

**P.R.I.M.E. Finance**  
**Panel of Recognized International Market Experts in Finance**

**A Year in Case Law: Decisions  
Affecting Financial Contracts – Japanese Supreme Court Moves On**



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# 1. Some Recent Precedents–Accountability

- Supreme Court Judgment dated March 7th, 2013 (1389HANTA (*hanrei taimuzu*) 95).
- Supreme Court Judgment dated March 26th, 2013 (1389HANTA95).
- Both are Interest Rate Swap Transaction cases.
- **Cause of Action:** Lack of accountability, namely hedge purpose of the transactions was not satisfied in each case.
- **Plaintiff:** Small size corporations (retail markets or mid-markets).
- **Defendant:** Sumitomo Mitsui Banking Corporation.
- **Holdings:** The basic structure or theory of the transaction is simple in that its profits or losses would depend on whether the customer’s forecast on the movement of the interest is successful or not. Any entrepreneur can understand the nature of such a transaction generally and there is no problem in holding that the Plaintiff did assume the risk of the transaction. As no early termination was permitted in the agreement explicitly, there is no need for the bank to disclose the calculation method or the early termination payment amount at the time of the entering into the agreement.
- **Analysis:** Accountability on the basic structure of the derivatives transaction and on the risk embedded in the transaction is the key.



## 2. Supreme Court Judgment Dated March 15th, 2016 (1424HANTA103)–Accountability

- **Cause of Action:** Lack of accountability in regard to the issuance of the structured bonds for the purpose of off-balancing, which has a character of “in-substance defeasance.” Requested economic terms by the Plaintiff were tough and the transaction itself was necessarily very complicated.
- **Plaintiff:** The receiver of a large-size listed money lender (currently under insolvency proceedings, but formerly known as “Takefuji” as a giant in the money lending business).
- **Defendants:** Merrill Lynch Japan (arranger) and its overseas affiliate (swap counterparty).
- **Holdings:** The basic structure of the transaction and the risks embedded in it were fully explained and disclosed to the Plaintiff. Therefore, there was no lack of accountability.



- **Analysis:** No new theoretical developments but the case followed the precedents in 1. above. However, this is the first case addressing the accountability issue in the wholesale markets transactions. Probably the same approach would be adopted in the mid-markets transactions, too.



# 3. Supreme Court Judgment Dated July 8th, 2016 (1500KINHAN (kin'yu shoji hanrei) 4)– Multi-party Netting

- **Cause of Action:** Invalidity of a tri-party netting provision (specifically agreed) in the ISDA Master Agreement, which allows the netting using the claims of its affiliates.
- **Plaintiff:** The receiver of Lehman Brothers Japan.
- **Defendants:** The Nomura Trust and Bank Co., Ltd. (NTB).
- **Holdings:** Such a netting arrangement which sets off the claims held by Nomura Securities Co., Ltd. against the indebtedness by NTB is unenforceable after the commencement of the Plaintiff's Civil Rehabilitation Proceeding, even though such arrangement was made when the Plaintiff (the insolvent party) was solvent.
- **Reasonings:** Equal treatment among general creditors rather than the protection of the expectations of the netting arrangement parties.
- **Analysis:** Complete ban on tri-party netting arrangement?
  - Concurring opinion by Judge Katsumi Chiba indicates some hope.
  - Any rescue by documentation?



# 4. Addendum

- The Legal Research and Training Institute of the Supreme Court of Japan is soon publishing a textbook on derivatives (160 pages) written by judges and sponsored by ISDA Tokyo (“Essays on the structure of the financial derivatives and related litigation issues,” 67 Judicial Study Report 2).
- Japanese Financial Services Agency is currently promoting the idea of a “fiduciary duty” of the financial intermediaries. Principle-based approach rather than rule-based approach has been adopted. The new guidelines will be introduced, but there will be no penalty close. The guidelines will be based on the best practice approach but there may be some effect on the judgements by the courts in the areas of accountability and suitability.

- End -



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