January 14, 2005
Financial Law Board

Discussions Concerning the Validity of the Security Trustee*

*The Japanese version of this paper was published in January, 2005. After the publication, new Trust Act in Japan was enacted in 2006, which admits clearly the possibility of Security Trust. However, especially, in the context of execution, there remain a lot of problems which have no clear rules in new Trust Act. The need to provide express provisions in the Real Property Registration Act, Civil Execution Act, and other related acts for eliminating ambiguity is still unchanged.

1. Issues

(1) Generally, a secured party and a creditor have been considered to be the same person in Japan.[1]

However, the Secured Bonds Trust Act enacted in 1905 contemplates a scheme which grants the title of collateral to a trustee instead of the respective bondholders and requires the trustee to exercise the security interest on behalf of all bondholders, thereby enabling separation of the creditor and the secured party. In contemplating this scheme, the common view holds that the enactment of the Secured Bonds Trust Act enables the separation of creditors and secured parties in such cases. This implies that the Act provides for an exception to the general requirement that the creditor be a secured party.[2] This view is premised on the assertion that such separation should not be

[1] For example, Dr. Wagatsuma states, "A person who acquires pledge, i.e., a pledgee, must be limited to the creditor of the secured claim. The Civil Code does not permit any person other than the creditor to own only pledge without claim." (Sakae Wagatsuma, *Shintei Tanpo Bukkenho (Minpo Kogi III)* (Asset-Backed Security Law, New Edition (Lecture on Civil Code III)) (1968) at 128 and "A person who acquires hypothec, i.e., hypothecary obligee, must be limited to the creditor of the secured claim," *supra* at 227.

[2] "Security interest under this Act exists in a very special form. Under the Civil Code, a pledgee or a hypothecary obligee has the right to receive payment for his claim in preference to other creditors with respect to the collateral therefor, which requires the security interest and the claim to be owned by the same person. Under the Secured Bonds Trust Act, a trustee assumes the obligation to preserve and execute security interest in its capacity as hypothecary obligee on behalf of all bondholders, who themselves have no security interest. The trustee, a hypothecary obligee, has no claim to be secured. In this case, security interest is vested in the trustee to ensure that the bondholders can receive repayments. This arrangement has been realized through the application of the trust system for the enjoyment of security interest. Though security interest and claim belong to different parties under this Act, this Act adopts a scheme to combine both parties with the theory of trust. In this regard, this mechanism constitutes a

acceptable in ordinary cases.

As for collateral by way of assignment (*johto tanpo*), we find some case precedents that allow the separation of the creditor and the secured party from the time of creation thereof, and jurisprudence agrees with such precedents from the viewpoint of the freedom of contract[3]. However, this does not lead to the conclusion that separation of creditors and secured parties is acceptable with respect to security interests in general. The mechanism of collateral by way of assignment, including extinguishment of secured claims upon execution of such security interest, may be determined by agreement between the parties. The parties may agree to exercise the security interest in such claim by definitely transferring the title of collateral to a third party who is not a creditor. On the other hand, the conditions and contents of the hypothec (*teitoken*) and other real rights are fixed by the principle of numerus clausus regarding to the rights in rem, and the hypothec and other rights are treated based on this principle under the Civil Execution Act. Therefore, separation of creditors and secured parties on the grounds of freedom of contract is not acceptable in the case of typical security interests.

(2) Nowadays there is also a growing need to approve the separation of creditors and secured parties for typical security interests so that they can be managed by security agents or security trustees who are not creditors of the claims concerned[4].

---

notable exception to the Civil Code." (Torajiro Ikeda, *Tanpotsuki Shasai Shintaku Ho Ron* (Discussions on the Secured Bonds Trust Act) (1909) at 59-60). After his quotation given in note 1, Dr. Wagatsuma adds, "It is exceptional that the Secured Bonds Trust Act allows a trustee to have security interest on real property on behalf of numerous bondholders," (Wagatsuma, *supra* at 128) and, "Generally, ownership of security interest by a person other than the creditor of a secured claim is approved only in the Secured Bonds Trust Act as an exception." (Wagatsuma, *supra* at 227) There is a registration precedent in which a registrar denied two or more creditors the right to quasi co-own hypothec on their respective claims as secured claims, on the grounds that the Real Property Registration Act does not allow separation of secured claims and security interests. (Notice by Director of Civil Affairs Bureau dated December 27, 1960) (See *Kinyu Homu Jijo* (Financial Law Affairs) No. 267 at 197).

[3] For case precedents, see Court of Great Judicature Judgment on November 5, 1918 (24 Minroku at 2122), and Court of Great Judicature Judgment on October 8, 1930 (Hyoron Vol. 20, Civil Code at 18). For academic theories, see Wagatsuma, *supra* at 609 and Rokuya Suzuki, *Johto Tanpo* (Collateral by Way of Assignment), Teruhisa Ishii et al. *Kigyo Tanpo* (Corporate Security) (1966) at 173, Kaoru Yunoki and Takio Takagi, *Tanpo Bukkenho-Daisan-han* (Asset-Backed Security Law-Third Edition) (1982) at 558-559, Akira Yonekura, *Johto Tanpo No Kenkyu* (A Study on Collateral by way of Assignment) (1976) at 74-75, 99.

[4] For example, "Interim Report of Industrial Finance Committee of Industrial Structure Council—Creation of financial functions for small- and mid- sized businesses" (April 2003) states, "To utilize collaterals in loans to be assigned at a later time, there is a need to apply an appropriate security system that enables the smooth change of creditors (for example, a security agent or security trustee system). The current system uses a scheme that permits the separate vesting of claims and security interests for secured bonds (Secured Bonds Trust Act) in order to address changes of creditor. However, no similar scheme has been established for secured loan

This tendency can be well understood if we consider why the Secured Bonds Trust Act permits the trustee to hold various security interests on behalf of creditors. We see two main reasons. First, the Act is intended to allow the transfer of secured claims without requiring the transfer of security interests thereto in order to obviate the troublesome procedure of transferring the security interests whenever a bond is assigned and the bondholder changes (a procedure requiring an accessory registration of hypothec transfer in the case of hypothec). Second, there is a need to collectively regulate the execution of security interests in order to avoid unreasonable results produced by decisions made on a case by case basis, and to reduce the overall costs for execution of security interests. These two reasons apply not only to secured bonds, but also to other cases involving security interests.[5]

Under these circumstances, we face the question of whether we should generally allow the acquisition of security interest by a person other than a creditor with respect to the typical securities beyond the framework provided by the Secured Bonds Trust Act. The following discussion focuses on the possibility of separation of creditors and secured parties for typical security interests, such as pledge and hypothec, based on the understanding that the collateral by way of assignment is not always the most

---

claims, hence it becomes necessary to adjust the interest relations when transferring security interest involving more than one creditor. The Secured Bonds Trust Act itself is also criticized for its systematic inflexibility. In order to encourage assignment of claims, we need to study an ideal security system that can flexibly cope with changes of creditor. The "Three Year plan for Regulatory Reform & Privatization Promotion" adopted by the Cabinet on March 19, 2004 indicates, "Recognizing the need to establish a system in which a single creditor can act as the secured party of all secured claims, including the claims owned by other creditors, and manage the security interest in certain transactions such as the syndicate loans, we will deliberate the necessity to establish such a system in its review of the trust system. Two articles examine the legislative and constructive potential of the security trustee system from a practical viewpoint: Satoshi Inoue, *Shikin Chotatsu No Tayoka Ni Tomonau Tanpotsuki Shasai Seido No Rippo Kadai* (Legislative Problems of Secured Bonds System in Diversified Financing Structure), Jurist 1238 (2003) and Takao Higuchi, *Security Trustee Seido No Nippon Do-nyu Ni Atatte No Shishin – jo, ge* (Guidelines for Introducing Security Trustee System in Japan—Parts I & II), NBL 787 & 788 (2004).

[5] In addition, a variety of financial methods applied in the current financial practices may require the use of very complicated procedures to determine the contents of the rights owned by the respective creditors, particularly the precedence among the creditors. Simply giving security interest either with the same rank or with subordinate rank cannot effectively reflect the creditors' rights in this case. A more effective approach to solve this problem would be to establish a scheme in which one person holds the security interest of all claims on behalf of all creditors, and each creditor recovers his claim according to its priority in the context of his right against the secured party. In analyzing the validity of the security trustee, the issue would be less complex when all the creditors are assumed to have the same kind of interests, and more complex when all the creditors are assumed to have different kinds of interests. In this paper we will examine the case where all creditors have the same kind of interests.

convenient security interest for all collaterals.

2. Basic Validity

(1) What constitutes the impediment which does not allow a person who is not a creditor to acquire security interests more extensively, beyond the scope of the Secured Bonds Trust Act? One popular opinion seems to attribute the impediment to the Civil Code, holding that that the Civil Code established the rule that the creditor and the secured party must be a same person.[6]
It is true that the definitions of pledge and hypothec in Articles 342 and 369 of the Civil Code provide that a pledgee or a hypothecary obligee "is entitled to obtain satisfaction of his claim." However, given that a literal interpretation of this text would be insufficient, we must find the substantive grounds for this wording.

In this context, we remember that no owner's hypothec or hypothec without secured claim has been accepted under Japanese law. However, the present-day business scenarios requiring security trustees in practice do not include cases without secured claims. Therefore, we need not take into account the denial of the owner's hypothec in studying the separation of creditors and secured parties.

The next point is that, in view of the nature of security interest, all monies collected from the execution of the security interest will be applied to payment of the obligation that gave rise to the secured claim. This is a very important point, but this requirement can be satisfied by establishing a scheme in which monies collected from the execution of security interests by the secured party other than creditors are distributed among the creditors of the secured claim.

(2) The last sentence in Item (1) above implies that the system which distinguishes between the owner of the right and that of the interests, and which protects the interests

[6] Some have also asserted the vague notion that the former Trust Business Act, which did not approve hypothec and other security interest as trust property (See former Trust Business Act Article 4), prevented the formation of the security trustee system. The Trust Act itself does not impede the holding of security interest as trust property, however, and theories on trust have recognized the validity of keeping in trust the security interests in rem apart from secured claims. (Yoshio Yusa, *Shintaku Hosei Hyoron* (Trust Legislation Review) (1923) at 61-62, Shintaro Irie, *Shintaku Ho* (Trust Act) (1940) at 39, and Kazuo Shinomiya, *Shintaku Ho* (Shinban) (Trust Act, New Edition) (1989) at 138). The former Trust Business Act imposed restrictions only for the purpose of the administrative law. The amended Trust Business Act enacted on November 26, 2004 (Act No. 154 of 2004, Enforced on December 30, 2004) has no restrictions on the scope of property held by trust companies, hence its enforcement has eliminated the problem under the former Trust Business Act. This amendment also applies to the financial institutions that handle trust business under the Act on Provision, etc. of Trust Business by Financial Institutions.

to which the parties are entitled is required. The trust system introduced in Japan by the enforcement of the Secured Bonds Trust Act realized exactly this structure.[7] However, the Secured Bonds Trust Act itself does not provide an exception to the rule that a creditor must be a secured party. In other words, the exception is allowed not because of this Act, but because of the introduction of trust concept in Japan, under which the trustee becomes hypothecary obligee and the beneficiary becomes creditor. It is the trust concept in this Act that realizes these mechanisms, not the Secured Bonds Trust Act.

Two reasons support the above understanding concerning the Secured Bonds Trust Act.

First, the Secured Bonds Trust Act has no provision that expressly excludes application of the rule under the Civil Code stipulating that the "creditor and secured party must be the same person." The Secured Bonds Trust Act prescribes that there may be a separation between the secured party and creditor under the scheme expected by the Act, but it does not exclude application of the rule under the Civil Code to the cases covered by the scheme. To sum up, the Act does not declare itself as an exception to the Civil Code.

Secondly, the Trust Act seems to take the same stand as the Secured Bonds Trust Act on the possible separation of secured parties and creditors by the trust system. In Japan, the Secured Bonds Trust Act was established before the Trust Act, and "trust" before the enactment of the Trust Act in Japan meant nothing but a legal scheme to separate secured parties and bondholders on the occasion of a bond issuance by the Secured Bonds Trust Act. For this reason, it may seem unnatural to assume that the Trust Act, which was established as a general law, did not include or intend to include the already existing mechanism of the trust scheme for separating secured parties and creditors. If we grant that the Secured Bonds Trust Act provides for the separation of creditors and secured parties as an exception to the Civil Code, as supported by the present dominant

[7] Concerning collateral by way of assignment, Dr. Shinomiya admits, as a legislation theory, that the right on collateral by way of assignment can be held in trust separately from the underlying secured claim: "Severance of owners of a claim and a right on collateral by way of assignment may present a problem in distinguishing whether such arrangement conflicts with the rule of 'adhesion' of security interest. But a creditor and a secured party are in a fiduciary relationship which substantively secures the creditor's title to the right on collateral by way of assignment. In particular, since the right on collateral by way of assignment can be restored for the creditor by canceling the trust, the trust system does not absolutely deprive creditors of their security interests. The theory concerning 'adhesion' of security interest should be understood to prohibit the existence of security interest without any underlying claim, and not to exclude the temporary separation of the vesting of a claim and security interest while liaising them in the trust framework. In addition, the Secured Bonds Trust Act has already approved such separation by maintaining the liaison through trust." (Kazuo Shinomiya, *Johto Tanpo Ho Yoko (Kaitei Daini Shian) Kaisetsu (1)* (Outline of collateral by way of assignment Law (Second proposal for the revision), Discussions (1)) Rikkyo Hogaku No. 2 (1961) at 180-181).

opinion, we can therefore assume that the Trust Act also accepts such exception.

(3) Based on the above discussions, we have no problem in accepting the validity of separating secured parties and creditors by means of the trust scheme when handling secured claims, provided that we can keep the system in place to ensure that the monies collected by executing security interests in secured claims may be applied for settlement of obligations subjected to such secured claims.

3. Consequential Issues

(1) Though the separation of secured parties and creditors is basically possible with the use of trust scheme, as described above, we encounter a number of issues when we actually attempt to separate secured parties and creditors in the case of a typical security. In considering these issues, we will take as an example the issues relating to a hypothec, a typical security now important in syndicate loans, etc.

(2) A trust for a hypothec can be created in the following manner. After first receiving a hypothec from a hypothecator (either a debtor or guarantor in rem), the creditor separates the hypothec from the secured claim, creates a trust, and transfers the hypothec to the trustee (this method is hereinafter called the "Dual Method"). Alternatively, a trust is created when the hypothecator creates a hypothec in favor of the trustee, designating the creditor as the beneficiary of trust (this method is hereinafter called the "Direct Method"). "Disposition" as mentioned in Article 1 of the Trust Act is interpreted to include not only the transfer of existing rights and interests, but also the "transfer by creation"[8]. Thus, we can assume that in the Direct Method, an act of disposition is performed by means of creation of security interest by a person providing security to the trustee.[9] The above two methods have significant practical and procedural differences in the immovable registration, however.

In the case of the Dual Method, the trust is created through the transfer of the hypothec (assignment by trust), hence the assignment will be published by way of the accessory registration concerning the transfer of the hypothec (Article 134 of Real Property Registration Act).[10] According to this method, the interested parties initially file an application for registration of hypothecation, designating the original creditor as

[8] Shinomiya, *supra* note 6, at 137.
[9] Shinomiya, *supra* note 7, at 182.
[10] Under the new Real Property Registration Act promulgated on June 18, 2004 , a provision that has the same effect as Article 134 of the former Act is established by ministerial regulation (Immovables Registration Regulation Article 3 Item 4). Hibiki Shimizu, *Shin Fudosan Toki Ho No Gaiyo Ni Tsuite* (Outline of New Real Property Registration Act), Minji Geppo Vol., 59, No. 8 (2004) at 93.

hypothecary obligee, while simultaneously filing an accessory registration for transfer of the hypothec from the original creditor to the trustee, and a registration of the trust (Real Property Registration Act Article 110-2 Paragraph 1 and Article 135). Information necessary to identify the beneficiaries and key clauses of the security interest trust will be specified in the trust ledger[11] (Real Property Registration Act Articles 110-6 and 135).

The Dual Method may appear inconvenient to the parties concerned since it necessarily requires the original creditors to participate in the registration procedure, as seen above. However, as the execution of security interest extinguishes the secured claims regardless of whether the security interest trust has been formed according to the Direct Method or Dual Method, it would be desirable, from the standpoint of substantive law, to require an agreement between the three parties, including the creditor for trust creation, or to at least require the consent of the creditor.[12] In this sense, the original creditor, who is always required to participate in the trust creation, would not feel too much additional burden in joining in the registration procedure under the Dual Method. Furthermore, if it would be desirable to have the trustee exercise powers of the creditor (under loan agreements, etc.) outside the scope of hypothec on behalf of the creditor, the scope of trust management could be easily broadened by including provisions expressly authorizing powers to the trustee and stipulating the conditions for exercising such powers in the trust agreement between the creditor and the trustee. Such provisions would contribute to the flexible planning of the security trustee system.[13]

Under the Direct Method, a hypothecator and a trustee file an application for the registration of hypothecation together with the registration of trust, and the original creditor need not participate in the registration procedure. Though, as far as we know, there is no such registration precedent, the entries like "Loan Agreement dated _____, and creation of security interest trust on the same day" or "Trust

[11] Renamed as "trust inventory" under the new Real Property Registration Act (Real Property Registration Act Article 97 Paragraph 2).
[12] Shinomiya, *supra* note 7, at 182-183.
[13] This advantage is not specific to the Dual Method. As described below, the Direct Method also allows creditors to authorize the powers to a trustee and to determine the conditions for exercising such powers through the hypothecator or by means of a three-party agreement. Whichever method is employed, it will be necessary to provide a provision in the loan agreement or some other protective proviso to ensure that the transfer of the secured claim does not invalidate the authorization to the trustee. Authorization may also be terminated upon bankruptcy of the creditor, given that such authorization can be regarded as a kind of "mandate contract" contained in the trust agreement or the loan agreement. Therefore, for both methods, when distinguishing between the creditor's powers (under a loan agreement, etc.) outside of the scope of the hypothec and within the scope of the hypothec, the latter will ideally include powers to the fullest extent possible.

dated _____ (as security under Loan Agreement on the same day)" could be acceptable. These entries are not likely to produce any disclosure problem since the amount of claim, provisions concerning interests thereon, and other related information for each creditor will be entered in the fact column of section B of the registry folio (Real Property Registration Act Article 117 Paragraph 1), while the information necessary to identify the beneficiaries and key clauses of the security interest trust[14] will be specified in the trust ledger.

It is true that there are some registration precedents[15] which were issued on the assumption that separation of secured claims and security interests is prohibited. In addition, considering that the new Article 119-3 of the revised Supplementary Provisions of Secured Bonds Trust Act specifically refers to the registration under Secured Bonds Trust Act as an exceptional case, the Real Property Registration Act may not have contemplated the registration of security interest trust (particularly trust by "transfer by creation"). However, since we find no provision expressly prohibiting such registration[16], we may interpret the absence of prohibition as an approval of registration insofar as such registration meets the disclosure requirements.[17]

The Direct Method also requires the creditor's consent to the creation of security interest trust, as already discussed above. For this purpose, provisions concerning the creation of security interest trust and the conditions thereof should be stipulated in a loan agreement or other related agreement between the original creditor and the hypothecator. If it is desirable, in this case, to have the trustee exercise creditor's powers (under the loan agreement, etc.) outside the scope of the hypothec, the creditor should be able to obligate the hypothecator in the loan agreement or other related agreement to authorize the trustee to exercise creditor's powers under certain conditions. As a result, the hypothecator will authorize the trustee to exercise creditor's powers under prescribed conditions when the hypothecator transfers the hypothec to the trustee

[14] The nature of a secured claim and its separation from security interest may be disclosed by entering the following statement in the "Object of trust" column of the trust ledger, together with or in place of the entry concerning the cause of registration: "This trust deposited by settler and accepted by trustee, was created for the benefit of all lenders under the loan agreement dated _____, in order to manage and execute the hypothec created in connection with the claims for payment of the principal, interests thereon, and damages under the loan agreement as the subject secured claims, designating all creditors of the secured claims as beneficiaries."

[15] See note 2.

[16] Article 98 Paragraph 1 of the new Real Property Registration Act may assume existence of usufruct, but as a whole, the Act expressly contemplates registration of creation of right by trust.

[17] Though we do not discuss here, payment of registration tax, or, more specifically, the application of Article 7 of the Registration and License Tax Act and Article 72 Paragraph 1 of the Act on Special Measures Concerning Taxation to the trust system will remain a material problem in registration practice.

by creating a trust in accordance with the trust agreement. The powers to be entrusted can be seen to constitute a portion of trust management since they closely relate to the management and execution of the hypothec.

(3) We will now examine the issues associated with the transfer of secured claims. Irrespective of the method employed for the transfer, both the creditor and beneficiary of security interest trust will change once a secured claim has been transferred. As the trust ledger contains entries of the name and office of the beneficiary (or the name and address in case of an individual) (Real Property Registration Act Articles 135, 110-5 and 110-6), we face the question of whether we need registration to reflect this change for each transfer of secured claim. To be very exact, we need it. However, when a transfer of secured claim accompanies the transfer of an ordinary hypothec, it is deemed to be perfected against a third party that has acquired a conflicting right on the secured claim without any accessory registration concerning such transfer, so long as the transfer of the secured claim is perfected.[18] By analogy, in the case of a security interest trust, the beneficiary will only be subordinated to a third party to whom the beneficial interest has been disposed if the transfer of secured claim is perfected, even if the transfer of beneficial interest is not perfected. Since beneficial interest in the security interest trust has no economic value in the market independent of the secured claim, there is little probability of the beneficial interest being subjected to seizure or transfer without the underlying claim[19]. Therefore, we need not worry about the need for registration.

(4) There are other legal issues which may arise before execution of the hypothec. In particular, we need to address the issues of defense against infringement of the hypothec and acts to preserve the hypothec. These actions can be carried out by the trustee in its capacity as hypothecary obligee. The trustee can be deemed a specific eligible party with respect to the procedure in a hypothec infringement case, such as an action demanding elimination of interference. [20] In contrast, the prescription period of the

---

[18] Toru Ikuyo, *Fudosan Toki Ho (Dai San Han)* (Real Property Registration Act (Third Edition) (1989) at 288.

[19] If separation of a secured claim and security interest is permitted solely because the trust system ensures payment of the obligation subjected to the secured claim by applying proceeds from execution of the security interest, as discussed above, the secured claim and beneficial interest under the security interest trust must be vested in the same person. Therefore, instead of designating a particular individual or a corporation as the original beneficiary, the trust agreement should stipulate that the beneficiary shall be "creditor, from time to time, of the secured claim." Alternatively, even when the trust agreement designates a particular beneficiary, it should stipulate that beneficial interest shall transfer with the transfer of the relevant secured claim as a matter of course. In this case, the trust agreement must have an indemnification clause exempting the trustee from liability when the trustee does not know the new beneficiary.

[20] A trustee is certainly generally eligible to be a party to the trust property. (Civil Procedure

secured claims has to be interrupted by each creditor unless the trustee is authorized by the creditor to interrupt the prescription period.

(5) The most important point relates to legal issues associated with the execution of the hypothec. In particular, we must identify an available mechanism by which to file a petition for hypothec execution, or to receive dividends, and extinguish the secured claims while ensuring the creditors that they will receive money.

Generally, when filing a petition for commencement of auction proceedings to execute its hypothec, a hypothecary obligee is required to submit not its title of debt, but a copy of the register in which the subject hypothec is entered (Civil Execution Act Article 181 Paragraph 1). In addition, if the hypothecation has been registered, the hypothecary obligee can naturally participate in the dividends when an auction proceeding is commenced on the object of his hypothec pursuant to the petition filed by another secured party to execute his security interest, or when an auction proceeding is commenced after attachment of the object by general creditors (Civil Execution Act Article 87 Paragraph 1, Item 4 and Article 188). Is it possible for a hypothecary obligee without secured claims to be entitled to a similar treatment? This raises the question of whether the term "creditor" can be interpreted as "hypothecary obligee" in Article 49 Paragraph 2 (Notice of Submission of Claims), Article 85 Paragraph 2 (Call on the Dividend Date) and Article 87 Paragraph 1 Item 4 (Parties Eligible for Dividends) of the Civil Execution Act.

Some jurists may hold that the hypothec encloses the preferential right to receive repayment, and that the existence of the hypothec itself makes it possible to file a petition for execution without any title of debt or to be granted entitlement to dividends. According to this theory, a trustee of security interest trust has the status of a specific party eligible to execute the security interest and to receive dividends even though the trustee is not a creditor of the secured claim. Therefore, the term "creditor" may be construed to be interchangeable with "hypothecary obligee" in the above-mentioned articles. Taking into account the existence of other parties that have interests in the secured claim (creditors), we note that if we adopt this theory, we may elect to agree on the execution of the hypothec by the trustee, as we do in the case of voluntary execution by appointed parties.[21]

Code Article 58 Paragraph 1 Item 3).

[21] Of all the effects of a secured claim, this theory holds that a trustee of the hypothec shares with the creditor the right to receive dividends in the hypothec execution proceedings under substantive law. In other words, the trustee is deemed to own the hypothec in place of the title of debt, and also to own the right to receive dividends related to the secured claim. In addition, a trustee of the hypothec exercises powers authorized to it under the act of trust on behalf of creditors, the ultimate owners of the interests. Considering this aspect, discussions on voluntary

Other jurists may think that a trustee owns a hypothec by means of trust, is authorized by a creditor to receive payments for secured claim, and exercises its rights under the authorization. If such authorization can be given apart from the security interest trust, the court will have difficulties in granting a petition for the execution without title of debt or entitlement to due dividends since the court is not able to determine whether such authorization has been really given. Therefore, if we adopt this opinion, we should think that the trustee's powers to exercise secured claim on the occasion of execution of security interest inherently lie in the mechanism of security interest trust. If such powers authorized to the trustee are expressly stipulated in the trust clause, they will be disclosed by the entries in the trust ledger. In this case, the trustee's procedural status can be likened to that of a voluntary executing party under the trust system.[22] Therefore, no additional agreement will be required.

Extinguishment of secured claim will take place when dividends are received by the trustee, as a result of preferential right in the hypothec to receive repayment according to the former theory, or as a result of the power to receive repayments under the latter theory mentioned above. In both cases, the secured claim extinguishes in relation to the debtor according to the rule of statutory satisfaction,[23] but it is possible to stipulate in

---

execution by a winning appointed party have some relevance to the issue of validity regarding hypothec execution by the trustee. Voluntary execution by a winning appointed party is generally accepted. Teiichiro Nakano, *Minji Shikko Ho (Shintei 4 Han)* (Civil Execution Act, Revised – 4th Edition) at 129.

[22] For voluntary execution person, see Nakano, *supra* note 21 (2000) at 129. Concerning the issue of whether a voluntary execution person that has no substantive right can act as execution person if so authorized by the person having appropriate right, many discussions have been raised in connection with compulsory execution by winning shareholders in shareholders' representative actions. These discussions focus on the interpretations intended to let the company receive the dividends obtained through the compulsory execution proceedings requested by the winning shareholders, and they intend to point out limitations of the above interpretations from practical aspect. Thus, we cannot directly apply these arguments to the discussions in this paper which assume receipt of dividends by trustee. See Noriyuki Tokiwa, *Kabunushi Daihyo Sosho Ni Okeru Kabunushi Ni Yoru Kyosei Shikko No Kahi* (Validity of Compulsory Execution by Shareholders in shareholders' representative actions), Hanrei Times 1140 at 21. Concerning the status of bond manager and security trustee, see Junichi Matsushita, *Shasai Kanri Kaisha No Chii, Kengen To Minji Tetsuzukiho No Kankei Ni Tsuite* (Relationship Between Bond Manager's Status & Powers and the Code of Civil Procedure), Gakushuin University Hogaku Zasshi, Vol. 31, No. 1 at 35 and subsequent pages, including note (3) at 43) (1955), Matsushita, *Shasai Kanri Kaisha, Shasaikensha No Tetsuzukiho Jo No Chii* (Bond Manager's and Bondholder's Status Under Procedural Laws), Kin-yuho Kenkyu Shiryo Hen (15) (1999) at 48 and subsequent pages, Katsumi Yamamoto, *Shasai Kanri Kaisha Oyobi Tanpo No Jutaku Kaisha No Soshyo Jo No Chii Ni Tsuite* (Status of Bond Manager and Security Trustee in Litigation), Kyoto University Hogakubu Soritsu Hyaku-shunen Kinen Ronbunshu, Vol. 3, (1999) at 545 and subsequent pages.

[23] Supreme Court Judgment of December 18, 1987 (41 Minshu No. 8 at 1592).

the trust agreement to apply a different distribution rule among the creditors.

To constitute a voluntary executing party, we must satisfy the following two requirements as the elements to support its legality and validity: first, the arrangement does not threaten to deviate from the rules of representation by lawyer and prohibition concerning trust for litigation, and second, there is a reasonable need to constitute the executing party.[24]

With respect to the second requirement, considering the demand for security trustee, already discussed, we recognize a sufficiently reasonable need for such arrangement. With respect to the first requirement, we can make the following analysis. The key objective of the security interest trust is clearly conceived as the execution of the security interest. However, the court has ruled that a trust is deemed a trust for litigation prohibited under Article 11 of the Trust Act if its principal object is to instigate acts of litigation (including compulsory execution), and a trust which is deemed a trust for litigation will not be exempted from the prohibition clause even if its trustee delegates a lawyer to prosecute the litigation.[25] This extensive application of Article 11 of the Trust Act has been strongly criticized by academics, and not a few hold that "acts of litigation" do not include compulsory execution or other similar proceedings, and that a trust will be prohibited only when it infringes Article 72 of the Attorney Act or Article 90 of the Civil Code.[26] If we affirm the institutional significance of the security trustee system from these standpoints, we may come to believe that this system will not infringe Article 90 of the Civil Code if properly operated in the course of ordinary financial business.

The regulatory wording contained in Article 72 of the Attorney Act is somewhat ambiguous, but if such wording should apparently apply to a specific case, the case will not be deemed to infringe Article 72 simply because of such fact.[27] This should not be

[24] For voluntary litigation representative, see the Supreme Court Judgment of November 11, 1970 (24 Minshu No. 12 at 1854).

[25] Court of Great Judicature Judgment of October 28, 1929 (19 Hyoron, Shoho at 149), and Supreme Court Judgment of March 14, 1961 (15 Minshu No. 3 at 444).

[26] See Shinomiya, *supra*, at 144, Minoru Tanaka, *Shintaku Ho Nyumon* (Introduction to Trust Act) (1992) at 68, Makoto Arai, *Shintaku Ho* (Trust Act) (2002) at 187.

[27] For example, the legal advice provided from the legal department of a parent company to its subsidiaries will usually be permitted as an act committed in the pursuit of lawful business (Criminal Code Article 35). Furthermore, with respect to Article 73 of the Attorney Act, an act which covers protected legal interest in substantially the same manner as Article 72, the courts tend to rule that the receipt of an assignment of disputable claims with the intention to execute rights thereto will not constitute infringement of Article 73 as long as such transaction falls within the "scope of socially and economically lawful business." See Supreme Court Judgment of January 22, 2002 (56 Minshu No. 1 at 123), and Tokyo District Court Judgment of November 30, 2000, Hanrei Jiho No. 1740 at 54.

construed to mean that all persons but lawyers are absolutely prohibited from providing the services of filing a petition for execution of security interest under the provisions of trust agreement and receiving dividends therefrom in accordance with the legal procedure.

4. Conclusion

As seen above, we find no legal impediments to the recognition of the security trustee system under the existing laws. This conclusion should be clearly recognized in the future amendments to the Trust Act.

In view of practical and procedural application, it is more desirable to eliminate ambiguity in the interpretation of the above issues by providing express provisions in the Real Property Registration Act, Civil Enforcement Act, and other related laws.