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Japan

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This article gives a brief overview of current arbitration trends in Japan. Recently, two trends have been observed: first, an increase in the number of court decisions in Japan relating to international commercial arbitration; and second, an increase in awareness of investment treaty arbitration.

Increase in arbitration-related court decisions in Japan

Arbitration is becoming a viable option for Japanese parties to resolve disputes, particularly in the context of international transactions. Evidence of this can be seen in the increase in Japanese court decisions involving arbitration awards. We examine three court decisions in this article, which we believe will help readers to understand the matters of which they need to be aware when parties agree to have arbitration seated in Japan.

The scope of arbitration clause – potential pitfall in joint venture agreement

In *Tokio Marine & Nichido Fire Insurance Co, Ltd v an undisclosed entity*,[1] the Tokyo District Court rendered an interim decision on jurisdiction, dismissing defendants' lack of jurisdiction defence based on the arbitration clause in the joint venture agreement. The issue resided in an interpretation of the scope of an arbitration agreement, from both subjective and objective perspectives, ie, the scope of the parties to be bound by the arbitration agreement and the scope of the claims to be subject to the arbitration agreement.

This case involved a joint venture company's contractual and product liability claims arising out of defective building material supplied by one of its shareholders. An Illinois-based company (a manufacturer and supplier of cement wall coverings) together with three other companies, formed a joint venture in Japan that was intended to be appointed as an exclusive distributor in Japan of such building material. However, the joint venture company was never appointed as an exclusive distributor, nor did it enter into a distribution agreement with the Illinois supplier and the joint venture company purchased the products indirectly from the Illinois supplier based on an individual sales order. The joint venture agreement had an arbitration clause which provided[2] that:

> *Any and all disputes relating to this agreement shall be subject to arbitration seated in Japan in accordance with the arbitration rules of the International Chamber of Commerce. The arbitration award shall be final and binding on each party (including a new company should the new company be made a party to this agreement).*

Due to defects in the products the joint venture company was required to provide repair services to house makers who purchased the products and thereby sustained damages. The Illinois supplier and its holding company agreed to compensate the joint venture company for expenses it incurred for the repairs of the defect; however, contrary to what was agreed, the Illinois supplier and the holding company only partially compensated the joint venture company, which sought reimbursement from an insurer. In return, the insurer sought compensation of the paid-out claim by subrogation and filed suit against the Illinois supplier and the holding company for recovery of the paid-out claim. The Illinois supplier and the holding company sought dismissal of the insurer's claim based on the arbitration clause in the joint venture agreement. The Tokyo District Court dismissed the lack of jurisdiction defence filed by the Illinois supplier and the holding company for two reasons: first, neither the joint venture company nor the holding company was a party to the arbitration agreement; and second, neither the contractual claim nor the product liability claim arising out of the defective building material supplied by the Illinois supplier were covered by the arbitration agreement.

In terms of the parties to be bound by the arbitration clause, there are two parties at issue who did not execute the arbitration agreement: the joint venture company and the holding company. The arbitration agreement was executed by the Illinois supplier, the holding company's wholly owned subsidiary – not by the holding company itself. However, both the holding company and the Illinois supplier agreed to compensate the joint venture company for the damages that it sustained. Therefore, it was on this basis that the insurer attempted to recover the paid-out claim by suing the Illinois supplier and the holding company in Japan. The court held that neither the joint venture nor the holding company was a party to the joint venture agreement; therefore, neither was a party to the arbitration agreement in the joint venture agreement. Regarding the joint venture company, the Illinois supplier and the holding company argued that, under the joint venture agreement, it was expected that the joint venture company would be bound by said agreement because it had provisions regarding the operation of the joint venture company and, furthermore, the arbitration agreement explicitly provided that the joint venture company would be bound by the arbitration clause should it be made a party to the joint venture agreement. On this point, the court held that while the joint venture agreement did provide for the operation of the joint venture company, the joint venture company never executed said agreement nor was it appointed as an exclusive distributor of the product in Japan, as originally planned when the joint venture company was established. Therefore, the court concluded that the joint venture company was not a party to the arbitration agreement provided in the joint venture agreement. Regarding the holding company, the court held that no evidence substantiating that the holding company was acting together with the Illinois supplier, its wholly owned subsidiary in forming the joint venture, and the mere fact that its wholly owned subsidiary, the Illinois supplier, is a joint venture partner alone does not qualify the holding company to be a party to the arbitration agreement. This joint venture agreement has an entire agreement provision, and any amendment to the joint venture agreement requires a

written agreement executed by the representative of each party. Since there was no such agreement executed by each representative to the effect that the joint venture company or the holding company would become a party to the agreement, neither the joint venture company nor the holding company could be subject to the arbitration agreement.

Regarding the subject matter of the agreement, the court again denied the claim. The court held that the claim to seek compensation and the product liability claim were not covered by the arbitration agreement. The court further held that, although the joint venture agreement provides for the establishment of a joint venture, and the appointment of a joint venture company as an exclusive distributor was anticipated at the time of the formation of the joint venture, the joint venture partners anticipated a separate distribution agreement governing the appointment of the joint venture company as the exclusive distributor and the terms and conditions of the sales of the products. Such distribution agreement was never executed; consequently, these claims to seek compensation arising out of the sales of defective products are not covered by the arbitration agreement.

The court strictly construed the arbitration agreement both in terms of the scope of the parties to be bound by the arbitration agreement and the subject matters of the arbitration agreement. Given the unique circumstances involved in this case, it is unclear to what extent this court decision will affect future cases involving similar issues. That said, it would always be prudent to ensure that a joint venture company executes the joint venture agreement itself together with all the other ancillary agreements to the joint venture agreement, such that any disputes relating to the joint venture can be simultaneously resolved in one arbitration proceeding. In addition, the author always recommends that the arbitration agreement in a joint venture and ancillary agreements be carefully drafted such that each arbitration agreement will not be treated as an independent arbitration agreement, but any dispute relating to any of the joint agreement and the ancillary agreements can be heard in one proceeding.

Multi-tiered dispute resolution provision

The Tokyo High Court decision dated 22 June 2011[3] addresses the issue of whether courts should dismiss a complaint when the parties failed to adhere to multi-tiered dispute resolution provisions in an agreement. The multi-tiered dispute resolution provision in dispute requires a 60-day negotiation period followed by private mediation prior to bringing a claim in the court; it does not involve arbitration. However, the author believes that this case is worth introducing because multi-tiered dispute resolution provisions are somewhat common in arbitration agreements, especially when Japanese parties are involved. The court held that the complaint should not be dismissed on the ground that the parties failed to meet the conditions to bringing a lawsuit, as provided in the agreement. This case involves a DRAM judgment-sharing agreement. Two Japanese DRAM manufacturers (the former joint venture partners) formed a joint venture in Japan to manufacture DRAM. The US subsidiary of the DRAM manufacturer formed by the former joint venture parties paid a substantial penalty to the US Department of Justice for alleged cartel activities. As the alleged cartel activities were conducted during the period when the former joint venture partners had control over the operation of the DRAM manufacturer, as well as its US subsidiary, the DRAM manufacturer entered into judgment-sharing agreement (JSA) civil DRAM cases with the former joint venture partners under which the parties agreed to settle the issue of how to share the settlement payment. The JSA required that parties first negotiate in good faith for 60 days; if such negotiations were unsuccessful, they were required to initiate private mediation. If, nonetheless, after the mediation, the parties still failed to settle the issue completely, the parties could bring litigation in the Japanese court. The DRAM manufacturer, after paying a settlement amount of more than $100 million, requested the former joint venture partners to share such settlement amount, and initiated the court-annexed mediation. This was, however, unsuccessful. As a result, the DRAM manufacturer brought a lawsuit against the former joint venture partners, seeking recovery of damages arising from the alleged cartel activities carried out under the control of the former joint venture partners. The district court dismissed the complaint because the DRAM manufacturer failed to meet the conditions to bring the lawsuit. However, the Tokyo High Court overturned the decision of the district court, holding that failure to meet the pre-litigation negotiation or mediation requirement cannot be the basis on which a court dismisses a complaint. This is because good faith negotiations and mediation, unlike arbitration, do not necessarily warrant the final resolution of the dispute because neither party is obligated to finally settle by negotiation or mediation, and if the court were to dismiss a matter due to the failure to meet preconditions to litigate, a party will, in effect, be unfairly deprived of a constitutional right to litigate. In relation to this, under the Alternative Dispute Resolution Act (the ADR Act), the court may stay the proceedings for up to four months upon the request of both parties to mediate. This means that, even when the parties agree to resolve a dispute using accreted ADR proceedings provided under the ADR Act, the court may not simply dismiss the complaint. Further, the court took into account that negotiation and mediation do not have a tolling effect (ie, they does not stop the statute of limitations from running) and, once the complaint is dismissed, some of the claims are subject to the statute of limitations and possibly may no longer be brought to court. The court also stated that it would be unfair for the plaintiff as it could be required to pay the court fee twice, which will grow exponentially should the complaint dismissed.

This court decision concerns litigation, but the underlying principle would likely apply equally to multi-tiered dispute resolution provisions, where the ultimate dispute resolution procedure is arbitration. The principle in this case is that the pre-litigation negotiation or mediation requirements are a mere gentleman's agreement, as the negotiation or mediation does not warrant the final resolution of disputes, unlike litigation or arbitration. This multi-tiered dispute resolution provisions often becomes an issue in two instances: at the beginning of arbitration and upon enforcement of the arbitral award.

When the parties initiate the arbitration, it raises the issue of whether or not the request for the arbitration should be dismissed due to the failure to meet conditions before bringing the arbitration. At the point of enforcing the arbitral award, the issue is whether or not the award should be challenged or refused to be enforced on the ground of material procedural flaw – because the arbitration was brought without satisfying the condition. The latter issue is even more problematic as a successful challenge or refusal of enforcement may force the parties to restart the whole process from the beginning, which is quite inefficient. On this point, according to the Tokyo High Court decision, as long as the arbitra-

tion is seated in Japan it appears that such alleged procedural flaw would not be a basis to challenge or refuse to enforce the award. This is good news in the sense that it provides certainty in enforcing arbitration awards; however, treating a multi-tiered dispute resolution provision as a gentleman's agreement may require further consideration, because the parties intentionally structured the multi-tiered dispute resolution provisions such that there would be no pre-emptive strike by either party. Treating a multi-tiered dispute resolution provision as a mere gentlemen's agreement should undermine the parties' intent in structuring the dispute resolution provision as such. It would be a most prudent approach for the court if it were to stay the proceeding if a party, without going through negotiations or mediation, were to immediately initiate arbitration in Japan. Unfortunately, the laws of Japan do not necessarily explicitly authorise the court to stay proceedings where the parties have agreed to mediate prior to commencing litigation or arbitration. In fact, article 26 of the ADR Act authorises the court to stay proceedings for up to four months and only upon the request of both parties. We hope to see the court, at least in practice, delay hearing dates, such that the court may observe the development of the mediation proceedings, while not formally staying the proceedings so that the parties' intentions in such multi-tiered dispute resolution clauses may be better respected. In the interim, for those with arbitration agreements where the arbitration is seated in Japan, they should be aware that multi-layered dispute resolution provisions may not be implemented as anticipated by the parties.

Governing law of Arbitration Agreement absent governing law provision

The Tokyo High Court decision dated 21 December 2010,[4] dealt with three issues:

- the governing law of the arbitration agreement in the absence of explicit governing law provisions;
- whether the written requirement of an arbitration agreement is met when an agreement executed by the parties does not contain an arbitration agreement but simply cites another that contains the arbitration agreement; and
- whether the parties are deemed to have agreed to the arbitration in circumstances in which a party did not receive the form of the agreement containing the arbitration agreement cited in the agreement that the parties executed.

This case involved a time charter party between a Japanese harbour transport business company and a Korean shipowner for shipping between Japan and Nakhodka, Russia. The time charter party itself did not contain an arbitration clause; however, the executed time charter party referred to another charter party form which contained a New York arbitration clause; however, in that instance, the New York arbitration clause was deleted and replaced with a clause for arbitration in Tokyo under the rules of the Japan Shipping Exchange, Inc. However, this charter party form was not distributed among the parties until after the parties executed the time charter party. The Russian authorities seized the ship because of the captain's underclaiming of the freight volume. Consequently, the Japanese company terminated the time charter party and made a request for arbitration to seek recovery of damages against the Korean shipowner in Tokyo under the rules of the Japan Shipping Exchange, Inc. The shipowner refused to proceed to arbitration in Tokyo alleging that the arbitration should be seated in New York. As a result, the Japanese company initiated litigation in the Tokyo District Court. The High Court dismissed the Japanese company's claim. In reaching such conclusions, the High Court examined the three issues discussed below.

The first issue was the governing law. The court held that absent explicit provisions on the governing law, based on sections 44 and 45 of Japanese Arbitration Act,[5] the law of the seat of the arbitration should govern the arbitration clause.

The second issue relates to the written requirement of the arbitration agreement. On this issue, the High Court held that, pursuant to section 13(2) and (3) of the Japanese Arbitration Law, even if the executed agreement does not contain an arbitration clause, as long as the executed agreement cites another agreement that contains an arbitration clause, the written requirement of arbitration agreement is met.

The third issue is whether the parties are deemed to have agreed to the arbitration clause when the parties had not even received a copy of the cited form agreement in which the arbitration clause is provided. The High Court held that, in principle, if the agreement containing the arbitration clause cited is not shared among the parties, it is difficult to say that the parties have agreed to the arbitration clause. However, in this particular instance, the parties are sophisticated shipping companies, and in the shipping industry arbitration agreements are widely used; therefore, they must have been aware of the existence of the arbitration clause itself. Consequently, the High Court held that there was a valid arbitration agreement where the parties elected to proceed to arbitration via the Japan Commercial Arbitration Association. The High Court followed the decision rendered by the Supreme Court prior to the enactment of the Arbitration Act. In other words, if there is no governing law provision, then the arbitral seat is most pertinent to the arbitration clause; therefore, the laws of the arbitral seat should govern the arbitration clause. Consequently, this approach would warrant the consistent interpretation of arbitration clauses, both when the court reviews the issue of whether or not the litigation should be dismissed based on the arbitration clause, and when the court reviews the issue of whether or not the arbitration award should be set aside or refused to be enforced.

The above is an introduction of some of the court decisions that would be useful for practitioners and arbitrators involved in arbitration seated in Japan. As an arbitration practitioner, the increase in the number of court decisions involving international arbitration is welcomed as it clarifies arbitration practice in Japan. Further guidance from the court in relation to arbitration would be helpful in deepening the practice and jurisprudence of arbitration in Japan.

Increased awareness of investment treaty options

Investment treaty arbitration, according to publicly available sources, has rarely been invoked by Japanese companies. The only reported case involving Japanese parties so far is *Saluka Investments BV v the Czech Republic* (UNCITRAL)[6] where Saluka, Nomura Securities Co Ltd's subsidiary in the Netherlands, filed a claim for a breach of fair and equitable treatment under the Czech Republic–Netherlands BIT against the Czech Republic. Since the *Saluka* case was handed down, no case involving Japanese entities has been reported.

In July 2013, Japan finally participated in negotiation of the Trans-Pacific Partnership Agreement (TPP). Such decision has generally been supported by the public, although a number of discussions, both for and against the TPP and FTAs in general,

have arisen in Japan. One of these is the investment treaty arbitration that is afforded to investors. Some of those who are strongly against the TPP refer to the investor-state dispute settlement clause, alleging that the investment treaty arbitration will restrain the Japanese government's ability to introduce initiatives such as pro-environment or pro-consumer initiatives; therefore, the TPP may be said to unfairly benefit foreign investors at the expense of the public in Japan. Some of those arguments may not be well founded, or may be based on a misunderstanding of the facts and investment treaty cases. However, these heated debates seem to have a beneficial side effect of increasing awareness among Japanese companies of investment treaty arbitration.

The ministries in Japan have been promoting investment treaties via seminars and publications, but with little reaction so far. However, lively debate relating to the TPP has, apparently, increased the awareness of investment treaty arbitration. This does not necessarily suggest that Japanese companies will be immediately initiating investment treaty arbitration in the near future; however, at least Japanese companies will factor in investment treaty and ISD clauses more when structuring foreign investment, and will be seriously considering investment treaty claims to improve their positions in negotiations.

Conclusion

Arbitration has been a standard dispute resolution mechanism when it involves international transactions; arbitration has indeed been used by parties as is demonstrated by the increase in court decisions involving arbitration. We welcome this trend as it in fact reinforces that international arbitration practice is generally applied.

Notes

1 Tokyo District Court, Interim decision, 28 February 2012 (2010(wa)34309) 2012WLJPCA02288010.

2 This is an unofficial translation of the arbitration clause written in Japanese.

3 Tokyo High Court decision, 22 June, 2011 (2011(ne)330)2116 Hanrei Jiho 64.

4 Tokyo High Court decision, 21 December 2010, (2010(ne)2785), 2112 Hanrei Jiho 36. Neither party's identity was disclosed in the court decision.

5 An unofficial translation of the Japanese Arbitration Act is available at www.jcaa.or.jp/e/arbitration/rules.html.

6 Partial Award, 17 March 2006 (http://www.italaw.com/cases/961).

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