a diversion form. Therefore, it may be appropriate to distinguish the two forms and examine individually how each system should be.

2. Subrogation right in the original form

(1) Necessity of the system of subrogation right in the original form

It is stated that the right of subrogation by the obligee is in essence the system that the subrogating obligee that possesses monetary claim preserves nonexempt property of the obligor and prepares for execution. In addition, case law grants the subrogating obligee to demand the third obligor to directly deliver the money which is the subject matter of the subrogated right to the subrogating obligee. Based on this, the subrogating obligee can collect claims without obtaining the title of debt through offsetting the obligation to return received money to the obligor by the preserved claim, which is simpler than attaching the obligor’s claim. (This is called “prioritized payment in effect.”)

On the other hand, there are the civil execution system (compulsory execution system) as a system to collect claims and the civil preservation system (attachment system) as a system to preserve nonexempt property of the obligor. Facing the fact that these systems and the subrogation right in the original form exist in parallel, there is a view that the system of the subrogation right in the original form should be abolished because there is inconsistency as a legal system. Accordingly, we need to deliberate the necessity to maintain the subrogation right in the original form under the current legal system that possesses fully equipped systems of civil execution and preservation.

(2) Appropriateness of prioritized payment in effect

As stated in above (1), the subrogation right in the original form performs another function of collecting claims in a simple way in fact (prioritized payment in effect) in

addition to the original purpose of the system (preservation of nonexempt property of the obligor). There is a debate over appropriateness of this prioritized payment in effect. How should we consider the appropriateness of the fact that current case law theory approves prioritized payment in effect to the subrogating obligee?

3. System design for subrogation right in the original form

[Note] In discussion below, in order to provide useful reference for the future discussion on “2(2) appropriateness of prioritized payment in effect”, “(1) Method to deny the function to collect claims” and “(2) Scope which the obligee can exercise the subrogated right” are discussed for the purpose of taking an overview of concrete system design in case where it is agreed that the significance of the subrogate right in the original form comes from preservation of nonexempt property of the obligor (denial of the function to collect claims).

In addition, “(3) Necessity of preservation in subrogation right in the original form – the requirement of insolvency” and “(4) The requirement of no-resources in case of exercising subrogation of the right of the right to apply for real property registration” are also discussed in this section as a reference for the ground to allow interference to the obligor’s properties without obtaining the title.

(1) Method to deny the function to collect claims

If we adopt the view that the significance of the subrogate right in the original form comes from preservation of nonexempt property of the obligor and the function to collect claims should be denied, there is a question that how the concrete method (scheme) for such view should be.

First, it is possible to consider a method that the subrogating obligee is prohibited or limited from demanding direct payment of money from the third obligor. Or it is proposed that, approving direct payment of money to the subrogating obligee and prohibiting from offsetting the obligation to return money to the obligor by the preserved claim, the obligees including the subrogating obligee should file execution over the claim of the money against the subrogating obligee.

(Related issues) Where the subrogated right is the right to demand delivery of a thing other than money

When the subrogated right is the right to demand delivery of a thing other than money, there are also problems whether direct delivery to the subrogating obligee is allowable and, if it is allowed, what are the requirements to allow it?

(2) Scope which the obligee can exercise the subrogated right

Case law limits the scope which the obligee can exercise the subrogated right to

the amount of the preserved claim where the subrogating obligee exercising the right of subrogation over monetary claim based on the subrogation right in the original form. However, if the significance of the subrogate right in the original form comes from preservation of nonexempt property of the obligor and the function to collect claims is denied, the reasonable ground to set the limit under the case law will be decreased. Accordingly, there is a view that the scope which the subrogate right in the original form is exercised should not be limited to the amount of the preserved claim.

(3) Necessity of preservation in subrogation right in the original form – the requirement of insolvency

The current Civil Code stipulates only abstract statement, “in order to preserve his/her own claim,” as a requirement to exercise the right of subrogation by the obligee. (This requirement is generally called “necessity of preservation.”) Case law and generally accepted theory understand the contents of the necessity of preservation that the obligor’s resources are insufficient to pay his or her whole obligation. (This requirement is generally called “the requirement of insolvency.”) Accordingly, a possible direction for deliberation is to clearly state the requirement of insolvency in a provision as a requirement to exercise the subrogation right in the original form.

(4) The requirement of insolvency in case of exercising subrogation of the right of the right to apply for real property registration

The subrogating obligee can exercise subrogation of the right to apply for real property registration (the right under the public law that a private person demands registration to the register who is a public institution) of the obligor based on the subrogation right in the original form (Article 59, no.7, Real Property Registration Act). However, it seems that most of occasions in practice where subrogation of the right to apply for real property registration is exercised are the cases that the title of the real property is transferred to the obligor, on the premise that the obligee attaches the real property which the obligor owns without title.

While the procedure for execution over real property does not require insolvency of the obligor, registration of attachment is the essential prerequisite for this procedure. Accordingly, if insolvency of the obligor is required to exercise subrogation of the right to apply for real property registration, the obligee may become unable to initiate the procedure through subrogation because the obligor is not insolvent even though the procedure for execution itself is able to initiate even when the obligor is not insolvent.

As to this point, there is a view that, even if the deliberation is advanced in a direction to concretely state the requirement of insolvency in a provision as a general rule, special treatment, such as excluding insolvency of the obligor from the

requirements, should be provided as to the cases where subrogation is exercised over the right to apply for real property registration in order to initiate execution over the real property.

4. Subrogation right in a diversion form

(1) Basic direction

The right of subrogation of the obligee is diverted to a measure to achieve the purpose of non-monetary claims (specified claims), unrelated to preservation of nonexempt property of the obligor. Examples of diversion under case law are: ① exercising subrogation over the right to claim registration possessed by the registration obligor in order to preserve the right to claim registration; and ② exercising subrogation over the right to exclude obstruction based on property right possessed by the lessor in order to preserve lease interest. The purpose of these subrogation rights in diversion forms is not to preserve nonexempt property of the obligor, and thus it is understood that the requirement of insolvency is unnecessary for these cases.

While there are possibly criticisms over the theoretical organization of the subrogation right in a diversion form, the conclusion of case law such as ① and ② are widely supported and stabilized as case law theory. Accordingly, a possible direction for deliberation is to provide written ground to the subrogation right in a diversion form in reviewing provisions on the right of subrogation of the obligee.

(2) General requirement of diversion

If a general provision is stipulated on the subrogation right in a diversion form, it is necessary to consider general requirements for diversion which are applicable to various diversion cases. As to this point, while there is a case stating that “when the obligee exercises subrogation of the right of the obligor under Article 423 of the Civil Code, a relationship is necessary that the obligor enjoys some interests through exercise of the right and the right of the obligee is preserved through that interests,” it is possible to establish more restrictive requirement from the aspect to prevent harmful influence through granting diversion of the subrogation right widely.

(Related issues) Admissibility of direct payment to the surrogating obligee and its requirement

When the subrogation right in a diversion form is maintained, there are issues on whether direct payment or delivery to the subrogating obligee is allowable if the subject matter of the subrogated right is the right to demand payment or delivery of money or any other thing, and if it is allowed, what are the requirements to allow it?

5. Clarification of provisions on requirements and effects

(1) Requirement on preserved claims and subrogated rights

As to the requirement on preserved claims, while Article 423 (2) of the current Civil Code provides that the right of subrogation by the obligee cannot be exercised as a general rule if the preserved claim has not become due, there is a view that the right of subrogation by the obligee cannot be exercised as well if the preserved claim is the claim which the obligee cannot demand performance through filing an action or satisfy through execution.

As to the requirement on subrogated rights, while proviso of Article 423 (1) provides that exercise of subrogation is barred over rights which are exclusive and personal to the obligor, there is a view that exercise of subrogation is also prohibited over the rights which attachment is prohibited. How should we consider appropriateness of these views and whether they should be stipulated in law?

(2) Requirement to exercise the right of subrogation – notification to the obligor

Under the current law, it is understood that the subrogating obligor does not need to send a demand notice to the obligor that the obligor should exercise the right before exercising the subrogation right. However, there is a criticism that it is inappropriate that the right of subrogation by the obligee is exercised and the obligor's right to control his or her property is interfered without knowledge of the obligor who is the most interested person.

As to this point, there is a view that notice to the obligor should be included as a requirement to exercise the subrogation right in order to give the obligor an opportunity to contest existence of the preserved claim and to ensure the opportunity to exercise the subrogated right by the obligor himself or herself. In addition, how should we consider, if a notice to the obligor is required, the effect of any violation of the time of notice or the duty of notice?

(Related issues) Effect of notice (limitation of the obligor's authority of disposition)

Under the current law, it is understood that, when the obligor receives notification of exercising the right of subrogation by the subrogating obligee or the obligor knows that the subrogating obligee exercises the right, the obligor cannot file his or her own action or dispose the right. (Decision of the Great Court of Cassation, May 16, 1939, Minshu vol.18, p.557) However, this conclusion is criticized that the status of the obligor or the third obligor becomes unstable if non-judicial notice or acknowledgment limits the obligor's right of disposition and it is inappropriate to limit the obligor's right of disposition without written ground such as Article 76 (2) of Non-Contentious Cases Procedure Act. Accordingly, it is possible to make the law that notice to the obligor does not limit the obligor's right of disposition. (*See*, "7 (2) Limitation of disposition by the obligor")

(3) Duty of care of a good manager

While the current Civil Code does not have any provision on the status of the subrogating obligee, many theories understand that the obligor and the subrogating obligee forms one kind of legal mandate relationship making the obligor as mandator and the subrogating obligee as mandatary, and it is appropriate to impose the subrogating obligee the duty of care of a good manager (Art. 644, CC) same as a mandatary in mandate. Accordingly, a possible direction for deliberation is to state in the text of law that the subrogating obligee owes the duty of care of a good manager in exercising the subrogating right.

(4) The right to demand compensation of expenses

Supposing that the obligor and the subrogating obligee form one kind of legal mandate relationship making the obligor as mandator, the subrogating obligee as mandatary (see, above (3)), it is appropriate that the subrogating obligee can claim compensation of expenses to the obligor if the subrogating obligee spends necessary expenses in order to exercise the subrogation right, same as the mandatary under mandate relationship (CC Art.650). Accordingly, a possible direction of deliberation is to clarify in the text of law that the subrogating obligee can demand compensation of expenses to the obligor if the subrogating obligee spends necessary expenses in order to exercise the subrogation right.

(Related issues) Expression of granting general lien to the compensation claim of expenses

While it depends on how to consider the significance of the system of the subrogation right in the original form, it may be possible to say that the expenses that the subrogating obligee spends in order to exercise subrogation right in the original form have the nature of common interest because they serve an increase of nonexempt property of the obligor, which is the interest of whole obligees. Based on this way of thinking, it is understood that general lien regarding common expenses (CC Art.306 (1) and 307 (1)) can be granted to the compensation claim of expenses above and the claim can be collected preferentially from the property of the obligor. If we adopt this way of thinking, it may be necessary to clarify in the text of the law that such expenses are common expenses.

6. Status of the third obligor

(1) Assertion of defense

While the current Civil Code does not have any provision on the status of the third obligor, case law and generally accepted theory understand that the third obligor can assert to the subrogating obligee defenses which the third obligor possesses against the obligor. When the right of subrogation by the obligee is exercised, it is

unreasonable if the third obligor is positioned into more disadvantageous status than where the obligor itself exercises the subrogated right. Therefore, a possible direction of deliberation is to clarify in the text of law that the third obligor can assert to the subrogating obligee defenses which the third obligor possesses against the obligor.

(Related issues) Assertion of defenses that the third obligor possesses against the subrogating obligee

As to defenses that the third obligor can assert against the subrogating obligee, many theories understand that the third obligor cannot assert against the subrogating obligee special defenses which the third obligor possesses against the subrogating obligee. On the other hand, some theory contests that, direct transfer of the subject matter of the subrogated right to the subrogating obligee is granted under the subrogation right in a diversion form (*see*, “4(2) Requirement of diversion” (Related issues)), the third obligor should be able to assert defenses to the subrogating obligee which the third obligor possesses against the subrogating obligee in addition to defenses that the third obligor possesses against the obligor because the nature is direct demand of the subrogating obligee to the third obligor in effect. How should we consider whether this way of thinking should be stated in the text of law?

(2) Expansion of the ground for deposit

The third obligor does not have any direct legal relationship with the subrogating obligee, and thus, he or she has no information to decide existence of the preserved claim. However, the current system of the subrogation right by the obligee grants the subrogating obligee the right of direct demand against the third obligor without interference of the court. Accordingly, it is pointed out that the system lacks due consideration to the status of the third obligor.

From the aspect to reduce burden of the third obligor, there is a view that, when the subrogation right of the obligee is exercised out of court in case where the third obligor owes the duty to deliver the subject matter of the subrogated right, deposit of the subject matter should be granted.

(3) Competing claims among rights of subrogation of multiple obligees

The current Civil Code does not have any provision regulating the occasion where the subrogation rights of multiple obligees compete each other. There is a view that, if judgments ordering delivery of money or other thing to multiple subrogating obligees are finalized, the third obligor is exempt from the obligation if he or she performs the duty to one of these obligees.

7. Subrogation actions by the obligee

The current Civil Code does not have any provision on subrogation actions by the

obligee and case law and theories for interpretation compensate this situation. As to this point, if the subrogation action by the obligee has significance even today, it may be necessary to conduct deliberation in a direction to stipulate specific provision within a necessary scope.

(1) Participation of the obligor in subrogation action by the obligee

It is pointed out that the current subrogation action lacks consideration to the status of the obligor such as the obligor's opportunity to participate in the proceedings is not guaranteed regardless that the judgment reaches the obligor. (Article 115 (1)no.2 of the Code of Civil Procedure) Accordingly, it is considered to require notification of an action to the obligor by the subrogating obligee in filing a subrogate action from the viewpoint of procedural guarantee for the obligor.

(2) Limitation of disposition by the obligor

Under the current law, it is understood that, when the obligor receives notification of exercising the right of subrogation by the subrogating obligee or the obligor knows that the subrogating obligee exercises the right, the obligor cannot file his or her own action or dispose the right. If the obligee can freely dispose the subrogated right even after the subrogate action is filed, the filing of the action can end in waste of effort. Therefore, it may be necessary to consider imposing limitation on the obligor to dispose subrogated right after the obligor receives notification of an action stated (1).

(3) Treatment of cases where the subrogated right is attached after subrogation action by the obligee is filed

While there is no provision on treatment of cases where the subrogated right is attached after a subrogation action by the obligee is filed, case law states that even if an action to attach the subrogated right is filed by another obligee, the authority to exercise subrogation right of the subrogating obligee is not extinguished and the court can approve both actions through consolidating both claims.

However, there is a view that in case where a subrogation action and attachment compete with each other the attachment should be prioritized because satisfaction of preserved claims by subrogation is ultimately achieved through execution.

(Related issues) Treatment of subrogation actions by the obligee

If advancement of the proceedings of a subrogation action by the obligee is barred after the subrogated right is attached by another obligee, there arises a problem on how to treat the subrogation action.

(4) Other issues

It is unobjectionable that the obligor is able to participate in the subrogation action by the obligee and other obligees can also participate in the subrogation action. Therefore, there is a view that they should be clearly stated in the text of the law.

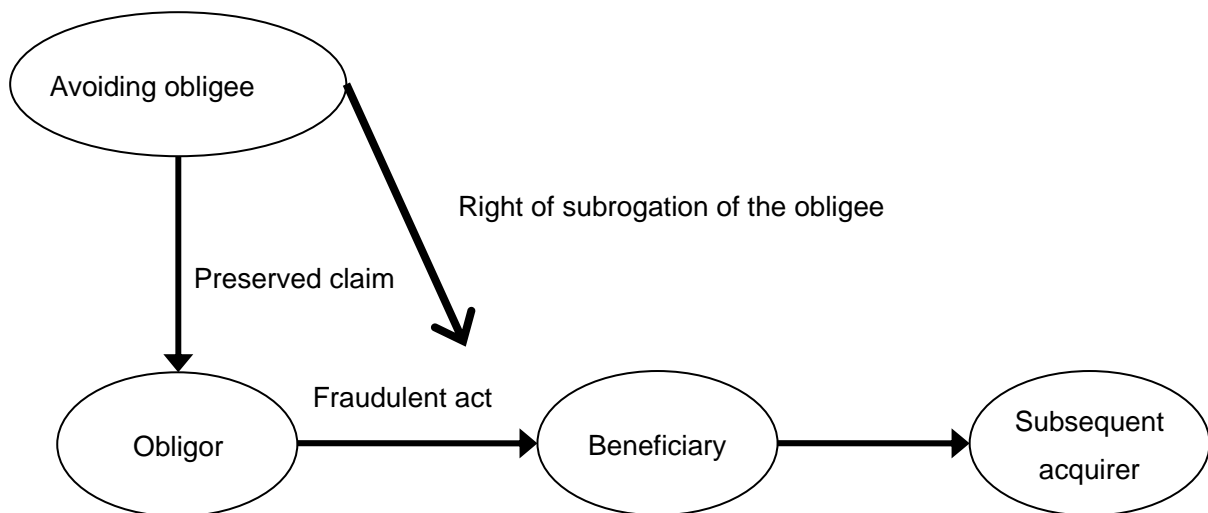
8. Subrogation in a judicial proceeding (CC Art.423(2))

Article 423 (2) of the current Civil Code provides that the obligee can exercise the subrogation right even if the preserved claim has not become due by way of subrogation admitted in a judicial proceeding. However, it is stated that the significance of the system of subrogation in a judicial proceeding is doubtful and in fact the number of used cases is small. Accordingly, there is a view that the system of subrogation in a judicial proceeding should be abolished.

Part II. Right to request avoidance of fraudulent acts

[Note] In this “Part II. Right to request avoidance of fraudulent acts,” the following terms are used:

- “Avoiding obligee” :The obligee exercising the right of avoidance
- “Obligor” :The obligor of the preserved claim which the avoiding obligee possesses
- “Beneficiary” :The opposing party of the act of the obligor (fraudulent act)
- “Subsequent acquirer” :The party who acquires the subject matter of the fraudulent act from the beneficiary (including acquirers succeeding from the subsequent acquirer)



1. General discussion

The scheme of the right to request avoidance of fraudulent acts aims to preserve and recover nonexempt property of the obligor and tries to adjust interests between multiple related parties, which is deeply related to execution proceedings and bankruptcy proceedings as well as litigation proceedings and thus unavoidably includes complex contents of regulation. Nonetheless, the current Civil Code has only three articles of Articles 424 to 426 with regard to regulation of this system and thus its legal nature is unclear. (See, below 2) Accordingly, it is necessary to advance deliberation to the direction to clarify provisions as much as possible after carefully examining its requirements (see, below 3) and effects (see, below 4) respectively. Then what kind of points should we consider in reviewing provisions on the right to request avoidance of fraudulent acts?

2. Legal nature of the right to request avoidance of fraudulent acts

(1) Method to recover nonexempt property of the obligor – legal nature theory

The right to request avoidance of fraudulent acts (*hereinafter* “RRAFA”) is essentially the system that an avoiding obligee, which has monetary claim to the obligor, requests the court to avoid acts of the obligor, which the obligor conducted with the knowledge that such acts would harm the avoiding obligee, in order to prepare for execution through preserving nonexempt property of the obligor. However, there is a discussion on the concrete method to return property which was missing through fraudulent acts of the obligor to nonexempt property of the obligor because it relates to how to understand the legal nature of the RRAFA.

On this point, it is stated that the case law understands the RRAFA as a system requesting the court to avoid fraudulent acts of the obligor and to recover the missing property based on this avoidance. (Eclectic theory) In addition, in case law the missing property is returned to the obligee as a general rule. If the missing property is immovable property, the title of registration is returned from the beneficiary or the subsequent acquirer to the obligor and then the voiding obligee and other obligees initiate execution proceedings over the immovable property. However, if the missing property is money or movable property, the avoiding obligee can request the court to deliver it directly to him or her.

Some people point theoretical problems on this case law theory such as that, while the court understands the effect of avoidance does not reach the obligor (relative avoidance), it is difficult to explain that the title of registration, in case the missing property is immovable property, returns to the obligor and the returned immovable property is subject to execution as nonexempt property of the obligor. Therefore, some theorists strongly argue that it is not necessary to actually recover missing property from the beneficiary or the subsequent acquirer in order to preserve nonexempt property and the missing property under avoidance should be treated as nonexempt property of the obligor leaving it with the possession of the beneficiary or the subsequent acquirer. (Responsibility theory) However, the responsibility theory is also criticized that it premises an idea which does not fit with the current law that the claims of the whole obligee of the third obligor are the secured claim, which is similar to the third party pledgor, and it arises difficult problems with the relationship to the right of avoidance in the bankruptcy procedure when bankruptcy proceedings are initiated against the obligor when an action to request avoidance of fraudulent acts is pending or completed.

Based on these situations of case law and theory, to which direction should we advance deliberation in reviewing the system of the RRAFA? The possible directions are as follows. ① Premising the stance of the case law theory which nonexempt property is returned to the obligor (eclectic theory), the deliberation is

advanced through overcoming theoretical or practical issues individually. ② Premising the responsibility theory that missing property is treated as nonexempt property of the obligor leaving it with the possession of the beneficiary or the subsequent acquirer, the deliberation is advanced through reviewing current related systems under the current law.

(2) Effects of avoidance to the obligee – the status of the obligee under an action for avoidance of a fraudulent act

Under current case law (eclectic theory), it is understood that the effect of avoidance reaches relatively between the avoiding obligee and the beneficiary or the subsequent acquirer, not the obligor, and the defendant of the action to request fraudulent acts are the beneficiary or the subsequent acquirer only. As to this relative avoidance, some criticize that it is difficult to theoretically explain that missing property is returned to the obligor and executed with the possession of the obligor regardless that the effect of avoidance does not reach the obligor.

In order to overcome these theoretical problems of the case law theory, while one option is to make the effect of avoidance reach the obligor, if we take this option, it is necessary to guarantee an opportunity of the obligor to participate in the procedure. Based on these viewpoints, there is a view that the obligor should be also included as a defendant of the action to request avoidance of fraudulent acts.

(Related issues)

1 Joinder of an action for payment against the obligor

Even under the current law which does not grant standing of the obligor as a defendant for an action for avoidance of fraudulent acts, it is possible to join an action for payment of secured claims of the obligee against the obligor to an action for avoidance of fraudulent acts. When the obligor becomes a defendant of an action for avoidance of fraudulent acts, it is necessary to examine regulations in case an action for payment against the obligor is joined to the action. For example, from the aspect of litigation economy, when the obligee does not have the claim title for the secured claim, there arise some issues such as appropriateness to oblige the obligee to jointly file an action for payment, and necessity to secure consistency between the action for avoidance and the action for payment.

2 Treatment of cases where multiple actions for avoidance of a fraudulent act are filed

Under the current law, multiple avoiding obligees request avoidance of the same fraudulent act, it is understood that the effect of avoidance relatively reaches between the avoiding obligee and the beneficiary or the subsequent acquire, not the obligor, and thus it is not necessary that the judgments are finalized consistently.

However, if the obligee becomes a defendant of the action for avoidance of fraudulent acts,

when multiple avoiding obligees request avoidance of the same fraudulent act, there arises necessity of having consistent judgments. Accordingly, in case multiple actions for avoidance of the same fraudulent act are filed, there are issues of necessity to provide some treatments such as compulsory joinder of these actions for the purpose of securing consistency of judgments, and the way of regulation in case multiple obligees request delivery of missing property to themselves respectively.

3. Review of a provision on requirements

The current Civil Code provides only abstract statement that “any juristic act which an obligor commits knowing that it will prejudice the obligee” (CC Art.424 (1)) on requirements for the RRAFA, and case law theory and theories for interpretation compensate this. In addition, some point out that the requirements for the RRAFA should be reconsidered because the requirements of the avoidance right under insolvency law, which has the common function with the RRAFA, was reviewed at the reform of the Bankruptcy Act etc. in 2004. Based on such situation, what kind of point should we consider in reviewing provisions on requirements for the RRAFA?

(1) Clarification of provisions on requirements

a. Requirement on preserved claims

While the current Civil Code does not stipulate specific provisions as to requirements of secured claims, case law requires that secured claim accrues before the fraudulent act. In addition, there is a view that an obligee cannot exercise the RRAFA when the secured claim does not have a binding power. How should we consider appropriateness of these views and whether it should be put into the text of the law?

b. Requirements on the obligor side – requirement of insolvency

While the current Civil Code provides only abstract statement that “any juristic act which an obligor commits knowing that it will prejudice the obligee” (CC Art.424 (1)) on requirements of the RRAFA, it is understood that this “prejudice the obligee” means that there arises a thread of lack of nonexempt property of the obligor through the act of the obligor (this requirement is called “requirement of insolvency”). Accordingly, it may be appropriate to clearly stipulate the requirement of insolvency in the article as a requirement for the RRAFA.

(2) Consistency with the requirements of the right of avoidance under the Insolvency Law

The RRAFA has the common function with the avoidance right under insolvency law and thus these two rights should be consistent. Reforms of the Bankruptcy Act

etc. in 2004 adopted the concept of unable to pay as a requirement of the time to exercise avoidance of an unfair act. Accordingly, there arises a situation that the scope of acts subject to avoidance is wider in the RRAFA, which is used at ordinary times, than in the avoidance right under the insolvency law where equality of obligees is emphasized. (Reverse phenomenon) Based on such condition, it may be necessary to advance deliberation in the direction to clarify provisions on requirements of the RRAFA paying sufficient considerations to the case law theories to date and consistency with the requirements of the avoidance right in insolvency law.

(Related issues)

1 Necessity of provision stating general requirement of avoidance of fraudulent acts

The provisions of the avoidance right under insolvency laws are stipulated by categories. Therefore, it is necessary to have individual examination based on categories as well in reviewing requirements of the RRAFA. (*See*, (1) to (6) below) It is better to have a provision which stipulates general requirements for avoidance of fraudulent acts in order to make the whole system more understandable even if we reach a conclusion that separate provisions are necessary based on categories. Therefore, it may be better to advance deliberation to the direction to maintain an article equivalent to current Article 424 (1).

2 Subject of avoidance

Current Article 424 (1) stipulates that “juristic act” can be avoided if it is made by an obligor knowing that it would prejudice the obligee. However, it is understood that the object of the RRAFA includes acknowledgment of a claim as a ground to interrupt prescription (CC Art. 147 (3)) and an act accruing the effect of statutory ratification (CC Art. 125) through interpretation of the current law. Accordingly, a possible way of deliberation is to change the object of avoidance through the RRAFA from “juristic act” to “act.”

a. Acts to extinguish an obligation

Case law says on the RRAFA that, as to payment to a part of obligees among acts to extinguish an obligation, it forms a fraudulent act if payment is made with an intention to harm other obligees in collusion with a specific obligee, and as to substitute payment to a part of obligees, it forms a fraudulent act if the obligor has an intention to provide prioritized satisfaction to only specific obligor with the knowledge that it would prejudice other obligees in collusion with the obligor regardless of the price of the subject matter.

On the other hand, the Bankruptcy Act stipulates on acts to extinguish an obligation to a part of obligees that the object of avoidance of unfair acts is only those acts occurred after the insolvent became unable to pay or after bankruptcy proceeding

was filed (BA Art.160 (1), 162 (1)1). The Act also provides time requirement on non-obligatory acts such as payment before due date or substitute payment that the object of avoidance of unfair acts is acts which were conducted only within 30 days prior to becoming unable to pay (BA Art. 162 (1)2). Accordingly, there arises a situation that the scope of acts subject to avoidance is wider in the RRAFA, which is used at ordinary times, than in the avoidance right under the insolvency law where equality of obligees is emphasized. (Reverse phenomenon)

While it is possible to think in a way that it is enough to explicitly state requirements of the RRAFA on acts to extinguish obligation based on above case law theory in provisions, there is another possible option that, considering the reverse phenomenon occurs, some considerations are necessary for consistency with the requirements of the avoidance right under insolvency laws. If the latter option is adopted, the following proposals are possible.

[Proposal A] Acts to extinguish an obligation by the obligor is not the object of the RRAFA except the value paid to the obligee is larger than the amount of an obligation extinguished (excessive substitute payment).

[Proposal B] The object of the RRAFA is limited to non-obligatory acts which were conducted with an intention to provide prioritized satisfaction to only specific obligor and excessive substitute payment.

(Related issues) Excessive substitute payment

Even if it is made that the RRAFA is available regardless of the amount of secured claims (*see*, 4 (3) Scope of avoidance), it is only the part of amount that exceeded the amount of claims that has the nature of an act to reduce property as to excessive substitute payment. Thus, it is one way to limit the object of avoidance for excessive substitute payment to the part of the amount exceeded.

b. Act to provide security for an existing obligation

Case law says that provision of security for an existing obligation to a part of obligees can form a fraudulent act because it gives prioritized payment to the obligees and harms other obligees. However, the Bankruptcy Act stipulates on provision of security for an existing obligation that, similar to acts to extinguish an obligation, the object of avoidance for unfair acts is only acts which were conducted after the insolvent became unable to pay or bankruptcy proceeding was filed (BA, Art.160 (1), 162 (1) 1). The Act also provides time requirement on provision of securities without an obligation that the object of avoidance of unfair acts is limited to acts which were conducted only within 30 days prior to becoming unable to pay (BA Art. 162 (1)2). As a result, similar to the cases of acts to extinguish an obligation, there arises a situation that the scope of acts subject to avoidance is wider in the RRAFA, which is used at

ordinary times, than in the avoidance right under the insolvency law where equality of obligees is emphasized. (Reverse phenomenon)

While it is possible to think in a way that it is enough to explicitly state requirements of the RRAFA on acts to provide security for an existing obligation based on above case law theory in provisions, there is another possible option that, considering the reverse phenomenon occurs, some considerations are necessary for consistency with the requirements of the avoidance right under insolvency laws. If the latter option is adopted, the following proposals are possible.

[Proposal A] An act to provide security for an existing obligation should not be the object of RRAFA.

[Proposal B] An act to provide security for an existing obligation should not be the object of RRAFA, except it is a non-obligatory act made with an intention to provide prioritized satisfaction to only specific obligor.

c. Acts to dispose properties with reasonable value

Case law says on acts to dispose properties such as immovable properties with reasonable value that an act to exchange immovable property, which has high value as joint security for obligees, to money, which is easy to use and hide, can form a fraudulent act because the act can substantially reduce joint security for obligees. On the other hand, the Bankruptcy Act limits the scope of formation with regard to avoidance of an act to dispose property with reasonable value through having provision on requirements of material threat that the insolvent disposes or hides the exchanged value, intent of the insolvent to dispose or hide the value, and acknowledgement of the beneficiary. (BA, Art. 161 (1)) It may be appropriate to advance deliberation in the direction to stipulate the same requirements with the avoidance right under insolvency laws as a basic rule with regard to requirements of the RRAFA for acts to dispose properties with reasonable value.

d. Acts of simultaneous exchange

With regard to so-called acts of simultaneous exchange such as newly borrowing money providing security, case law says that such act does not form a fraudulent act if it is reasonable considering the purpose and the motivation of borrowing and the value of secured objective. On the other hand, while the Bankruptcy Act excludes acts of simultaneous exchange from the object of avoidance of unfair acts (BA Art. 162 (1)), if security was set prior to or simultaneous with formation of the contract on financing, such act can be avoided with the same requirements as acts to dispose property with reasonable value because it is economically same situation as selling the object of security and obtaining money. Accordingly, from the aspect to pursue consistency of requirements between the RRAFA and the avoidance right under

insolvency laws, it may be appropriate to advance deliberation in the direction to establish the same requirements with the avoidance right in insolvency laws on acts to dispose property with reasonable value.

e. Gratuitous acts

Under the current Civil Code, it is understood that those acts such as transferring property without compensation, selling property with unreasonably low price, exempting the obligor from an obligation, and assuming an obligation without value can constitute fraudulent acts if the obligor knows “that it will prejudice the obligee” and the beneficiary knows “knowing that it will prejudice the obligee.” (CC Art.424(1)) On the other hand, the Bankruptcy Act stipulates that a gratuitous act or equivalent onerous act which was conducted after or six months prior to the insolvent stopped payment or the bankruptcy proceeding was filed can be the object of avoidance (gratuitous avoidance) regardless of subjectivity of the insolvent or the beneficiary (BA, Art. 160 (3)).

While it is possible to maintain regulations under the current law on the RRAFA regarding gratuitous acts and equivalent onerous acts, it is also possible to consider to establish requirements paying due considerations to consistency with the provision of gratuitous avoidance. In addition, when we adopt the latter option, there is a way of thinking that the subjective requirement for both the obligor and the beneficiary is unnecessary, and there is another way of thinking that only subjective requirement for the beneficiary is unnecessary.

(Related issues) Special provision on effects of avoidance for fraudulent acts which are gratuitous

The Bankruptcy Act has a special provision on not only the requirement but also the effect with regard to gratuitous avoidance. Namely, the Act states that the scope of property to be returned is reduced to the scope that the beneficially actually received benefit if the beneficiary was without knowledge. (BA, Art. 167 (2)) This aims to protect the beneficiary without knowledge while the Act does not require subjectivity of the beneficiary as a requirement for gratuitous avoidance. Accordingly, if we adopt that subjectivity of the beneficiary is unnecessary as a requirement for the RRAFA regarding gratuitous acts and equivalent onerous acts, similar to gratuitous avoidance under the Bankruptcy Act, it may be appropriate to advance deliberation in the direction to similarly have a special provision to reduce the scope of property to be returned into the scope that the beneficiary actually received the benefit if the beneficiary was without knowledge.

f. Acts to obtain requirements of perfection

The case law on acts to obtain requirements of perfection states that the object for

the RRAFA is the action to decrease property of the obligor itself, and an act to obtain requirements of perfection is a separate act from the act to transfer the right which decreases the property, and thus it is inappropriate to grant use of the RRAFA over only the act to obtain requirements of perfection.

On the other hand, the Bankruptcy Act provides that, where an act to obtain requirement for perfection was conducted after suspension of payments or filing of bankruptcy proceedings took place, such act may be avoided if it was conducted after 15 days had elapsed since the date of transfer of the right, while knowing that suspension of payments or filing of bankruptcy proceedings had taken place (BA, Art.164).

Accordingly, a possible direction of deliberation is to establish a special provision on acts to obtain requirements of perfection in a similar way to the right of avoidance in the Bankruptcy Act. However, there are criticisms on the point that it is inappropriate to raise suspension of payment or subjectivity on it as a requirement for the RRAFA which covers the stage where the bankruptcy proceedings are not yet initiated.

g. Requirements of the right to request avoidance of a fraudulent act against a subsequent acquirer

While the current Civil Code Article 424 (1) proviso requires knowledge of a subsequent acquire about “the fact that the obligee is to be prejudiced” as a requirement to exercise the RRAFA over the subsequent acquire, the case law states that even if the beneficiary did not have such knowledge, the RRAFA over the subsequent acquire is available if the subsequent acquire had such knowledge.

On the other hand, Article 170 (1) of the Bankruptcy Act, which provides the right of avoidance against the subsequent acquire requires that the subsequent acquirer knew, at the time of acquisition, that there were grounds for avoidance against their predecessors (subparagraph 1). But if the subsequent acquirer is any of the inside persons of the bankrupt, it is expected that he or she knew such ground for avoidance (subparagraph 2). Also, where the subsequent acquirer acquired the subject matter by any gratuitous act or by any onerous act that should be deemed to be equal to such an act, the requirement is not the knowledge of the subsequent acquire but the existence of the ground for avoidance against their predecessors (subparagraph 3).

As a result of this, there arises a situation that the scope of acts subject to avoidance is wider in the RRAFA, which is used at ordinary times, than in the avoidance right under the insolvency law where equality of obligees is emphasized. (Reverse phenomenon)

Accordingly, it is considered that the requirements to exercise the RRAFA against a subsequent acquire are made same as the avoidance right under the Bankruptcy

Act. However, there is a view that the requirements should be that the beneficiary and all subsequent acquires have the knowledge of “the fact that the obligee is to be prejudiced”, not that the knowledge about the ground for avoidance against their predecessors (in this case, it is required that the subsequent acquire knew the subjective requirement of predecessor).

(Related issues) Special provisions on effects of avoidance of a fraudulent act against a subsequent acquirer

As to cases where a subsequent acquire acquired the subject matter by any gratuitous act or any onerous act which should be deemed to be equal to such an act, if a special provision that does not ask subjective view of the subsequent acquire or assume knowledge of the subsequent acquire about the ground for avoidance is set forth, a possible direction of deliberation is to establish a special provision that the scope to be returned is reduced to the scope that the subsequent acquire actually receives interests in order to protect unknowing subsequent acquire.

h. Succession of an act for avoidance of a fraudulent act

Even if provisions on requirements of the RRAFA are carefully reviewed with due considerations to consistency with the requirements of the avoidance right under the Bankruptcy Act, it is possible that the scope of acts subject to avoidance is wider in the RRAFA, which is used at ordinary times, than in the avoidance right under the insolvency law where equality of obligees is emphasized. (Reverse phenomenon)

Article 45 of the Bankruptcy Act provides succession of the proceedings by the trustee in bankruptcy when the action to request avoidance of fraudulent act brought by a bankruptcy creditor or a bankruptcy estate was pending at the time of initiating the bankruptcy proceeding. If the reverse phenomenon were to remain, among succeeded proceedings of the action to request avoidance of fraudulent act, the part which exceeds the object of the avoidance right under the Bankruptcy Act cannot be treated as an action of avoidance. Thus, it is necessary to consider if any treatment is necessary.

There are following two views on exercise of the RRAFA which cannot be replaced to the right of avoidance: (1) a view that the person who has the right of avoidance can maintain the RRAFA in parallel to the bankruptcy proceedings; and (2) the bankruptcy trustee can continue proceedings as an action to request avoidance of fraudulent act.

4. Review of a provision on effects

There have been various discussions over understanding of legal nature of the effect of the RRAFA (*aforesaid* 2 (1)). A possible direction of deliberation is to suppose the stance of recovering missing property to the obligor, respecting continuity

with the current operation of the system as a basic rule, and to overcome theoretical and practical problems individually (*aforsaid 2 (1)*).

The current law provides on the effect of the RRAFA “the rescission ... shall have an effect for the benefit of all obligees” only (CC Art.425). The case law theory and theories for interpretation supplement this simple provision. Therefore, it may be necessary to advance discussion in a direction to clarify the provision as much as possible. What else should we consider in reviewing the provision on the effect of the RRAFA?

(1) Appropriateness of prioritized payment in effect

It is explained that the RRAFA is the system that the avoiding obligee prepares for compulsory execution preserving nonexempt property of the obligor. However, the case law grants the avoiding obligee to request the beneficiary or the subsequent acquire to deliver money to be returned directly to the avoiding obligee himself. Based on this, the avoiding obligee is able to satisfy own claim prior to the beneficiary or other obligors in fact through offsetting the obligation to return the received money to the obligor and the preserved claim.

It is pointed out that the fact that the RRAFA functions in this way contradicts with the language of the Civil Code Article 425, “for the benefit of all obligees”, and deviates from the original purpose of the system. It is also pointed that it is unreasonable that the beneficiary who first started debt collection becomes subordinated to the avoiding obligee who later started debt collection.

On the other hand, it is pointed that if the function of debt collection is totally denied, the avoiding obligee loses the incentive to exercise the RRAFA through litigation and as a result the brake against the fraudulent act is lost. Considering the situation of problems above, how should we consider appropriateness of the fact that the avoiding obligee receives prioritized payment in fact.

(2) Method to deny or limit the function to collect claims

If we support a view that the system of the RRAFA exists for the purpose of preserving nonexempt property of the obligor and thus the function of debt collection should be denied or limited, we need to consider concrete method (structure) for this stance.

If we deny the function of debt collection of the RRAFA, we need to consider the same method with the cases where prioritized payment in fact is denied without abolishing the system of the right of subrogation of the obligee (*see, aforsaid Part I, 3(1)*).

On the other hand, persons who support the stance which respects the incentive to exercise the RRAFA for the avoiding obligee and remains to limit the function of

debt collection propose that, affirming direct delivery of money to the avoiding obligee, the avoiding obligee is prohibited from offsetting the obligation to return the money to the obligor and the preserved claim for certain period. This certain period enables all obligees including the avoiding obligee to attach or provisionally attach the monetary claim of the obligor against the avoiding obligee, but if the certain period lapses without attachment being made, the avoiding obligee can enjoy prioritized debt collection through setoff.

(Related issues) Period prohibiting setoff

The period prohibiting setoff becomes an issue if we affirm direct delivery of the money to the avoiding obligee but limit the function of debt collection through prohibiting the avoiding obligee from offsetting the obligation to return the money to the obligor by the preserved claim. It is necessary to decide this issue considering the balance between the necessity to secure the opportunity of other obligees to enter into execution and the necessity to give an incentive to the avoiding obligee.

(3) Scope of avoidance

The case law states that the avoiding obligee can avoid a fraudulent act to the extent of the amount of his claim when the amount of preserved claim is smaller than the amount of property which is the subject matter of the fraudulent act and that property is divisible.

However, in case of above-stated (1) and (2), the reasonableness to set the limit stated in the case law will decrease in the future if we value that the effect of avoidance exists for all obligees (CC Art. 425) and deny or limit the function of debt collection (prioritized payment in fact). Accordingly, a view is proposed that the scope that the avoiding obligee can avoid should not be limited to the amount of the preserved claim.

(4) Method to recover missing property

When the legal nature of the RRAFA (see *aforsaid* 2 (1)) is understood as to avoid a fraudulent act and to request recovery of missing property based on avoidance, the concrete method to recover missing property are not specifically provided in the current Civil Code and the case law theory and theories for interpretation supplement this situation.

Considering the purpose of the system which is preservation of nonexempt property of the obligor, the basic way of thinking is to recover missing property to the obligor. Based on this, considering current case law and practice, it is possible to consider whether to stipulate concrete method of recovering missing property with regard to the following items.

a. Property that can be registered

On the method of recovery where missing property is immovable property, the case law admits both the method through registration to delete transfer registration to the beneficiary or the subsequent acquire and the method through transfer registration from the beneficiary or the subsequent acquire to the obligor based on the basic way of thinking to recover the missing property to the obligor.

Based on this case law theory, there is a view that it should be clearly stated in a provision that where missing property is something which can be registered, the avoiding obligee can request the beneficiary or the subsequent acquire who obtains the title of its registration to delete that registration or to transfer the registration to the obligor.

b. Money and other property

On the method of recovery where missing property is money or any other movable property, the case law grants the avoiding obligee to request to deliver the property directly to the avoiding obligee himself. It is also possible to consider the method that the avoiding obligee requests to return the property to the obligor, in relation to the issue that the effect of avoidance reaches the obligor. In addition, with regard to the issue that the function of debt collection through the RRAFA is denied or limited, it is possible to adopt an idea that the avoiding obligee can choose to request the beneficiary or the subsequent acquire to deposit the missing property. Based on these issues, it is possible to consider whether the avoiding obligee should be able to request to deliver the missing property to the obligee or to deposit it, as to the method of recovery where the missing property is money or any other movable property as well as clearly stipulating that the avoiding obligee can request the beneficiary or the subsequent acquire to deliver the missing property directly to the avoiding obligee himself.

c. Claims

On the method of recovery of the claim where transfer of a claim was regarded as a fraudulent act, as to the relation with the effect of relative avoidance which the case law applies, lower court decisions are divided into the view that the avoiding obligee can request the beneficiary (transferee) to send a notice that the transfer of the claim is avoided to the third obligor (the obligor of the claim which is the missing property) and the view which denies this. The conclusion that the avoiding obligee can request the beneficiary (transferee) to send a notice that the transfer of the claim is avoided will bring more stable legal relations regarding recovery of missing property. Therefore, it is considered to advance deliberation whether legislative solution for

such conclusion is possible paying due considerations to other related issues.

d. Principle of returning the original thing – compensation of value

On the method of returning missing property, the case law requires the original thing to be returned, and if that is impossible or extremely difficult, it allows compensation of value. Accordingly, it is considered to deliberate in a direction to clearly state in a provision that compensation of value is available only when returning the original thing is impossible or extremely difficult with regard to the method to return missing property.

(5) The right to demand compensation of expenses

As to the problem of compensation of expenses when the avoiding obligee spent necessary cost in exercising the RRAFA, while this relates to the issue whether the effect of avoidance reaches the obligor, there is a view that the avoiding obligee can demand the obligor to compensate expenses.

In addition, if we choose the direction that, valuing the fact that the effect of avoidance accrues for the benefit of all obligees (CC, Art. 425) in above (1) and (2), the function of debt collection (prioritized payment in effect) is denied or limited, it is possible to consider that these expenses have the nature of expenses for common benefits and forms statutory lien for expenses for common benefits (CC Art.306 (i) and 307). Based on these points, it is considered to advance deliberation on stipulating a provision regarding the claim for compensation of expenses of the avoiding obligee with due considerations to other related issues.

(6) Status of beneficiary and subsequent acquirer

a. Recovery of claims of the beneficiary where an act to extinguish obligation is avoided

Under the case law theory that the effect of the RRAFA is relative avoidance (eclectic theory), it becomes an issue whether the claim of the beneficiary is recovered when an act that payment or substitute payment was made from the obligor to the beneficiary is avoided. The case law states that the claim of the beneficiary is recovered. This supposes to make an act to extinguish an obligation the object of the RRAFA (see, above 3(2)(a)) and relates to the issue whether the effect of avoidance of a fraudulent act reaches the obligor. However, as a basic direction, it is considered to advance discussion in a direction to clearly state in a provision that the claim of the beneficiary is recovered through avoidance.

b. Compensation of the value of payment in return by the beneficiary

Under the current law, when the beneficiary returns obtained property to the

obligor through the avoiding obligee exercising the RRAFA, the beneficiary cannot request the obligor to return payment in return immediately even if the beneficiary delivers some value in return when receiving the property. The beneficiary can request the obligor to return unjust enrichment only when the avoiding obligee satisfies all preserved claims in fact.

Under such situation, in fact it is difficult for the beneficiary to receive unjust enrichment from the obligor at face value because the obligor is insolvent. As a result, the beneficiary is substituted to the avoiding obligees and other obligees with regard to the value paid to the obligor concerning the property recovered to the obligor. While there is a possible view that such conclusion is justifiable as a sanction that the beneficiary assisted the fraudulent act, there is another possible view that such conclusion is problematic from the aspect of consistency with the Bankruptcy Act that treats the beneficiary's payment in return as the bankruptcy estate as a general rule and pay it giving preference to bankruptcy claims.

Based on these points, there is a view that, when the beneficiary makes payment in return for the avoided fraudulent act, the beneficiary should be able to request recovery for that payment in return or compensation for the value giving preference to the avoiding obligee or other obligees.

(Related issues) Priority with the right to demand compensation of expenses by the avoiding obligee

When the beneficiary is granted the prioritized right to compensate the value, priority between the avoiding obligee's claim for compensation of expenses and the beneficiary's claim becomes an issue. A view is proposed that the avoiding obligee's claim for compensation of expenses should be prioritized because of the necessity to secure the incentive of the avoiding obligee and the necessity to protect the avoiding obligee rather than the beneficiary who knew of the fraudulent act.

c. Payment in return by a subsequent acquirer

Under the current law, when the subsequent acquirer returns property obtained from predecessor through the avoiding obligee exercising the RRAFA, the subsequent acquirer cannot request to return payment in return immediately even if the subsequent acquirer delivers some value in return to the predecessor when receiving the property. The subsequent acquirer can request the obligor to return unjust enrichment only when the avoiding obligee satisfies all preserved claims in fact.

Under such situation, in fact it is difficult for the subsequent acquirer to receive unjust enrichment from the obligor at face value because the obligor is insolvent. As a result, the subsequent acquirer is substituted to the avoiding obligees and other obligees with regard to the value paid to the predecessor concerning the property

recovered to the obligor. There is a debate over such conclusion in relation with the treatment of payment in return of the beneficiary in above (b).

If the view is adopted under (b) that, when the beneficiary makes payment in return for the avoided fraudulent act, the beneficiary should be able to request recovery for that payment in return or compensation for the value giving preference to the avoiding obligee or other obligees, it is considered to advance deliberation in a direction that the subsequent acquire is also entitled to preferentially collect the value of payment in return made to the predecessor.

5. Exercise period of the right to request avoidance of fraudulent act (CC Art.426)

The current Civil Code provides that the exercise period of the RRAFA is two years from the time that the obligee acquired knowledge of the cause of the rescission.(Art.426 (1)) In addition, the RRAFA is also extinguished if twenty years pass from the time of the act. (Art.426 (2)) The legal nature of these twenty years is regarded that it is automatically extinguished when twenty years lapses. It may be better to deliberate this exercise period when the system of extinctive prescription is reviewed.