

Supreme Court Judgment, January 17, 2002

[Keyword]

Surety, Public Works, Construction Contract, Advance Payment, Bank Deposit, Trust Asset,, State of Bankruptcy

[Summary of the Judgment]

In this case, the court held that (i) the advance payment made by a local government to a contractor of public works on the condition that a surety company guarantees the performance of the repayment obligation to the contractor and that it becomes an asset of the trust with the purpose of being applied to the payment of expenses accrued in the contracted construction, and that (ii) the remainder of such advance payment as a part of the trust asset shall belong to the surety company which paid to the local government the amount equivalent to such remainder as a performance of its surety obligation, and therefore shall not be included in the contractor's bankruptcy state.

[Case Name]

Supreme Court Judgment, January 17, 2002; (Minshu, Volume 56, No.1, Page 20.)

[Name of Parties]

Bankruptcy Trustee of Nakata Construction Corporation v Toyota Shinkin Bank, and East Japan Construction Surety Co., Ltd.

[Summary of the Facts]

Nakata Construction, which had a contract with Aichi Prefecture to provide public works, received an advance payment of approximately six million nine hundred seventy thousand yen (16,970,000 yen) having East Japan Construction Surety Co. Ltd. guarantee its repayment obligation of the advance payment in accordance with the Law Concerning the Guarantee Business Regarding Advance Payments for Public Works. Such payment was made through using bank transfer to a savings account which was separately opened by Nakata Construction with the defendant Toyota Shinkin Bank and it was provided (i) in the construction contract between Nakata Construction and Aichi Prefecture that the advance payment shall not be applied to anything other than expenses for the construction; (ii) in the terms and conditions of the guarantee between Nakata Construction and East Japan Construction Surety Co. Ltd that the advance payment shall be kept in a separate savings account and that it is necessary for Nakata Construction to submit and have a verification by the bank of the documents regarding the proper usage of the funds in order to make withdrawal from such bank deposit; (iii) in the operating agreement between East Japan Construction Surety Co. Ltd. and Toyota Shinkin Bank, Toyota Shinkin Bank shall refund the deposit only if Nakata Construction makes a request for withdrawal accompanied by a breakdown of the use of the funds and evidentiary documents thereof, and if such request conforms with the breakdown of the use of advance payment provided by East Japan Construction Surety Co. Ltd. Nakata Construction went into bankruptcy and East Japan Construction Surety Co. Ltd. paid approximately six million seven hundred thousand yen (6,700,000 yen), which is the portion of the advance payment that corresponds to the work which has not started, to Aichi Prefecture as the performance of its guarantee obligation, and Nakata Construction's Bankruptcy trustee commenced an action requesting the declaration that such bank deposit is a part of the bankruptcy state and the refund of it.

[Holding]

Appeal dismissed.

Costs of the appeal shall be borne by the appellant.

[Reasoning]

“...3 “The Standard Terms and Conditions of the Public Works Construction Agreement of Aichi Prefecture”, which is applicable to the construction contract in this case, merely provides that the advance payment must not be applied to those other than necessary expenses of the construction and does not provide any method of safekeeping the advance payment or the method of managing and auditing the use of that payment. However, the payment in advance was conditioned to the existence of a guarantee for the repayment obligation under Article 27 of the Law Concerning the Guarantee Business Regarding Advance Payments for Public Works, that states that a surety companies is obliged to conduct a strict audit as to whether the contractor which entered into a guarantee agreement is using the advance payment properly, and under Article 12 Paragraph 1, surety companies is obliged to use “Standard Terms and Conditions in Guarantee for Advance Payment” when entering into an guarantee agreement for repayment obligations regarding advance payment, and this “Standard Terms and Conditions...”, which were used in this case as the terms and conditions in the guarantee agreement, were sent to each prefectural government by the Ministry of Construction. Furthermore, the terms and conditions in this guarantee, as stated in 1(3) above, provide for the method of safekeeping and withdrawal of the advance payment, the audit regarding the use of advance payment to be conducted by the defendant surety company, and the suspension of withdrawal for improper usage. Therefore, taking into account that not only Nakata Construction but also Aichi Prefecture have transferred the advance payment agreeing to be bound by the terms and conditions in the guarantee agreement, and taking the existence of such agreement into consideration, it should be understood that a trust agreement was formed between Aichi Prefecture and Nakata Construction at the time of the bank transfer of the advance payment to the savings account. And having Aichi Prefecture as the trustor, Nakata Construction as the trustee and the advance payment as the trust asset, with the purpose to apply it to the expenses of the construction. Therefore, it cannot be said that the construction fee was paid to Nakata Construction at the transfer of the advance payment to the savings account but rather it should be construed that the funds becomes part of Nakata Construction’s asset as a result of the payment of the construction fee only when the funds were paid out

from the savings account to Nakata Construction.

Also, since the purpose of the trust is to make payment for the necessary expenses of the construction and the outcome of the administration of the trust, will be reflected in the amount, to be paid to the trustor Aichi Prefecture, it should be construed that the beneficiary of the trust is the trustor Aichi Prefecture.

Furthermore, as the bank deposit is separated from Nakata Construction's regular assets and maintained identifiable, and considering that there is no method of registration for bank deposits, the trustor Aichi Prefecture is entitled to assert against third parties that the bank deposit is a part of the trust asset (cf. Article 3 Paragraph 1 of the Trust Law) and the outcome would be the same even if the trust has ended and a statutory trust was formed under Article 63 of the Trust Law, the bank deposit, being a trust asset, shall not be included in the bankruptcy state of Nakata Construction (cf. Article 16 of the Trust Law).