

# Ship Finance

**in 18 jurisdictions worldwide**

# 2014

**Contributing editor: Lawrence Rutkowski**



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## Ship Finance 2014

**Contributing editor:**  
**Lawrence Rutkowski**  
**Seward & Kissel LLP**

*Getting the Deal Through* is delighted to publish the first edition of *Ship Finance*, a new volume in our series of annual reports, which provide international analysis in key areas of law and policy.

Following the format adopted throughout the series, the same key questions are answered by leading practitioners in each of the 18 jurisdictions featured.

Every effort has been made to ensure that matters of concern to readers are covered. However, specific legal advice should always be sought from experienced local advisers. *Getting the Deal Through* publications are updated annually in print. Please ensure you are always referring to the latest print edition or to the online version at [www.gettingthedealthrough.com](http://www.gettingthedealthrough.com)

*Getting the Deal Through* gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. *Getting the Deal Through* would also like to extend special thanks to contributing editor Lawrence Rutkowski of Seward & Kissel LLP for his assistance in devising and editing this volume.

## Getting the Deal Through

London  
July 2014

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Published by  
**Law Business Research Ltd**  
87 Lancaster Road  
London, W11 1QQ, UK  
Tel: +44 20 7908 1188  
Fax: +44 20 7229 6910  
© Law Business Research Ltd 2014  
No photocopying: copyright licences do not apply.

ISSN 2056-4015



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Printed and distributed by  
Encompass Print Solutions  
Tel: 0844 2480 112



# Japan

**Norio Nakamura**

Yoshida & Partners

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## Due diligence

- 1 How does one demonstrate title to or legal ownership of a vessel registered under the laws of your jurisdiction?

Vessels are registered at a competent office of the Legal Affairs Bureau. Registration of vessels is intended to announce the legal position (rights and obligations) of the parties involved in vessels in view of private law. Vessels are also recorded at a competent office of the Transport Bureau, for the purpose of administrative supervision. National certificates of vessels are issued by the Transport Bureau upon the vessel being duly registered and recorded.

Title to or legal ownership of a vessel is demonstrated by a transcript of the ship register issued by the Legal Affairs Bureau, in which the name and address of the shipowners and the date and the cause of acquisition of the title are stated.

- 2 How can one determine whether there are any liens recorded over a vessel?

A mortgage on a vessel can be recognised in a transcript of the ship register, but there are no means of determining whether there are any liens over a vessel because non-registered liens (eg, maritime liens or other liens on a vessel) are not entered in the ship register.

- 3 How does one determine whether there are any security agreements, liens, charges or other encumbrances granted by a vessel owner or affiliated party who might be a borrower, guarantor or other credit party in connection with a vessel finance transaction?

We can determine the nature and amount of credit that has been secured by a mortgage upon viewing a transcript of the ship registry. However, security agreements, liens, charges or other encumbrances are neither registered in the ship register nor disclosed to the public by the Legal Affairs Bureau.

- 4 Can one determine whether an obligor registered in your jurisdiction is duly organised and in good standing from a search of a public registry?

From the certified commercial register it is possible to determine whether an entity has been duly organised and is in good standing. A transcript of the commercial register can be obtained by anyone at the Legal Affairs Bureau with an application fee of ¥600.

- 5 Can the shareholders or other equity interest holders, directors and officers or other authorised signatories of an obligor organised in your jurisdiction be determined from a search of a public registry? If not, how are these parties customarily identified?

Only the name and address of the representative director and the name of other directors of an entity in question can be determined by viewing a transcript of the commercial register issued by the Legal Affairs Bureau. Shareholders or other equity interest holders,

officers or other authorised signatories of an obligor organised in Japan are neither registered nor determined.

- 6 What corporate or other entity action is necessary for an obligor to enter into or guarantee a debt obligation? When is action by the board of directors or other governing body required? Must shareholders approve a guarantee?

Any guarantee to secure debts or obligations of the principal must be given in writing pursuant to the civil law and be made before the principal debts or obligations cease to exist.

If the guarantee is made by a corporation, a certain internal procedure is required. If the amount of guarantee to be made by a corporation would result in it falling into 'a large amount of debt' stipulated in the corporation law, prior approval by the board of directors is required. A company may devolve the authorisation for such approval to a resolution of the shareholders' meeting if it specifies the provision in the articles of incorporation.

- 7 Must foreign lenders qualify to do business in your jurisdiction to extend credit to a borrower organised in your jurisdiction? Will foreign creditors be deemed resident as a consequence of making a loan or other extension of credit to an obligor within your jurisdiction?

Foreign lenders (banks and other lenders) are required under the banking law to qualify to do business in Japan to extend credit to a borrower organised in Japan if the finance is made there as in the course of business.

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## Repayment

- 8 Is central bank or other regulatory approval required for repayment of a loan in foreign currency?

Repayment of a loan is effective in a currency designated in a loan agreement. If the agreement designates a foreign currency for repayment, no particular regulatory approval is required other than a certain requirement under the foreign exchange and foreign trade control law, such as an ex post facto report.

- 9 Do usury laws limit the interest payable to a lender in respect of a vessel financing?

If the Japanese law is designated as a governing law of a finance agreement, the interest rate restriction law is applied. It limits the interest to up to 15 per cent per annum where the amount of the principal credit is more than ¥1 million.

- 10 Are withholding taxes payable on principal or interest payments to non-resident lenders?

Non-resident lenders are required to pay a withholding tax, in principle, at 20 per cent on the interest to be earned from the domestic borrower. Where the tax convention is applied, the rate may be reduced. For the period of 25 years from 2013 to 2037, withholding

tax of 20.42 per cent is payable due to the requirement for the special reconstruction income tax.

### Registration of vessels

**11** What vessels are eligible for registration under the flag of your country? Are offshore drilling rigs or mobile offshore drilling units considered vessels under the laws of your jurisdiction? What is the effect of registration?

Vessels more than 20 gross tons are eligible for registration. Vessels less than 20 gross tons and those solely or mainly propelled by oars are excluded from the requirement to register under the ship law.

Offshore drilling rigs or mobile offshore drilling units, which are not intended to be used for carriage of passengers or cargo, are excluded from the concept of a vessel. If objects are taken as out of the vessel concept, they are deemed to be structures on land or moveable properties, where the owners of the object are not entitled to limitation of liability as shipowners and maritime lien over the vessel is not created.

**12** Who may register a vessel in your jurisdiction?

The following parties may register a vessel:

- the Japanese government or a Japanese government authority;
- a Japanese national; or
- a legal entity incorporated under Japanese law of which the representative director and two-thirds of executive officers must be Japanese nationals.

**13** Is there an alternate registry for international shipping operations?

There is no alternate registry in Japan for international shipping operations, such as an offshore register, for foreign owners to have their vessels registered.

### Ship mortgages and other liens over vessels

**14** What types of ship mortgages exist and what obligations may a ship mortgage secure? Can contingent obligations, including swap obligations, be secured? Are there standardised forms?

Japan has two types of ship mortgage:

- (i) the standard mortgage, which secures a specified credit together with its interest which has fallen due in the last two years; and
- (ii) a revolving mortgage, which secures unspecified credits created in a specific contracts with the obligor for continuous transactions or created in a certain kinds of transactions with the obligor.

Contingent obligations or swap obligations may be secured by a standard mortgage as far as the obligation is specified when the mortgage is provided. Unspecified obligations may be the target of the revolving mortgage and are subject to the condition of (ii) above. There are no particular standardised forms for registry of the mortgage and a comprehensive English-style deed of covenants is not required.

**15** Give details of any required form for ship mortgages in your jurisdiction?

As mentioned in question 14, there is no particular required form. In a mortgage deed, creditors, debtors and the secured credit must at least be identified. The principal amount is to be applied in Japanese currency.

**16** Who maintains the register of mortgages? What information does it contain and where are such filings to be made? What is the effect of registration?

The register of mortgages is maintained by the competent Legal Affairs Bureau. The register of mortgage contains:

- the date of filings;
- the secured credit;
- the kind of mortgage;
- the amount of the secured credit at the time of register; and
- the name and address of a mortgagee and debtor.

Upon a mortgage on the vessel being registered, it keeps a priority over rights of the third party such as subordinated mortgages or new owners of the vessel but is behind maritime liens created on the vessel.

**17** Must the total amount of the mortgage be stated therein? Must the mortgage contain a maturity date? Must the underlying debt instrument be filed with or attached to the recorded mortgage?

The amount of a credit secured by the mortgage is stated for the standard mortgage and the maximum amount of the mortgage is stated for the revolving mortgage. A maturity date is not recorded in the mortgage. The underlying debt instrument such as the loan agreement and the mortgage deed must be provided to the Legal Affairs Bureau in filing the mortgage but these instruments are not filed with or attached to the recorded mortgage.

**18** Can a mortgage be registered in the name of an agent or trustee for the benefit of multiple lenders?

A mortgage cannot be registered in the name of an agent or trustee for the benefit of multiple lenders and the mortgagee must be the creditor of the secured credit.

**19** If the mortgagee is an agent or trustee for a lending syndicate, must any filings be made upon transfer of a portion of the underlying debt among existing lenders or to a new lender?

The mortgagee must be the creditor of the secured credit and the agent or trustee for a lending syndicate cannot be registered as a mortgagee. If an agent or trustee for a lending syndicate wishes to be registered as a single mortgagee, all of the underlying debt must be obtained and transferred from the lending syndicate to the agent or the trustee.

**20** If the mortgagee transfers its interest to a new lender, agent or trustee, what filings are required? Is the mortgagor's consent required?

If the mortgagee assigns the credit secured by the mortgage to a third party, the mortgage is also assigned to such party following the transfer of the secured credit and the mortgagor's consent is not required.

In order to perfect the assignment of the credit, the notice of the assignment or the acknowledgement of the assignment must be made attaching a fixed-date certificate. Under the civil law, assignment of a claim may not be accepted by the obligor or any other third party unless the assignor gives a notice to the obligor or the obligor has acknowledged the same, and such notice or acknowledgement must have the fixed date to be effective against the third party other than the obligor. A fixed-date certificate is obtainable by either a content-certified mail or certification by a notary public.

**21** What other maritime liens over vessels are recognised in your jurisdiction? Do these claims give rise to a right to arrest a vessel? In what circumstances may associated ships be arrested?

The following claims would create a maritime lien, by which the vessel may be arrested:

- costs incurred from the auction sales of the vessel after the auction procedure is commenced;
- costs to maintain the vessel at the last port;
- tax and other dues for her voyage;

- pilotage and towage;
- salvage and general average;
- claims arisen out of necessity to continue her voyage;
- crew's claim under the employment contract;
- claims arisen out of ship sales, construction, equipment but before her departure and claims for equipment, provisions or bunker for her last voyage; and
- claims under the Japanese COGSA or the law concerning limitation of liability of shipowners or the law concerning compensation for damage from oil pollution by ship.

Associated ships may be arrested by way of 'provisional attachment', similar to the *Mareva* injunction under English law, but not on maritime liens. Provisional attachment is only to preserve assets (eg, vessels) of the debtor as owner from being disposed of until the judgment or arbitration award becomes enforceable. The arrestor must provide a counter security to the court in cash or by a bond issued by a bank or a foreign bank admitted by Japanese laws.

**22** What maritime liens rank higher than a mortgage lien?

Maritime liens on the vessel mentioned in question 21 have a priority over the ship mortgage even if they are created after the mortgage is registered.

**23** May non-mortgage liens be recorded over a vessel?

We have no means of recording non-mortgage liens over a vessel.

**24** Will mortgages on 'foreign' flag vessels be recognised in your jurisdiction? If so, do they share the same priority as those on vessels registered under the laws of your jurisdiction?

There is a legal dispute on the issue of whether the mortgage on foreign flag vessels is recognised in Japan. Japanese courts have in fact accepted enforcement of the foreign ship mortgage in many ship-arrest cases but a few courts refuse to recognise by reason that it does not have any ground of Japanese law. If the foreign ship mortgage is recognised, it has the same priority as those registered under Japanese law.

**25** What is the procedure for enforcing a mortgage in your jurisdiction by way of foreclosure? Are interlocutory sales permitted? How long does a judicial sale take? What are the associated court costs and how are they calculated?

If a debtor is in default under the loan agreement or other contracts, the mortgagee may apply for judicial auction sale of the vessel. The mortgagee first needs to arrest a vessel in Japan as a precondition for the court to order the commencement of the judicial auction sale proceedings, for which a vessel must be put in a possession of the court-marshal. After the court orders the commencement of the proceedings, the vessel is physically maintained by a ship-manager appointed by the court until she is sold. In the meantime, the court inspects and makes a valuation of the vessel to determine the minimum price for bidding. A judicial auction is made by way of open bids or tender bids upon consultation with the financier as mortgagee.

Interlocutory sales are not provided for under Japanese law. It usually takes several months to have a judicial sale. Costs that the applicant must bear are the deposit ordered by the court for the vessel's expected maintenance and preservation costs or expenses, including port charge, crew wages, insurance, bunker, etc, for several months until the vessel is sold.

**26** May a vessel be sold privately by a mortgagee? Will the sale discharge liens over the vessel?

A vessel may be sold out of court privately by a mortgagee according to the terms and conditions provided in a mortgage deed. However, in a private sale, liens over the vessel are not discharged without

settling lien-claims while any liens are discharged through a judicial auction sale. Thus, if it is expected that the vessel may be subject a lien, financiers must bear risks of a lien in selling a vessel by a private sale.

**27** What are the limitations on rights of self-help by a mortgagee?

A mortgagee is allowed to bid for and purchase a vessel by itself in the same way as the law normally requires and there is no particular limitation on the right of self-help.

**28** What duties does a mortgagee owe to an owner or third-party creditors?

A mortgagee does not obtain any possession of the vessel and the owner is allowed to use the vessel. Thus, a mortgagee does not owe any duties or responsibility to the owner or other third-party creditors in connection with the use of the vessel.

**Collateral**

**29** May finance leases or other charters be recorded over vessels flagged under the laws of your jurisdiction?

Rights that can be registered over vessels under Japanese law are ownership, mortgage and lease only. In a certain scheme for finance lease, (i) where a finance lessor holds the right of ownership of the vessel, he or she is registered as owner and the right to lease of the vessel may be registered in the name of a lessee, and (ii) where a finance lessee obtains the right of ownership of the vessel, he or she is registered as owner but the lessor's credit is not registered as security because there are no means to register such interests in Japan. The title to lease by a bareboat charter may be recorded as a lease if it falls in the meaning of 'lease' under Japanese law.

**30** May finance leases be recharacterised by a court as a financing contract? If so, is there any procedure for protecting the lessor's interest against third-party creditors?

A judgment of the Supreme Court in 1995 mentioned, in a dispute under the corporate reorganisation proceedings, with regard to a finance lease contract with full-payout scheme, that monthly payment for lease by the lessee was not valued to monthly use of the leased object and the substantial nature of this finance lease was to give the lessee financial benefits.

It is thought in the proceedings of a lessee's bankruptcy, civil rehabilitation or corporate reorganisation that unpaid credits for finance lease may be categorised in a secured claim, not an unsecured claim.

**31** How is a security interest created over earnings of a vessel, charter contracts, insurances, etc? How are these security interests perfected?

Assignment of a charter contract (eg, earning of a vessel or charter hire) or insurance is often created as security interests by a contract between the financier and the owner.

Charterparty or charter hire may be assigned by the assignor with a notice of assignment issued by the assignor to the assignee and an acknowledgment by the assignee. In order to perfect the said assignment, a notice of the assignment by the assignor or an acknowledgement by the assignee must have a fixed-date certificate (see question 20).

Security interests over the insurance can be created by a pledge or a mortgage by transfer. To perfect the pledge or mortgage by transfer of the insurance, a notice of pledge or transfer from the pledgor to the insurer or an acknowledgment by the insurer, having a fixed-date certificate, is required (see question 20). A title of the pledge or the mortgage by transfer can be registered at the Legal Affairs Bureau, in which case a notice by the pledgor or an acknowledgment by insurer is not required to have perfection.



- 32** Must security interests against non-vessel collateral be registered to be enforceable? If so, where are such filings made?

One of the typical security interests against non-vessel collateral for ship finance other than mortgage is a pledge of corporate shares which the borrower owns (for registration see question 35).

In Japan, financiers often require a borrower to provide a personal guarantee issued by directors of the borrower or a corporate guarantee issued by affiliated companies. No register filings are required.

- 33** How is a security interest over a deposit account established?  
How is a security interest perfected?

A security interest over a deposit account may be established by way of a pledge agreement between a financier as pledgee and a borrower as pledgor. In order to perfect the said pledge of a deposit account, a notice of the assignment by a pledgor or an acknowledgement by a bank of the said deposit account, having a fixed-date certificate, is required (see question 20).

- 34** How are security interests in non-vessel collateral enforced?

Security interests in non-vessel collateral are enforceable according to the contracts between the financier and the borrower or by a law of a place where each security interest exists or is located.

A share pledge is enforceable by the law under which the company is incorporated, details of which are mentioned in question 35.

- 35** How are share pledges for vessel financings established? Are share pledges or share charges common in your jurisdiction?

Share pledges or transferable mortgages over the share are available for financiers as security of the loan credit. It is construed under the international conflict law of Japan that share pledges for vessel financings may be established by the law under which the company is incorporated and Japanese law is applicable when it is designated as governing law of the share pledges.

In Japan, share pledge is established (i) by physical delivery of the share certificate if it is issued by the company, (ii) by recording the pledgee in the book-entry transfer form if the share certificate is not issued by the company but the book-entry transfer system is adopted, or (iii) by recording the pledgee in the shareholder list of the company if such company neither issues the share certificate nor adopt the book-entry stock system.

- 36** Is there a risk that a pledgee, before or after exercise of the share pledge, may be exposed to debts or other liabilities of the pledged company?

A pledgee would not be exposed to a risk of having debt or liabilities of the pledged company beyond the value of the shares before or after exercise of the share pledge.

#### Tax considerations for vessel owners

- 37** Is the income earned by the owners of vessels registered in your jurisdiction subject to domestic taxation? At what rate?

The parties who are allowed ownership of Japanese flagged vessels is limited to the Japanese government, Japanese nationals or a company incorporated by Japanese law as mentioned in question 12. Assuming a Japanese vessel make a profit, the owners as a corporate body (they must be a Japanese entity) are to bear (i) a fixed property tax for vessels, a corporation inheritance tax or a business income tax as local taxes and also (ii) a corporate tax as a national tax. A rate of a corporate tax is presently 25.5 per cent and the total effective tax rate is 35.64 per cent after 1 April 2015.

- 38** Is there an optional tonnage tax exempting vessel owners from tax on income?

Japan adopted the tonnage tax regime from 2008 replacing the standard corporate tax regime. A tax base of tonnage tax is calculated on the net tonnage of the trading vessels and its rate is (i) if it pays at each entry to open ports, ¥16 per net tonnage, and (ii) in case of a lump-sum payment for one year, ¥48 per tonnage.

- 39** What special tax incentives are available to shipowners registering vessels in your jurisdiction?

Japan's tonnage tax regime is applicable only to Japanese flagged vessels.

- 40** Are there any other noteworthy tax provisions specifically applicable to shipping, shipping income or ship finance?

There is no particular tax regime favorable to shipowners incorporated in other jurisdictions.

#### Insolvency and restructuring

- 41** Is there a general scheme of reorganisation or insolvency administration in your jurisdiction?

Procedures for re-organisation or insolvency are stipulated in different laws. For example, the Bankruptcy Law provides for bankruptcy of an individual or a corporation who wishes to close its business. The Civil Rehabilitation Law provides for rehabilitation of an individual or a corporation and the Corporate Reorganisation Law provides for reorganisation of a corporation only. In the former proceedings, the current executives may continue to keep management of the company but in the latter proceedings, the management of the company is fully succeeded by the trustee.

In bankruptcy proceedings or civil rehabilitation, the credits secured by a ship mortgage are enforceable at any time out of the proceedings, but in a corporate reorganisation, even the ship mortgage must follow the reorganisation plan and may not be enforced voluntarily out of the proceedings.

- 42** Will the courts of your jurisdiction respect the rulings of a foreign court presiding over reorganisation or liquidation proceedings?

Japan has legislation concerning recognition and assistance for foreign insolvency proceedings following the model law for recognition and assistance of the foreign insolvency proceedings formulated by United Nations Commission on International Trade Law (UNCITRAL).

Tokyo District Court has exclusive jurisdiction over this matter and the applicant is required to put up a deposit decided by the court. The court may order suspension of the attachment or other proceedings over the property in Japan and, if necessary, may prohibit disposal of the property to assist the foreign proceedings.

- 43** What is the order of priority among creditors? In what circumstances will creditors be required to disgorge payments from an insolvent company?

The following claims are given priority to recover from the bankruptcy estate before the liquidating distribution is made to relevant bankruptcy creditors:

- expenses for court proceedings performed for the common interest of bankruptcy creditors;
- expenses for the administration, realisation and liquidating distribution of the bankruptcy estate;
- tax, etc arising from a cause that has occurred before the commencement of the bankruptcy proceedings, for which, by the time of commencement of the bankruptcy proceedings, the due

date of payment has not yet arrived or one year has not yet elapsed after the due date of payment; and

- claims arising from an act conducted by a bankruptcy trustee with respect to the bankruptcy estate.

Bankruptcy claims, for which a general statutory lien or any other general priority exists over property that belongs to the bankruptcy estate, have a priority over other general bankruptcy claims, such as:

- tax etc arising from a cause that has occurred before the commencement of the bankruptcy proceedings, for which, by the time of commencement of the bankruptcy proceedings, the due date of payment has elapsed more than one year after the due date of payment;
- unpaid fees for a pension insurance or health insurance; and
- unpaid wages.

A creditor may be required to disgorge payments from an insolvent company if he or she knew the fact that receiving payment in preference would prejudice other creditors.

- 44** May a vessel owner provide security on behalf of other related or unrelated companies? What are the requirements for it to be enforceable?

An owner of a vessel may provide security on behalf of other related or unrelated companies and no particular relation between the owner and debtor or borrower is required. To enforce the mortgage on the vessel in such cases, upon the event of default having been occurred on the principal debtor or borrower, the vessel must first be arrested by the mortgagee as creditor in Japan to put her in the possession of the court-marshal.

- 45** Is there a law of fraudulent transfer that permits a third party creditor to challenge, for example, the grant of a mortgage because of insolvency of the mortgagor or insufficient consideration received by the mortgagor in exchange for the grant of the mortgage?

The bankruptcy law provides legal effects when a fraudulent transfer (prejudicial act to creditors) has been made by a debtor, mortgagor or others. The following acts may be avoided by a bankruptcy trustee after the commencement of the bankruptcy proceedings is declared:

- acts conducted by the debtor having knowledge that the said acts would prejudice creditors, or acts which prejudice creditors and have been conducted after the payment was suspended or filing of the bankruptcy proceedings had taken place;
- gratuitous acts or onerous acts equal to gratuitous acts conducted by the debtor after or six months before the payment was suspended; or
- acts conducted to give security for a debt or to settle a debt after the debtor became insolvent or the bankruptcy proceedings were filed provided that a creditor must knew the fact that the debtor was insolvent, payment has been suspended or the bankruptcy proceedings was filed.

The above rights of avoidance may not be exercised after two years have elapsed since the bankruptcy proceedings were commenced.

- 46** How may a creditor petition the courts of your jurisdiction to declare a debtor bankrupt or compel liquidation of an insolvent obligor?

Any creditors may apply for a debtor bankrupt upon putting up a deposit to the court. The court will order much higher deposit than a debtor application for bankruptcy case. The applicant creditor must make prima facie proof as to the applicant's credit and debtor's insolvency. The court will hold a hearing with both the applicant and the debtor before declaring the commencement of the bankruptcy proceedings.

- 47** Has your jurisdiction adopted the Model Netting Act of the International Swaps and Derivatives Association (ISDA)? If not, may a swap provider exercise its close-out netting rights under an ISDA master agreement despite an obligor's insolvency?

Japan has not adopted the Model Netting Act of the International Swaps and Derivatives Association (ISDA). However, there are some provisions that reflect the netting regime for certain transactions in the bankruptcy law, the civil rehabilitation law, the corporate reorganisation law and the special law called the Law on Collective Liquidation of Specified Transaction Conducted by Financial Institutions. These provisions are applicable to the netting between two parties but not among multiple parties.

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