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New Developments in Arguments on Legal Liability of Financial Institutions

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While in the United States lender liability actions have recently increased year after year, in Japan arguments have been developed regarding the legal liability/duties of financial institutions parallel with further deregulation and internationalization. This article reviews and analyzes certain new types of legal liability/duties to which Japanese financial institutions are now, or may hereafter be, subject under Japanese law and which are attracting significant attention in banking and legal circles. Legal liability of financial institution can be classified into two: (i) liability/duties arising under general laws (the Civil Code and Commercial Code) which include (a) the liability of a lender to make a loan; (b) the liability of a lender to properly evaluate collateral; (c) the liability of a lender to provide clients with appropriate information; and (d) the "network liability" of a financial institution; and (ii) those under special statutes regulating financial institutions or their business which include (e) the duties of a financial institution under special laws and regulations prohibiting money laundering activities (hereinafter sometimes collectively referred to as the "Money Laundering Prevention Law"); and (f) the liability/duties of a financial institution under the Anti-Monopoly Law. At the end, I present my own view on why lender liability arguments have suddenly become topical in Japan and suggest a practical approach Japanese lenders can take to properly deal with their liability/duties.

I. Introduction

Recently, business corporations have been exposed to ever increasing pressure calling for the expansion of their legal liability in some form or another. Financial

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institutions[1] are no exception. In fact, after a series of scandals involving a number of financial institutions, various legal arguments have been newly developed with respect to the nature and extent of the legal liability of financial institutions. In the United States, the pressure to expand lender liability is getting intensifying as evidenced by the fact that lender liability actions have been increasing. However, many of the newly developed arguments in Japan are founded on either an obscure or an inconsistent legal basis.

In this article I will fundamentally analyze the legal bases and extent of legal liability/duties of financial institutions under Japanese law and then elucidate the importance of such analysis and suggest a practical interpretative approach.

To this end, legal liability/duties will be defined in the Section II. Section III divides them into two: (i) those under general laws (the Civil Code and the Commercial Code); and (ii) those under special statutes regulating them and then analyzes each legal liability/duty for each. Then, Section IV stresses the importance of such analysis and need for a clear-cut legal basis for any such liability/duties to stand, and suggests a practical approach for interpreting the nature and extent of legal liability and obligations to which financial institutions should be subject under Japanese law.

II. Types of Liability to Be Discussed

What does "liability" encompass when used in connection with financial institutions? Though there may be several ideas, it can be classified roughly into two, legal liability and social (or ethical) liability.

Legal liability, which, is invariably accompanied by some disadvantage and/or sanction, can be further classified into three sub-categories: civil liability, which makes the defendant liable to provide the plaintiff with such remedy or relief as damages, restitution or injunctive; criminal liability, which makes the defendant and/or its officers involved subject to a penal sanction; and administrative liability, which makes the defendant or respondent and/or its officers involved subject to an administrative penalty such as the revocation or suspension of a business license, disqualification from office and/or a non-criminal fine. Another possible classification of legal liability is to classify it into the following two groups: (i) liability based on ordinary laws; and (ii) that based on laws enacted specifically for the purpose of regulating financial institutions or their business.

University). However, the interpretation of the applicable laws and regulations, the opinions, and comments introduced in this article are purely the author's who remains fully and solely responsible for any errors.

[1]As used herein, "financial institutions" or "lenders" means only those financial institutions which are mainly engaged in accepting deposits, lending money, and conducting exchange transactions under a valid license issued by the government of Japan under applicable laws; namely, commercial banks, long-term credit banks, trust banks, and *Shinkin* banks and so on.

Like any other business corporation, a financial institution is expected and required to do more than what the law permits it to do, namely it should serve the interests of society; this is social liability. Generally, mere deviation from an applicable social standard does not result in any civil, criminal, or administrative liability, but simply in ethical criticism or reproach. In this sense, social liability has a broader meaning than legal liability. In fact when one talks generally about the liability of financial institutions including its ethical aspect, one often talks about their social liability rather than their legal liability. Legal liability is legally enforceable. From this viewpoint, it has a greater deterrent effect and other effects on financial institutions and their business activities than social or ethical liability. If a financial institution breaches a legal duty, it could result in liability for damages, which could substantially and adversely affect the financial position of the financial institution concerned.

In this article I will discuss legal liability of financial institutions only, not their social or ethical liability.[2] Because of the nature of the business in which financial institutions are engaged, there may be a number of different kinds of legal liability to which they may be subject under Japanese law. Some of them are based solely on long-established civil/commercial law doctrines or principles (conventional legal liability). For example, the concept of contractual or tort liability is generally considered to have been derived from the conventional civil/commercial law doctrine to protect the interests of *bona fide* parties thereto and/or the principle of fair distribution of damages among the parties concerned, another conventional civil/commercial law principle. Another example of the legal liability of financial institutions is their administrative legal liability, which may make them subject to administrative sanction. Their administrative legal liability is generally considered to have stemmed from the statutory requirement to maintain financial soundness as well as the nation's overall banking system.[3] This article only discusses legal liability which is not entirely based on well-established conventional legal

[2]Social liability could, if strictly interpreted, be taken as one form of legal liability. Also, social liability can become legal liability by legislation which would result in a legally enforceable deterrent or sanction. Such legislation is often called "social liability legislation." In this article, social liability is strictly distinguished from legal liability. Therefore, if any element of social liability becomes legal liability by such legislation, it will thereafter be treated as legal liability or obligations in this article.

[3]In this regard, a wide variety of arguments have been made. Some say that the purposes of the Banking Act, which regulates banks and their business, are, as expressly provided in Article 1, "recognizing the public nature of banking, this law aims at maintaining orderly credit, ensuring the sound and appropriate management of banking with a view to protecting depositors and facilitating financial transactions, thereby contributing to the sound development of the national economy." (*See* Article 1 of the Banking Act.) Others argue that the purposes of administrative legal liability are to stabilize banks' operations and performance, to maintain the nation's banking system in good order, to prevent the nation's banking industry or financial market from being adversely affected by a monopoly or oligopoly and to maintain the stability of the nation's banking industry and financial markets. (Most of these arguments are made by monetary or financial theorists to explain "the rational of regulations and supervision over financial institutions conditioned by public sector.")

principles.

Examining recent arguments in favor of legal liability of a certain kind for financial institutions, one easily sees that the proponents have one thing in common — the tendency to emphasize that the protection of customers' rights and interests is more important than maintaining and improving the safety of banking transactions or the financial soundness of financial institutions and/or to try to base their arguments on legal principles which are based on obscure or vague legal concepts, though the degree of such tendency slightly varies from one to another. One typical example of this tendency is that when they argue that a financial institution has a certain obligation, they tend to argue, as one of the grounds for their argument, that financial institutions should have characteristics ("public service characteristics") similar to organizations that serve the public; an argument seldom used in the past. Specifically, this article focuses on financial institutions' liability/duties to extend loans, to fairly evaluate collateral, to provide customers with appropriate information in a timely manner; network liability; and liability under the Anti-Monopoly Law.

III. Analysis of Newly Emerging Legal Liability/Duties

In Japan, when the legal liability/duties of a financial institution are discussed, the "public service characteristics" is often presented as one legal ground upon which such liability/duties can be based. Therefore, in this section an analysis will be made to ascertain the meaning of "public service characteristics" and the substance of other special characteristics which financial institutions are generally believed to have in the context of their legal liability/duties.

A. Legal Status of Financial Institutions

1. "Public service characteristics" of financial institutions and their legal liability

The concept in this context has so changed and expanded with the times,[4] that it is now used in a very equivocal or rather ambiguous or abstract manner.

[4]I believe it is useful to divide the last 65 years (since 1928 when the old Banking Act was put into force) into three: (i) from 1928 to the late 1960s, during which many commentators point out, public interest was understood to mean the "protection of depositors" and the "maintenance of the nation's banking or credit system in good order"; (ii) the late 1970s and the early 1980s, during which decade the current Banking Act was enacted (in 1981) and during which the definition or concept was expanded to include "proper and undisturbed distribution of funds" and the "maintenance of fair trade" in the banking industry; and (iii) from around 1985 to date, during which active arguments have been made so as to ascribe various new meanings in addition to or in lieu of the aforesaid "protection of depositors," "maintenance of the nation's banking or credit system in good order" and "proper and undisturbed distribution of funds," making the concept of "public interest" more vague and equivocal than ever. Such arguments are often placing greater emphasis on maintenance of credit system

It does not seem proper any longer to use or refer to the "public service characteristics" concept as a legal ground when we discuss the legal liability or legal status of financial institutions in a strict sense. Because the concept is often used in a very vague or ambiguous way as explained above, if we permit it to be used as a tool to justify legal liability/duties of, we would virtually make financial institutions subject to an endless list of legal liabilities/duties — a situation in which they would no longer be able to understand the nature, or extent of the legal liability/duties to which they may be subject or exposed.

2. Factors to be taken into consideration when discussing the legal status of financial institutions

If the "public service characteristics" concept cannot be the decisive factor determining the legal status of financial institutions, then can the unique characteristics, if any, of financial institutions still be factors to be taken into consideration?

When asked in what respects the business of financial institutions is unique or distinctively different from that of any other businesses, one could easily answer (i) that a financial institution usually has many more small creditors than any other single business can possibly have, and (ii) that if a financial institution goes bankrupt, it could more easily and adversely affect the entire financial system. Also when asked where their relative strength over their customers comes from or what effect that strength could possibly have, you could answer that (iii) their strength comes from the fact that they have greater professional skills, knowledge and information than their customers; and (iv) any clerical mistake could cause serious damage to the financial position and/or credit standing of the customer concerned, no matter how small the mistake may be.

Financial institutions are under governmental regulation and supervision, primarily because of (i) and (ii) above. If governmental regulation and supervision under existing law is proven insufficient to fully satisfy any reasonable policy goal because of any particular factor or characteristic peculiar to the banking or transactions which financial institutions routinely make, then there may be cases in which new legislation is considered desirable or justifiable to impose additional legal liability; provided that such factor or characteristics be clearly identified.

The need to protect consumers, (iii) and (iv) above, is another factor which we should take into consideration when we discuss the legal liability/duties of financial institutions. This need is not peculiar to the banking industry, but common to all other industries. Though I do not say for sure that there should be more need to protect consumers in banking transactions than in other transactions, it may be safe to say that

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(especially payment system) in good order above any other meanings. Such arguments are also tend to use the term the same meaning as "ethical value." This tendency has become noticeable after the recent scandals involving financial institutions.

financial institutions are expected to protect consumers no less than any other business corporations.[5] Therefore, it is also necessary to correctly define the legal liability/duties of financial institutions from this standpoint.

B. Liability/Duties under General Laws (the Civil Code and the Commercial Code)

For the sake of convenience, legal liability/duties are classified into two: (i) those under general laws such as, without limitation, the Civil Code and the Commercial Code including, but not limited to, the liability to make a loan, to properly evaluate collateral and to provide clients with appropriate information; tort liability; network liability; and fiduciary duties;[6] and (ii) those under special laws — laws such as, but not limited to, the Money Laundering Prevention Law and the Anti-Monopoly Law.

1. Liability/duties to make a loan

a. Scope of the problem

The liability/duties of a financial institution to make a loan can be explained as a contractual obligation to which the financial institution is subject under a loan agreement to which it is a party. This obligation often becomes an issue when a financial institution is sued for damages by a client for its failure or refusal to make a loan which it allegedly promised to make.[7] When one refers to lender liability in Japan, one often refers to either liability of a financial institution under Article 415 of the Civil Code, for the lender's failure to perform a contractual obligation to make a loan or the lender's tort liability under Article 709 of the Civil Code. Needless to say, before a client of a financial institution can effectively argue that the financial institution is under an obligation to make a loan, there must be a binding loan agreement between them. Therefore the time

[5]The term "other business corporations" as used herein means and includes any and all corporations engaged in commercial activities including, without limitation, such utility companies as power companies, but excluding "financial institutions" in a broad sense as mentioned in footnote 1 above and insurance companies and securities companies. Thus, business corporations significantly differ from each other in the nature of their business. To make the analysis more accurate, such difference would have to be taken into consideration when discussing their legal liability/duties in comparison with those of financial institutions. But for the sake of simplicity, I have decided to ignore this difference. When I use the term "other business corporations," I mainly means manufacturing and trading corporations unless otherwise indicated.

[6]There is a wide variety of legal liability/duties to which financial institutions are subject under the Civil Code and the Commercial Code. In this article, however, a preliminary analysis and discussion will be made on only those which cannot be fully explained by the conventional legal theories (*see* Section I), particularly their legal liability/duties with respect to loan transactions and other transactions ancillary thereto.

[7]The problem of the liability/duties of a financial institution may also be raised by its clients if they go bankrupt, allegedly because of the fact that the financial institution suddenly and unexpectedly collect loans or that the financial institution refused to extend an overdraft loan in violation of its overdraft agreements with clients. To make the discussion very clear and concise, however, these problems will not be considered here. If they were, very extensive and complicated argument would be required.

when a loan agreement is concluded by and between the parties thereto is the crucial point to determine whether the financial institution is in fact under a legally enforceable obligation to make a loan to the client. Also, there may be cases where a lender liability problem is raised even before a financial institution and its client enter into binding agreement — a problem of negligence in the conclusion of a contract (*culpa in contrahendo*).

b. Case law

There are several useful court cases dealing with lender liability.[8] Cases in which the conclusion of a valid and legally enforceable loan agreement between a financial institution and its client was denied include the decisions rendered by the Miyazaki District Court (Miyakonojo Branch) on January 20, 1989, the Tokyo High Court on April 13, 1989 and the Shizuoka District Court on September 28, 1989. These cases were instituted against financial institutions by their clients, who mistook what they had been told by lending officers of the defendant for a binding lending commitment. The Shizuoka District Court held in its decision that there was no legally binding or enforceable loan agreement between the parties because the plaintiff failed to produce evidence showing that the defendant made itself "subject to a legally binding obligation to make the loan in question to the plaintiff."

In contrast, in a case for damages brought against a bank by its client, the Tokyo District Court held in its decision delivered on January 27, 1992 that the fact that the bank, after having entered into a legally binding loan commitment agreement with the plaintiff, refused to extend to the plaintiff the loan without justifiable reason constituted a tort and that the bank was liable to pay damages to the plaintiff. In this case, which was a tort liability case, the court found that there existed between the parties a legally binding loan commitment on which the plaintiff's claim could be based. Such court, however, denied the plaintiff's allegation that a legally binding loan agreement[9] came into existence between the parties at the time when the defendant bank issued the written statement to the plaintiff certifying the defendant bank's commitment to make the loan in question. This case also involved the problem of the lender's default in the performance of a legally binding obligation to make a loan, a contractual default. "It is reasonable," the court held, "to consider that a binding loan commitment agreement came into existence between Y Bank and the X_1 Corporation when the former prepared and delivered to the latter a written statement certifying the bank's commitment to make a

[8]Recently, in Japan some cases have been seen in which financial institutions are sued for damages by their clients for their failure or refusal to make loans that they agreed to make under legally binding loan agreements (*see* Yamada, 1991). For court cases dealing with loan commitments or agreements or financial institutions' obligations to extend loans, see also T. Matsumoto, 1990.

[9]According to the Civil Code in Japan, a legally binding "commitment" agreement has a different effect from a legally binding agreement, that is, the "commitment" is a kind of promise which a party has the option to conclude the agreement formally (*see* Article 556 of the Civil Code).

loan to the latter. The fact that Y Bank...refused to extend the loan as promised without justicable reason and, as a result thereof, forced the X_1 Corporation to desperately look for an alternative sources of funds and caused excessive anxiety to X_2, who was the chief executive officer of the X_1 Corporation, constituted a tortious act against the X_1 Corporation and X_2."

c. When and how does a financial institution become legally liable to make a loan?

Did the courts in the above-mentioned cases introduce any new interpretative rule or theory that the conclusion of a legally binding agreements is a significantly earlier stage than any other agreements which other business corporations may make with their customers? Opinion is divided on when a loan agreement becomes a legally binding contract, particularly in relation to Article 587 of the Civil Code.[10]

Because of the lack of an express provision or guiding principle in the Civil Code governing the time when a legally binding consensual contract comes into existence, namely, when the agreement between the parties is considered reached, if a dispute arises between any two parties as to whether or when a consensual contract between them comes into existence, the matter should be resolved on a case-by-case basis by interpretation of their respective intent (express or implied) and all other relevant factors involved (*see* Kawakami, 1988). In this respect, there are some commentators in Japan

[10]A contract for a loan for consumption is an agreement by which one person delivers to another a certain quantity of things which are consumed by the borrower, with the obligation to return as much of the same kind and quality. Article 587 of the Civil Code stipulates that a loan for consumption becomes legally binding and enforceable only when a party thereto receives from the other something, such as a money loan, which he agrees to borrow from the other and return not in specie, but in kind. Opinion is divided as to when such a contract becomes legally binding and enforceable in relation to this statutory requirement for delivery — the lender under the contract is required to deliver to the borrower something, such as a money loan before the contract is legally completed and becomes legally binding and enforceable. Those who emphasize this requirement, tend to argue that no contract for a loan for consumption can become legally binding and enforceable unless and until the lender actually effects delivery and that therefore he is under no obligation to make such delivery. Against this view is the opinion that in view of the fact that the Civil Code expressly contemplates and permits in Article 589 an option to extend or obtain a loan for consumption, there is enough room to permit something like a "consensual contract for a loan for consumption" which can be founded on and completed solely by the mere agreement of the contracting parties. Followers of this opinion argue that Article 587 does not exclude a consensual contract for money loan, in other words, an oral agreement is enough to make a binding agreement. In this respect, too, opinion is divided on the nature of the loan agreement which financial institutions make in their day to day business. One opinion provides that the loan agreement is essentially a legally binding and enforceable option to extend or obtain a loan. The other provides that the loan agreement is essentially a consensual contract for a money loan. Followers of the former view, however, generally agree that upon exercise by the borrower of the option, a legally binding formal loan agreement comes into existence, in accordance with which the lender is legally obliged to extend a loan to the borrower. Which one of the two views you would follow in this respect would not make much difference in terms of the respective legal positions of the lender and the borrower, except for the assignability or seizability of the borrower's right to obtain the loan (*see* T. Matsumoto, 1990). There is a court case which approved the theory of a consensual loan contract (*see* the judgment of the Supreme Court delivered on March 26, 1973).

who are of the opinion that a simple oral promise is enough to constitute a legally binding loan agreement. The majority opinion, however, is that where there is only an oral promise to make a loan and no physical evidence whatsoever to support such promise, it is practically very difficult, if not altogether impossible, to make the finding that there exists a legally bindig loan agreement.

In the case cited above, in which the Tokyo High Court denied, in its decision rendered on April 13, 1989, the existence of a legally binding loan agreement between the parties, no written request for a loan was made by the borrower nor any credit check of the borrower by the credit investigation section of the headquarters of the lender. Also, as mentioned earlier, in the case decided on January 27, 1992, the Tokyo District Court, which obviously considered it very important that the defendant bank had gone as far as giving the defendant a written statement certifying its lending commitment, still denied that a legally binding loan agreement had come into existence, though it held at the same time that an option to enter into a formal loan agreement was considered to have been granted by the bank.

Precedent indicates that when it comes to agreements other than loan agreements, particularly sale and purchase agreements involving very expensive real property or ships or large development agreements, courts are very cautious about determining when such agreements came into existence as legally binding agreements. Courts often take the position that an oral agreement or even a letter of intent made or signed between any two or more parties during the course of negotiation is nothing but a matter of record to confirm what has so far been discussed between them so that they can use it as reference material to expedite future negotiations (*see* Kawakami, 1988). These facts seem to indicate that courts do not arbitrarily apply laws or legal principles that loan agreements which financial institutions make in their day to day business become legally binding and enforceable at an earlier stage of negotiation than any other contracts or agreements. Therefore, we can say that even if a financial institution is held by a court to be liable to extend a loan, it does not necessarily mean that it is so held because of the public service characteristics in an abstract sense and/or other special legal status nor mean that courts in general arbitrarily apply laws and/or legal principles to make financial institutions subject to unreasonably greater legal liability/duties.

d. Forced loan agreements and financial institutions' duty to extend loans thereunder

The arguments in paragraphs *b.* and *c.* above are based on the principle of "freedom of contract."[11] It may be theoretically possible to bend freedom of contract in favor of

[11]"Freedom of contract" is one of the most important principles of the Civil Code. It embraces the concept of (i) freedom of entering into a contract, which can be further classified into (a) freedom of entering or not entering a contract; and (b) freedom of selecting a party/parties with whom to make a contract; (ii) freedom regarding the substance of a contract; and (iii) freedom regarding the form of a contract (*see* Hoshino, 1987). These days, however, freedom of contract is subject to various legal restraints designed to champion the weak against the strong.

consumers and impose upon financial institutions a legally enforceable obligation to extend to their clients loans (which they do not intend to make) by legally restricting their right or freedom to refuse to make loan agreements. Suekawa and Yamashita call it, a "mandatory obligation" (*see* Suekawa, 1970, and Yamashita, 1983). Though this "mandatory obligation" theory is not new, in the absence of any express statutory provision the theory has never been tested to any meaningful extent in relation to financial institutions and loan agreements.

In Japan it is practically very difficult, if not impossible, for any person or corporation other than existing financial institutions to obtain a banking business license now. From this aspect, existing financial institutions are very well protected from competition from outsiders. These circumstances are similar to these of certain corporations engaged in utilities or which enjoy a monopoly by law. Considering that these corporations are made subject to the mandatory contractual obligations,[12] it is not impossible to make financial institutions subject to these obligations. In addition, for the interest of and protection of consumers, the right to refuse to enter loan agreements can be restricted or limited to a certain extent. These ideas deserve attention when considering lender liability.

e. Emphasizing lender liability from an economic effect viewpoint

Apart from the jurisprudential discussions we have just made, any argument in favor of making financial institutions indiscriminately subject to a lending obligation is unacceptable from a practical economic effect viewpoint. There are some who overemphasize the role which financial institutions are expected to play in the proper distribution of available funds and argue that the government should intervene more actively in commercial transactions of financial institutions so that they can be more easily forced to extend loans which they do not intend to make. But if the government is allowed to force commercial financial institutions to play a more active role in the proper distribution of available funds, it would tend, I am afraid, to lead to excessive governmental intervention in a market ecomomy.

Too much emphasis on the proper distribution of available funds is undesirable from the viewpoint of regulation and supervision of financial institutions. Needless to say, as a member of the financial system each financial institution is expected to maintain its own financial soundness. If financial institutions were pressured into extending loans against their will to help smaller and less creditworthy borrowers, obviously they would ultimately be forced to extend loans even to very risky borrowers. This is entirely against one of the most important regulatory policy goals — to maintain and to improve the financial soundness of financial institutions under its supervision. In view of the fact that most Japanese financial institutions are commercial enterprises, any idea allowing too much

[12] *See* Article 18.1 of the Electricity Enterprises Act and Article 16 of the Gas Enterprises Act.

governmental intervention may be incompatible with the freedom of enterprise which they are entitled to pursue and enjoy.

Since the lending obligation is associated with main business which are unique and exclusive to financial institutions, we need distinct criteria to enable us to correctly judge when a financial institution becomes liable to make a loan.

f. Lender liability before the conclusion of a loan agreement

We have just discussed the legal liability/duties of financial institutions to their clients after the conclusion of loan agreements with them. In this subparagraph a brief discussion will be made on lender liability of another type, that is, the legal liability to which lenders may be subject to because of any act or omission before the conclusion of a loan contract. Some forcefully argue that even in the absence of a legally binding loan agreement financial institutions should be held legally liable to clients or potential clients for misleading them into believing that they could obtain loans. If a financial institution willfully deceives a client, it undoubtedly constitutes, they argue, a fraud and the financial institution should be subject to tort liability. Even if a financial institution does not go as far as to commit a fraud, it could, they continue, still be made liable for damages by the "doctrine of fault in the course of the conclusion of a contract (*culpa in contrahendo*)."[13] The doctrine has been developed to entitle a *bona fide* party to claim damages against the other party to a contract where an invalid contract was concluded and the *bona fide* party who concluded the contract erroneously believed that the contract was valid and, as a result, thereof suffered damages. Liability under this doctrine is based on the "principle of good faith and fair dealing,"[14] which is different from contractual or tort liability.

Courts used to be reluctant to accept liability of this kind with respect to financial institutions until the Osaka District Court awarded, in its decision delivered October 12, 1991, damages against the defendant financial institution for certain conducts during the course of negotiations relating to a note and bill discounting agreement. The court held that once any two parties "have started negotiating with each other with a view to entering into a contract, and negotiations have progressed to a stage where they have started placing a certain degree of confidence in each other, a relationship closer than that between any ordinary citizens, namely a legal relationship which is governed by the

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[13]The "doctrine of fault in the course of the conclusion of a contract (*culpa in contrahendo*)" is where a party to a contract can be made liable for damages to the other if the first party is proven to have concluded the contract despite the fact that he knew or could have known at the time of conclusion that the contract was totally or partially impossible and because of conclusion misled the other party into believing that the contract was fully valid and enforceable in accordance with its terms and hence caused damage. This doctrine was originally developed by German courts and scholars. Though the doctrine has not been made a written law in our Civil Code, it is generally accepted by scholars. For more details about the doctrine and court cases based on it, *see* Kawakami (1988).

[14]The "good faith and fair dealing principle" is the requirement that everyone must act in good faith and in an equitable manner in exercising or performing his rights or obligations. This principle is found in Article 1.2 of the Civil Code.

principle of good faith and fair dealing, is considered to have been developed and come into existence. Once they are bound by such a legal relationship, they fall under the principle of good faith and fair dealing and are obliged to deal with each other in such way as to cause the least possible damage to each other's honor, reputation, or assets." Since liability/duty of this kind seldom became an issue for financial transactions in the past,[15] it needs further review and analysis, and the future development of court cases on this particular issue also needs close monitoring.

2. *Other liability/duties to which financial institutions may be subject under general laws (the Civil Code and the Commercial Code) in connection with financial transactions*

Lender liability, discussed above, is the liability to which a financial institution may be subject when it fails or refuses to make a loan which it is legally obliged to make. There may also be cases in which a financial institution may be held liable for damages for making, rather than not making, a loan or for taking any other action or committing an omission in connection with financial transactions with clients. This subsection addresses this kind of liability.

a. Financial institutions' duty to properly evaluate collateral

Financial institutions' duty to properly evaluate collateral is the duty to fairly and properly evaluate any asset which they are about to accept as collateral when they make a loan. This particular duty was first recognized in the argument of a defendant in a case decided by the Osaka District Court on October 29, 1991. The defendant argued that its rights and interests should be protected based on the principle of good faith and fair dealing in a situation in which it fully relied on the plaintiff bank's evaluation of the assets it offered as collateral and believed that the evaluation was fair and reasonable. Ever since, this particular liability has become topical among academic circles concerned (*see* Nagao, 1991). In the case, the Osaka District Court, though not expressly referring to the "liability to fairly and properly evaluate collateral," held that the defendant borrower itself was fully aware, when the plaintiff bank evaluated the assets which the defendant borrower gave to the plaintiff bank as collateral, that the plaintiff bank made the evaluation not for or on behalf of any purchaser (in this case, borrower) of such assets but for its own benefit and on its own behalf.

Some commentators, however, criticize the Osaka District Court's decision (*see*

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[15]The problem of a fault committed before the execution of a contract seldom became an issue in court cases in the past involving an actual or alleged contract for a loan, though it often became an issue in court cases involving a sale and purchase contract or contract for work (*ukeoi keiyaku*; Article 632 *et. seq.*of the Civil Code). This is obviously because of the fact that the majority opinion considered a loan contract required delivery (*see* footnote 10) and that the parties to loan agreements did not negotiate as often as parties to sale and purchase agreements or agreements for work (*see* Yamada, 1991).

Nagao, 1991). They argue that financial institutions are considered to be always under the obligation to make a fair and reasonable evaluation of any asset which they accept as collateral for two reasons. First, every financial institution is expected, as an institution licensed by government to engage in banking, to fulfill its official role of "protecting depositors, maintaining the integrity of the financial system, effective and appropriate distribution of the available funds," and dealing with clients in a fair and equitable manner so as to repay the confidence placed in them. The line of credit it offers or extends to any particular client should be determined strictly on the value of the collateral put up by or for the client. If a financial institution offered or extended to any client a line of credit far in excess of the value of the collateral offered, it would constitute an excessive credit or undercollateralized loan, which runs against the public service charateristics of financial institutions. Second, most persons who offer assets to a financial institution as collateral to obtain a loan or other form of credit usually have blind confidence that the financial institution will make a fair and equitable evaluation of the collateral and, such confidence, if placed, should be properly repaid. (This is based on the principle of good faith and fair dealing, one of the fundamental principles of our law of obligations.)

However, in view of the fact that the "public service characteristics" notion as used in connection with financial institutions is yet to be clearly defined as mentioned in Section III. A. above, it is not proper, I believe, to argue that because of their public service characteristics, whenever they take any asset as collateral, financial institutions are under the obligation to make a fair and equitable evaluation. Also, the argument that financial institutions should properly repay the confidence placed in them by their clients *per se* seems weak as a reason for imposing the legal liability on financial institutions to make a fair and equitable evaluation of any asset they take as collateral. Financial institutions are to make a fair evaluation of any asset they accept as collateral, not merely because they owe their borrowers the legal obligation, but primarily because by so doing they can minimize their potential credit risks.

Besides, if borrowers were legally permitted to refuse repayment of their outstanding loans for any actual or alleged unfair evaluation made by their lender of any asset offered by them as collateral, even solvent borrowers might try to refuse repayment of their outstanding loans under the pretext of an actual or alleged unfair evaluation made by their lender of any asset they offered as collateral, thereby significantly increasing the lender's credit risks. There is also another anxiety. It is important for every financial institution to make a fair and equitable evaluation of collateral they accept from their borrowers or guarantors from the viewpoint of the maintenance of financial soundness of their operations. There is no question about that. But if they were to be held fully and solely liable for any and all financial losses that might be caused by their failure in making a fair and equitable evaluation of any collateral they accepted, the result would be entirely against the stated regulatory purpose of maintaining financial soundness of financial institutions.

For this reason, it is difficult to accept the idea that financial institutions are always under the legal obligation to make a fair and equitable evaluation of the collateral they accept.

b. Financial institutions' liability to provide their clients with appropriate information

Financial transactions have become more and more sophisticated, complicated, and technical. This subsection focuses on whether financial institutions should always be under a legal obligation or duty to provide their clients with appropriate information about financial products, services or transactions they are selling, providing or offering to their clients even if no such information is solicited and in the absence of any express statutory provision imposing such duty on them, and if so, what is the possible legal basis therefor.

Cases in which financial institutions can be sued by their clients for a failure to provide sufficient information can be classified into two categories (*see* Onishi, 1991). The first category comprises cases where financial institutions are sued by clients for damages for actual or alleged failure to provide sufficient information in breach of the obligation to do so. The second category comprises cases where financial institutions are sued by clients for a declaratory judgment that contracts made between them are null and void *ab initio* because of a material misunderstanding on the part of the plaintiffs caused by insufficient information provided by the defendant financial institutions.[16] Financial institutions may also incur substantial financial losses if they lose these cases. Cases belonging to the first category will be discussed because whether financial institutions are always under the implied legal duty to provide clients with appropriate information will always be at issue in those cases.

Financial institutions used to deal primarily or exclusively with fixed-income type of financial products with full guarantee to repay principal. Recently, however, a number of new sophisticated financial products (whose investment value and/or investment income fluctuate widely depending on the stock and/or exchange markets) have been developed, and, as a result of the deregulation of the financial industry, financial institutions have started actively dealing with such new financial products. The underlying concepts of these new financial products are very new to their clients. Under these circumstances, if an officer or account representative of a financial institution gives (in a conversation with his/her clients) any forecast with respect to the stock market, foreign exchange market and/or the money market, it tends to mislead the clients. It is under these circumstances

[16]In cases belonging to the first category, if the financial transaction contract in question is proven to have been properly concluded and has become a legally enforceable contract, then they are primarily contractual default cases governed by Article 415 of the Civil Code. Otherwise, they are essentially cases of fault or negligence in the course of the conclusion of the contract. The main issue in cases belonging to the second category is always whether there was any material misunderstanding on the part of the clients for the purposes of Article 95 of the Civil Code. Tort liability under Article 709 of the Civil Code may be at issue in cases in both categories.

that financial institutions' implied legal duty to provide appropriate business information has become topical these days.

The decision of the Osaka District Court, January 29, 1987 is useful for reference purposes when discussing financial institutions' implied legal duty to provide appropriate business information. In this case, the court held that when the defendant bank solicited the plaintiff corporation (an unsophisticated smaller enterprise having no knowledge or prior experience in transactions involving foreign exchanges) to raise funds by borrowing an "impact loan" (a loan denominated by foreign currency), particularly when the plaintiff corporation had no reason or need for using such a financing technique, the defendant bank had the implied legal duty under the principle of good faith and fair dealing to give the plaintiff corporation a full explanation to enable it to fully understand the mechanism of an impact loan and the potential risks to which it might be exposed depending on fluctuations in commercial interest rates in the money market and/or of the exchange rates involved. On the other hand, It may be worthwhile mentioning, however, that in a recent case (a tort call) a bank was held not legally liable to its client for the information given or not given by it to the client because the court saw no illegality in the bank's act of providing to or withholding any information from the client in light of common sense (*see* the decision of the Tokyo District Court, June 26, 1992).

In view of the fact that financial products or services offered or dealt with by financial institutions have become more and more sophisticated, complicated, and technical, it is practically difficult to flatly deny the argument that when financial institutions enter into transactions with their clients they are always under the implied legal duty to give the clients proper and sufficient information about the nature of the transactions and the risks involved, if any. Under these circumstances, perhaps the practical and recommendable approach would be to discuss to whom financial institutions should give such information and to what extent financial institutions should explain the nature or risk of the financial products or services they offer in order to be effectively exempted from liability for damages.

Most argument that financial institutions always have the implied duty to provide their clients with proper and sufficient information in a timely manner is based on the principle of good faith and fair dealing as courts did, but not on the social status such as public service characteristics of financial institutions in an abstract sense. The extent to which financial institutions are required to give their clients information about the transactions they are going to make depends very much on the degree of sophistication of the clients. Therefore, any attempt to generally justify such argument by referring to the social status of financial institutions such as public service characteristics in an abstract sense apart from the nature of the specific transactions involved is rather unconvincing. Thus, if financial institutions are subject to any implied legal duty to provide information about their products or services, it must not be special in nature, but essentially common to the implied legal liability, if any, to which manufacturers, traders or providers of special or sophisticated products or services.

As more sophisticated or novel financial products or services are expected to emerge during the years to come, financial institutions' implied legal duty to provide information will become more topical than ever. In order to be fully prepared, financial institutions must undertake extensive preliminary analysis and research as to what information they will be required to give clients, when, how, and to what extent.[17]

c. Tort liability

When a financial institution's tort liability (under Articles 709 *et seq.* of the Civil Code) arises, it is in most cases for "transactional torts."[18] A tort liability claim even in the case of transactional torts is seldom alleged by itself. In most cases it is alleged together with a contractual default liability claim under Article 415 of the Civil Code.

An analysis of recent leading court cases in which financial institutions' tort liability under Article 709 was at issue indicates that no judge was particularly in favor of the idea of expanding financial institutions' tort liability. Some scholars or commentators, however, tend to expand financial institutions' tort liability under Article 709 by broadly interpreting the elements of the tort thereunder as applied to financial institutions. For example, some scholars argue that even a simple clerical mistake committed by an officer or clerk of a financial institution in a financial transaction for any of its clients may, because of the nature of their business, result in serious damage to the financial position and/or credit standing of that client and/or other person involved in the transaction and that therefore it is necessary to explore the possibility of broadening the legal definition of "negligence" as applied to financial institutions or making financial institutions subject to stricter tort liability akin to "strict liability" or "absolute liability" (*see* Tokumoto and Sakamaki, 1981). Technically, financial institutions have special characteristics, but this cannot fully justify the idea of expanding financial institutions' tort liability by means of establishing a negligence test for exclusive application to financial institutions which is broader than typical negligence so that courts could easily find "negligence" on the part of financial institutions. Recently, attempts have been made by scholars to change the concept of "negligence liability" to make it close to that of "strict liability" or "absolute liability. These attempts, however, have been made primarily in connection with factual

[17]It may also be necessary and desirable for financial institutions to make similar preliminary research as to what information they should provide to whom, when, how, and to what extent, when they provide to their clients any new sophisticated financial product or a complicated packaged transaction in which a sale and purchase contract (*see a.* above), service contract and/or other contract(s) are packaged with a loan agreement.

It may also be necessary and desirable for them to provide information about how the loan agreement would be affected if the ancillary sale and purchase contract and/or service contract is cancelled, or held invalid for any reason.

[18]The term "transactional tort" is defined to mean any tortious act which takes the form of a transaction or which arises in the course of a transaction. Technically it is distinguishable from a "factual tort," which is a pure tort independent of a transaction.

tortious acts, typically, involved in pollution cases. I doubt that similar attempts can be justified with respect to the tort liability of financial institutions in view of the fact that the type of tort arising out of financial transactions is limited to transactional torts.

Thus, it is difficult to accept the argument that tort liability should be interpreted so as to make financial institutions subject to "stricter tort liability" than other business corporations. It is, however, expected that as the number of court cases in which financial institutions are sued for violations of their contractual liability increases in the future, the number of cases in which they are sued for both violations of their contractual liability and tort liability will also increase proportionately. If that is the case, we must keep a close eye on the changes in the interpretation of existing tort liability as applied to financial institutions.

d. Network liability theory

In their day-to-day business every financial institution provides its clients with settlement services through one or more banking networks in which many financial institutions participate. These days such settlement services are provided mostly by an electronic system — an electronic funds transfer (EFT) system. This raises a serious question. If any failure occurs and any account fails to be settled properly in time as a result of such failure, who, among those parties involved in the EFT networks concerned, including financial institutions and communication service companies, should be held liable for damages resulting from such failure or for the time, efforts, and costs that may be required to explain the trouble to the clients involved or to correct the failure and process the settlement contemplated, and to what extent? It is under these circumstances that "network liability theory" has become topical in countries in which EFT systems are in operation, particularly in the United States.

Network liability theory is generally understood as a theory that makes a bank ("payer bank") primarily liable to its client when an instruction given by a client to transfer a sum of money to a payee at the payee's account maintained with another bank ("payee bank") fails to be properly excecuted somewhere in the process of the transfer, even though due to an unidentified cause or a cause attributable to a person or entity other than the payer bank, including, but not limited to the payee bank.[19] As discussed below, traditionally, leading scholarly opinion and case law in Japan agreed that an instruction given by a client to the payer bank to transfer a sum of money to the account of the payee creates an agency relationship between the client and the payer bank rather than a contract between them as independent contractors. Under these circumstances, it seems difficult for the network liability theory to gain general public acceptance in Japan. Therefore, in this area the development of new interpretative theories of the Civil Code and the Commercial Codes is much desired.

[19]As "network liability" or "network liability theory" are not clearly established among scholars and practitioners, I use them in the most commonly accepted meaning.

Should the payer bank be held liable to its client if a sum of money transferred by the payer bank at the request of the client fails to be properly credited to the payee's account in time, and, if it should, to what extent? There are three different answers. Two at polar opposites and the third in the middle. One answer is that the payer bank should not be held liable in any way to the client except in certain limited cases. Another is that the payer bank should be held fully and solely liable to the client for any and all acts and omissions done by any parties involved in the banking networks concerned. The third is that the payer bank should be liable to the client only for those failures or problems which occur before a certain point (liability distribution point) in the whole process between the payer bank and the payee bank. Which answer one takes depends very much on how one categorizes the nature of the legal relationship between the payer bank and client when the client gives the payer bank an instruction to transfer a sum of money to the payee's bank account. Traditionally leading scholarly opinion and case law in Japan on this issue agree that an instruction which a client gives to his bank to transfer a sum of money to the payee's account creates an agency relationship. Under this theory, the payer bank's liability to the client tends to be very limited. If, on the contrary, such an instruction is considered to create a contract as independent contractors, the extent of the liability of the payer bank to the client tends to be expanded.[20] Scholars and practitioners in favor of the network liability theory say (i) in EFT transactions, in which it is often practically difficult to identify or prove the true cause of a failure or problem which occurs during the process, clients' interests can be better protected by making the payer bank primarily liable to clients for any and all failures or problems which occur in the process of the transactions; (ii) that financial institutions have a great advantage from using these networks dealing with a very high volume of funds transferring transactions in their day-to-day operations; and (iii) financial institutions are in a better position than their clients to identify and control risks and costs involved in EFT transactions because they have far greater power to develop and gather data and information than their clients. Against this,

[20]If an instruction given by a client to a bank to transfer a sum of money to the payee's account is to be considered to constitute a contract between them as independent contractors for the purpose of Article 632 of the Civil Code, the bank is obliged to complete the job undertaken by it thereunder. This view tends to lead to the conclusion that the payer bank is fully and solely responsible to see that the job undertaken by it is fully completed as contemplated, namely, that the money is fully and properly credited to the payee's account in time, and that therefore the payer bank should be held fully and solely liable to the client for any and all failures or problems which occur during the process of transferring funds. If, on the contrary, such instruction is to be considered to involve only an agency relationship between them for the purpose of Article 643 of the Civil Code, then the payer bank would be considered to have fully and properly performed its duties as agent as long as it makes a proper arrangement for the transfer of the funds and that it could not and should not be held liable to the client for any subsequent problems which occur in the process of transferring funds. Leading scholarly opinion and case law on this particular issue agree that such an instruction given by a client to his bank involves an agency relationship between them. (For legal implications of such an instruction, *see* Matsumoto (1990) and references listed in the bibliography thereof.) Note that some commentators argue that the legal nature of EFT transactions cannot be fully explained by the typical argument (*see* Iwahara, 1988).

scholars and practitioners who are against the network liability theory point out (i) that in any EFT transaction, the payee bank is not selected or designated by the payer bank, but by the client of the payer bank; (ii) that the payer bank has no effective power or means to prevent any other intervening banks from committing errors or mistakes in processing EFT transactions; and (iii) that if the payer bank were to be held primarily liable to its client for any failure or error which occurs in the process of an EFT transaction, the payer bank would be required to assume unduly great financial risks because of making up for these losses.

As mentioned earlier, traditionally, case law has taken the view that an agency relationship is created between a client and the payer bank when an instruction is given by the client to the payer bank to transfer a sum of money to the payee's account maintained with the payee bank and that in no event shall the payer bank be held liable to the client for any failure or error committed by the payee bank or intermediary banks. It should be noted, however, that where the funds to be credited to the account of the payee were credited to someone else's account because of an error on the part of the payee bank, the Takamatsu High Court held in its decision delivered on October 18, 1989 that the transfer of funds actually made in this case, made by "Bank X (the payer bank) either jointly with Bank Y (the payee bank) or with the assistance of Bank Y as its assisting agent... could not be considered to be full and satisfactory performance by Bank X of the obligation undertaken by it..." and that therefore Bank X was liable to the plaintiff client for a default under Article 415 of the Civil Code. While sticking to the traditional view that an instruction given by a client to the payer bank to transfer a sum of money to the account of the payee maintained with the payee bank created an agency relationship, this decision was unique that the payer bank as the agent for the client was liable to the client even for an error or failure committed by the payee bank, which the high court characterized as an assisting agent hired by the payer bank. It is still premature to jump to the conclusion that such high court decision marked the turning point in case law in Japan on this particular issue towards support for network liability theory. We must monitor case law developments on this particular subject. If the network liability theory is accepted in Japan, the agency relationship theory, to which leading scholarly opinion and case law have long stuck, may be reconsidered.

In the field of the international transfer of funds, however, there is an active movement for the introduction of a liability theory which is very close to network liability theory. For example, Article 14 (money-back guarantee) of the model law drafted by UNCITRAL provides that in certain circumstances the originator's bank (the payer bank) is obliged to refund to the originator (payer) any payment received from it.[21] This

[21]The term "money-back guarantee" as used in connection with international transfers means the mandatory guarantee obligation which the originator bank (payer bank) is required to assume when it accepts a payment order given by an originator (a client). Subject to certain exceptions, this obligation is to refund to the

provision is generally considered a liability provision similar to the network liability theory.[22] Obviously when the drafters of the model law decided to introduce Article 14 they considered the public acceptance or reliance factor: namely, that an international network established for transferring funds from a point in one country to another point in another remote country connected with the network could not gain public acceptance or reliance unless the originator bank (payer bank) was made primarily liable to pay the money back to the client if the money got lost or mislaid in the course of the transferring process and failed to be credited to the payee's account for any reason or cause, regardless of whether the originator bank (payer bank) could ultimately recover the money back from the bank, among other intervening banks, which still held the money in its possession or under its control or whose fault it was that the money got lost or mislaid. In Japan, however, case law has not yet gone far enough to interpret existing laws so flexibly as to accept network liability theory with respect to international fund transfer transactions (*see* the decision of the Tokyo High Court delivered on February 14, 1979). This difference between the model law and Japanese case law stems, some commentators point out, primarily from the fact that while the model law has been drafted under the assumption that every bank is free to reject an instruction given by the client to transfer funds to the payee's account, in Japan banks are practically not allowed to enjoy such freedom (*see* S. Matsumoto, 1990).

Network liability theory has been developed to provide better protection to clients in exchange for imposing heavier than ever legal liability on payer banks, but has certain negative effects. As mentioned earlier, under this theory, the payer bank has to assume the primary liability to compensate the client for any financial loss, even if such loss is beyond the reasonable control of the payer bank. This will certainly discourage many financial institutions from participating in an international network. Also, if financial institutions are to pay damages to clients simply because they acted as payer banks in

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originator (payer) any payment recived from it, with interest from the day of payment to the day of refund, if the sum of money gets lost or mislaid in the transferring process and fails to be credited to the payee's account for any reason or cause whatsoever, regardless of whether the originator bank (payer bank) gets the money back. Of course, the originator's bank and each subsequent receiving bank is entitled to the return of any funds it has paid to its receiving bank, with interest from the day of payment to the day of refund. Therefore, theoretically the originator bank (payer bank) can ultimately recoup the money it pays back. However, there still remains an unresolved serious problem in this connection. That is, who should assume the resulting financial loss, if any of the receiving banks is prevented from returning of any funds it has paid to its receiving bank due to its bankruptcy or any exchange regulations imposed by any government.

[22]In the process of reviewing the legal guide for drafting UNCITRAL's Model Law, it had been initially expected that the originator bank's (payer bank's) obligation to pay the money back to the client in case of a total failure to credit the money to the payee's account or pay damages to the client in case of late crediting would be dealt with in the model law as an integral part of liability under the network liability theory. However, network liability theory was finally dropped from the model law, and the money-back guarantee obligation is now dealt with in what is now Article 14 of the model law, and its obligation to pay damages in case of delayed credit transfer in what is now Article 17 thereof.

these transactions without any fault on their part, their financial soundness may be unexpectedly substantially hurt. Accordingly, how to compromise the need to protect clients and maintain reliability and sound development of EFT systems is a big hurdle to clear when establishing a rule to divide legal liability in an EFT transaction.

As banking networks are expected to expand and improve in the years to come, more attention will focus on who should be held liable for what and to what extent. Accordingly, we must keep a close eye on developments concerning the network liability theory and the general trend of case law regarding EFT transactions.

3. Fiduciary duty

"Fiduciary duty" is fundamentally a duty to act for someone else's benefit, while subordinating one's personal interests to that of the other person. It is the highest standard of duty implied by law. Recently, it is considered "fiduciary duty" also means a duty which a person has when he acts in a professional capacity and which is higher in degree than a duty or obligation founded simply on contract.[23] The concept of "fiduciary," which has been developed and accepted by U.S. case law, was originally developed in the field of trust law to mean someone with the attributes of a trustee. The concept of "fiduciary" has not yet been widely recognized or accepted in Japan[24] (*see* Kanda, 1991).

As persons with professional knowledge or skills play increasingly greater roles in our society, they are expected to maintain a high standard of business ethics so that they will not pursue their own profit at the expense of those for whom they serve, such as the beneficiaries of a trust. It is under these circumstances that strong calls have arisen from various parts of society that professionals should be made subject to a higher degree of legal liability/duties than those founded simply on contract. It is not altogether surprising to hear someone arguing that financial institutions should be made subject to a higher degree of legal liability/duties than other business corporations because they are organizations consisting of persons having professional knowledge and/or skills.

Let us analyze a bit further the idea that business corporations or entities which deal with products or services of a highly professional/technical nature must assume a legal duty to exercise a higher degree of care.[25] Nowadays the financial industry is not the only

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[23]A fiduciary duty is not easily discernable unlike the duties to make a loan, to make a fair and equitable evaluation of collateral, or to provide appropriate information to clients discussed in Section III. B. *1.*, *2. a.* and *2. b.* above. Therefore, I consider it proper to discuss fiduciary duty separately from those other liability/duties in connection therewith.

[24]In Japan, which has developed essentially as a non-discriminatory homogenous society, some commentators point out that individualism is not as strong as in the United States or the United Kingdom. This is one reason why the idea that someone with the attributes of a trustee has to take a higher degree of responsibility has not been more widely accepted (*see* Kanda, 1991).

[25]The concept of "fiduciary duty" has been traditionally developed in connection with a trustee's duty. It means that a person acting as a trustee for a trust is considered to have the legal duty to manage the assets of the trust strictly for the purposes specified by the beneficiary of the trust and not to seek his own profit at the

one which deals with services or products of a highly technical nature. Therefore, it does not seem reasonable to overemphasize the technical nature of the services or products which financial institutions provide, and to argue that only financial institutions should be subject to a legal duty to exercise a higher degree of care in their day-to-day business operations than other business corporations. Thus, the issues of financial institutions' fiduciary duty still need further study and debate before such duty can be generally recognized as a legal duty to which financial institutions are subject independently from any other legal duties. However, as products and services become more and more complex, there is the possibility that the need for highly professional knowledge and skills will be taken into consideration and the concept of fiduciary duty thus play a greater role when discussing concrete legal liability, such as liability in regard to providing clients with appropriate information.

4. Financial institutions as regulated business entities and their liability under the Civil Code and the Commercial Code

Article 4.1 of the Banking Act provides that no financial institutions shall be permitted to engage in banking activities unless they obtain and maintain a valid business license. In this sense they are regulated entities. This paragraph briefly discusses whether financial institutions are, or should be, subject under the Civil Code and/or the Commercial Code to any special or additional legal liability/duty to which they would not otherwise be subject merely because they are regulated business entities.

There have been controversial arguments as to the legal nature of a "statutory business license." But a statutory licensing system, if introduced in any industry, is essentially a means to effectively prevent or limit new entrants. Therefore, the fact that an industry has a statutory licensing system and therefore is considered as a regulated industry has nothing to do with the argument that participants in such an industry should bear greater or less legal liability than others under the Civil Code or the Commercial Code. Like any other statutory licensing system, the Banking Act was designed to only affect the rights and duties of those persons or entities who are participants or proposed

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expense of the beneficiaries. Basically it has nothing to do with any professional knowledge, skill, or qualification. It is, however, true that persons with professional capacity play greater roles than ever before. If, under these circumstances, the need for making such persons subject to greater legal liability than others is to be discussed, the professional nature of the services they provide *per se* may be justification for making them subject to special legal liability close to fiducial duty. It may be worth mentioning here that the Commercial Code expressly stipulates the fiduciary duty of members of the board of directors of business corporations in Article 254-III. On an issue involving the relationship between directors' fiduciary duty under Article 254- III and the duty to exercise reasonsable care and skill under the Civil Code, the Supreme Court held that Article 254-III was introduced "simply to clarify and amplify the duty" under the Civil Code to exercise the care of a good custodian, not to establish any new duty of a higher degree than the duty to exercise the care of a good custodian which is associated with an ordinary agency relationship (*see* the decision delivered by the Supreme Court on June 24, 1970). Leading scholarly opinion supports this decision.

participants in the industry, not to affect directly those of other people or entities. Therefore, the argument that financial institutions should be subject to any special or additional legal liability/duties thereunder simply because they belong to a regulated industry is unreasonable because it would consequently allow the legal effects of the licensing system to extend beyond financial institutions to clients and other parties with whom they deal.

C. Legal Liability/Duties of Financial Institutions under Special Laws and Regulations

1. Legal duties under money laundering prevention laws

Money laundering prevention laws primarily comprise the Narcotics and Psychotropic Drugs Control Amendment Act (hereinafter the "Drugs Control Act") and the Law of Special Treatments for the Narcotics and Psychotropic Drugs Control Act for the Prevention of Activities to Promote Offenses Involving Controlled Drugs under International Cooperation Act (hereinafter referred to as the "Special Act"), as well as circular (*KURA-GIN* No.1283, 1992) entitled "Prevention of Money Laundering Activities Associated with Drug Trafficking Offenses" issued by the Banking Bureau of the Ministry of Finance. These acts and regulations have been enacted or introduced as part of the Japanese government's program to make its domestic laws and regulations compatible with the international standards recently adopted for the effective prevention of international drug trafficking offenses which have lately become more internationalized and institutionalized. Included in such international standards were what was known as the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances which Japan ratified in December, and the statement of Principles of the Basel Communique issued in December 1988.

Financial institutions are now subject to two new major legal duties specifically designed to prevent of illegal money laundering: (i) the duty under Article 5.1 of the Exceptions Act which requires financial institutions to report doubtful transactions ("reporting duty") and (ii) the duty under the ministerial circular to positively identify clients with whom they deal ("identifying duty").[26]

Why does the law impose these new legal duties only on financial institutions? There can be two possible logical explanations: (i) to effectively deprive criminal organizations and syndicates involved in drug trafficking offenses of huge amounts of profits it is necessary to prevent financial institutions from being used for illegal money laundering; (ii) because of the public service characteristics of financial institutions, it is undesirable to allow their services to be used for such illegal transactions as money laundering.

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[26]This duty is based solely on the circular notice. Therefore it may not be proper to describe it as a legal duty in a strict sense. But in this article it will be treated as one of the legal duties to which financial institutions are subject, since it has been introduced by the circular notice, which has been issued for the effective implementation of the statute under which it has been issued.

This latter explanation is weak because it is just as undesirable for other business corporations to be involved in criminal offenses. Therefore, any argument emphasizing financial institutions' public service characteristics to support their reporting duty or identifying duty is unacceptable.

Some criticize the identifying duty imposed on financial institutions arguing that since allowing a person or entity to open and maintain an account for the purpose of laundering money obtained from illegal drug trafficking *per se* could not and would not directly and adversely affect the financial soundness of the financial institution, it seems that financial institutions are unduly forced to incur and pay additional expenses by complying with the identifying duty to help prevent money laundering. But, as mentioned earlier, the cooperation of financial institutions in preventing money laundering is specifically requested because it is considered most effective. Such additional expenses would be minimal and financial institutions should, I believe, assume such expenses as minimum business expenses to help implement a policy measure which is in the public interest. If financial institutions bear a small share of the cost to achieve such a goal, it must ultimately benefit them too. In this sense, additional expenses which financial institutions are required to pay for compliance with the identifying duty are necessary.

It may be worthwhile mentioning that there was a Supreme Court case in which financial institutions' duty to check the identity of clients in usual deposit transactions was denied. (*see* the decision of the Supreme Court delivered on March 2, 1989). In this case the Supreme Court held that financial institutions had no duty to check customer identity or since each effected "hundreds of thousands of deposit transactions with numerous customers daily and if a bank were to do so operational speed and efficiency would be so seriously and adversely affected that ultimately economic activity would be hampered." The rule established by this case does not necessarily affect the interpretation of "identifying duty" for money laundering prevention purposes because the person or entity to whom financial institutions owed the duty to check the identity of their customers or purported customers in the above-cited case was different from the person or entity to whom they owe such duty. However the "operational speed and efficiency" which the Supreme Court emphasized in the above case, is one important factor which should be taken into consideration when discussing identifying duty. Therefore, while financial institutions should positively evaluate the purposes for which this duty has been introduced and accept it as a special duty imposed on them of necessity to help the police detect money laundering activities, they must seriously consider how to effect or dovetail it with their need for "operational speed and efficiency."

2. Legal liability duties under the Anti-Monopoly Law

a. Underlying reasons why the enforcement of the Anti-Monopoly Law against the financial industry has become suddenly topical

The Prohibition of Private Monopolization and the Maintenance of Fair Trade Act (hereinafter referred to as the "Anti-Monopoly Law") was enacted primarily for the purpose of promoting fair and free competition so as to help safeguard the interests of consumers and facilitate the democratic and sound development of the nation's economy. (The Anti-Monopoly Act and rules and regulations promulgated thereunder shall hereinafter be sometimes collectively referred to as the "Anti-Monopoly Law.") The Anti-Monopoly Law prohibits or otherwise regulates a number of trade practices which are designed to impede or have the effect of impeding fair competition. Included in such prohibited or regulated trade practices are what are called the "three major prohibitions," namely; (i) the prohibition of private monopolization; (ii) the prohibition of unlawful trade restraint; and (iii) the prohibition of unfair trade practices.[27]

In Japan the stricter application and enforcement of the Anti-Monopoly Law to the trade practices of financial institutions has suddenly become topical. Of course there have been several cases in which financial institutions were named defendants or respondents in suits or administrative proceedings instituted under the Anti-Monopoly Law.[28] Why has it suddenly become topical? Generally the three factors explained below are pointed out as the possible reasons (*see* Hasegawa, 1991 and others).

First, parallel with the recent Structural Impediments Initiative (SII) sessions between the U.S. and Japanese Government, the latter has launched several action programs designed to enforce the Anti-Monopoly Law more strictly. Included, new legislation was promulgated on April 26, 1991 to amend the Anti-Monopoly Law to increase the

[27] A violation of the Anti-Monopoly Law may result in: (i) an administrative sanction such as an order to take a remedial action or an administrative fine; (ii) a criminal sanction; and/or (iii) a civil sanction. Unlike civil sanctions under other statutes, those under the Anti-Monopoly Law take the form of strict liability for damages (*see* Article 25 of the Anti-Monopoly Act). While it is one of the guiding principles of the Civil Code and the Commercial Code to exclude governmental intervention in private economic activities as much as possible under the assumption that all individuals, corporations, and other entities have equal economic power, the Anti-Monopoly Law is a statute specifically designed to empower the government to positively interfere in private economic activities. Thus, in this article the legal liability of financial institutions under the Anti-Monopoly Law will be taken as legal liability under special laws as distinguished from general law such as the Civil Code or the Commercial Code.

[28] As early as an award delivered on December 22, 1947, the Fair Trade Commission held that the act of forming and maintaining an interest rate cartel constituted a violation of the Anti-Monopoly Law. In a case where a certain financial institution interfered with the personnel affairs of some of its borrowers, the Commission held in an award delivered by it on June 3, 1957 that the financial institution's act in question constituted a violation of the Anti-Monopoly Law. There was also a Supreme Court case. In its decision delivered on June 20, 1977, the Supreme Court held that financial institutions' business practice of forcing borrowers to maintain *buzumi* and *ryodate* deposits, which are compensating deposits which must retain a part of the amount lent at the time of lending, constituted a violation of the Anti-Monopoly Law.

basic ceiling of the administrative fine which the Commission could impose on any individual, corporation or other entity which found guilty of an illegal trade practice under the act from 1.5% to 6% of the amount of gross sales obtained by such individual, corporation, or entity through such illegal trade practice. As these action programs have been put into practice, the Commission is now expected to play a more active role in the strict enforcement of the act, as amended.

Second, recent further deregulation and reform of Japan's financial system may be an explanation. As many of the statutory restrictions and/or restrictive trade practices which existed have now been either totally lifted or substantially mitigated as a result of the recent further implementation by the government of its programs for the deregulation of the financial system, financial institutions are enjoying such an unprecedented and freedom of business operations that the Anti-Monopoly Law is now expected to play a more active role than ever to check their business activities.

Third, a series of scandals involving major financial institutions also acted to trigger stricter enforcement of the Anti-Monopoly Law vis-à-vis financial institutions. Strong calls arose demanding an effective system(s) which would enable the public to monitor the business practices of securities firms and financial institutions more easily and directly than before and which would be helpful to achieve greater fairness in their trade practices. As a means to achieve these goals, stricter enforcement of the Anti-Monopoly Law vis-à-vis securities firms and other financial institutions was proposed.

Thus, the activities of financial institutions are now subject to stricter scrutiny under the Anti-Monopoly Law. Why could the financial industry virtually stay out of the reach of the Anti-Monopoly Law in the past? There are two different types of exemptions from the Anti-Monopoly Law, statutory exemptions and those which have been developed through the interpretation of the act ("interpretative exemptions"). It is generally considered that the exemptions which the financial industry heretofore enjoyed were interpretative exemptions. It was taken for granted that the industry was entitled to those exemptions because its business was regulated by statutory licensing, which, in fact, worked as effectively as free competition to establish and maintain good order in the industry and also to prevent the adverse effects of becoming a statutory oligopolistic industry (*see* Hasegawa, 1991). This view may be subject to strong criticism from those scholars and practitioners who are in favor of strict enforcement of the Anti-Monopoly Law. They would probably argue that no logical interpretation of the existing laws and regulations permits the financial industry to stay out of the reach of the Anti-Monopoly Law and that if the industry has, in fact, so far stayed out of its reach, it must be nothing but a mere luck and coincidence.

Whichever opinion you accept, the fact still remains that the Anti-Monopoly Law is, and will be, enforced more strictly than ever vis-à-vis financial institutions, as well as other businesses or corporations. Thus, it is probably not true that the law is interpreted and enforced so as to make financial institutions subject to greater legal liability than other businesses or corporations.

Based on this understanding, financial institutions should, I believe, make themselves fully familiar with the restrictions and requirements under the Anti-Monopoly Law and assume whatever additional costs they may incur (to comply with such restrictions and requirements) as necessary costs associated with the deregulation of the financial system as other businesses or corporations do.

In the following subsections I will discuss some of the restrictions and requirements under the Anti-Monopoly Law which seem important to financial institutions.

b. Prevention of private monopolization and undue trade restraints

The Anti-Monopoly Law prohibits both "private monopolization" and "undue trade restraint" because if permitted to occur in any particular market or sector thereof, they would substantially restrict competition. "Private monopolization," defined in Article 2.5 of the Anti-Monopoly Act is expressly prohibited by Article 3 thereof, while "undue trade restraint," defined in Article 2.6 and which usually takes the form of a cartel, is also expressly prohibited by Article 3.

Recent suspected cartel cases involving financial institutions include one which occurred in mid-September 1991 when all major city banks simultaneously changed their respective short-term prime lending rates. Being suspected of forming a cartel, all major city banks were summoned to the Fair Trade Commission to explain the change in the rates.

Most commentators and practitioners agree that if in the above-cited case any concerted act for the purpose of Article 2.6, a necessary condition for finding a cartel, was involved among city banks, or, in other words, if there was any collusion (such as any prior discussions), what they did constituted a violation of the Anti-Monopoly Law. Few commentators or practitioners disagree with this (*see* Negishi, 1992, for example).

It is often said that the ability of financial institutions to do business on their own initiative in fact restricted by such *gyosei shido* (administrative directives) which may be given from time to time by the regulatory agencies (*see* Negishi, 1992). There was a very famous court case on *gyosei shido* (*see* the decision of the Supreme Court delivered on February 24, 1989). Arguments have been made for several decades and continue to rage on the relation, from different aspects, between *gyosei shido* and cartels.[29] Included in them is the argument on whether the illegality of a cartel created based on, or as a result

[29]There are two basic questions about cartels involving *gyosei shido*. The first is in the case of a cartel created in compliance with *gyosei shido*, whether such *gyosei shido per se* is against the public interest which the Anti-Monopoly Law is expected to protect and therefore illegal in the light of the principle of priority of law over *gyosei shido*. The second question is if the very act of creating a cartel committed by businesses or corporations in compliance with *gyosei shido* constitutes a violation of the Anti-Monopoly Law. The problem in the second question is whether the cartel so created can be considered illegal as a product of a concerted act by the members of the cartel for the purpose of Articles 3 and 8.1.1 and, if it can, then whether its illegality can be eliminated due to the involvement of *gyosei shido*.

of *gyosei shido*, can be diminished or totally eliminated for the purpose of the Anti-Monopoly Law due to the involvement of an administrative agency. Before that Supreme Court case, case law and the Fair Trade Commission shared the common view that as a matter of principle, the illegality of an act committed in violation of the Anti-Monopoly Law could not be eliminated due to the involvement therein of *gyosei shido*. In the above-cited case, however, the Supreme Court held that subject to certain limitations, the illegality of a concerted act committed by two or more businesses or corporations in compliance with *gyosei shido* could be eliminated. According to the principle laid down by that case, in order for *gyosei shido* to be justified as an act to facilitate a lawful concerted act committed by any two or more businesses or corporations, it should satisfy the following three tests:

(1) that there exists an objective circumstance demanding such action;

(2) that the actions or omissions requested are reasonable in all respects from a common sense standpoint; and

(3) that the purpose is compatible with the ultimate purpose for which the Anti-Monopoly Law was enacted.

But it is considered that even under this principle the possibility is rather remote that a concerted act in compliance with gyosei shido can be legally justified. Thus, in view of the fact that cases in which a concerted act in compliance with *gyosei shido* can be legally justified are exceptionally rare and, considering the requirement under the compatibility test mentioned in (3) above, I see no reason why financial institutions should be treated differently from other businesses or corporations in cartel cases.

c. Prevention of unfair trade practices

Article 19 of the Anti-Monopoly Act expressly prohibits the use of any unfair trade practice. This article has been introduced to prevent any business or corporation from employing any trade practice which can impede fair competition. Pursuant to the authority given by Article 2.9 of the Anti-Monopoly Act, the Fair Trade Commission issued the Commission's Notification No. 15 "Unfair Trade Practices — General Designation," which is a list typifying unfair trade practices. Among other unfair trade practices typified in the list, what concerns financial institutions most is "abuse of dominant bargaining position" (*see* Group 14 of such list). For the purposes of the Anti-Monopoly Law, any business, corporation, or entity is considered to have a dominant bargaining position over another person, business, corporation or entity not only when it has absolute dominant bargaining position guaranteed by its monopolistic or oligopolistic position in the market, but also when it has dominant bargaining position over its opponent to such an extent as to enable it to force its opponent to accept any unduly unfavorable trade terms or condition against the latter's will. In a certain transaction, whether one party has dominant bargaining position over the other is determined based upon, among several factors, the degree of the other's dependence on the first mentioned party, the first mentioned party's ranking or position in the market, and so on.

It seems that financial institutions are generally considered to have a dominant bargaining position over borrowers who are invariably dependent on financial institutions as sources of funds. If it is correct, financial institutions would have a greater risk of being caught by the Anti-Monopoly Law in connection with their transactions with borrowers. As mentioned earlier, however, whether one has dominant bargaining position over another for purposes of the Anti-Monopoly Law is to be determined not generally but specifically on a case-by-case basis. Therefore it is not proper to conclude hastily and unconditionally that financial institutions always have dominant bargaining position over their borrowers for purposes of the Anti-Monopoly Law. Conversely, this means that every financial institution should be alert about its legal position for purposes of the Anti-Monopoly Law whenever it makes any transaction with any of its customers, particularly when it has a dominant bargaining power with the customer.

d. Limitations on stockholding

Stockholding is one of the most effective means to obtain control over any corporation. To prevent economic power from being excessively concentrated in and controlled by a limited number of individuals or large corporations, however, the Anti-Monopoly Law places certain limitations on stockholding which any individual, corporation, or entity can make in another corporation (*see* Articles 9, 9-2, 10, 11 and 14 of the Anti-Monopoly Act). Financial institutions are subject to a particularly stringent limitations (*see* Article 11 of the Anti-Monopoly Act).

Though opinion is equally divided on the interpretation of the purposes for which Article 11 of the Anti-Monopoly Act was introduced, both schools agree that financial institutions are different from other business corporations in that they have far greater financial resources and influence. Hence, from this angle, it is true that financial institutions are subject to greater legal restrictions or liability under the Anti-Monopoly Law than other business corporations. But it should be noted that they are not so subject because of their "public service characteristics" or any other unique characteristic they have in an abstract sense.

It should also be noted that while under Article 10.2 of the Anti-Monopoly Act, every corporation of a certain size or greater is required to periodically report to the Fair Trade Commission its holdings in other corporations, financial institutions are exempted from this reporting obligation. Thus, it may be said that the stockholding restrictions imposed on financial institutions are not substantially stricter than those imposed on other business corporations thereunder.

In addition to the areas of the Anti-Monopoly Law we have just discussed, there are also other areas of the Anti-Monopoly Law about which financial institutions must be careful including, but not limited to, mergers and acquisitions. The greater the role financial institutions play in our economic life, the higher the possibility of their exposure to legal liability under the Anti-Monopoly Law in several aspects.

IV. Future Developments in Arguments on the Legal Liability of Financial Institutions

Based on previous discussion, this section will examine the importance of analytical approaches and the need for solid legal principles when discussing or determining the legal liability of financial institutions and the degree to which they should assume it.

A. Importance of Using Analytical Approaches when Discussing or Determining the Legal Liability of Financial Institutions

As mentioned, there are various factors which make the legal liability of financial institutions a topical subject including the ongoing movement to reexamine corporate legal liability in general. Another factor is the deregulation of the financial industry. Thereby financial institutions may now advance into new business fields which used to be closed to them. Financial services or products which they now provide are so complicated and diversified that they tend to get trapped in legal problems or disputes more easily than before. There may be two aspects. First, as many services and products which financial institutions provide have become technically very complex and diversified with recent deregulation, the way they handled clients in the past became obsolete and ineffective in complying with the legal duties they owed their clients, such as the duty to provide proper and sufficient information in a timely manner. Failure to provide such information in a timely manner tends to damage their clients, thus exposing financial institutions to greater liability for damages. Second, as a result of deregulation, the public is now more concerned with financial institutions' legal liability in certain areas, such as liability under the Anti-Monopoly Law, and pays more attention as well as the legal liability of other business corporations. If recent deregulation has indeed triggered reexamination of the legal liability, financial institutions may well encounter more problems in various fields as the current deregulation schedule progresses.

Under these circumstances, it is very important that financial institutions analyze and identify the nature and extent of legal liability/duties to which they are now or may hereafter be subject. Such efforts will be rewarded because they will provide useful knowledge and data, which can be used to prevent unnecessary costly litigation or other legal proceedings such as huge awards for damages or expensive out-of-court settlements.

The court cases we reviewed indicate that the court did not interpret or apply laws to financial institutions so as to impose unduly heavy legal liability/duties. This seems to indicate that financial institutions could have avoided such cases had they correctly identified the nature and extent of their legal liability.

Also, to make themselves mindful of legal risks and liability to which they may be exposed, financial institutions must have a full and correct knowledge about the nature and extent of all legal risks and potential liability involved in their operations. In other words, financial institutions must have such knowledge before they can make themselves mindful of potential risks and liability, and properly use such knowledge for their day-to-day operations. As shown above, in some of the cases cited the court developed new interpretations (*see* the Osaka District Court's decision delivered on October 12, 1990 *supra.* and the Takamatsu High Court's decision delivered on October 18, 1989 *supra*). Therefore, future developments in arguments concerning on financial institutions' legal liability must be closely monitored.

B. Need for a Clear Legal Basis

The legal environment in which financial institutions operate is getting increasingly severe. Under these circumstances, it is important for every financial institution to have, before making any transaction, a clear picture of the nature and extent of the legal liability to which it may be exposed in the course of or as a result of such transaction. For that purpose, they must carefully review the legal base upon which such legal liability is founded. As mentioned earlier (Section I. A.), it does not seem proper to use or refer to such an abstract concept as "public service characteristics" when discussing the legal liability of financial institutions in a strict sense. Since this concept is often used in a very vague or ambiguous way, if it is used to justify or explain any legal liability/duty of financial institutions, it would confuse, rather than clarify, the nature and extent of such legal liability/duty, making financial institutions unable to correctly discern what they are legally permitted to do and what they are not in their daily transactions (especially with respect to legally complicated transactions). Should such a situation happen, their basic operating principle of "do things at your own risk and responsibility" would end in empty talk.

Also, if existing laws and regulations are permitted to be arbitrarily interpreted and applied to financial institutions to unduly extend the legal liability/duties to which they are subject, they would be dispirited for fear of potential legal risks, or they might be forced to make loans or do things which they did not intend, which is entirely against the current direction of Japan's financial, *i.e.* deregulation.

Besides, if such arbitrary interpretation and application is permitted, financial institutions would be required to incur additional costs and expenses. In the United States for example, debate continues on the effects of the regulatory burdens. As mentioned in connection with financial institutions' liability to provide information, what is important here is to how to keep a balance between the benefits accruing from the achievement of the purposes and the cost required.

Traditionally, there has been an argument that financial institutions' legal liability should be treated differently than that of other business corporations (*see* Kunii, 1986, for example). But the argument that different legal standards or tests should be applied to financial institutions from those applied to business corporations is also problematical. If such discriminatory treatment is permitted before making a thorough analysis to identify the legal ground or justification therefor, financial institutions would soon be forced to accept an unduly heavy legal liability. Therefore, any discussion on their legal liability should be based on a non-discriminatory interpretation of applicable laws and regulations, at least initially.

From this viewpoint, any interpretation of applicable laws and regulations which is biased or designed to unduly and excessively expand, or has the effect of unduly and excessively expanding financial institutions' legal liability, be avoided by all means.

C. Extent of Legal Liability to be Undertaken by Financial Institutions

Then, how should we interpret applicable laws and regulations when we discuss the legal liability of financial institutions?

The case law and the scholarly opinions we have reviewed seem to indicate that there may be an opinion or a point of view when interpreting applicable laws for the purpose of discussing financial institutions' legal liability. That rule essentially dictates that when discussing financial institutions' legal liability under general law, such as their duty to provide information, such laws should be interpreted so that financial institutions will be made subject to similar legal liability to the similar extent as that imposed on other business corporations. This does not, however, totally deny the possibility that there may be cases in which the principle of general law needs to be modified for certain specific purposes. There may also be cases where such a rule will be modified by special legislation introduced to achieve a reasonably specific policy goal and financial institutions' legal liability will be thereby expanded to a certain extent. But even in such a case, no such vague or abstract excuse as the "public service characteristics" of financial institutions should be used to modify such a rule. Such a rule may be modified only when there is a specific and reasonable policy goal to attain and when such goal cannot be effectively attained without such modification. Even in such cases, laws should not be unnecessarily or arbitrarily stretched against financial institutions. In this sense, if such a law is to be modified in any way, it would be better to modify it by new legislation rather than by changing the interpretation of existing laws.

There may be cases where financial institutions alone should be required to undertake special legal liability under a special law ("reporting duty" under the Money Laundering Prevention Law is a good example), but such cases should be strictly limited to where there is no other practical alternative to achieve a specific and reasonable policy goal or to effectively reduce the social cost that may be required to achieve such goal. Also, when interpreting a special law which imposes special legal liability not only on financial institutions but also on other business corporations or on a particular group of other business corporations, such as, but not limited to, the Anti-Monopoly Law, it should be interpreted so that legal liability will be imposed on financial institutions in, and to the same degree and extent, as such other business corporations or groups.

V. Concluding Remarks

As Japanese corporations and the public become more conscious about corporations' legal liability, particularly product liability and that under intellectual property laws including copyright and patent laws, it is expected that financial institutions' risk of being exposed to legal liability will substantially increase. Arguments on their legal liability, among other arguments touching financial institutions or Japan's banking system, will inevitably and substantially affect their business behavior and operations and therefore are not negligible.

Under these circumstances, there is an immediate need for more intense study and analysis of financial institutions' legal liability *per se* and also its relation to the maintenance of the reliability and integrity of the financial system, how to maintain balance between their legal liability and the need for the protection of customers and the extent of the applicability of the basic business principle of "do things at your own risk and responsibility."

Thus, it is absolutely necessary to correctly identify those legal problems that financial institutions may encounter in their day-to-day operations and make correct interpretations of all basic laws to which they are subject. It is particularly important that before any legal liability can be imposed on financial institutions without any express statutory basis, careful discussion and research be made to find an unchallengeable legal justification.

It is also important to undertake further research on financial institutions' legal liability from different points of view and approaches, such as how to share liability and responsibilities between financial institutions and their clients and investors or making a comparative study of financial institutions' legal liability and that of other corporations or other financial institutions, for example, insurance companies or securities firms.

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