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The Japanese and Korean Law of Secured Transactions

by Rex Coleman*

INTRODUCTION

The Japanese and Korean laws of secured transactions stand in a position today very similar to that which prevailed in the United States prior to the adoption of the Uniform Commercial Code. They rest upon a foundation of sundry security devices imported into Japan in the nineteenth century based upon French and German models to which have been added a variety of newer forms developed both by legislation and custom to meet the financial needs of rapidly developing economies. The result is a hodgepodge of possible security interests for which basic distinctions are made much more along formal than functional lines.

The security devices available (notwithstanding the degree to which they are actually utilized in Japan and Korea) are (1) the pledge (shichi-ken in Japanese and chilgwŏn in Korean 質權), (2) the hypothec (teitō-ken in Japanese and chŏdanggwŏn in Korean 抵當權), (3) enterprise security (only in Japan) (kigyō tampo in Japanese 企業擔保), (4) assignment as security (jōtō tampo in Japanese and yangdo tambo in Korean 讓渡擔保), (5) retention of title (shoyūken ryūho in Japanese and soyukwŏn yubo in Korean 所有權留保) and (6) the use of a trust (shintaku in Japanese and shint’ak in Korean 信託).

Of course the Japanese and Koreans employ these devices in a much broader context than secured transactions alone. In fact the words “secured transactions” (tampo-zuki torihiki 担保付取引 in Japanese and tambo-bu kŏrae in Korean 担保付来) do not fit the Japanese and Korean legal systems with their continental European origins although they are familiar to most Japanese and Korean legal scholars through various Japanese translations and commentaries that have appeared in recent years dealing with the United

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The term usually used in Japan and Korea is “security rights-in-rem” (tampo bukken in Japanese and tambo mulgwŏn in Korean 担保物件), covering all forms of security interests running against movables, immovables and in some exceptional cases obligations as collateral whether they arise in accordance with the intention of the owner of the property or by operation of law. Nevertheless, we will limit ourselves here solely to the consideration of those Japanese and Korean security interests that are created through the consent of the parties and not due to their status (as, for example, artisans or landlords) and that are designed to secure transactions by attaching to only such items as would be regarded as personal property by American law. Accordingly, we will omit the “right of retention” (possessory lien) (ryūchi-ken in Japanese and yuch’ikwŏn in Korean 儘置権) and “privileges” (non-possessory lien) (sakitori tokken 先取特権 in Japanese and usŏn t’ukkwŏn in Korean 先取特権) since they always come into being through the operation of law rather than the will of the parties.

THE GENERAL NATURE OF JAPANESE AND KOREAN SECURITY DEVICES

The Pledge

The pledge (shichi-ken in Japanese and chilgwŏn in Korean 質権) is the classical form of security device available for movables. Specifically, the collateral may consist of movable property and such rights (kenri in Japanese and kwŏlli in Korean 権利) as documentary bills, obligational instruments, shares of stock, patent rights, utility model rights, design rights, copyrights, publication rights and Japanese trademark rights.4 “Movable property” (dōsan

3. JAPANESE CIVIL CODE arts. 303-41. The KOREAN CIVIL CODE no longer contains provisions dealing with “privileges,” which were formerly called by the same term as in Japan, pronounced sŏnh’i t’ukkwŏn in Korean. Cf. FORMER KOREAN CIVIL CODE, enforced by the Chosen Civil Affairs Order, Chosen Government-General Institutional Order No. 7 of 1912, and the KOREAN CONSTITUTION OF 1948 art. 100, arts. 303–41. However, provisions thereon do appear in other Korean statutes, Korean Mail Law, Law No. 542 of 1960, art. 24(3); Korean National Tax Basic Law, Law No. 2679 of 1974, arts. 35–37; Korean Local Tax Law, Law No. 827 of 1961, art. 31; Korean Customs Law, Law No. 1976 of 1967, art. 20; KOREAN COMMERCIAL CODE, Law No. 1000 of 1962, arts. 858, 861.
4. Japanese Trademark Law, Law No. 127 of 1959, art. 34(3). Korea does not recognize a pledge of trademarks on the grounds that a trademark may not be assigned without assign-
in Japanese and dongsan in Korean (動當) is limited solely to corporeal or tangible property, including electricity and other controllable natural energy.\(^5\) The Japanese (but not the Korean) Civil Code also imposes a conclusive presumption that bearer (innominate) obligations will be deemed to be movable property.\(^6\) Accordingly, whenever the term “movable property” is used it may be considered as including physical things which are movable, and in the case of Japan, bearer obligations. “Documentary bills” refer to land (kamotsu hikikaesho 資物引換証 in Japanese and hwamul sanghwanjung 貨物相換証 in Korean) and seagoing bills of landing (funani shōken in Japanese and sŏnha ch'unggwŏn in Korean 貨荷証 券) as well as warehouse receipts (sōko shōken in Japanese and ch'anggo ch'unggwŏn in Korean 倉庫証券),\(^7\) while “obligational instruments” (saiken shōsho in Japanese and ch'aekwŏn ch'ungso in Korean 償権証 証) cover all obligations reduced to a written instrument\(^8\) including bills and notes (tegata 手 形 in Japanese and ōum 어움 in Korean), Japanese national bonds (kokusai 個 債), Korean public bonds (kongch'ae 公 債), company bonds (shasai in Japanese and sach'ae in Korean 社 債) and Japanese telephone installation rights (denwa kanyū ken 電話加入権).\(^9\) The above is a complete list of the forms of property for which the pledge may be used in secured transactions. Therefore, it is not available for other types of intangibles.

Pledge rights are created by a “real contract”\(^10\) (yobūtsu keiyaku in Japanese and yomul kyeyak in Korean 資物契約) to which the parties are the pledgor and the pledgee. Normally this contract is concluded by the pledgor delivering the particular collateral of which he has a right to dispose to the pledgee\(^11\) with the

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\(^{5}\) Japanese Civil Code arts. 85, 86(2); Korean Civil Code arts. 98, 99(2).

\(^{6}\) Japanese Civil Code art. 86(3).


\(^{8}\) Japanese Civil Code arts. 362–63; Korean Civil Code arts. 345–47.


\(^{10}\) Contract réel in French and Real-vertrag in German.

\(^{11}\) Japanese Civil Code art. 344; Korean Civil Code art. 330.
intention that it will serve as security for an obligation which may be his own or that of a third party. The collateral must be presently in existence, identifiable and assignable. Delivery may be either actual or by directing another person having the custody of the collateral to hold possession now in behalf of the pledgee. But the pledgor is forbidden from announcing that he will henceforth keep the goods as possessory agent for the pledgee.

A pledge of shares of stock, innominate (i.e. bearer) obligational instruments and obligational instruments to a named party (other than Japanese telephone installation rights) follows the above rules. But the general requirement of delivery is altered somewhat for documentary bills, order obligational instruments, patents and forms of intangible property similar thereto and obligations not reduced to writing. Documentary bills and order obligational instruments must be endorsed before delivery. Copyrights, publication rights, Japanese telephone installation rights and obligations not reduced to writing can be pledged without delivery simply by the agreement of the parties to do so. A pledge of patent, utility model, design and Japanese trademark rights must be recorded in order to be valid.

Pledge rights run not only to the original collateral, but also to its natural and legal fruits which the pledgee may apply to the satisfaction of the obligation. Thus, except for a special agreement to the contrary, dividends on stock, interest on bonds and rent on moveables may all be used for this purpose. The pledge also reaches the proceeds of a sale of the collateral or insurance receipts for its damage or destruction.

12. JAPANESE CIVIL CODE art. 342; KOREAN CIVIL CODE arts. 329, 355.
13. JAPANESE CIVIL CODE art. 343; KOREAN CIVIL CODE arts. 331, 346, 355. Thus, national treasures, pornography and the right to a pension cannot be pledged.
14. Traditio breui manu in Roman law.
15. JAPANESE CIVIL CODE art. 345; KOREAN CIVIL CODE arts. 332, 355. Constitutum possessorium in Roman law.
16. KOREAN CIVIL CODE arts. 347, 351; KOREAN COMMERCIAL CODE art. 338(1); WAGATSUMA 113–14, 122; 1 CHUSÔK MINBÔP 670–72.
17. JAPANESE COMMERCIAL CODE, Law No. 48 of 1899, arts. 574, 603(1), 627(2), 776; KOREAN CIVIL CODE art. 350; KOREAN COMMERCIAL CODE arts. 130, 157, 820; WAGATSUMA 104–05, 114; 1 CHUSÔK MINBÔP 676–77.
The obligation secured need not necessarily be a pecuniary debt; any obligation is satisfactory. It may even be subject to a condition precedent which has not yet arisen, be for a bank line of credit up to a specified maximum which has not yet been drawn against or be for an uncertain future debt which can be ascertained in amount at the time the pledgee seeks preferential satisfaction from the collateral.\(^2\)

Quite apart from the requirements for creating a pledge between the pledgor and the pledgee are the equally important prerequisites for retention of such rights. In principle the pledgee retains his pledge rights only so long as he keeps possession of the collateral in his own custody or an agent acting in his stead. If he loses possession, he loses his pledge rights and therefore cannot assert them against a third person coming into possession of the collateral\(^2\) or in Korea, against even the pledgor.\(^2\) But if the pledgee is unlawfully deprived of the collateral (e.g. by theft), he is entitled to bring an action for its restoration.\(^2\) The same rule applies to shares of stock (only innominate—i.e. bearer—shares in Korea), innominate company bonds, documentary bills and innominate and order obligational instruments not running solely to a named party.\(^2\)

The situation with Korean nominate (i.e., registered) shares of stock, nominate company bonds, obligational instruments to a named party, copyrights, publication rights, patent rights, utility model rights, design rights and Japanese trademark rights is somewhat different. Here retention of possession or other prerequisites are looked upon as a problem of perfecting the security interest in regard to third parties and not as a matter of the loss of pledge rights. A pledgee of Korean nominate stock must keep possession in

\(^{22}\) WAGATSUMA 90–91; 1 CHUSŌK MINBÔ 608–09.

\(^{23}\) JAPANESE CIVIL CODE arts. 352, 362(2).

\(^{24}\) This is the current prevailing view of the Korean scholars such as Professors Chung-han Kim and Sik Ch’oe, who emphasize the possessory nature of pledges and contend that the requirements for establishing a pledge and retaining it are now the same, pointing to the fact that the KOREAN CIVIL CODE no longer contains a provision similar to FORMER KOREAN CIVIL CODE art. 352 and JAPANESE CIVIL CODE art. 352 which deals with the matter simply as one of perfecting rights against third parties, and who apply (in the case of Professor Ch’oe) KOREAN CIVIL CODE art. 328 (dealing with the extinction of a right of retention) to pledges by analogy. On the other hand, former Justice Sun-won Pang, of the Korean Great Court (supreme court) disagrees with this view and feels that the grounds for retaining a pledge are different from those for its establishment and therefore the old principle that the loss only involves setting up rights against third parties still governs because KOREAN CIVIL CODE art. 343 expressly fails to mention art. 328 in its corresponding application of the rules regarding a right of retention to pledges. 1 CHUSÔK MINBÔ 624–25.

\(^{25}\) JAPANESE CIVIL CODE art. 353; KOREAN CIVIL CODE art. 204; 1 CHUSÔK MINBÔ 615.

\(^{26}\) WAGATSUMA 105, 113–15; 1 CHUSÔK MINBÔ 663, 687–89. Japan does not apply this rule to telephone installation rights.
order to be able to assert his rights against third parties.\textsuperscript{27} Pledges of nominate company bonds must be recorded in the company’s bond ledger.\textsuperscript{28} Obligational instruments to a named party require a notice of the pledge to the third party or his consent thereto.\textsuperscript{29} So too pledges of copyrights, publication rights, patent rights, utility model rights, design rights and Japanese trademark rights must all be recorded at the competent government office.\textsuperscript{30} However, it should be noted that many scholars are of the opinion that the loss of possession of a documentary bill other than one endorsed in blank does not terminate the pledgee’s right to set up his interest in the deposited goods.\textsuperscript{31}

The pledgee bears the duty of preserving the collateral with the care of a good administrator and returning it to the pledgor upon the performance of the underlying obligation.\textsuperscript{32} Normally he may not use, lease or secure the collateral without the consent of the pledgor. If he does so, he is subject to suit for extinction of the pledge.\textsuperscript{33} Nor may he impose terms in a contract with the pledgor made prior to the expiration of the period of the obligation to the effect that he may acquire ownership of the collateral or sell it in satisfaction of the underlying obligation unless this underlying obligation arose through a commercial act.\textsuperscript{34} But he is entitled to repledge the collateral subject to full liability for its loss even if due to \textit{vis major} except where it consists of Japanese telephone installation rights.\textsuperscript{35}

If the object of the obligation is something other than money and the collateral is not an obligational instrument, patent right, utility model right, design right, copyright or publication right, the only remedy open to the pledgee is to continue to hold on to the collateral when the debtor fails to perform his obligation. But if the

\textsuperscript{27} KOREAN COMMERCIAL CODE art. 338(2).
\textsuperscript{28} JAPANESE CIVIL CODE art. 365; JAPANESE COMMERCIAL CODE art. 303; KOREAN COMMERCIAL CODE art. 479.
\textsuperscript{29} JAPANESE CIVIL CODE art. 364(1); KOREAN CIVIL CODE arts. 349, 450; 1 CHUSÔK MINBÔP 663.
\textsuperscript{30} Korean Patent Law, art. 56(1)(iii); Korean Utility Model Law, art. 29; Korean Design Law, art. 37; Korean Copyright Law, arts. 43(1), 57(1); 8 CHUSHAKU MIMPO 354 (Japan 1965); 1 CHUSOK MINBOP 672.
\textsuperscript{31} WAGATSUMA 106; 1 PALLYE HAKSOŁ CHUSOK SANGBÔP (Academic Theory and Case Annotated Commercial Code) 423 (Rak-hun Ch’a, Byông-su An, Jonggap Sô, and Jun’ch’ao Son ed. 1977) (hereafter cited as CHUSOK SANGBÔP).
\textsuperscript{32} JAPANESE CIVIL CODE arts. 298, 350; KOREAN CIVIL CODE arts. 324(1), 343, 355.
\textsuperscript{33} JAPANESE CIVIL CODE arts. 298, 350; KOREAN CIVIL CODE arts. 324(2)–(3), 343, 355.
\textsuperscript{34} JAPANESE CIVIL CODE art. 349; JAPANESE COMMERCIAL CODE art. 515; KOREAN COMMERCIAL CODE art. 339, 355; KOREAN COMMERCIAL CODE art. 59. \textit{Lex commisoria} in Roman law.
\textsuperscript{35} JAPANESE CIVIL CODE art. 348; Japanese Law of Extraordinary Special Cases Concerning the Pledge of Telephone Installation Rights, art. 4; KOREAN CIVIL CODE art. 336–37.
subject matter of the underlying obligation is money and the debtor delays in his performance, the pledgee is entitled to receive preferential satisfaction of his claim from the collateral. The pledgor and pledgee may mutually agree after the date of performance for the pledgee to take ownership or liquidate the collateral in full or partial satisfaction of the debt. In the absence of such an agreement, the pledgee must normally seek his remedy out of the proceeds produced by selling the collateral in accordance with the Auction Law\(^36\) of his country or, in certain exceptional cases such as where there is an official price or where the value of the item is so low that it would be exhausted in meeting auction expenses, by notifying the debtor, applying to the court for the appointment of an expert to value the item and then treating this appraised value as being in full or partial satisfaction of the debt.\(^37\) Satisfaction may be sought not only for the principal of the underlying obligation, but also interest, liquidated damages, enforcement and preservation costs and damages due to non-performance of a debt and hidden defects.\(^38\)

Of course, the pledgee is also entitled as a creditor to proceed against the general assets of the debtor as well.

When the collateral pledged is an obligational instrument, the pledgee can naturally wait for the obligation to be performed.\(^39\) If the proceeds are money, he can apply them to the debt.\(^40\) If not, his pledge covers them as well and he can enforce his rights against them as described above.\(^41\) He may also institute proceedings under the Code of Civil Procedure to enforce his rights by seeking a court order to have the ownership of the debt transferred to him, a court order permitting him to collect the debt from the third party debtor or a court order allowing liquidation of the debt for money.\(^42\)

The above proceedings under the Code of Civil Procedure must also be taken to enforce a pledge of patent rights, utility model rights, design rights, copyrights or publication rights.\(^43\)

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39. Japanese Civil Code art. 367(1); Korean Civil Code art. 353(1).
40. Japanese Civil Code art. 367(2); Korean Civil Code art. 353(2).
41. Japanese Civil Code art. 367(4); Korean Civil Code art. 353(4).
43. Wagatsuma 127; 1 Chusōk Minbōp 686.
The Hypothec

The hypothec (teitō-ken in Japanese and chōdanggwŏn in Korean 担当権) is the continental European legal equivalent of the modern Anglo-American statutory mortgage. Hypothecs are recognized by the Japanese and Korean Civil Codes as a security device only for immovable property and rights therein. But the Commercial Codes of both countries and a number of special statutes provide—each in accordance with their own terms—for the hypothecation of various specific movables and conglomerations of property. This development grew out of the twentieth-century demand of first Japanese and later Korean business for the provision of some sort of regular security using movables as collateral that would permit the retention of such collateral in the hands of the debtor. Consequently, a hypothec may be established for recorded ships (including those under construction), automobiles, aircraft, Japanese movables used in agriculture, Japanese recorded construction machinery, Korean registered heavy machinery, and groupings of property in factory, mining, fishing, harbor transport business, road traffic business, railroad, tramway, canal and tourist facilities foundations (the last seven only in the case of Japan).

Japanese “movables used in agriculture” (nōgyō-yō dōsan 農業用動産) are limited to various sorts of listed machines, implements and equipment—such as motors, tractors, trucks and storage tanks—and farm animals—cattle, horses, sheep, pigs, chickens and ducks.45 “Aircraft” in both countries means airplanes and helicopters.46 Japanese “construction machinery” (kensetsu kikai 建設機械) covers 52 different types and Korean “heavy machinery” (chunggi 重機) 26 different types of enumerated equipment used in construction work.48 For the purpose of establishing a hypothec a “foundation” (zaidan in Japanese and chaedan in Ko-

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44. Japanese Commercial Code art. 848(1); Korean Commercial Code arts. 871(1), 874.
46. Japanese Agricultural Movables Credit Law, Law No. 30 of 1933, art. 2; Japanese Agricultural Movables Credit Law Enforcement Order, Imperial Order No. 307 of 1933, art. 1.
47. Japanese Aircraft Hypothec Law, Law No. 66 of 1953, art. 2; Korean Aircraft Hypothec Law, Law No. 867 of 1961, art. 2.
rean财団) may be created consisting of all or only a portion of the following items:

1. Factory foundation (kōjō zaidan in Japanese and kongjang chaedan in Korean 工場財団). Land and structures belonging to a factory; machinery, implements, electric poles and lines, sundry conduit pipes, tramways and other accessories; Korean rights of transmission (chonsegwŏn 伝賃權); leases of things consented to by the lessor; industrial property; Japanese dam-use rights; and automobiles owned by a Japanese factory owner.49

2. Mining foundation (kōgyō zaidan in Japanese and kwangŏp chaedan in Korean鉱業財団). Mining industrial rights (only in Japan); land and structures; superficies and rights to use land; leases of things consented to by the lessor; machinery, implements, rolling stock, ships, cattle, horses and other accessories (cattle and horses only in Japan); and Japanese extraction rights providing that they relate to mining and belong to a holder of extraction rights.50

Japan also recognizes the hypothecation of the following additional foundations:

1. Fishing foundation (gyogyō zaidan漁業財団). Fixed and limited fishing rights; ships, their gear and their accessories; land and structures; superficies and rights to use land or the surface of water and to draw water or for drainage; principal and incidental fishing implements; machinery, implements and other accessories; leases of things; and industrial property provided that these items belong to a person engaged in the business of fishing.51

2. Harbor transport business foundation (kōwan unosŏ jigyō zaidan 港湾運送事業財団). Boathouses, cargo-working machinery, other freight-handling facilities and their sites; lighters, tugboats and other vessels; offices, other buildings necessary for the harbor transport business and their sites; superficies and recorded lease rights existing over the immovables of others needed for the ownership or use of the above structures on land; servitudes existing in respect to the above sites; and implements and machinery necessary for the conduct of the harbor transport business provided that all of these items relate to that business.52

3. Road traffic business foundation (dōro kōtsu jigyō

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50. Japanese Mining Hypothec Law, Law No. 55 of 1905, arts. 2, 2-2; Korean Mining Foundation Hypothec Law, Law No. 750 of 1961, art. 4.
51. Japanese Fishing Foundation Hypothec Law, Law No. 9 of 1925, art. 2(1).
zaidan 道路交通事業財団). Land, structures, automobiles, superficies, lease rights, servitudes, machinery, implements, lighters, cattle, horses and other means of conveyance, etc., pertaining to the general automotive transportation business (truck-ing), the motor highways business and the express business.\textsuperscript{53}

4. Railroad foundation (tetsudō zaiden 鉄道財団). Tracks, warehouses, factories, electric-power control towers, offices, communication facilities, business equipment, rights-of-way and structures thereon, buildings needed for work and transportation and their sites, related implements and machinery, rolling stock, superficies, lease rights and servitudes, etc., of a private local railroad.\textsuperscript{54}

5. Tramway foundation (kidō zaidan 軌道財団). Tramway tracks, rights-of-way and structures thereon, buildings needed for work and transportation and their sites, related implements and machinery, superficies, servitudes, lease rights, rolling stock and maintenance and other repair materials of a tramway business.\textsuperscript{55}

6. Canal foundation (unga zaidan 運河財団). Channels, canal sites and structures thereon, factories, etc., and their sites, related implements and machinery, superficies, servitudes, lease rights, vessels and canal repair materials, etc., of a canal enterprise.\textsuperscript{56}

7. Tourist facilities foundation (kankō shisetsu zaiden 観光施設財団). Land and structures; machinery, implements and fixtures; animals, plants and exhibits; superficies and leases of things consented to by the lessor; ships, rolling stock and aircraft and their accessories; and the right to use a hot spring of a business engaged in providing the use of facilities for tourists and travelers.\textsuperscript{57}

Hypothecation rights come into existence through a "hypothecation contract" whereby the hypothecator secures his own obligation or that of a third party to the hypothecary by establishing a hypothec in property respecting which the hypothecator has the right of disposal.\textsuperscript{58}

A separate hypothec must be created for each individual item of property in the case of recorded ships,\textsuperscript{59} automobiles,\textsuperscript{60} movables

\textsuperscript{53} Japanese Road Traffic Business Activities Hypothec Law, Law No. 204 of 1952, arts. 4–5.

\textsuperscript{54} Japanese Railroad Hypothec Law, Law No. 53 of 1905, art. 3.

\textsuperscript{55} Japanese Law Concerning the Hypothecation of Tramways, Law No. 28 of 1909, art. 2.

\textsuperscript{56} Japanese Canal Law, Law No. 16 of 1913, art. 14.

\textsuperscript{57} Japanese Tourist Facilities Foundation Hypothec Law, Law No. 91 of 1968, arts. 2, 4.

\textsuperscript{58} JAPANESE CIVIL CODE art. 369; KOREAN CIVIL CODE art. 356, 371(1); Korean Automobile Hypothec Law, art. 4; Korean Aircraft Hypothec Law, art. 4; Korean Heavy Machinery Hypothec Law, art. 4.

\textsuperscript{59} JAPANESE COMMERCIAL CODE art. 848(1); KOREAN COMMERCIAL CODE art. 871(1).

\textsuperscript{60} Japanese Automobile Hypothec Law, art. 3; Korean Automobile Hypothec Law, art. 3.
used in agriculture,61 aircraft62 and construction or heavy machinery.63 However, a single hypothec may be used to cover all the different forms of property permitted to be grouped together under one type of foundation hypothec on condition that all of them are recorded in a foundation inventory kept by the hypothecator.64 Factory, mining, fishing, harbor, transport business and tourist facilities foundations only include such property as is placed in the foundation at the time the foundation is created.65 But road traffic business,66 railroad,67 tramway68 and canal foundations69 automatically include later-acquired property of the same sort as well.

In some instances special qualifications have been imposed as to the person who may create and receive a hypothec in movables and incorporeal property quite apart from restrictions on the nature of the property itself. Thus, the hypothecator must be (1) a Japanese farmer, agricultural cooperative society or other specified juridical person to establish a hypothec in a movable used in agriculture,70 (2) a registered person in the construction business to establish a hypothec for construction machinery,71 or a person licensed in the construction business or approved to engage in the heavy machinery business in Korea in order to establish a hypothec for heavy machinery,72 (3) a factory owner to establish a factory foundation hypothec,73 (4) a Japanese holder of extraction rights in Japan to establish a mining foundation hypothec,74 (5) a Japanese holder of

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61. Japanese Agricultural Movables Credit Law, art. 12(1).
62. Japanese Aircraft Hypothec Law, art. 3; Korean Aircraft Hypothec Law, art. 3.
63. Japanese Construction Machinery Hypothec Law, art. 5; Korean Heavy Machinery Hypothec Law, art. 3.
64. Japanese Factory Hypothec Law, arts. 11, 14, 21–22; Japanese Mining Hypothec Law, arts. 3–4; Japanese Fishing Foundation Hypothec Law, arts. 2–6; Japanese Harbor Transport Business Activities Law, arts. 24, 26; Japanese Law Concerning the Hypothecation of Tramways, arts. 1–2; Japanese Canal Law, arts. 13–14; Japanese Tourist Facilities Foundation Hypothec Law, arts. 4, 10; Korean Factory Hypothec Law, arts. 11, 14–15, 38–36; Korean Mining Foundation Hypothec Law, arts. 4–5.
65. WAGATSUMA 213; 1 CHUSOK MINS0 838–39.
66. Japanese Road Traffic Business Activities Law, art. 6(2)–(3).
67. Japanese Railroad Hypothec Law, art. 11(1).
68. Japanese Law Concerning the Hypothecation of Tramways, art. 1.
70. Japanese Agricultural Movables Credit Law, art. 4(1).
72. Korean Heavy Machinery Hypothec Law, art. 2; Korean Construction Business Law, Law No. 2290 of 1971, art. 5(1); Korean Heavy Machinery Control Law, art. 14(1).
73. Japanese Factory Hypothec Law, art. 8; Korean Factory Hypothec Law, art. 11(1).
74. Japanese Mining Hypothec Law, art. 1; Korean Mining Foundation Hypothec Law, art. 1.
fishing rights with the approval of the competent metropolis, circu-
cuit, urban prefecture or prefecture to establish a fishing foundation hypothec,\textsuperscript{75} (6) a person with cargo-working machinery and build-
ings in Japan to establish a harbor transport business foundation,\textsuperscript{76} (7) a person engaged in business in Japan on a sufficient scale to be recognized by the competent Minister to establish a road traffic business foundation,\textsuperscript{77} (8) a Japanese railroad company or tramway entrepreneur with the validation of the competent government office to establish a railroad or tramway foundation hypothec,\textsuperscript{78} (9) a Japanese canal entrepreneur with the approval of the competent Minister to establish a canal foundation hypothec\textsuperscript{79} and (10) a holder of rights in land or buildings in Japan used for tourists or travelers to establish a tourist facilities foundation hypothec.\textsuperscript{80} Moreover, Japanese hypothecaries of movables used in agriculture are limited to agricultural cooperative societies, credit societies and certain other specified juridical persons.\textsuperscript{81}

Unlike a pledgee, the hypothecary acquires no rights to the natural or legal fruits of the collateral.\textsuperscript{82} But he is entitled to pursue his rights in regard to all items received in substitution for the collateral such as the proceeds from its sale, insurance, damages and indemnities.\textsuperscript{83} While the underlying obligation must be a pecuniary debt, it may be a future obligation or one which will fluctuate up to a maximum amount.\textsuperscript{84}

Normally a hypothec is perfected in regard to third parties by recording or registration.\textsuperscript{85} But recording is unnecessary in Japan in order to set up rights against a third party in bad faith when the collateral is a movable used in agriculture.\textsuperscript{86} A hypothec for immov-
ables, ships, movables used in agriculture and a factory, mining, fishing, harbor transport business, road traffic business or tourist facilities foundation is recorded in Japan in the relevant recording book at the competent Legal Affairs Bureau, Local Legal Affairs Bureau or branch or field office thereof or in Korea at the competent Local Court or branch thereof. Hypothecs for aircraft and railroad, tramway and canal foundations are entered in the aircraft register or railroad, tramway or canal hypothec book maintained by the Ministry of Transportation. A hypothec for Japanese construction machinery is noted in the construction machinery recording book kept by the competent metropolitan, circuit, urban prefectural or prefectural office, while a hypothec for Korean heavy machinery is entered in the heavy machinery register kept by the Ministry of Construction. A hypothec for a Japanese harbor transport business foundation must be reported to the Minister of Transportation. Finally, hypothecs for automobiles are entered in the Japanese automobile registration file of the Ministry of Transportation or the Korean automobile register kept by the office of the Mayor of the Special City of Seoul, the Mayor of the City of Pusan or the governor of a province.

The hypothecator is responsible for maintaining the collateral. If it is lost, damaged or destroyed through his fault, the hypothecary can seek restitution of the property from whomever has it, damages from the hypothecator under a theory of tort and immediate execu-

88. JAPANESE COMMERCIAL CODE art. 848(3); KOREAN COMMERCIAL CODE art. 871(3).
89. Japanese Agricultural Movables Credit Law, art. 13.
90. Japanese Factory Hypothec Law, art. 17; Korean Factory Hypothec Law, art. 32.
91. Japanese Mining Hypothec Law, art. 3; Korean Mining Foundation Hypothec Law, art. 5.
92. Japanese Fishing Foundation Hypothec Law, art. 6.
95. Japanese Tourist Facilities Foundation Hypothec Law, art. 11.
96. Japanese Aircraft Hypothec Law, art. 5; Korean Aircraft Hypothec Law, art. 5; Korean Air Law, Law No. 591 of 1961, art. 3.
98. Japanese Law Concerning the Hypothecation of Tramways, art. 1.
100. Japanese Aircraft Hypothec Law, art. 7(1).
101. Korean Heavy Machinery Hypothec Law, art. 5; Korean Heavy Machinery Control Law, art. 7(1).
102. Japanese Harbor Transport Business Activities Law, art. 27.
103. Japanese Automobile Hypothec Law, art. 5; Korean Automobile Hypothec Law, art. 5; Korean Road Transport Vehicles Law, Law No. 962 of 1962, art. 6.
tion of the hypothec. In addition Japanese and Korean security contracts almost always provide that the hypothecary can demand further security for the impairment of the collateral regardless of the hypothecator's fault. But lacking such a clause, it is the opinion of scholars that additional security may be demanded only when it has been established that the value of the collateral has been markedly reduced due to the fault of the hypothecator. It does not infringe the rights of the hypothecary for the hypothecator to use and take the fruits of the collateral or permit someone else to do so. Nevertheless, the collateral subject to a factory, mining, fishing, harbor transport business, road traffic business or tourist facilities foundation hypothec cannot be assigned or pledged and in some cases it is a crime to do so.

The underlying debt secured by the hypothec may be assigned or pledged and when it is the hypothec is required to accompany it. Such assignment or pledge must be recorded or registered in order for the change in the hypothec to be set up against third parties in Japan or to be effective in Korea and the debtor must be notified of any assignment before he will be bound in regard to his debt.

In Japan the hypothecary can rehypothecate his hypothecation rights, using them as security for a new debt in which he is the debtor rather than the creditor. Naturally, the size of the debt and the term of the new hypothec may not exceed those of the original one. The original debtor must consent to or be notified of the transfer and the rehypothecation recorded or registered in order for it to be effective against third parties. However, rehypothecation is

104. Japanese Civil Code art. 137(ii); Korean Civil Code art. 388(i).
105. See Korean Civil Code art. 382.
107. Japanese Factory Hypothec Law, art. 33; Japanese Mining Hypothec Law, art. 3; Japanese Fishing Foundation Hypothec Law, art. 6; Japanese Harbor Transport Business Activities Law, art. 25; Japanese Road Traffic Business Activities Law, art. 19; Japanese Tourist Facilities Foundation Hypothec Law, art. 11; Korean Factory Hypothec Law, art. 23; Korean Mining Foundation Hypothec Law, art. 5.
108. Japanese Factory Hypothec Law, art. 49; Japanese Mining Hypothec Law, art. 11; Korean Factory Hypothec Law, art. 64; Korean Mining Foundation Hypothec Law, art. 13.
111. Korean Civil Code art. 186.
115. Wagatsuma 189–90.
not permitted in Korea.  

The hypothecary can execute the hypothec upon a declaration of bankruptcy by the debtor, the debtor’s impairment or diminution of the collateral, the debtor’s failure to provide further security when obliged to do so or delayed performance by the debtor. The parties may agree at any time that the hypothecary will receive ownership of the collateral in satisfaction of the debt. Should they fail to do so, the usual method of execution is by means of public auction. A third party which has acquired the collateral must be notified of this auction. After this notice is given the hypothecary may petition the competent court for the auction to take place. The court will then proceed with the following steps: (1) order commencement of the auction, (2) serve the owner of the collateral with notice thereof, (3) record or register the petition for auction, (4) set the date of auction, (5) give official notice of this date and inform all interested parties, (6) hold auction at the court, (7) receive payment from the successful bidder and (8) deliver the collateral to him. The proceeds of the auction cover not only the principal of the debt, but also interest, liquidated damages and expenses required to execute the hypothec. Such auction, however, does not cut off other superior rights existing in the collateral.

Enterprise Security

The Japanese “enterprise security” is an attempt to introduce the Anglo-American floating charge (ふたな浮動担保) into Japanese law in order to avoid the cost and formalities of the foundation hypothec. It may be employed only by a stock company (株式会社) and

116. 1 CHUSŌK MINBŌP 751–53.  
117. JAPANESE CIVIL CODE art. 137; KOREAN CIVIL CODE art. 388.  
118. WAGATSUMA 163; 2 CHUSŌK MINBŌP 71 (1972).  
119. WAGATSUMA 163; 1 CHUSŌK MINBŌP 757.  
120. JAPANESE CIVIL CODE art. 381; KOREAN CIVIL CODE art. 363.  
121. See JAPANESE CIVIL CODE art. 387; KOREAN CIVIL CODE art. 363.  
122. Japanese Auction Law, arts. 25–27, 29–33; Korean Auction Law, arts. 23–37. Also see JAPANESE COMMERCIAL CODE art. 848(3); Japanese Execution of Hypothecation Rights in Movable Used in Agriculture Order, Imperial Order No. 309 of 1933; Japanese Automobile Hypothec Law, art. 17; Japanese Aircraft Hypothec Law, art. 20; Japanese Factory Hypothec Law, art. 46; KOREAN COMMERCIAL CODE art. 871(3); Korean Automobile Hypothec Law, art. 7; Korean Aircraft Hypothec Law, art. 7; Korean Heavy Machinery Hypothec Law, art. 6; Korean Factory Hypothec Law, art. 30.  
123. KOREAN CIVIL CODE art. 390; WAGATSUMA 150–51; 1 CHUSŌK MINBŌP 739–43.  
125. For example, the requirement that a full inventory be prepared of all subject property.
it must cover all the property of that company as its collateral. Consequently, while every form of property coming into the ownership of the company is subject to the security interest, it does not attach to property transferred to others. No special record of the company’s property other than that required by normal accounting practice need be kept and the company is free to assign away the collateral as it sees fit.

Enterprise security may be established only to secure company bonds as the underlying obligation. It is created by the company executing a contract in the form of a public authentic instrument and recording its existence in the stock company recording book at the Japanese Legal Affairs Bureau, Local Legal Affairs Bureau, or branch or field office thereof, with jurisdiction over the company’s head office. A bondholder is entitled to preferential satisfaction of his debt out of the property as of the time at which the company is declared bankrupt or it fails to meet its obligation under the bond. Execution is commenced by petitioning the District Court having jurisdiction over the head office of the company. The court immediately attaches the property, appoints an administrator and gives public notice of its ruling to open proceedings. The administrator records these proceedings generally and in regard to those particular items of property within the collateral that are ordinarily subject to recording, notifies the company’s creditors, prepares a detailed list of the property and provides for its preservation. Next, the property is liquidated by auction which may dispose of all of the property as a whole or item by item. In the latter case, the consent of the secured bondholders and the validation of the court are necessary. The proceeds of the liquidation are then turned over to the

129. Japanese Enterprise Security Law, art. 3.
131. Japanese Enterprise Security Law, art. 2(1); JAPANESE CIVIL CODE art. 137.
139. Japanese Enterprise Security Law, art. 34.
140. Japanese Enterprise Security Law, art. 32.
which distributes them to the creditors in accordance with their priorities. The administrator winds up the proceedings by making all necessary final recordings as required.

Assignment as Security

Assignment as security (jōto tampo in Japanese and yangdo tambo in Korean 譲渡担保) has been characterized by some Japanese scholars as an illegitimate child of the security system, seeking to meet needs which the legitimate offspring—consisting of pledges, hypothecs and more recently enterprise security—have been ill-equipped to satisfy. Like many such children this device appears to be much stronger and more viable than its legitimate half-brothers and sisters for it is in widespread use.

There is no statutory basis for assignment as security. Instead it has developed through first Japanese and later Korean business practices since the end of the 19th century that have been accorded general recognition by the Japanese and Korean courts based on accepted principles of the transfer of ownership. The fundamental concept is a simple one. The person wishing to secure an underlying obligation (the securing party) assigns rights (usually ownership) in property held by him to the secured party pursuant to a contract which provides that the property will be reassigned back to the securing party when the debt is met. Technically speaking the secured party acquires full rights to the collateral rather than a mere security interest in it. The securing party only retains an in personam claim against the secured party for the restoration of his rights, but he cannot pursue his interest against third parties coming into ownership of the property. He does, however, retain the

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146. There are many similar parallels in other countries. Germany has Sicherungsübereignung and Sicherungskauf, while in the Netherlands a technique known as "transfer of property as security" is reportedly employed. Dainow, Civil Code Revision in the Netherlands: Some New Developments in Obligations and Property, in XXTH CENTURY COMPARATIVE AND CONFLICTS LAW 172, 182-85 (Legal Essays in Honor of Hessel E. Yntema; Nadelmann, Von Mehren & Hazard ed. 1961). But the Japanese and Korean development appears to have been entirely indigenous. A 1916 court decision indicates the presence of the device in Japan since 1885. Kawano v. Kawano, Great Court of Judicature, III Civil Department, Nov. 8, 1916, 22 DAI SHIN IN MINZI HANREI SHU (A Collection of Civil Great Court of Judicature Cases) 2193, 2204 (Japan).
147. The Japanese and Korean courts have developed a distinction between the internal and external transaction in an attempt to protect the debtor. They hold that while the rights are transferred as far as third parties are concerned, this is not true between the securing and secured party. The securing party retains his rights along with the collateral and the secured party acquires only a security interest. See Wagatsuma 228-29; 1 CHUSÔK MINBÔP 862-66.
possession and use of the collateral under the conception of a lease-back or loan for use from the secured party.

The collateral may be any form of assignable property interest. Special terms in the security agreement can even provide that collateral may be added or subtracted over time. Yet there must always be an underlying debt secured. Without such a debt, the courts will strike down the transfer as lacking a legal basis and require the restoration of the property on grounds of unjust enrichment.4

Perfection of the security interest against third parties depends merely upon whether all the normal requirements for setting up an assignment against third parties have been met. Thus, the securing party is able to retain custody of a movable without physical delivery to the secured party49 on the theory that he now holds as the latter's possessory agent.5

The secured party is obligated to hold his rights solely for security. If he sells the collateral without just cause, the courts will grant the securing party damages under a theory of nonperformance of an obligation (breach of contract). But if the underlying debt is not met, the secured party can easily execute his security interest simply by disposing of the collateral.

The risks inherent in this form of security device are readily apparent. The securing party might well lose the ownership of the collateral because of an unjustified action on the part of the secured party or actions by the secured party's creditors unrelated to this obligation.151 On the other hand, there is the danger that an unscrupulous securing party might lose or damage the collateral remaining in his possession.

148. JAPANESE CIVIL CODE art. 703; KOREAN CIVIL CODE art. 741; 1 CHUSÔK MINNÔP 885–86.

149. "Delivery" is required to set up the assignment of a movable against third parties under Japanese law or actually assign the movable under Korean law. JAPANESE CIVIL CODE art. 178; KOREAN CIVIL CODE art. 188(1).

150. It qualifies as a "delivery" for an agent, holding possession of his own movables, to declare that he will henceforth hold them in behalf of his principal. JAPANESE CIVIL CODE art. 183; KOREAN CIVIL CODE art. 189; 1 CHUSÔK MINNÔP 872. This practice is known as constitutum possessorium in Roman law.

151. Scholars contend that the securing party can oppose compulsory execution by the secured party's creditors under JAPANESE CODE OF CIVIL PROCEDURE art. 549 and KOREAN CODE OF CIVIL PROCEDURE art. 509, providing for an objection by a third person holding rights in a thing. T. Ikuyo, Kappu Hanbai (Installment Sales), in 2 KEIYAKU HÔ TAIKEI (System of Contract Law) 289, 295 (1962) (hereafter cited as Ikuyo); 1 CHUSÔK MINNÔP 891. The Korean Great Court has also held and certain Japanese and Korean scholars are of the opinion that the secured party can object to action by the securing party's creditors only when there is a "strong assignment as security." Judgment of March 23, 1971, Great Court, 71 Ta 225 (Korean); Ikuyo 289, 295; 1 CHUSÔK MINNÔP 894.
Retention of Title

Retention of title (shōyūken ryūho in Japanese and soyukwŏn yubo in Korean 所有權保留) has developed as the counterpart of assignment as security for the situation where title to the collateral is originally in the secured party rather than the securing party. Accordingly, it is widely employed in Japan to secure installment sales transactions. Naturally, it is prone to the same strengths and weaknesses as assignment as security.

Retention of title is created by a contract pursuant to which the relationship between the seller and the purchaser of the collateral can be regarded as a transfer of ownership subject to a condition precedent ("suspensive condition"). The retention is usually provided by express terms of the contract, although the Japanese Installment Sales Law presumes such to be the intention of the parties if there is no proof to the contrary. As with assignment as security, this interest can be established in regard to any form of assignable property. Technically there is no formal means to perfect the transaction against third parties. However, in Japan, recording of the domicile or place of business of the purchaser as the "principal locus of use" tends to perform this function.

While the buyer obtains possession of the collateral, he cannot sell it without the consent of the seller because he does not actually own it. If the seller disposes of the property a second time, he is liable to the first buyer for an infringement of rights subject to a condition precedent, but the first buyer cannot pursue his interest against the second buyer unless there is some way the second buyer would have been put on warning of this interest. The buyer must preserve the property with the same care as his own. Taxes and public charges on it shall be met by the seller unless there is a special agreement to the contrary. Of course, such an agreement always exists in Japan in the case of the sale of an automobile.

If the underlying obligation is not met, the secured party (the seller) may rescind the contract and claim restoration of the collat-

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152. Installment sales are not yet a common consumer practice in Korea.
153. Ikuyo 295–304.
154. Ikuyo 293.
156. Japanese Road Transport Vehicles Law, Law No. 185 of 1951, art. 7.
157. Ikuyo 297.
158. Ikuyo 302.
159. Ikuyo 303.
eral from the securing party (the purchaser). The secured party can then sell it to satisfy the debt.

The Use of a Trust

Japan and Korea have imported the Anglo-American law of trusts (shintaku in Japanese and shint’ak in Korean 信託) by special legislation. Yet it is remarkable that these statutes have not been used as a basis for developing new security devices in view of the visible inadequacies of the existing recognized interests. More will be said about the social implications of this failure later, but certainly any full examination of possible Japanese security devices cannot ignore the trust.

Assignment as security performs many of the functions of the trust receipt and the deed of trust, but far from adequately. More extensive protection could be given by structuring the arrangement as a true trust. The only obstacles would seem to be a provision in the respective Trust Laws forbidding a trustee from being the sole beneficiary of a trust and the fact that the conduct of trust activities as a business must be done by a trust company or a bank authorized to act as such.

It can be argued that placing the ownership of collateral in the secured party as a trustee with his right to later repossess it makes him the sole beneficiary of the trust. But Japanese scholars are inclined to reject this argument on the grounds that the securing party is also a co-beneficiary of the trust.

The limitation on the trust business appears to be a greater hurdle. Unquestionably, this provision would require that trust banks (there are no longer any trust companies in either Japan or Korea) always participate in the use of trust security. However, this fact does not necessarily limit the scope of credit to funds provided by them. A new security arrangement much like escrow could be worked out whereby the trust banks would furnish the service of acting as trustees of the ownership of the collateral for a fee while its possession is retained by the securing party. In view of the strong desire of the trust banks to expand their activities by inventing new

160. JAPANESE CIVIL CODE art. 545; KOREAN CIVIL CODE art. 548.
162. Japanese Trust Law, art. 9; Korean Trust Law, art. 29.
164. 9 CHUSHAKU MIMPÔ 326 (1965).
forms of business trusts, this possibility may well become a reality in the future. The only reason that it has not become so earlier is probably because of the general unfamiliarity of Japanese and Korean legal specialists with the trust and its possible uses.

PRIORITIES

In Japan and Korea the question of priority of interests is formally described as the issue of the "right of preferential satisfaction" (yūsen bensai ken in Japanese and usŏn pyŏnje kwŏn in Korean 優先弁済権) or "preferential rights" (yūsen-ken in Japanese and usŏngwŏn in Korean 優先権). Because of a wide variety of special statutes establishing many legal interests—rights of retention (possessory liens) and privileges or preferences (nonpossessory liens)—and numerous exceptions and special situations requiring adjustment, it is difficult to present a full and up-to-date list.

Be that as it may, the following is a general summary of the order of priorities. The numbers indicate the level of priority and letters distinctions within the same level. With items listed together, the one perfected prior in time governs. Priorities in a specific property take precedence over those in property in general. And finally, attaching creditors take after all previously perfected priorities.

Table of Priorities

Outside and Above the List

Retention of title, assignment as security.

Priorities in a Specific Movable or Intangible (Including a Foundation)

1. a. Customs tariff.
   b. Ship privilege.
2. Costs, etc., of a compulsory liquidation proceeding.
3. a. Costs of preserving movables used in agriculture.
   b. Claim for the loan of funds to preserve movables used in agriculture, etc. (in Japan).
   c. Cargo assistance fees.
   d. Claim for the reimbursement of costs by a third party acquiring a hypothecated automobile.
4. a. Rent and fruits of immovables, etc.

165. This list is based on 8 Chūshaku Mimpō 189–90, 192–93.
b. Costs of meals and lodging incurred before taxes have become due.

c. Transportation fees incurred before taxes have become due.

d. Hypothecation rights arising before taxes have become due.

e. Pledge rights created before taxes have become due.

f. Ship hypothecation rights arising before taxes have become due.

g. Rights of retention created before taxes have become due.

h. Wages of agricultural workers arising before taxes have become due (in Japan).

i. Cost of seed and fertilizer received before taxes have become due (in Japan).

j. Rent for land arising before taxes have become due (in Japan).

k. Return of funds deposited under the form of recorded lease known as a “right of transmission” (chonsegwon 伝遺権) arising before taxes have become due (in Korea).

5. National taxes and local taxes.

6. Public charges, social insurance premiums, etc.

7. a. Costs in the public interest.

b. Claim of a condominium owner of a building (in Japan).

c. Claim of a trustee for the reimbursement of expenses, etc.

8. Funeral expenses (including the privilege in Japan or preferential satisfaction in Korea against a reserved portion).

9. Costs of preserving the property in 10. below.

10. Items listed in 4. except h. after taxes have become due when the existence of 12. below is not known (in Japan).

11. Costs of preserving other property.

12. Japan:

a. Price of property.

b. Cost of seed and fertilizer after taxes have become due.

c. Wages of agricultural and factory employees.

d. Claim for the loan of funds to purchase movables used in agriculture, etc., or seed, etc.

13. Items listed in 4. except h. after taxes have become due when the existence of 12. above is known (in Japan).

14. Privileges or preferences converted from commercial rights of retention.

15. General preferential rights other than those listed above.
Priorities in Property in General

1. Costs of compulsory liquidation and costs of delinquency disposition.
2. Recorded general privileges.
3. National taxes, etc.
4. Local taxes, etc.
5. Public charges, social insurance premiums, etc.
6. Costs in the public interest, claim of a condominium owner of a building (in Japan), and claim of a trustee for the reimbursement of expenses, etc.
7. Claim for compensation of automobile damages against one who is self-insured.
8. General privileges of insurers, etc.
9. Claims of employees based upon an employment relationship with a company.
10. Other compensation of employees.
11. Funeral expenses.
12. Supply of daily necessities.
13. Public and company bonds, etc.

CONFLICT RULES

A complete discussion of Japanese and Korean private international law covering the law applicable to secured transactions deserves an essay in itself. Space dictates that we limit ourselves here to a mere summary of the basic rules.

The nature and effects of security interests in movables and bearer obligations are governed by the law of the situs of the property at the time the interest was established. The nature and effects of interests in other obligations and the form and effect of the acts creating any interest—whether in movables or not—must comply with the law elected by the parties or, in the absence of such an intention, by the law of the place of the act. One's ability to perfect rights in an obligation against third parties will depend upon the law of the domicile of the debtor. However, if any of the above rules should violate the public order and good morals of Japan or

Korea, the domestic law of the country will apply.\textsuperscript{169} Furthermore, all procedures for executing a security interest that require the participation of the Japanese and Korean courts must comply with the applicable domestic law.

**A FUNCTIONAL OVERVIEW OF JAPANESE SECURITY DEVICES**

Now let us take a look at the security devices of Japanese and Korean law in terms of the forms of property covered by Article 9 of the *United States Uniform Commercial Code* and see to what extent they are available for use.

*Consumer Goods*

Consumer goods can be pledged except for ships,\textsuperscript{170} automobiles,\textsuperscript{171} aircraft\textsuperscript{172} and Japanese construction machinery\textsuperscript{173} for which a special hypothec is available. These latter goods, as well as Japanese movables used in agriculture, can only be hypothecated separately unless the goods qualify for placement under a foundation hypothec. Goods recorded under a foundation hypothec may not be pledged even if they would ordinarily be eligible had they not been so recorded.\textsuperscript{174} Consumer goods held by a Japanese stock company issuing bonds can be subjected to enterprise security. Assignment as security and retention of title are also always available for all goods.

A pledge prevents the securing party from retaining possession of the goods. Assignment as security and retention of title accord the highest priority to the secured party while Japanese enterprise security has a very low priority. Neither assignment as security nor retention of title fully protects the securing party's legitimate interests in the collateral.

\textsuperscript{169} Japanese Law for the Application of Laws, art. 30; Korean Private Transnational Law, art. 5.

\textsuperscript{170} *JAPANESE COMMERCIAL CODE* art. 850; *KOREAN COMMERCIAL CODE* art. 873.

\textsuperscript{171} Japanese Automobile Hypothec Law, art. 20; Korean Automobile Hypothec Law, art. 8.

\textsuperscript{172} Japanese Aircraft Hypothec Law, art. 23; Korean Aircraft Hypothec Law, art. 8.

\textsuperscript{173} Japanese Construction Machinery Hypothec Law, art. 25.

\textsuperscript{174} Japanese Factory Hypothec Law, art. 33; Japanese Mining Hypothec Law, art. 3; Japanese Fishing Foundation Hypothec Law, art. 6; Japanese Harbor Transport Business Activities Law, art. 26; Japanese Road Traffic Business Activities Law, art. 19; Japanese Railroad Hypothec Law, art. 4; *Japanese Law Concerning the Hypothecation of Tramways*, art. 1; Japanese Canal Law, art. 13; Japanese Tourist Facilities Foundation Hypothec Law, art. 11; Korean Factory Hypothec Law, art. 23(1); Korean Mining Foundation Hypothec Law, art. 5.
Farm Products

Farm products can be pledged, subjected to assignment as security and, in some cases in Japan, hypothecated. Enterprise security is not available because Japanese stock companies are forbidden to engage in agriculture.\footnote{Japanese Agricultural Land Law, Law No. 229 of 1952, art. 3(2)(ii-ii).} Farm products face the same other difficulties as consumer goods.

Inventory

Inventory can be pledged, subjected to assignment as security and, in Japan, subjected to enterprise security. If pledged there must be a transfer of physical possession to the pledgee or some third party acting in his stead. The items are also required to be identifiable. These restrictions make a pledge impractical in the usual situation for a merchant will normally wish to continue to deal in his stock of goods. The priorities and problems with enterprise security and assignment as security remain the same as for consumer goods.\footnote{On the use of assignment as security for inventory in Korea see 1 CHUSOK MINBOP 867.}

Documents, Instruments and Chattel Paper

Documents, instruments and chattel paper may be pledged provided that they are of a bearer character or meet the Japanese and Korean formalities for obligational instruments. They also may be the subject of assignment of security, retention of title and enterprise security. Priorities and problems follow the rules described for consumer goods.

Contract Rights

Contract rights may be pledged if they are in a bearer form or reduced to an obligational instrument. They may not be hypothecated, but are eligible for assignment as security, retention of title and enterprise security. Here too priorities and problems follow the rules for consumer goods.

Accounts

One of the most glaring deficiencies in the Japanese and Korean law of secured transactions is the lack of a device for segregating accounts from other property and using them as collateral. Naturally they can be the subject of enterprise security in Japan, but
this device is only available for bondholders in a stock company and it must involve all the property of the company—not just its accounts. In theory accounts can be pledged and subjected to assignment as security if a separate instrument is prepared for each contract due. This practice being a practical impossibility for the average business, accounts are not normally used as collateral.

**PAST, PRESENT AND FUTURE**

Despite the rickety character of their security devices, Japan and Korea are unquestionably nations founded upon credit. Foreigners are often shocked when they hear that Japan's business financing is based on two-thirds to three-quarters loan rather than equity capital. In Korea this figure goes as high as four-fifths. Although Japan has not attained the level of the United States in its use of consumer credit, it probably makes greater use of it than any country in Western Europe. It can be anticipated that a similar situation will begin to emerge in Korea in the not too distant future. How has all this been possible in Japan, and will it become possible in Korea, without a more sophisticated body of security law?

Historically, the Japanese and Koreans have placed their greatest emphasis in the credit field upon expediting the direct flow of funds to the businessman instead of improving security devices. Accordingly, a great proliferation of different types of financial institutions has emerged to guaranty that all levels of the business world—from the great conglomerate alignments to the smallest shopholder—have a financial institution designed to serve their needs. Policing of the use of funds has been left primarily to careful investigation of the character of the borrower and the still very real sanction of opprobrium of the community against him and his family rather than to the automatic operation of private law security devices. Japanese and Korean business tends to be organized into a series of collective associations\(^\text{177}\) covering the various segments of the economy and types of business operations which pyramid up to the state and its powerful ministries at the top (particularly the Japanese Ministry of Finance and the Korean Economic Planning Board and Ministry of Finance). The financial institutions of the society are closely connected with these associations. Through these organizations the state, which acts essentially as the ultimate source or controller of capital in Japan and Korea, is able to filter funds

177. Even the *zaibatsu* (called *chaebol* in Korean) alignments may be regarded as such associations. In Japan their members have not been subject to any central holding company since the end of World War II.
down to the user and control their employment. The unreliable businessman will not only find that all his sources of funds dry up, but that he may be suspended or expelled by his association with resultant loss of influence in obtaining supplies and the ability to distribute products. Upon this foundation Japan and Korea have constructed what may well be described as a de facto socialist economy and what is certainly the most successful economic organization measured by its results in developing an underdeveloped country ever put into practice in the history of mankind. These countries have had really little need for more efficient security devices. However, various chinks have begun to appear in the armor indicating that what has been true in the past may no longer be true in the future.

Today Japan’s capital needs are so vast and Korea’s are becoming so that by one means or another these countries must obtain funds from the nations of the west. They can no longer depend principally upon economic contacts with countries in a part of the world whose institutions and practices are based upon and mesh well with their own, but must now adjust their operations to the attitudes and assumptions of the western business world. Consequently, Japan has been forced to admit European and American business enterprise into its domestic market in order to avoid having doors slammed in its face abroad. Similar pressures may soon be brought to bear upon Korea as well. Nevertheless, most foreign enterprise has proven itself unwilling to operate in Japan and Korea in accordance with the largely unwritten structure of economic controls and collective organizations founded chiefly upon mutual understanding and custom. Although undeniably this has been partially true because of the incapability of foreigners to understand the system, it is also because Japanese and Korean institutions often conflict directly with the foreigner’s belief that he should always be able to maximize his profits regardless of the effects on other entrepreneurs and the economy as a whole.178

Forces within Japan and Korea are also at work to intensify these foreign pressures. A society normally works most effectively in those sectors where its best people seek employment. The accepted pattern has been for the elite of the leading universities of these nations to become government officials in the economic ministries

178. Naturally this belief is based on the assumption that intense competition among many business units working at cross-purposes will work to the overall common good. On the other hand, the traditional Japanese view since 1867 and the independent Korean view since the early 1960's have been that there should be government planning and cooperative development of business enterprise.
with the result that the economic authority of the state and its bureaucracy has been made legitimate through the high caliber of its personnel. But the great individual economic rewards furnished by Japanese business since the late 1950’s have brought about a major alteration in this trend. Today top-flight Japanese graduates are more likely to seek business than governmental careers. Japanese business is becoming increasingly restive under the system of traditional restraints and sanctions. It is quite conscious of its increasing power and thinks that it can obtain greater benefits if it can free itself from these limitations. While it does not yet have the political might to overturn the authority of the Japanese bureaucracy, it can and has blocked all attempts by the bureaucracy to institutionalize the government’s customary powers through legislation. Korea may be expected to follow a comparable course of development in the near future.

Thus, as more and more foreign enterprise enters Japan and Korea and Japanese and Korean business becomes ever more independent, we can expect the traditional economic system to fragment and for the historical sanctions no longer to work. Consequently, the need emerges for the development of more sophisticated security devices to protect the lending of funds.

Naturally, these prospects lie in the future. But the world economy is operating right now under assumptions quite different from those of the Japanese and Korean domestic economies. While it is true that Japan needs capital in an overall economic sense, it is equally true that its ties with the rest of the world are so close that it is upon the verge of becoming a major capital market in terms of the smaller day-to-day economic world of the average businessman. This development means that more and more loans will be negotiated within Japan with foreigners who are not subject to the traditional safeguards and sanctions of Japanese society. Already many Japanese firms have discovered that a mere credit check is not enough to prevent a loss when dealing with Europeans and Americans. Japanese businessmen will probably demand that the loan agreements be subject to Japanese law which they as creditors can understand. Consequently, that law must possess security devices adequate to protect Japanese interests.

Japanese and Korean commercial law scholars are quite conscious of these economic and social forces at work and of the inadequacies of their particular country’s law of secured transactions. In Japan, many scholars have become quite enamored with the U.S. Uniform Commercial Code and a growing body of voices has begun to emerge calling for the introduction of something along the lines
of UCC Article 9. Enterprise security was a halting attempt to import Anglo-American principles on top of a continental European law base, but its failings are already apparent to all. As the economic and social pressures push toward more extensive and automatic credit guaranties, we may expect the forces of reform in both countries to grow in strength.