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November 22, 2016

Japan's Economy –Current Conditions and Outlook-¹

I. Virtuous cycle by the Three Arrows in Abenomics

To put it briefly about the current situation of Japanese Economy, virtuous cycle by the Three Arrows in Abenomics has been making Japanese economy better. Abenomics is declared by Mr. Abe Shinzou, Prime Minister of Japan, in 2012 to aim at recovery of Japanese economy.

Three arrows of abenomics come from the lesson of three arrows. In the lesson, Motonari Mori, famous Samurai Warrior requests at his death in 1571 to his three sons to cooperate each other by showing one arrow is easy to break but three difficult.

Three arrows referred to in Abenomics are (1) large scale monetary easing policy, (2) expanded fiscal policy and (3) a growth strategy to encourage private investment. Before the Abenomics started, the Japanese economy was in the situation of continuous decrease of the commodity price. For example, a person who had US\$1000 hesitated to purchase personal computer for US\$500 because the price of computer would become US\$300. If a person would not purchase personal computer, the computer shop would not get profit. If the computer shop would not get profit, then the computer manufacture would not get profit. If the computer company would not get profit, the salary of employees of the computer manufacture would decrease. The salary of the employees would decrease, the employees would not purchase the computer.

This was called deflationary spiral. To cut down the deflationary spiral, it was necessary to create the

¹ This article refers to speech “JAPAN’S ECONOMY: CURRENT CONDITIONS AND OUTLOOK” made by Seiichiro Inoue, who is the director of Macro Economic Affairs Division at Economic and Industry Policy Bureau in the Ministry of Economy, Trade and Industry, in the seminar “Country Risk Conference” held by Coface Japan on November, 8, 2016

situation where the price of the commodity continuously increase or inflation.

To do this, the first arrows of Abenomics allowed the Bank of Japan to provide large scale money to the commercial banks in Japan in order for the commercial banks to lend large scale money to the companies and individuals all over Japan. It would take a while, however, for the companies and individual all over Japan to make profit by the money borrowed from the commercial banks.

The second arrow of Abenomics therefore provided public works for the companies and individuals all over Japan for them to make profit from the money borrowed by the commercial banks. The Japanese government, however, could not provide the public works forever.

The third arrow of Abenomics therefore did relaxation of the regulations of various fields in order for the companies and individuals to make investments for profits. Abenomics also supports the companies and individuals by providing subsidiary to challenge the risky but high potential area, such as inbound and outbound medical care.

Because of the Three Arrows in Abenomics, ordinary income of the corporate earning of the fiscal year 2015 was largest ever. The job offers to the applicants increased. The consumption was expanded and capital investment increased. Japan got out of deflationary spiral.

Growth of corporate earnings was brought to Japanese economy by the Three Arrows in Abenomics and ordinary income in fiscal year 2015 is the largest ever. This growth of corporate earnings also brought increase of employment and income to Japanese Economy, and job offers to applicants' ratio changed to shift in high ratio for the first time in 24 years and workers' income has generally increased. Moreover, this made increase of consumption and capital investment increased because of increase of consumption. Domestic consumption is feeble due to strong saving-minded behavior in Japan and investment of tangible assets is lack in dynamism, and expected growth rate is low to be sure, but as a whole, there is virtuous cycle of economy now and it persists for several years.

II. Risk of Donald Trump on the Economic Growth of Japan

Now, however, the growth of Japanese economy is challenged by newly elected US president, Trump's protectionism policy.

As Japan does not have much national resources, the Japanese economy has been heavily depended on the import of the low price materials and export of the value added products.

To make the products with more competitive price, Japanese manufactures has been producing

products in China by using high technologies in Japan and inexpensive labor in China.

As the result, 35.1 % of total import of Japan came from China (24.8%) and WE (10.3%) in 2015 and 37% of total export went to US (20.1%) and China (17.5%). The growth of Japanese economy is now heavily depend on China and US.

Newly elected president of the United States on November 13, 2016 is a protectionist who oppose to a free trade. He said in his presidential campaign that he will impose tariffs up to 45% of all imported goods from China. Although this ridiculous tariff is little direct impact on Japan, it is said that China's gross domestic products will decline 3%.

In that case, it is also said that the US economy will fall into recession within 3 years due to increase of the import goods from China. In that case, Japanese economy will also fall into an unprecedented crisis as the result of the two major engines of Japanese economy lose their output.

Japanese therefore do hope that Trump's ridiculous protectionism idea is merely expressed as obtaining more votes from frustrated US people with income inequity and decrease of income after the financial crisis in 2008.

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The Current Trend of Tomb Stone Industry in Japan

I. Introduction

Recently we have received many cases from the Xiamen branch of Sinasure, to collect the debts from the debtors in tomb stone industry in Japan.

Replying our enquiry/demanding letters, around half of the debtor said that there were quality issues in the tomb stones delivered from the policy holders of Sinasure (you) and around half of the debtors told us that they were willing to pay the debts if they were to have money.

In this memo, we would like to analyze the current trend of the tomb stone industry of Japan and

warn you who are producing and exporting tomb stones to Japan

II. Transfer of the Manufacturing Center

Until the end of high economic growth era of Japan in 1973, tomb stone was produced in Japan. Because of the increase of salary of the labor cost in Japan became unacceptable, the Japanese tomb stone manufacture moved to Korea where good stone and well trained craftsmen exists. However, the labor cost of Korea was not acceptable in 1988, when Olympic was first held in Korea. Since then the Japanese tomb stone manufacture went to China, in particular Xiamen where the good stone and export port exist.

The Japanese tomb stone manufactures found that not only the labor cost was competitive but also the quality of the labor in China was very good. They therefore decided to transfer the manufacturing center from Japan to China by transferring the highly skilled workers and cutting edge machinery from Japan to China.

Now more than 80% of tomb stones sold in Japan are produced in China, in particular Xiamen.

III. Japanese Market

1. Funeral Business Market

The funeral business is one of the growing businesses in Japan. Recently there are a number of new joining enterprises from different business field, and it is said that the number of companies amounts to 6500.

In spite of expectation to the growth of funeral industries, the average amount spent by one customer is decreasing.

This is because of the paradigm shift of the person who spent the cost of funeral from the family of the deceased to the deceased (and his/her spouse).

In 2001, Tokyo Metropolitan Government sent out questionnaires regarding preference in funerals. According to the answers, more than 50% of people wish to hold funeral “compactly, with only close peoples”. Among over 40s, more than 70% of people prefer to simplify their funeral.

This is significant changes among Japanese, who traditionally regarded funeral as one of the most important life events. Japanese people, in general, spouse or eldest son of the deceased spent

millions of yen to hold funeral, inviting relatives, friends, and even acquaintances of deceased. Also Japanese people had graves not only for the deceased but also for feudalistic family system based on the traditional feudalistic idea.

The above idea has been dramatically changed recently.

For example, I am 60 years old. My father died 5 years ago. I spent as much money as possible for my father's funeral. I, however, do not want my son or daughter to spend much money for my funeral. I am preparing for my funeral, including my tomb with my wife. As I want to leave as much money as possible to my wife and children, I do not intend to spend too much money for my funeral, including my tomb with my wife. My wife would agree to my plan (although I have not yet discussed my idea with my wife.).

As the consequence of the above paradigm shift, the market volume has even decreased.

2. Increase Competition

Because of the increase of the new participants in the funeral industry, who offer funeral package plan (including tomb stones), the competition of the price of tomb stones has become fierce.

Previous tomb stone whole seller (and importer of the tomb stone from China, in particular Xiamen) starts losing customers and profits because of competition.

3. Tomb without Tomb Stone

Relating to the above, there is a new trend in tomb without tomb stone.

In urban areas, such as Tokyo and Osaka, the locker-type tomb (please see Photo 1 and 2) becomes popular. These types of tombs are collectively administered in a building. Those who come to visit can easily see the tomb (urn) by requesting the specific grave, and it will be transferred automatically from the locker to prayer space. This tomb does not use grave stones and are kept indoors, thus visitors can pray in convenient conditions and do not require maintenance. The locker-type tombs are located in the central area of Tokyo or Osaka where the real estate prices are intolerably expensive (one tsubo (坪) (3.3 square meter) cost 2-3 million yen or US\$ 20,000 to 30,000.) where most of the customers of the tomb stone could not afford to purchase for the tomb stone yard.

Another example is Jumokuso or 樹木葬 (burial in which a tree is planted instead of a tomb)

(Please see Photo 3.). The ashes of the deceased are buried close to a low tree or trees. Because of the fills of green, Jumokuso also becomes popular in Japan.

Another extreme example is Sankotsuso (scattering ashes of the deceased) or 散骨葬. In Japan, burial is the traditional funeral style, but more and more Japanese people become preferring to choose ash scattering in the sea. It is said that those who choose this burial state that it would not burden the family of the deceased to pray, which is said to be ordinary duty for them each year.

4. The Decrease of Birth Rate and Increase of Single Person

The life style of Japan has changed significantly and in urban area, the number of single person and people who get married as age of over 30, and divorce rate are increasing, therefore, the birth rate is decreasing significantly.

Tomb stones have been made for respect for ancestors, however, as there are many families without a child, tomb stones lose their function as mentioned above.

IV. Conclusion

As discussed above, the importers and whole seller of tomb stones manufactured in China are now in the very difficult positions in Japan. This is not only because of the increase of the labor cost in China but also the chance of the tomb stone (or funeral industry in Japan), which would be change of the mind of the people (in particular urban people) of Japan.

(Over)

Debt Collection in Japan

I. Introduction

Haraguchi International Law Office has been collecting debts owned by Japanese debtors to foreign creditors since the establishment of the office in 2003. Our clients in the early age were foreign debt collection agencies in the United States. Recently our clients are shifting to Asian collection agencies and trade insurance companies in China and Hong Kong. Recently we have been entrusted more than 100 cases (total debt amounts exceeding US\$200 million) from China each year and we have collected more than US\$5 million debts on behalf of Chinese creditors within a couple of years.

II. Characteristics of Transactions

In most debt collection, for Sinosure (and the policy holder), the creditors are the manufacturers in China and the debtors are the whole sellers of Chinese products in Japan. The products are sold to retailers in Japan. We, therefore, are normally negotiating with Japanese debtor (the “Debtor”) on behalf of Chinese creditor (the “Creditor”), the policy holder of Sinosure.

III. The Different Expectation between Japanese Debtor and the Chinese Creditor

Perhaps most of the Creditors are surprised at how strongly the Debtor sticks to the quality of the products. For example, the Debtor would not accept the products with a small scratch. The Debtor would say that products with a scratch cannot sell in Japan. The Creditor would say a small scratch, such as scratch on the sole of the shoes, do not affect the utility of the products. Then, the Debtor would say that the Japanese consumers love beautiful products and therefore hates the products with even a small scratch. The Creditor, however, would say the Japanese consumers should consider the cost of manufacturing if they want the commodity goods for reasonable price. The quality issue like this has never been solved through amicable collection.

It is true that the Japanese consumers are perhaps the most quality-oriented customers in the world. It perhaps comes from the nationality of Japanese.

In my experience in US, Europe and Asia, in particular, China, I found that Japanese have unique characteristics in sticking to the quality of products. Japanese do not mind sparing time and effort to produce the best quality in the products they produce.

For example, in 1543, a Portuguese visited Tanegashima Island by Chinese ship with guns. Tokimasa Tanegashima, the chief of the Tanegashima Island, who fell in love with the gun and Western technology, which first came to Japan. He managed to purchase two guns for 2,000 Ryo (worth US\$100 million). He then decomposed one of them and analyzed the details of it thoroughly. He tried and failed many times to manufacture the similar gun but he never gave up. He finally succeeded in manufacturing the similar (or even better) guns within only 1 year and sold the guns to Samurai lords all over Japan.

Because of the recommendation by the Tokugawa Shogunate and competition among feudalistic lords, the education level of common people in the Edo era was high. National Literacy rate of 70% was then the highest in the world.

After the Meiji restoration in 1868, Japan was quickly catching up with the western technology and culture due to the strong curiosity of foreign technology and culture and high education level of common people.

After perfect defeat of World War II in 1945, the Japanese tried very hard to get recover from scorched earth of atomic bombs. At first, Japan did not have high technology. As usual, Japanese showed strong curiosity of US products, decomposed and analyzed them, then produced the own products until it became the highest level of products. By exporting highest quality products to all over the world, Japan soon became top economy in the world. The richer the customers in Japan become, the more they become quality oriented.

As the Japanese could produce the highest level of products by quickly learning foreign products, only the products with highest quality can be purchased in Japan. Because they get used to purchase only the products with highest quality, the Japanese consumers are extremely demanding in the quality of the products not only from Chinese manufactures but also the manufactures from all over the world including Japanese manufactures.

This might be the reasons why the shoes without scratch on the sole can be sold in Japan.

IV. Chinese Debtor in Japan

Compared to the above, there are some significant differences between Debtor and Chinese debtor living in Japan (“Chinese Debtor”).

Besides quality issue, most of (but not all of) Debtor tries to pay the debts as much as possible and as soon as possible but sometimes fails to do so due to financial difficulty.

Not all but most of Chinese Debtor tries to pay the debts as little as possible and as late as possible. Chinese Debtor normally does not pay the debts until the Chinese Debtor has no choice but pay even though his financial condition is not so bad.

Some of Chinese Debtor buys the time by saying that they are in the business trip in China. We claim that China is civilized country and you have telephone, fax and mobile phone. They claim that there is no internet service in the rural areas in China. We doubt about their words but have to wait until they come back to Japan.

Also, in case we finally have managed to enter into settlement agreement with Chinese Debtor, they

do not make payment without remind by us.

In case the payment term is several months, we have to remind Chinese Debtor to make payment before the payment date, check if Chinese Debtor has made payment or not, and if not we have to urge them to make payment.

The cost of collecting the debts from Chinese Debtor is very high.

Because of the cultural difference, we recently often ask Chinese debt collection agencies run by Chinese to collect the debts from the Chinese Debtor in Japan.

V. Using CISG to Challenge Quality Dispute by the Debtor

1. What is CISG?

CISG is an international treaty critical to collect the debts in Japan.

The United Nation Convention on Contracts for the International Sale of Goods (“CISG”) is one of the most successful international laws made by UNCITRAL (United Nations Commission on International Trade Law).

CISG is applicable to the international sale and purchase agreement from which the international debts are accrued. As China and Japan are both the member states of CISG, we encounter issues of interpretation of CISG every day.

2. Why CISG is important to collect the Debts in Japan?

As we discussed above, the quality issues are often raised by the Debtor and Creditor. The quality issue can be, in fact, sort out in favor of Creditor by correctly interpreting and applying CISG.

In our experience, most of the debts owned by Debtor to Creditor accrued from the sales and purchase agreement between them under which Creditor manufactured the products in China and exported to Japan.

Most of the sales and purchase agreements (if exist in writing) are extremely short (often only 1 page of sales order) and do not include critical terms and conditions, such as inspection and notification requirements of the products imported by Debtor. In that case, the governing law of the sales and purchase agreement is critically important for interpreting the agreement.

In the court of Japan where litigation against the Debtor is normally submitted, the governing law of

the sales and purchase agreement is decided by the interpretation of the conflict of laws of Japan until July 31, 2009.

Under the conflict of laws of Japan, the governing law of the sales and purchase agreement is the governing law of the location of the production of the products in accordance with Article 7 and 8(1) (2) of the conflict of laws of Japan.

After August 1, 2009, CISG has become a domestic law of Japan and the court of Japan shall apply CISG first in the interpretation of the sales and purchase agreement between the parties in China and Japan, which both are the member states of CISG (Article 1(1) (a) of CISG).

In some quality disputes between Creditor and Debtor, we have been protecting Creditor by creatively applying CISG recently.

3. How CISG could be applicable for Creditor in the Quality Dispute against the Debtor?

We would like to explain the critical importance of CISG in debt collection in Japan by showing a successful example in relation to the Agricultural Pesticide issues.

We found it possible to collect the sales proceeds of the sales and purchase agreement of red ginseng² from Chinese manufacturer, although the ginseng delivered by the Creditor contained agricultural pesticides 30 times more than standard provided in Food Sanitation Act. In the sales and purchase agreement, the obligation of the Creditor was merely to deliver red ginseng of 3000 kg to Japan. There was no specific language in the agricultural pesticide limitation of the red ginseng. After the inspection by third party inspector, the Japanese debtor became furious as the red ginseng include 0.67 ppm of Quintozene, which is more than 30 times of the statutory limitation of 0.02 ppm provided by Article 11(3) of Food Sanitation Act of Japan and other relevant provisions³.

Debtor claimed that the red ginseng did not conform to the purpose of the sales and purchase agreement as red ginseng was purchased for the sales in Japan. Debtor demands Creditor to cancel

² Red ginseng was admired by royal family of Korea, China and Japan in the ancient age, and currently it is widely used thanks to improvement in cultivation. It has effect in fatigue recovery, nutritional fortification, lowering blood pressure, preventing dementia, etc. Red ginseng is also becoming popular in Japan, and the exporter is shifting from Korea to China because of cheap price. However, red ginseng is difficult to be raised because it is perishable (containing water for about 70 to 75%) and can be easily eaten by insects. Therefore, agricultural pesticides such as quintozene, BHC and DDT are essential. Also, it needs couple to several years to raise red ginseng, and it absorbs nutrients in soil well (including agricultural pesticides), thus the contamination might be severe. This risk may arise in Chinese ginseng. As Japanese importers may acquire them in competitive price, and Chinese exporters may obtain benefits by selling to Japanese buyers.

³ See http://m5.ws001.squarestart.ne.jp/zaidan/fooddtl.php?f_inq=8000 for your reference

the sales and purchase agreement and demands the damage of the loss of the profit of ginseng.

In relation to this case, Article 35(1) of CISG provides that “The seller must deliver goods which are of the quantity, quality and description required by the contract.” Thus the Creditor must provide goods which conform to quality required by the sales and purchase agreement. The sales and purchase agreement, however, has no specific requirement of the agricultural pesticide in red ginseng.

Article 35(2) of CISG shall be applied where no specification was made in qualities of goods in the contract. It provides “the goods do not conform with the contract unless they: (a) are fit for the purposes for which goods of the same description would ordinarily be used; (b) are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement.”

According to Article 11(3) of Food Sanitation Act, it is prohibited to sell the products in Japan which contain agricultural pesticides above the regulatory standard. In this case, red ginseng containing agricultural pesticide exceeding regulatory standard may not be sold in Japan.

This is why Debtor claimed that the red ginseng delivered by Creditor did not fit the purpose of the sales and purchase agreement.

However, the regulation of Food Sanitation Act was in detail, including various substances and criteria. These rules might also change in both substances and criteria. It was extremely difficult for Creditor to understand the rules of Japan, which might impose too much cost in production and inspection for Creditor.

The issue was whether Creditor was obliged to manufacture and export red ginseng in accordance with the Food Sanitation Act of Japan or not.

In our interpretation of CISG, which was supported by German Supreme Court judgment on CISG, the Creditor was not required to manufacture and export red ginseng in accordance with the Food Sanitation Law of Japan, unless the same provisions exist in China, or the Debtor informed Creditor such provisions in Japan relying on Creditor’s expert knowledge, or the seller had knowledge of the provisions in Japan due to special circumstances.

We therefore found that Debtor may not raise the quality issue against Creditor under CISG.

VI. The Place of the Dispute Resolution

Under the Civil Procedure Law of Japan (“Code of Civil Procedure”, Law No. 109 of 1996), the place of the litigation or arbitration is the place of the debtor unless the parties of the contract specify the other place (Article 3-2 of (1) of Code of Civil Procedure). In general, there is no arbitration clause or jurisdiction clause in the sales agreement between Creditor and Debtor. Therefore the litigation against Debtor is in general submitted to the courts of Japan.

Please note that even when the parties to the sales and purchase agreement specified the dispute between the parties shall be resolved in the court of the People’s Republic of China, the judgement in Chinese court is not enforceable in Japan. In other words, even when Creditor wins the case in China, it is required to file a law suit again in Japan if Creditor wants to enforce the judgment against the assets of Debtor in Japan.

VII. Arbitration Award in China

We understand that Creditor (policy holders of Sinasure) would like to settle the dispute through the arbitration in China, such as the arbitration submitted to the China International Economic & Trade Arbitration Commission (“CIETAC”), Beijing.

As both China and Japan are the contracting states of the Convention on the Recognition and Enforcement of Foreign Arbitration Award of 1958 (the “New York Convention”) since 1987, the arbitration award in China shall be recognized in Japan.

In accordance with article V of New York Convention, the recognition and enforcement of the Arbitration Award in China may be refused **only if**:

- (a) The parties to the agreement referred to in article 2 were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made;
- (b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or
- (c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration.
- (d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

- (e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

The recognition and enforcement of an arbitral award in China **may also be refused if** the competent authority in the country where recognition and enforcement is sought finds that:

- (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
- (b) The recognition or enforcement of the award would be contrary to the public policy of that country.

For example, the recognition and enforcement of an arbitration award in China may be refused in Japan if the district court of Japan finds that the recognition or enforcement of the award would be contrary to the public policy of Japan (Article V2(b) of New York Convention.).

Suppose Debtor failed to pay the debts on time and after three years from the due date Creditor demands the repayment of the debts. Under Japanese Law, the statute of limitation period is 2 years and Debtor could submit the statute of limitation defense. CIETAC arbitrators, however, would most likely apply Chinese Law, under which the statute of limitation period is 4 years, and deny the statute of limitation defense and render the arbitral award for Creditor. The issue is whether the Arbitral award is enforceable under Article V (2) of the New York Convention against Debtor in Japan. If the 2 year shorter statute of limitation period of Japan is related to the public policy of Japan, the 4 year statute of limitation period of Chinese law would be in violation of public policy of Japan and the arbitration award might not be enforceable in Japan (the repayment obligation of the debtor is discharged because of 2 year statute of limitation period has elapsed.).

VIII. Amicable Debt Collection

Our amicable debt collection is quite aggressive (some says that our debt collection is not amicable but hostile).

We normally demand to Debtor by sending demand letter, e-mail, content certified notice and even fax. Although the management of Debtor hates to receive the demand fax as it could spread the financial difficulties of Debtor to their employees through the person who receives the fax, we sometimes intentionally send the demand fax if the management ignore our demand letter and e-mail.

We, however, try not to destroy Debtor by too much demand of repayment of the debts. We understand most of Debtors are willing to repay the debts as long as they have money. We therefore

try to understand the real reasons why they are not able to repay the debts on time and how long it would take for Debtor to repay the debts while keeping its business. This is a kind of art that requires long experience and some talents.

Our amicable debt collection is also different from our competitors (if exist in Japan) in that we consider the bankruptcy risk of Debtor. Recent statistics shows that the collection (distribution) of the debts reduces dramatically upon the bankruptcy of Debtor (normally only less than 5%). Upon the settlement of the dispute with Debtor, we normally request Debtor to provide us with the security interest in its assets because the security interest is enforceable even upon the bankruptcy of Debtor. Upon the demand or receipt of the repayment of the debts, we tried to avoid the written financial information, such as the financial statements or tax return, from Debtor to avoid the avoidance (invalidation) of the repayment by the bankruptcy trustee of Debtor.

IX. Collection through Litigation

We always consider the efficient collection of the debts upon the commencement of the litigation. We often file a provisional attachment or provisional disposition prior to the commencement of the litigation against Debtor.

Please note that we could file a provisional attachment or provisional disposition even for the enforcement of arbitral award in CIETAC (even prior to the commencement of the arbitration) against the assets of Debtor in Japan.

The provisional disposition is originally designated to preserve the assets of Debtor prior to the judgment. Normally we file a provisional disposition of the real estate or valuable personal property of Debtor to prevent Debtor from selling the property and consummating or concealing the sales proceeds prior to the judgment (become enforceable).

We recently found that the provisional attachment to the future cash from of the customer of Debtor is an efficient method of collection. As the provisional attachment order prohibiting the customer to repay its debts to Debtor shows that the dispute between Creditor and Debtor, the customer of Debtor start reconsidering continuance of the business with Debtor. In our previous experience, Debtor immediately started negotiation with us to settle the dispute (to lift the attachment order against its customer).

X. Security Interest (to avoid Bankruptcy Risk)

1. Introduction

Because of the radical increase of labor cost in China, the previous business model of Debtor to manufacture the products in China is no more sustainable. The number of the bankruptcy of the Debtor is recently increasing in Japan. To avoid the bankruptcy risk of Debtor, we recently recommend Creditor to create the security over the assets of Debtor in Japan. This is because the security interest can be enforceable upon the bankruptcy of Debtor.

2. Creation of Security in the Future Cash Flow of the Customer

We understand that it is difficult for the Creditor (or Sinosure) to create the securities over the assets of the debtors until the debtor is in default of the debts. In that case, we strongly recommend the Creditor (and Sinosure) to create the security interest in the assets of the debtor upon the acceptance of the repayment plan offered by the Debtor. This is the best and perhaps the last chance to create security interest in the assets of the Debtor.

In most cases, we recommend Creditor (Sinosure) to create the assignment by way of security of the future cash flow from the customer of the debtor and register it.

Upon the perfection of the assignment by way of security in the products, Creditor (or Sinosure) has the security interest which may be claimed against not only the customer but also the third party, including the bankruptcy trustee.

There are two ways of the perfection method of the assignment by way of security. One is the notice or consent with the content certified notice in accordance with Article 467 of the Civil Code of Japan. The notice to or consent by the customer of Debtor is not popular among Debtor as it shows the financial difficulty of Debtor to its customer.

We therefore normally register the assignment by way of security in accordance with Article 4 of the Perfection Law (“Act on Special Provisions, etc. of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims”, Law No. 104 of 1998) because the registration itself is not known to the customer until Creditor give a notice of the registration to Debtor’s customer upon the enforcement of the assignment by way of security with the registration certificate in accordance with Article 4(2) of Perfection Law.

In the above perfection method under the Perfection Law, Debtor could continue its business with its customer in the ordinary way until it fails to meet the settlement agreement without knowledge of the customer in relation to the financial difficulty of Debtor. Creditor (or Sinosure) could enforce the security upon the default of Debtor or even upon the bankruptcy of Debtor.

3. Assignment by Way of Security of a Group of Personal Property

Debtor sometimes told us that the assignment of the future cash flow of the customer is prohibited by the agreement with the customer. In that case, the assignment by way of security of the future cash flow is null and void in accordance with Article 466(2) of the Civil Code of Japan (the assignment by way of security of the future cash flow is governed by the Civil Code of Japan)

As the second best security interest, we recommend the Creditor to create the assignment by way of security of a group of personal property in the inventory of Debtor.

Please note that the prohibition of the assignment of the future cash flow between Debtor and its customer, in general, does not prohibit the assignment of a group of personal property in the inventory of Debtor.

The problem of the security interest in the personal property in the inventory is the enforcement of the security as it is not easy to sell the personal property in the inventory of Debtor on time.

4. Governing Law of Assignment by Way of Security

The perfection under the Perfection law is only used for the assignment by way of security agreement governed by the laws of Japan. Under the Conflict of Law of Japan, the governing law of the assignment by way of security is governed by the governing law of the debts to be assigned by Debtor to Creditor. In most cases, both Debtor and its customers are Japanese and therefore the governing law of the debts is mostly the laws of Japan. Please note that some customers of Debtor are not Japanese and the debts are not governed by Japanese law. In that case, the governing law of the assignment by way of security of the debts may not be governed by Japanese law and perfection method under the Perfection law is not available.

The governing law of the Group Personal Property Assignment Agreement is the laws of Japan as the personal property is located in the inventory in Japan in accordance with Article 13(1) of the Conflict of Law of Japan.

XI. Conclusion

As I mentioned above, Debtor is highly quality oriented and therefore quality issue cannot be easily resolved in an amicable way.

Besides the quality issue, the debts collection in Japan is relatively easy because Debtor is willing to

pay the debts as long as they have money. Unfortunately the increase of the wages and labor administration cost, not all Debtors are profitable and some are on the verge of bankruptcy. Debts collection in Japan becomes more and more difficult in recent years. We have to consider the risk of the bankruptcy of Debtors in Japan.

To minimize the risk of the bankruptcy of Debtor, we suggest Creditor (the policy holder) to create the security interest in the assets of Debtor. At this moment, we believe the most effective security is the assignment by way of security of the future cash flow from the customer of Debtor to Debtor and fulfill perfection requirement under the Perfection Law.

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