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Japan

Yoshimi Ohara
Nagashima Ohno & Tsunematsu

Introduction

Japan has, in recent years, become one of the most arbitration friendly jurisdictions in the world for two primary reasons: (i) in 2004, Japan adopted the new Arbitration Act[1] that follows the UNCITRAL model law (Model Law), and (ii) the Japanese courts have consistently taken a non-interventionist approach towards both domestic and international arbitration. In June 2011 a court decision came out to set aside an arbitration award for the first time in Japan.[2] However, the fundamental trend of Japanese courts to approach arbitration with a favourable disposition remains intact. This article aims to briefly introduce the Japanese Arbitration Act, to discuss arbitration-friendly courts in Japan, together with the latest somewhat controversial court decision, and finally to highlight some of the present trends in arbitration in Japan.

Arbitration Act

New Arbitration Act

The original law on arbitration was enacted in 1890, forming part of the Code of Civil Procedure of 1890 which was basically a translation of the German Code of Civil Procedure of 1877. The original arbitration law remained virtually unchanged until 2003. This outdated arbitration law was blamed by many commentators as being responsible for the limited use of arbitration as a means of resolving international commercial disputes in Japan.

In 1999 a widespread judicial reform effort was launched in Japan. The judicial reform was called for in response to the deregulation of Japanese society, that saw a move away from a society where administrative bodies engaged in extensive ante-facto review of various transactions or undertakings to a society in which administrative bodies do not conduct such an extensive ante-facto review, but instead rely on a more general post-facto review by the judiciary. Amid the increasing role of the judicial system in Japanese society, the arbitration law was completely modernised in 2003, essentially following the Model Law, in order to facilitate the use of arbitration as a means of resolving international commercial disputes, with the hope of reducing the burden on the court system.[3]

Slight differences from the Model Law

The new Arbitration Act adopted the Model Law in principle, with slight modifications. For example, while the Model Law pertains to international commercial arbitration, the Arbitration Act applies to arbitration seated in Japan regardless of whether it is domestic or international, civil or commercial.[4] Another key difference is that, absent an agreement between the parties, the arbitral tribunal will apply the substantive law of the state most closely connected to the dispute under the Arbitration Act.[5] On this point, the Model Law provides that the tribunal is to apply the law as determined by the conflict of laws rules that the tribunal considers applicable.[6] The Japanese Arbitration Act follows the laws of Germany and Korea in order to increase predictability for the parties with respect to applicable substantive laws that apply to the disputes.

The new Arbitration Act also has certain unique provisions that are not found in the Model Law. For example, arbitrators, while an arbitral proceeding is pending, may attempt to settle the dispute subject to the arbitration upon agreement of the parties.[7] This reflects the practice in Japanese courts to encourage the parties to settle pending litigation. On the other hand, the Arbitration Act restricts the use of arbitration where disputes involve consumers and employees.[8] As stated, while the new Arbitration Act essentially adopts the Model Law, the Act makes some additions and slight modifications to address certain concerns in an attempt to further improve the arbitration system and to reflect existing practices in Japan.

Arbitration-friendly courts

The courts in Japan offer various forms of assistance in relation to arbitration proceedings, but do not intervene in a given arbitration proceeding unless it is so permitted under the Arbitration Act.[9] In fact, regardless of whether an arbitration award is rendered domestically or outside of Japan, the Japanese courts never seem to refuse the enforcement of an arbitration award, and no Japanese court had ever set aside an arbitration award until June 2011.

Court assistance

The courts in Japan may offer various forms of assistance in relation to arbitration, including with respect to appointment, challenge and removal of arbitrators and examination of evidence of third parties.[10] In principle, such assistance is only provided for arbitration proceedings that are seated in Japan. However, some services, such as appointment, challenge and removal of arbitrators, may be provided even before the seat of arbitration is determined, as long as such arbitration could be seated within Japan and the Japanese court has jurisdiction over any of the parties to the arbitration.

The courts in Japan may also offer provisional measures with respect to disputes subject to arbitration, not only before arbitration commences, but also during the pendency of arbitration. Provisional measures are available for arbitration regardless of whether or not it is seated in Japan. Such provisional measures[11] include provisional attachment, provisional disposition of the subject matter in dispute and preliminary injunction. While the arbitral tribunal may also issue provisional orders, provisional orders issued by the courts in Japan, particularly provisional attachment, are very useful and convenient for a party seeking monetary payment in arbitration to secure the other party's funds for payment, as such orders can be commonly obtained at an ex parte proceeding within one or two days upon provision of security to the court.

Challenge and enforcement of an arbitration award

An arbitration award is effective only when it meets the requirements listed in the Arbitration Act, and the courts in Japan may set aside an award upon the request of a party to the arbitration if those requirements are not met.[12] Consistent with the Model Law, the requirements pertain to validity of the arbitration agreement,

fundamental due process of the arbitration proceeding (for example, a party may apply to set aside an award on the basis that it was not given the opportunity to be heard, notices were not properly given, and so on) and consistency with public policy in Japan. As such, in principle, the courts in Japan are not permitted to review whether or not there were any errors in fact-finding or the application of law. In fact, it is said that until June 2011, there were no published court decisions that had ever set aside an arbitration award.

An arbitration award, whether domestic or international, must be recognised by the courts in Japan in order to be enforced in Japan.[13] As a signatory to the New York Convention, and consistent with the Model Law, the courts may refuse to enforce an award only where there are fundamental procedural errors or the award is contrary to the public policy of Japan. Again, as a matter of practice, there do not appear to be any published court decisions in which the court has refused to enforce an arbitration award. This is in contrast to the various court decisions in which the court has refused to enforce a foreign court decision due to lack of proper service of process.

Simply put, the courts in Japan have taken a non-interventionist approach when it comes to the challenge and enforcement of arbitration awards.

New case - first court decision to set aside an award

Amid the backdrop outlined above, in June 2011 the Tokyo District Court took the unprecedented step of setting aside a Japan Commercial Arbitration Association (JCAA) award.[14] It is said that this is the first time that a Japanese court has ever set aside an arbitral award. The decision is yet to be published; however, it has already drawn the attention of the arbitration community in Japan and has been received with mixed reactions. The below summary is understood to reflect the decision and rationale of the court.

The facts

In 1979, a US company and a Japanese company formed a joint venture (JV) to sell certain products in Japan that were manufactured by the Japanese JV partner under a licence granted by the US JV partner. Under the Manufacturing Licence and Technical Assistance Agreement between the JV partners, the US JV partner granted a licence under a Japanese patent to, and shared know-how with, the Japanese JV partner. In return, the Japanese JV partner paid 10 per cent of the ex-factory sales price of the products to the JV company. The licensed patent expired in 1992, but the Japanese JV partner continued to pay the royalty under the licence to the US JV partner. The JV suffered net losses and was eventually dissolved. At the time of dissolution, in 2001, the JV partners agreed that (i) the Japanese JV partner would assume the business of the JV and (ii) the Japanese JV partner would pay a 'technology services fee' to the US JV partner as long as the Japanese JV partner continued to manufacture and sell licensed products. The Japanese JV partner subsequently refused to pay the technical service fee and sent a termination notice to the US JV partner in 2007.

JCAA arbitration

In December 2008, the US JV partner filed an arbitration request in Tokyo under the JCAA rules. One of the most disputed facts was the nature and characterisation of the technical service fee. This is because, under the Japanese anti-monopoly law, in principle, collecting royalties, without justifiable reason, for patent licences after the expiry of licensed patents or for know-how after it becomes public (without involving licensee's breach of contract) is a violation of the anti-monopoly law in Japan and, therefore, if the technical service fee could be regarded as a royalty, the US JV partner's claim would likely have been void.

Not surprisingly, the Japanese JV partner contended that the 2001 agreement was void ab initio and that the US JV partner was not entitled to receive a 'technical service fee' because the licensed patent expired in 1992 and there was no longer any know-how or trade secret being provided under the agreement. Conversely, the US JV partner argued that the technical service fee was not a royalty, but rather constituted a continued split of the profits of the JV business since no consideration was paid for the transfer of the JV business to the Japanese JV partner.

The solo arbitrator issued an award on 20 August 2009 in which he found that the technical service fee was 'undisputedly' a split of profits of the JV business and ordered the Japanese JV partner to pay approximately ¥50 million for the technical service fee plus approximately ¥25 million for the recovery of arbitration costs incurred by the US JV partner. In essence, while the nature of the technical service fee was the centre of the dispute, the arbitrator seemed to have treated the nature of the technical service fee as if it were an undisputed fact.

Decision to set aside the award

The Japanese JV partner filed a request with the Tokyo District Court in 2009 seeking to set aside the award on the ground that the award violated public policy in Japan because (i) the tribunal treated the central issue in the dispute as undisputed and (ii) the award is in breach of the anti-monopoly law in Japan. The court held that in Japan it is very likely that charging a royalty for the use of patented technology after the expiry of the patent constitutes a violation of the anti-monopoly law and any such agreement to this effect could be found null and void. Accordingly, whether or not the technical service fee is a royalty for the patented technology is a matter central to the dispute that could have affected the outcome of the arbitration. Treating such a matter as undisputed deprives the parties of due process and accordingly violated public policy in Japan. The court did not review whether the technical service fee was in fact a royalty under licence or a split of profits of the JV business.

Impact of the decision

As stated earlier, the court in Japan has consistently denied requests to set aside awards that have been filed by dissatisfied parties. The court has held on a number of occasions that a breach of public policy can be found only when enforcement of the arbitration award would lead to a violation of public policy and mere improper fact-finding or improper application of law does not in and of itself constitute a violation of public policy and therefore would not be a ground to set aside an award.

At first glance, the latest Tokyo District Court, in its recent decision, seems to have taken an approach inconsistent with such a long standing tradition of Japan having an arbitration-friendly court. On this point, however the author does not believe this case represents a shift in the approach of the court and considers that the impact of the Tokyo District Court decision is limited. In fact this decision could be viewed as not really deviating from the non-interventionist approach consistently adopted by the court in Japan.

While the court found a breach of public policy because the arbitrator treated the fundamental matter in dispute as undisputed, in reality the court seemed to be more concerned about a possibility of breach of public policy caused by the failure of fact-finding. In other words, the court did not seem to take the position that the court may set aside an award whenever the arbitral tribunal fails to find material facts by treating facts in dispute as undisputed facts, but rather the court set aside the award because such failure of fact-finding could likely result in breach of public policy in Japan.

The court did not go so far as to make a finding on the merits of the facts that were treated as undisputed (namely, whether the technical serve fee was in fact a royalty or split of the JV profits.) The court seems to have intentionally avoided reviewing the facts found by the tribunal. This is not only because the evidence in the record of the arbitration appeared to be insufficient for fact-finding, but also because the court considered that it should not review the arbitrator's fact-finding as the court is not permitted to review the substance of disputes on the merits under the Arbitration Act.

In principle, it is true that the court may review significant procedural errors but not the substance of disputes. However, when a breach of public policy is involved, it is the author's view that the court should have certain powers to find facts on the merits, particularly when a tribunal has failed to find facts by treating disputed central facts as undisputed facts, and the court should only set aside an award where the court, in fact, finds a breach of public policy based on proper fact-finding.[15] The question of the permitted scope of judicial review when public policy is involved, however, is vast and beyond the scope of this article. In this case, the court, presumably in an attempt not to review the substance of the case so as to adhere to its non-interventionist principles, rendered a decision that could be construed as having quite the opposite effect, namely, that the court may set aside an award whenever a tribunal fails to find a fact by erroneously treating disputed central facts as undisputed facts, regardless of whether or not a breach of public policy could be implicated. However, the author believes that this is not the intention of the Tokyo District Court in its latest court decision.

The unprecedented approach adopted by the Tokyo District Court, once published, will surely generate debate among the arbitration community in Japan. The key point here is that for the reasons discussed above, the impact of the court decision should not be over-stated.

Recent trends in arbitration in Japan

Japan has been known for not being a particularly litigious country, in general. Many Japanese companies have traditionally preferred to settle disputes without going through official dispute resolution procedures, be it litigation or arbitration. However, the author has observed some changes in such a general approach in recent years. This change appears to reflect an increasing demand for accountability within Japanese companies, which is leading them to resort to arbitration in order to obtain the neutral and fair decision of a third party. The recent increased level of overseas investment by Japanese companies, particularly in emerging markets, has further spurred the adoption of arbitration agreements, particularly when the judicial system in such overseas jurisdiction is viewed as being less reliable. The increase in the number of court cases involving a request to set aside or refusal to enforce the award (particularly with respect to China International Economic and Trade Arbitration Commission (CIETAC) arbitrations[16]) itself demonstrates the increased utilisation of arbitration by Japanese companies to resolve international commercial disputes. Further, the recent case of an arbitration award issued in Japan not being recognised in China has caused concerns within the Japanese arbitration community. In that case, the Chinese court refused to recognise the JCAA award on the grounds that the award was rendered in alleged breach of the JCAA rules that formed a part of the arbitration agreement and therefore the award was not based on the arbitration agreement.[17]

All these disputes and concerns indicate that arbitration is in fact being used more and more by Japanese companies and in the author's view such a trend is unlikely to be reversed.

NAGASHIMA OHNO & TSUNEMATSU

Kioicho Building
3-12, Kioicho
Chiyoda-ku
Tokyo 102-0094
Japan
Tel: +81 3 3288 7000
Fax: +81 3 5213 7800

Yoshimi Ohara
yoshimi_ohara@noandt.com

www.noandt.com

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Notes

1 Act No. 138 of 2003. An unofficial translation of the Act is available at www.jcaa.or.jp/e/arbitration-e/kisoku-e/kaiketsu-e/civil.html

2 Tokyo District Court, 13 June 2011 (Heisei 21 (Chu) No. 6), yet to be published as of 5 September 2011.

3 As a part of the judicial reform, the so called ADR Act was enacted to register private ADR organisations and thereby facilitate mediation administered by private ADR organisations. The legislative intent behind this Act is, like the new Arbitration Act, to facilitate out-of-court dispute resolution.

4 Article 1 of the Arbitration Act.

5 Article 36 of the Arbitration Act.

6 Article 28(1) of the Model Law.

7 Articles 38(4)(5) of the Arbitration Act.

8 Articles 3 and 4 of the Supplemental Provisions of the Arbitration Act.

9 Article 4 of the Arbitration Act.

10 The Japanese courts can examine (i) evidence owned or controlled by a party other than parties to arbitration and (ii) witnesses who are not a party to the arbitration. This is based on the assumption that the arbitral tribunal should have a strong influence over the parties such that it can successfully persuade the parties to produce evidence owned or controlled by parties to the arbitration and cause party witnesses to appear before the tribunal for examination and therefore court assistance is not needed in order to examine such evidence. See Junya Naito, '*Examination of Witnesses in Court for Arbitration Proceedings in Japan*' (*JCAA Newsletter* No. 18, March 2007): www.jcaa.or.jp/e/arbitration/docs/news18.pdf.

11 Civil Provisional Remedies Act (Act No. 91 of 1989).

12 Article 44 of the Arbitration Act; Article 34 of the Model Law.

13 Article 45 of the Arbitration Act, Article 35 of the Model Law.

14 Tokyo District Court, 13 June 2011 (Heisei 21 (Chu) No. 6).

15 Similar arguments have been made by commentators in the context of enforcement of foreign court judgments.

16 In contrast, so far, there seems to be no published court decisions in which the court in Japan refused to enforce an award of arbitration administered by CIETAC.

17 *Shin-Etsu Chemical Co Ltd v Jiangsu Zhongtian Technologies Co Ltd* Nantong Intermediate People's Court, (16 April 2008) article 5, paragraph 1 (d) of the New York Convention. The court found that the alleged breaches of the JCAA rules were a failure of the tribunal to (i) render its award within the dates set by the tribunal and (ii) notify the timing of the award once the tribunal missed the date originally set by the tribunal. (The award was said to be rendered on 20 September 2005 but was, in fact, rendered on 23 February 2006.) For the sake of fairness, the court in the PRC has recognised some other JCAA arbitration awards in the past.

Yoshimi Ohara
Nagashima Ohno & Tsunematsu

Yoshimi Ohara is a partner at Nagashima Ohno & Tsunematsu, Tokyo, Japan, where she focuses on cross border transactions and dispute resolution (both litigation and arbitration). With the growing globalisation of her clients' business activities, Ms Ohara's practice has become increasingly focused on complex commercial international arbitration matters involving an extremely broad range of challenging multi-jurisdictional legal issues. She has practised international arbitration under the rules of the ICC, AAA, and JCAA. She is particularly experienced in joint venture, distributorship, construction, infrastructure, and intellectual property licence disputes. She obtained an LLB from the University of Tokyo in 1990 and an LLM from Harvard Law School in 1996. She is currently a court member of the LCIA, a member of the IBA Task Force on Counsel Ethics and a member of the Japan Association of Arbitrators.

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