

[Title]
Subrogation by Performance

[Deciding Court]
Supreme Court

[Date of Decision]
29 May 1984

[Case No.]
Case No. 351 (o) of 1980

[Case Name]
Appeal in Objection to Subrogation Ratio

[Source]
Minshu Vol. 38 No. 7: 885

[Party Names]
Appellant (Defendant, Intermediate Appellee) Nagayuki Endo
Vs.
Appellee (Plaintiff, Intermediate Appellant) Tokyo Guarantee

[Summary of Facts]
Company B entered into a credit union contract involving an overdraft with Credit Union A. In order to make it possible for Company B to borrow, Company B's representative director, C, set up a revolving mortgage (the "Revolving Mortgage") with a limit of 6 million yen (6,000,000 yen) on a building he owned, and jointly and severally guaranteed the obligation. Pursuant to the said contract, Company B borrowed 4.8 million yen (4,800,000 yen) from Credit Union A (with an interest rate of 11% and damages for delay to be calculated at 18.25%), at which time Company B received a credit guarantee from Credit Guarantee Association X (Plaintiff, Intermediate Appellant, Final Appellee) with regard to its obligations toward Credit Union A. The special agreement between Company B and X included the following: (1) with regard to X and the obligor Company B, in the event that X made subrogated payment to Credit Union A, Company B would reimburse X the total amount of the subrogated payment that X made, in addition to damages for delay to be calculated at an annual rate of 18.25%; and (2) with regard to X and the third party mortgagor and joint and several guarantor C, in the event that X made subrogated payment to Credit Union A, X would subrogate A with regard to the entirety of the Revolving Mortgage that C set up for Credit Union A, and X had a right, within the limits of (1) in the above special agreement, to exercise all rights involving the Revolving Mortgage that Credit Union A possessed (hereinafter the special agreement is referred to as the "Special Agreement").

Later, as Company B defaulted on its obligation, this fixed the principal of the Revolving Mortgage, and as a result X made subrogated payment to Credit Union A in the amount of 4.54 million yen (4,540,000 yen), and at the same time, processed the supplementary registration for the transfer of the Revolving Mortgage. It should be noted that other mortgagees including Y (Defendant, Intermediate Appellee, Final Appellant) held subsequent revolving mortgages over the building belonging to C, which was the subject of the Revolving Mortgage.

When the said building was auctioned, X submitted its claim, listing as the claim amount the principal of 4.54 million yen (4,540,000 yen) and damages at the annual interest rate of 18.25%. The court of execution, however, prepared a statement of the proceeds of the sale which listed X's principal as half its claim, 2.27 million yen (2,270,000 yen) (pursuant to Item (v) of the proviso to Article 501 of the *Civil Code*) and damages to be calculated at a rate of 6%, the statutory annual interest rate (pursuant to Articles 459(2) and 442(2)). X therefore filed this suit against Y, a subsequent mortgagee, objecting to the subrogation ratio. The court at first instance (the Tokyo District Court) ruled against X, and the lower court (the Tokyo High Court) ruled in favor of X. In response, Y filed a final appeal on the following grounds: (1) the Special Agreement that X and the obligor B entered into, with regard to the right to reimbursement arising out of any subrogated payment, which prescribed a contracted interest rate for payment for damages that was higher than the statutory rate prescribed by Article 442(2) applied *mutatis mutandis* under Article 459(2) of the *Civil Code*, could not be raised against Y, a third party (Supreme Court decision, 5 November 1974, *Kinyu Homu Jijo* No. 738: 34); and (2) the Special Agreement that X and the third party mortgagor C entered into which prescribed a subrogation ratio different to that prescribed by Item (v) of the proviso to Article 501 of the *Civil Code*, could not be raised against Y, a third party.

[Summary of Decision]
Final appeal dismissed.

“Article 442(2), applied *mutatis mutandis* by Article 459(2) of the *Civil Code*, prescribes the statutory interest that accrues on or after the day of the performance, in addition to the subrogated payment amount, with regard to the right to reimbursement that a guarantor acquires vis-à-vis an obligor when the guarantor is commissioned by the obligor. This provision is a default provision, and it does not prohibit the guarantor and the obligor from entering into a special agreement that prescribes damages for delay to accrue from the day following the day of the subrogated payment at a different contracted interest rate, in lieu of the said statutory rate. Also, there is no basis for the interpretation that the system of subrogation by performance has, by definition, the nature of limiting the effect of a special agreement between the guarantor and the obligor such as that described above. Indeed, not only is there no specific language limiting the effect of a special agreement such as that described above, but where the security is a revolving mortgage there is no change in the fact that the revolving mortgage secures the underlying claim to the extent of its maximum limit. Even if the guarantor and the obligor increase the total amount of the right to reimbursement through a special agreement that prescribes damages for delay calculated at a contracted interest rate, the extent to which the guarantor can execute the revolving mortgage by subrogation is limited by the said maximum limit and the balance of the underlying claim and moreover, the interest rate for damages for delay in relation to the underlying claim is unchanged. In any event, the Special Agreement neither increased the material burden on the security real property, nor had any unfair impact on the third party pledgor, subsequent mortgagees, or any other interested parties.”

“The body of Article 501 prescribes the effect of subrogation by performance, and the proviso clauses prescribe priority among subrogated parties and subrogation ratios. The system of subrogation by performance, as explained above, has the effect of transferring the underlying claim and the security over the same formerly held by the obligee to the person subrogated on an “as is” basis. It does not transfer any other rights, and hence does not give rise to any change in the features of the said underlying claim and the security over that claim. Since the subrogated person does no more than exercise the underlying claim and the security that were transferred to him within his actual right to reimbursement, the occurrence of subrogation by performance, assuming there is a security such as a revolving mortgage securing the said underlying claim in

relation to the security real property owned by the third party pledgor, cannot be said to unfairly impact, such as by infringing the rights of, interested parties who have recognized interests such as mortgages or other securities. It follows that, the subrogated person, by acquiring by subrogation a security such as a revolving mortgage securing the underlying claim, does not stand in a relationship materially adversarial to those interested parties. Moreover, Item (v) of the proviso to the same Article, which assumes the effect of subrogation described above, sets certain restrictions such as subrogation ratios among subrogated persons with regard to the relationship between third party pledgors and guarantors, in order to avoid unfair advantage being obtained by the person who subrogated first, or indefinite repetition of subrogated performance. Its ultimate purport and purpose is to regulate interests as between subrogated persons fairly and reasonably. Therefore, when a third party pledgor and a guarantor enter into a special agreement that prescribes a subrogation ratio differing from the said proviso, and thereby regulate their interests in a concrete manner on their own, there is no reason to insist on the ratio according to the said proviso. The fact that the said proviso prescribes the subrogation ratio with regard to guarantors and the third party pledgors *per capita* and in proportion to the value of each security real property is no more than provision for general situations where there is no special agreement or other special circumstances, and the said proviso should be interpreted as what is known as a supplementary provision. It follows that a guarantor who enters into a special agreement with a third party pledgor that prescribes ratios differing from the said proviso can assert the effect of the said special agreement against interested parties, including subsequent mortgagees, and can exercise his security, including a mortgage, in accordance with the ratios prescribed in the special agreement, within his right to reimbursement. Working from this understanding, when there is a special agreement between a third party pledgor (who established a revolving mortgage) and a guarantor that prescribes full subrogation for the guarantor, as in this case, and the guarantor has made subrogated payment, the guarantor will be able to execute the entirety of the revolving mortgage that the obligee held, irrespective of the said proviso, and subsequent mortgagees and other interested parties will be placed in disadvantageous positions compared to if the special agreement did not exist. However, the said proviso, whilst positively acknowledging the rights of subsequent mortgagees and other third parties with regard to security real property, does not go further, as does Article 392 of the same *Code* on joint mortgages, to prescribe subrogation ratios. Also, the existence and maximum limit of the revolving mortgage to be executed by the guarantor who made subrogated payment are registered, and even if there is a special agreement it is not possible for the guarantor to execute the revolving mortgage in excess of the said maximum limit. Naturally, subsequent mortgagees and other interested parties are in the position of being forced to consent if the obligee claims priority payment of the full secured claim of the Revolving Mortgage within the maximum amount. The disadvantage that they suffer from the Special Agreement is no more than a practical reflection of being in the legal position of disinterested parties with no power of disposition. Even if no measures were taken to publicly announce the Special Agreement, they were in a position where they had no choice but to submit to the effect of the Special Agreement.”