

# A class act

Yoshinori Ono and Miki Fujita of Nishimura & Asahi explore the potential impact of the introduction of a class action litigation system

The Japanese government is considering whether to introduce a new class action litigation system. According to statements by the government, consumer damages claims are quite common and are often of a similar kind, while at the same time there is a disparity between business operators and consumers in terms of the information available to them and their relative bargaining power. Furthermore, it is difficult for individual consumers to bring a case to the court due to costs and the effort required.

Some class action cases overseas have resulted in judgments or settlements for enormous sums accompanied by exorbitant attorney fees. In the United States, the system's adverse effects on the economy have been a frequent topic of discussion. Some believe a number of IPOs have been cancelled due to the risk of class claims and there are heated discussions on restraining the system. France considered introducing a class action system, but eventually decided against the idea due to its economic condition after the global economic crisis following the bankruptcy of Lehman Brothers in 2008 and the potential effect that such a system might have on businesses. Overall, although a class action system may be helpful to consumers, it can present serious concerns for businesses and the economy.

The Japanese class action system was set out in the Proposal on the Litigation System for Recovery of Collective Consumer Damages, which the Consumer Affairs Agency announced in August 2012 (CAA Proposal).

## Outline of the proposed system

The procedure laid out in the CAA Proposal consists of two stages. In the first stage of a class action, a specified qualified consumer organisation (*tokutei tekikaku shouhisha dantai*) (SQCO) files a petition to declare a common obligation, and the court decides whether the business operator bears a monetary obligation to a considerable number of consumers based on factual and legal causes that are common to such consumers. If such a monetary obligation is affirmed, the case proceeds to the second stage. The SQCO issues an individual or public notice to the relevant consumers. The claims are then determined through a summary procedure with respect to those consumers who authorised the SQCO to do so on their behalf.

Under the CAA Proposal, a SQCO is a qualified consumer organisation that will be certified by the Prime Minister as an organisation that has a system, the ability and adequate finances to adequately pursue a lawsuit as a plaintiff seeking the declaration of a common obligation. A qualified consumer organisation in turn is an organisation certified by the Prime Minister as an organ-

“Although a class action system may be helpful to consumers, it can present serious concerns for businesses and the economy”

isation that is eligible to adequately exercise an injunction claim to protect the interests of consumers overall under the Consumer Contract Act. Eleven organisations are certified across Japan.

During the first stage of the process, the district court will examine whether the business operator owes an obligation to a class of consumers and will render a judgment as in an ordinary civil litigation procedure. If the judgment is unsatisfactory to either the business operator or the SQCO, they may file an appeal to a higher court and then to the Supreme Court. No procedure for the second stage will commence until a declaration of a common obligation at the first stage has become final and binding.

The second stage is a summary procedure to determine the claims of each of the consumers. First, the SQCO, which was the

party to the lawsuit to declare a common obligation at the first stage, files a petition to commence the second stage. Following a court decision to start the procedure, the SQCO then issues a notice to consumers who may have a claim relevant to the declared obligation. After receiving authority from the consumers to file and perform the procedures relating to their individual claims, the SQCO may proceed to submit the claims to the court. The business operator then either accepts or rejects the claims. If the business operator rejects the existence or the amount of any of the claims, the court will decide them after hearing arguments from both sides. If neither party objects to the court's decision, it will become final and binding. If an objection is filed, however, the disputed claims will be examined as ordinary lawsuits (other than the issues certified at the proce-

cedure for a declaration of common obligation at the first stage).

Under the CAA Proposal, only the following claims by consumers against business operators may be the subject of Japanese class actions:

- (i) performance of obligations relating to a consumer contract;
- (ii) unjust enrichment relating to a consumer contract;
- (iii) damages due to failure to perform obligations under a consumer contract, and damages based on defect liability; and
- (iv) damages due to tort under the Civil Code relating to a consumer contract.

In addition, under the CAA Proposal, the court may dismiss a lawsuit to declare common obligations in whole or in part (first stage) if it finds that it would be difficult to adequately and promptly determine the



#### About the author

Yoshinori Ono is a partner of Nishimura & Asahi. Since the start of his practice in 1986, he has been advising foreign clients on various dispute resolution matters under Japanese law. His practice focuses on various cross border matters including dispute resolution, corporate restructuring/insolvency, investment/licensing, joint ventures, mergers and acquisitions, antitrust, labor issues and real estate investment. Mr. Ono is a graduate of The University of Tokyo (LL.B., 1981) and was admitted to practice law in Japan in 1986.

#### Contact information

**Yoshinori Ono**  
Nishimura & Asahi

Ark Mori Building  
1-12-32 Akasaka, Minato-ku  
Tokyo 107-6029, JAPAN  
T: +81-3-5562-9010  
F: +81-3-5561-9711/12/13/14  
E: y\_ono@jurists.co.jp  
W: www.jurists.co.jp



#### About the author

Miki Fujita is a partner at Nishimura & Asahi. She specialises in international commercial litigation and arbitration and corporate litigation. She has represented international and domestic clients in litigation and arbitration on a variety of matters such as M&A, product liability, land pollution, labour and insurance. Ms Fujita graduated from the University of Tokyo (LL.B., 1998) and Duke Law School (LLM, 2007). She was admitted to practice law in Japan in 2001 and New York in 2008.

#### Contact information

**Miki Fujita**  
Nishimura & Asahi

Ark Mori Building  
1-12-32 Akasaka, Minato-ku  
Tokyo 107-6029, JAPAN  
T: +81-3-5562-8388  
F: +81-3-5561-9711/12/13/14  
E: m\_fujita@jurists.co.jp  
W: www.jurists.co.jp

claims in a summary determination procedure (second stage) in light of the nature of the cases, the examination process, necessary evidence and other circumstances.

The question of what types of claims will be covered by the Japanese class action system is an important one. Thus, various business groups have vigorously provided their views on this issue to the Consumer Affairs Agency in the course of preparation of the CAA Proposal.

## Performance of obligations relating to a consumer contract

According to the Consumer Contract Act, a consumer contract is a “contract executed between a consumer and a business operator”. Here, a consumer is an “individual excluding those who became a party to a consumer contract as a business operator or on behalf of a business operator” and a business operator is an “entity or other organisation, or individual who is a party to a contract as a business operator or on behalf of a business operator.” Therefore, any and all contracts that a person who operates a business concludes with an individual without a business purpose are consumer contracts. This means that a case that relates to the performance of a contract between a business operator and a consumer may be subject to Japanese class actions.

Japanese class actions may, however, only cover monetary obligations. So, for example, in the case of a defective product, a claim for the repair of a defective product will not be subject to Japanese class actions, whereas a claim for damages in lieu of repair will be covered since it satisfies category (iii) or (iv) in the list above.

## Unjust enrichment relating to a consumer contract

The typical example of this category is a claim for unjust enrichment due to provisions of a contract (such as terms requiring cancellation charges) which are found to be void under Japanese law.

Since cancellation charges sometimes become high in continuous contracts, the

validity of such cancellation charge provisions are often disputed in the court. For example, in a case between NOVA (an English conversation school) and a student who had made an advance payment for lesson coupons but cancelled the contract before using all the coupons, the parties argued about how to evaluate the lessons that the student had already attended. The contract stipulated that the school may calculate the price of the lessons already rendered based on non-discounted price which is higher than the discounted price of the lessons if the student had continued to attend classes. In this case, the Supreme Court ruled that the contract provision was void as it was in violation of Article 49, paragraph 2 of the Act on Specified Commercial Transactions which provides that service providers must return advance payments after deducting amounts to cover services already rendered (Supreme Court judgment dated April 3 2007 [Supreme Court Civil Case Book (*Minshu*) Vol. 61, No. 3, page 1010]).

In addition, a qualified consumer organisation is asking various business operators (such as English conversation schools, various schools, wedding ceremony companies) to voluntarily refund cancellation charges which it alleges to be overcharged.

In light of the current activities of qualified consumer organisations, and the court precedent regarding a continuous contract described above, it is very likely that when the new Japanese class action system is introduced, it will be used to proceed with class actions seeking refunds of fees paid under contract provisions that impose cancellation charges or clerical fees which could be considered overcharged even if such cancellation charges are not very high.

Other cases may proceed seeking claims for refund of money by the consumer based upon unjust enrichment where a contract is cancelled due to false or exaggerated advertisements or unjust solicitation. However, a lawsuit for declaration of a common obligation at the first stage can be brought only when a business operator bears a monetary obligation based on a “factual and legal cause common to

a considerable number of consumers.” Therefore, claims for unjust enrichment will only fall under this category if they involve false or exaggerated advertisements or unjust solicitation of a considerable number of consumers by the same method such as solicitation using a business operator’s internal manual, or solicitation in a brochure that has a false description.

## Damages due to failure to perform obligations or damages based on defect liability

The type of claims that are typical in this category are claims relating to defective products. A lawsuit seeking to declare common obligation at the first stage can, however, be brought only when a business operator bears a monetary obligation based on a “factual and legal cause common to a considerable number of consumers.” Therefore, this type of claim will only fall under this category when the product is defective and the defect is found in many of the products held by consumers. In this sense, a defect in the design of a product would generally fall under this category. On the other hand, in the case of a defect in the manufacturing process which results in a defect that is only found some of the produced goods (for example a defect found in 10 out of 1,000 products), the Japanese class action will be available only for the claims of damages of those who purchased the defective products. It should be noted, however, that the CAA Proposal explains that special considerations should apply when determining whether a class action may proceed regarding a case where the safety of the product is not guaranteed and the use of all of the products is affected due to the defect found in some products.

It should be noted that damages to a person’s other property or to a person’s life or health are not included in the scope of the claim under this category. Japanese class actions will only cover damages that occur to the product itself, namely, the price of the product. No claim for additional damages will be available under the Japanese class action system.

### **Damages due to tort under the Civil Code relating to a consumer contract**

This category covers claims for damages pursuant to the tort provisions of the Civil Code. Therefore, a claim for damages under laws and regulations other than the Civil Code such as a company's liability under Article 21-2, paragraph 1 of the Financial Instruments and Exchange Act arising from false descriptions in a securities report, or a liability under the Product Liability Act will not be subject to the Japanese class action system.

### **Potential effect on the consumer business**

In the briefing session for the CAA Proposal, the Consumer Affairs Agency explained to business corporations that the introduction of the Japanese class action system will not change the substantive law, but is solely a revision of procedural law which simply puts together consumers' rights under the substantive law.

There is a possibility, however, that introducing the Japanese Class Action will not simply be a revision of the procedural law, but will have a substantial effect on business operators in Japan.

For example, suppose that a product did not perform as described in its instruction booklet. Under the current litigation system, the normal possible consequences are that only consumers who tried to use the missing function and were dissatisfied would file a claim against the business operator that manufactured or sold the products. If the proposed Japanese class action is used, and the lack of the function is certified at the first stage, then all the consumers may be certified with a claim for damages regarding the difference between the price of the product and its reduced value due to the missing function, on the basis that the price of the product should have been lower since it lacks the features that it claims. In other words, the Japanese class action system may create a situation where consumers who did not intend to use the function and therefore did not realise the defect, or who knew of the defect but did not find it inconvenient, may receive monetary

compensation if they agree to be included in the class action. Accordingly, it is only natural for these consumers to agree to be included in the claim and receive monetary compensation, given that they are sure to receive compensation as long as they take the necessary steps. Such circumstances are, however, completely at odds with the type of damages the current litigation system awards. Thus, the introduction of the Japanese class action system will not simply be a revision of the procedural law, but, in practical terms, will have a substantial effect on business operators in Japan.

There are concerns that introducing a class action system in Japan may cause adverse effects on the Japanese economy, or may reduce the international competitiveness of business operators in the country. In this respect, the Consumers Affairs Agency explained that it decided to adopt a two-stage class action system similar to that of Brazil after taking the interests of business operators who could be disadvantaged into consideration. In a nutshell, the agency explained that it intended to propose a system that would have less potential to harm business interests than the class action system in the United States.

Indeed, the proposed Japanese system requires each consumer to opt into a class at the second stage. This is different from the class action system adopted in the United States where if a consumer does not take an affirmative step to opt out (in other words if the consumer does not choose to be excluded from the class action system), he/she will be included in the class.

Under the Japanese class action system, consumers would receive notice after the business operators' payment obligations are declared at the first stage, and choose whether they wish to participate in the class action procedure in order to receive monetary compensation. The consumers do not have to indicate their participation when the outcome is still unclear to them. Since consumers receive a notice at the stage where a valid claim has been declared by the court, and on the assumption that the consumers

will almost certainly receive payment if they just agree to be included in the lawsuit, a reasonable consumer is likely to take the necessary steps. Thus, an adverse effect on the economy which is similar to the one caused by the US class action system may still be possible. The introduction of the Japanese class action system may also reduce the competitiveness of corporations that do business in Japan because their costs may greatly increase in trying to avoid any misrepresentations to the consumers such as mistakes in their instructions booklet.

Given the foregoing, the introduction of the proposed class action system in Japan may seriously affect every business operator in Japan. Business operators will need to prepare themselves for the possibility of new legal risks.

Qualified consumer organisations are questioning business operators on the validity of provisions relating to cancellation charges and clerical fees in the business operators' contracts with their consumers. They are focusing their efforts on activities that seek the revision of such provisions. Given this situation, business operators who enter into contracts with their consumers should review such provisions carefully to examine whether or not the provisions regarding the cancellation charges and clerical fees conform to the law.

Under the Consumer Contract Act of Japan, if a cancellation charge or a clerical fee is in excess of average time, effort or damages incurred by the business operator, the contract provision will be void as to such excess amount. If such cancellation charges or clerical fees are regarded as void under the Consumer Contract Act, there is a risk of a class action seeking refunds of such over-charged amounts.

If the Japanese class action system is introduced in Japan, it will be necessary for all types of business operators to carefully watch the actions of the SQCOs and take necessary precautions to minimise the risks of becoming the subject of a class action.