

International Bonds and Application of Japanese Mandatory Rules (Summary)

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The Japanese Company Law has two important mechanisms for the protection of debentureholders (hereinafter referred to as “bondholders”): the requirement of a “trustee” (Commercial Code Article 297) and the regulation for the bondholders’ meeting by the courts (particularly, Commercial Code Articles 319 and 327). These rules are mandatory in the sense that they cannot be derogated from by contract. However, it is not clear whether they are mandatory irrespective of the law otherwise applicable.

This Article intends to clarify the manner and grounds of application of the bondholder protection rules. In particular, it examines whether the protection rules should be applied as part of the applicable law designated by the conflict-of-law rules or whether they should be applied as absolute or international mandatory rules, which are obligatory irrespective of the law otherwise applicable.

Article 297 of the Commercial Code provides the requirement for a “trustee”. It requires the debenture issuer to contract with the *Shasai-kanri Kaisha* (commissioned company for bondholders, hereinafter referred to as the “Commissioned Company”). The Commissioned Company, acting on behalf of the bondholders, receives payments, protects rights, and does other matters for the management of special bonds. Most writers interpret this requirement to be mandatory irrespective of the law otherwise applicable. Though I agree with this conclusion, I argue that the reasoning is theoretically faulty in two ways.

First, these writers argue that the Commissioned Company requirement is applied irrespective of the law otherwise applicable, because it belongs to the “public law” or has a public law nature. Secondly, they reason that because the rule is characterized as public law, it should be applied “territorially” in the country of the bond issue. This Article argues that it is the purpose and manner of the regulation intended and employed by the particular legal rule that determines how it should be applied, and not the character of the rule as public or private law.

The Commissioned Company rule is intended for the protection of the individual investors who acquire the publicly offered bonds. It interferes in the issuer-bondholders relationship by inserting a compulsory contract with the Commissioned Company. For the failure of the issuer to comply with the rule, a penalty (*karyo*) not exceeding one

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million yen (approximately US\$9,000) is imposed on the directors and other officers of the issuer (Commercial Code Article 498). This is an expression of a strong public policy that must be implemented irrespective of the law otherwise applicable by choice of law, especially one chosen by the parties.

In contrast, the regulation of the bondholders' meeting by the courts is intended for the proper administration of a bondholders' meeting, which might not be realized by contractual private ordering. The purpose of this regulation is not limited to protection for individual investors of the publicly offered debentures. The regulation is given teeth by requiring a court's consent to make the bondholders' meetings effective (Commercial Code Article 327). Thus, the method of regulation is by way of extension or enhancement of private ordering. The public policy at which this regulation aims is not so mandatory as to apply irrespective of the law otherwise applicable by choice of law. This conclusion is shared by some of the writers who consider the Commissioned Company requirement as internationally mandatory.

The second weakness of the "public law analogy" approach is that it appears to explain the territorial application of the Commissioned Company rule from its public law nature. It is widely accepted that the territorial principle is not the only basis of international or "extraterritorial" application of so called public law. The principle of nationality has long been accepted as a *prima facie* ground for the application of criminal law. The effects doctrine, though not officially recognized in Japan, has support among academic writers for the international application of Japanese anti-monopoly law.

This Article argues that it is important to properly refer to mandatory rules with a public law nature. It is proposed that the terms "absolutely mandatory" rule or "international mandatory" rule be used as they have gained international currency. It is suggested that if the Commissioned Company rule is to be interpreted as an "international mandatory" rule, the scope of its application should be made clear by legislation. It is reasonable to provide that the rule should apply, irrespective of the law otherwise applicable, to the bonds that are publicly offered in the Japanese market.

In the remainder of this Article, I discuss whether the Commissioned Company requirement, as it stands, should be applied when the governing law of the debentures is Japanese. I answer in the affirmative on the following grounds: To say that the Commissioned Company requirement should be *applied* irrespective of the law otherwise applicable does not mean that the rule is *not to be applied* as part of the applicable law designated by the conflict-of-law rules. If the Japanese law is chosen in the terms and conditions of the bonds, it should be applied to protect the expectations of

the parties, i.e., the issuer, subscribers and the investors who acquire the securities on the secondary market. It would be contrary to the expectation of these parties and legal stability if the mandatory rule of the forum is *interpreted* to interfere.

This Article concludes by suggesting that as a matter of legislative policy the Commissioned Company provision, as it stands, is not a wise method of regulation. This provision has produced conflicting interpretations of the scope of international application, and decreases predictability in international business. Its benefit is not demonstrated as against the cost of the regulation. It is suggested that the provision should be deleted completely or more preferably be modified into a default rule, which is used to supplement and enhance the private autonomy of the parties.