

## Banking - Japan

### Court rules on freezing bank accounts

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### Introduction

If a debtor defaults on a loan agreement, the financial institution may collect that loan from the debtor's ordinary deposit through acceleration and offset. However, an issue arises as to whether the financial institution may freeze the ordinary deposit in order to secure its claim without taking formal acceleration when the debtor's credit is uncertain, resulting in the debtor being unable to withdraw the deposit – and, if so, under what conditions.

Under the Civil Code, an ordinary deposit should be returned when the depositor requests it, and the freezing of a bank account generally has a serious and negative impact on the debtor's credibility. Therefore, the freezing of a bank account may develop into a legal dispute where the debtor claims compensation for damages against the financial institution on the grounds that the freezing of a bank account is a tortious act or a default of the financial institution's obligation. Most of the relevant lower courts' decisions deny the liability of financial institutions. However, a recent decision of the Tokyo High Court (acting as the court of appeal), while maintaining the decision of the district court, denied the liability of a financial institution and indicated the grounds on which it is justified to freeze a bank account.

### Facts

In May 2005 a bank and a debtor entered into a banking transaction agreement and began banking transactions. The agreement had an acceleration clause; it stated that one of the causes of acceleration is "[a] situation which requires the bank to take measures to secure its claim against the debtor" and that acceleration was conditional on the notice from the bank to the debtor.

In May and June 2008 the bank loaned Y150 million on the bills to the debtor. According to the bank, the bank and the debtor agreed that the debtor should allocate the money received from its customers to the repayment of the loan, although the debtor denied such agreement between the parties. The debtor used the money received from its customers for working capital, rather than allocating it to the loan on the bills, and continued to ask the bank to reschedule the loan payments.

Although the bank demanded that the debtor provide additional security, repay Y50 million by September 10 2008 and submit its rehabilitation plan by September 17 2008, the debtor did not respond to such demands. On the contrary, on September 22 2008 the debtor asked the bank to approve the allocation of money received from customers to the employees' salaries. Refusing such request, the bank froze the debtor's ordinary deposit at the bank in order to secure its claim against the debtor that day.

On December 25 2008 the bank sent the notice of acceleration to the debtor. Thereafter, the bank sued the debtor for payment of the balance of the loan on the bills; as a counterclaim, the debtor demanded that the bank pay damages caused by the freezing of the ordinary deposit, which impaired the debtor's credibility, on the grounds of default of obligation or a tortious act.

### Lower court judgment

On November 8 2011 the Kofu District Court admitted the bank's demand and dismissed the debtor's claim, denying the bank's liability for freezing the ordinary deposit on the grounds of default of obligation and a tortious act.

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The district court recognised the fact that the bank had made the loan on the condition of the agreement that money received from the debtor's customers would be allocated to repayment of the loan. Based on this fact, the district court held that as of September 22 2008, there was an objective necessity for the bank to secure its claim against the debtor, and the bank had reason to freeze the ordinary deposit as an urgent and unavoidable measure. Thus, the freezing was a reasonable measure and a legal act.

The debtor appealed to the Tokyo High Court on the following grounds:

- The banking transaction agreement provided that "[a] situation which requires the bank to take measures to secure its claim against the debtor" was one of the causes of acceleration. However, the bank did not accelerate when it froze the ordinary deposit.
- The bank used the freezing of the ordinary deposit to demand that the debtor provide additional security. However, the bank must not use such measure as a bargaining chip against the debtor, the customer of the bank.

## Decision

On April 26 2012 the Tokyo High Court judged that the freezing of the ordinary deposit was a legal act for the following reasons (recognising almost the same facts as the district court):

- Because the debtor did not repay ¥50million, did not submit its rehabilitation plan and showed no active attitude towards the repayment of the loan, the court held that there were objective and reasonable grounds for the bank to have concerns that the debtor was insolvent and might not repay the loan on the bills – this falls under the cause of acceleration in the banking transaction agreement (ie, "[a] situation which requires the bank to take measures to secure its claim against the debtor").
- When there is a situation which falls under any causes of acceleration, the bank may at any time accelerate by notice and offset its credit against its obligation to return the ordinary deposit. Leaving room for the last measure of acceleration to secure the claim by rejecting the request to return the ordinary deposit or freezing the ordinary deposit, thus avoiding the debtor becoming bankrupt, the bank may expect voluntary repayment from the debtor in the event that its credit situation improves. For the debtor as well, the disadvantages of freezing the ordinary deposit are no larger than those in the event of immediate acceleration and offset because there still is room for the debtor to avoid acceleration by providing a concrete business plan or an additional security.
- Although freezing the ordinary deposit deprives the debtor of its right to take back the ordinary deposit, considering the function of the deposit as security and precedence in payment and the advantage for the debtor of freezing the ordinary deposit compared to acceleration and offset, when there are reasonable grounds for the bank to be concerned about non-repayment of the loan, it is appropriate for the bank to reject the debtor's request for return of the ordinary deposit under the principle of good faith or fairness.

Thus, the Tokyo High Court's decision provides an example of a case in which the freezing of an ordinary deposit by a bank can be justified.

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