

## Client Alert

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### Civil Code amendments affecting real estate transactions

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#### For further information please contact

**TOK-RealEstate**  
**@bakermckenzie.com**

Baker & McKenzie  
(Gaikokuho Joint Enterprise)

Ark Hills Sengokuyama  
Mori Tower 28F  
1-9-10, Roppongi, Minato-ku  
Tokyo 106-0032, Japan  
Tel + 81 3 6271 9900  
Fax +81 3 5549 7720  
[www.bakermckenzie.co.jp](http://www.bakermckenzie.co.jp)

## Civil Code amendments affecting real estate transactions - Volume Two

The Civil Code of Japan, one of the major Japanese codes covering real estate, contract and tort law, family law and inheritance law, is due to undergo significant amendment in 2020.

The amendments to the Civil Code, which are due to come into effect on April 1 next year, are of a magnitude not seen since the Civil Code was first enacted 120 years ago.

The majority of the amendments are intended to codify case law principles which the courts have adopted since enactment and are expected to help modernize the Civil Code. However, a few amendments vary or update existing case law principles.

The amendments are also intended to update the language and terminology of the Civil Code in order to make the Code more accessible to non-lawyers.

### 1. Change to Warranty against Defects

#### (1) Overview of the operation of new warranty rule

The most important change introduced by the Amended Civil Code affecting the sale and purchase of real estate is the change to the warranty against defects.

Under the current Civil Code, if there is any "latent defect" in the subject property, a buyer under a contract for the purchase and sale of real estate is entitled to demand that the seller compensate it for loss or damage (excluding lost profit) as a result of the defect, and to terminate the purchase and sale agreement.

However, under the Amended Civil Code, the seller is required to ensure that the type, quality and number/quantity of the subject property delivered to the buyer conforms to the terms of the contract. In other words, in place of the "warranty against defects" under the current Civil Code, the Amended Civil Code introduces a new "warranty against non-conformity". Under this new warranty, if the subject property delivered to the buyer does not conform to the terms of the contract with regard to type, quality and number/quantity, the buyer is entitled to demand that the seller performs the contract in accordance with its terms (e.g. by repairing the property). If the seller fails to perform the contract within a reasonable period, the buyer can demand a reduction of the purchase price. In addition, the buyer can demand compensation for loss or damage incurred because of the breach and terminate the contract.



The underlying concept of "non-conformity" is essentially the same as that of "defect" and reflects the way in which the courts have defined the term "defect". The Japanese courts have generally held that the term "defect" means "non-conformity to contractual terms". The Ministry of Justice explained that it sought to make this concept an express statutory provision. However, whereas the "warranty against non-conformity" under the Amended Civil Code concerns the non-conformity in the quality of the property, the "warranty against defects" under the current Civil Code concerns the defects in the property. In addition, the current warranty against defects requires that the defect be "latent". However, latency is not a condition or requirement of the new "warranty against non-conformity" under the Amended Civil Code. Accordingly, in addition to any "warranty against defects", a buyer of real estate should consider including in the purchase and sale contract warranties to the effect that the property will conform to (i) the quality or the function agreed between them, or (ii) the quality and function of comparable properties.

#### (2) Remedies for breach of the new "warranty against non-conformity"

Under the Amended Civil Code, the buyer can pursue the following remedies for breach of this warranty:

- demand performance so that the property conforms to the applicable contractual term, such as the repair of the property;
- demand compensation or damages;
- terminate the contract; and
- demand a reduction of the purchase price.

By contrast, the current Civil Code does not provide for any repair or reduction of purchase price remedies.

In order to pursue the remedies that a buyer has under the current Civil Code, the buyer must file a claim against the seller within one year after the date when the buyer became aware of the defect. In addition, the claim must specify the details of the defect and the compensation or damages sought. This requirement has been viewed as burdensome for buyers.

The Amended Civil Code has sought to lower the procedural burden on buyers by requiring them only to notify the seller of the details of the non-conformity of the property to the contract within one year after the date when the buyer becomes aware of the non-conformity.

#### (3) Law Concerning Promotion of Housing Quality Assurance

The Act Concerning Promotion of Housing Quality Assurance (the "Housing Quality Assurance Act") implies a special "warranty against defects" in purchase and sale contracts in order to protect the buyers of newly developed residences.



The implied "warranty against defects" applies to the basic structure and framework and waterproofing of the newly developed residences and provides for:

- a warranty period of 10 years;
- the repair of the building, if there is a defect; and
- invalidation of any provision which conflicts with or detracts from the warranty.

In conformance with the new "warranty against non-conformity" under the Amended Civil Code, the term "defect" under the Housing Quality Assurance Act is defined as "non-conformance to the contractual term with regard to type or quality". However, the Amended Civil Code does not otherwise modify the basic terms of the implied warranty under the Housing Quality Assurance Law.

## **2. Repurchases**

Under the current Civil Code, if the parties agree to a repurchase of the property, the repurchase price must be equal to the amount of the original sale price and related costs.

However, under the Amended Civil Code, the parties are free to determine the repurchase price themselves.

## **3. Other Changes**

Other provisions under the Amended Civil Code affecting real estate purchase and sale agreements include:

- (1) The seller is obliged to register and perfect the transfer the ownership of the property on behalf of the buyer; and
- (2) The risk of loss of the property passes from the seller to the buyer upon the delivery of the property.

The purpose of these provisions is to clarify rather than change existing case law rules.