

## Banking - Japan

Usury claims - challenging grey-zone interest

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### Introduction

In recent years, borrowers have brought numerous claims against money lenders<sup>(1)</sup> in Japan for restitution of usurious interest, especially with respect to loans to individual consumers and small businesses. These claims are often referred to as *kabara* claims.<sup>(2)</sup> The number of such claims is increasing - in 2009 they accounted for more than 40% of the new civil lawsuits in the district courts. Moreover, some law firms advertise their services in relation to such claims on posters and on television - which would once have been unthinkable. This update considers the origins of usury claims and the issues surrounding them.

### Law on usury

The legal regime governing the maximum allowable interest rates that money lenders (and their assignees) may charge borrowers can be loosely divided into two periods: the regime that existed before June 18 2010<sup>(3)</sup> and the regime thereafter.<sup>(4)</sup>

Before June 18 2010 the civil usury interest rate was between 15% and 20% a year, depending on the principal. The criminal usury rate was 29.2% a year for all loans. Interest charged at a rate between the civil and criminal rates is called 'grey-zone' interest. Moneylenders could lawfully charge grey-zone interest, provided that:

- a money lender made a loan to a borrower;
- the money lender provided the borrower with certain documents in accordance with Article 17 of the former Money Lending Business Act on the borrower's execution of the loan agreement;
- the borrower voluntarily repaid the loan in accordance with the terms of the loan; and
- the money lender provided the borrower with certain documents in accordance with Article 18 of the former Money Lending Business Act immediately on receipt of each payment from the borrower (or its guarantor).

On June 18 2010 amendments to the usury laws took effect, prohibiting money lenders from charging grey-zone interest on loan agreements entered into on or after June 18 2010. The amendments have been confirmed by cabinet order. The amendments provide that grey-zone interest may continue to be charged on loans made before June 18 2010, provided that the grey-zone criteria are followed.

### Challenging grey-zone interest

Borrowers who executed loan agreements before June 18 2010 have brought legal challenges against money lenders, claiming that the latter unlawfully charged grey-zone interest. In many cases the money lenders have failed to demonstrate compliance with the grey-zone requirements - specifically, delivery of the necessary documents to the borrower or voluntary repayment by the borrower.

As many loan agreements contain acceleration clauses, the courts have had to consider whether repayment can be said to be voluntary in the context of such loan agreements. On January 13 2006 the Supreme Court held that, in principle, the existence of an acceleration clause in a loan agreement imposing grey-zone interest

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makes a borrower's payments involuntary as a matter of law (even where acceleration has not taken place). The judgment has significant repercussions - money lenders can no longer rely on compliance with the grey-zone requirements with respect to loan agreements containing acceleration clauses.

## **Defence against usury claims**

### ***The statute of limitations defence***

A money lender is not required to disgorge grey-zone interest received from a borrower if the statute of limitations has passed. A Supreme Court judgment of January 24 1980 established that the statute of limitations on claims seeking disgorgement of grey-zone interest is 10 years. The question of when this 10-year period starts to run has been the subject of a number of lawsuits. In 2009 several Supreme Court judgments set out that the statute of limitations begins to run on the most recent transaction date, which is either a payment date or the loan execution date. Therefore, the starting point of the limitation period is now a relatively settled area of law.

### ***Constitution of torts***

If the requirements are not complied with, money lenders may not charge or receive grey-zone interest under Japanese law. In this connection, many money lenders fail to prove compliance with the grey-zone requirements; as a result, borrowers can argue that demands for, and the receipt of, grey-zone interest are tortious, and can file suit for damages.

The statute of limitations on the right to demand compensation for damages in tort is (i) three years from the date on which a victim becomes aware of the damage and the identity of the perpetrator, or (ii) 20 years from the date on which the tortious act was committed, whichever is first. Therefore, a money lender may be required to disgorge any grey-zone interest received from a borrower within 20 years of each receipt of grey-zone interest.

However, in a judgment of September 4 2009 the court held that a money lender's receipt or demand of grey-zone interest constitutes a tort only where the receipt or demand is unacceptable by prevailing social standards - for example, the demand or receipt is executed with the use of battery or assault, or if a money lender continues to charge or receive grey-zone interest knowing that it has no factual and legal grounds for doing so. Therefore, it appears difficult for borrowers to establish that a tort has been committed.

## **Comment**

Moneylenders in financial distress have increasingly turned to insolvency or bankruptcy proceedings; usury claims have been a significant contributory factor in their financial problems.

Grey-zone interest may continue to be charged lawfully on loan agreements concluded before June 18 2010, provided that the relevant requirements are met. Since the statute of limitations for disgorgement of unlawful grey-zone interest is 10 years from the most recent transaction date (ie, payment date or loan execution date), it is likely that many usury claims will be brought in the coming years.

The many significant issues surrounding usury claims, and the inherent legal and business ramifications, make this an area of Japanese law that companies and legal experts should watch closely.

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## **Endnotes**

(1) The term 'money lender' means a person or company registered to make loans or intermediate lending as a business under the Moneylending Business Act (Law No. 32 of 1983) Article 3 paragraph 1.

(2) In Japanese, the word '*kabara*', meaning 'payment of usurious interest', is used to describe such claims.

(3) The Law Concerning Partial Amendment of the Money Lending Business Act (Law 115/2006) was passed on December 13, 2006, which amended the Money Lending Business Act (Law 32/1983), the Interest Rate Restriction Act (Law 100/1954) and the Regulating the Receipt of Contributions, Receipt of Deposits and Interest Rates Act (Law 195/1954).

(4) On June 18 2010 enforcement of the amendments to the following laws took effect under Law 115/2006: the Money Lending Business Act (final), the Interest Rate

Restriction Act and the Regulating the Receipt of Contributions, Receipt of Deposits and Interest Rates Act.

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