

New frontiers in the Reiwa imperial era: Future challenges for Japan Inc in international arbitration and cross-border investigations

10 December 2019

SEA View, Article VIII: December 2019

As Japan enters the new Reiwa imperial era, it is time to refresh the aged stereotypes of Japanese companies (hereafter referred to as "Japan Inc") and their approach to international arbitration and cross-border investigations. Culturally, some observers still like to think of Japan as somewhat like the Galápagos, an isolated country with its own unique business culture and customs. However, such parallels of isolationism no longer ring true.



As the Japanese economy has stagnated in the last few decades, Japan Inc's thirst for growth has led them to enter high-margin emerging markets with limited legal recourse and high-corruption risk (particularly in South East Asia, China, and the Middle East). At the same time, many U.S. and European MNCs have entered certain sectors of the Japanese economy, which continue to

thrive; it is easy to forget that Japan is still widely regarded as the third-biggest economy in the world in pure GDP terms.

Therefore, whether you are a Japanese MNC with overseas operations or a U.S./European corporate with business interests in Japan, understanding how Japan Inc will confront the challenges of international arbitration and cross-border investigations is vital.

Japan Inc and international arbitration: An evolution in handling cross-border disputes?

Over the past decade, international arbitration has become one of the dispute resolution methods preferred by many MNCs. Japan Inc is not an exception – it has started incorporating sophisticated arbitration clauses into commercial contracts and has even undertaken investor-state arbitration against a foreign government. In light of this development, we observe certain trends and common features of international arbitration involving Japan Inc.

A trend towards more international arbitrations in Asia and the Middle East

The most notable outbound investments by Japan Inc include those by large construction and infrastructure companies (e.g., general contractors and relevant divisions of trading houses) into South East Asia and the Middle East. Likely encouraged by the existence of regional arbitral institutions that have modern sophisticated rules, such as those stipulated by Singapore International Arbitration Centre (SIAC) and Hong Kong International Arbitration Centre (HKIAC), these companies have become highly experienced in resolving disputes related to their projects through international arbitration. Other Japan Inc companies may catch up in the coming years as they expand their outbound investments into popular investment destinations, including South East Asia and the Middle East, where international arbitration is becoming increasingly common. We suspect mainland China may also be counted as one such destination, particularly in light of recent developments in Chinese law that promote the use of international arbitration.

Adversity to litigating against business partners

Japan Inc has traditionally been known for its unwillingness to litigate because its commercial strategy is often based on long-standing business relationships. This adversity tends to be more apparent in the context of litigating against other Japan Inc entities (partially due to the pattern of cross-shareholding between large Japanese companies), although it can also be seen in the context of international arbitration against non-Japanese entities. Japan Inc may therefore make every effort to settle a dispute amicably where it wishes to preserve the relationship with the counterparty. Combined with a multilayered decision-making process which emphasises risk avoidance, this could potentially result in prolonged negotiation periods before any arbitration proceeding is initiated. Having said that, some large Japanese companies have begun to introduce non-Japanese personnel into their management, which may render Japan Inc more willing to taking legal actions, including international arbitration against its business partners.

Limited (and temporary) international arbitration expertise at Japan Inc in-house

While Japan Inc now has more qualified lawyers in-house, few of them specialise in dispute resolution and even fewer do in international arbitration. Some large Japan Inc companies are now hiring arbitration specialists as secondees from international law firms, but their terms tend to last for only one or two years and the level of experience of the secondee can vary. This could pose a challenge when Japan Inc considers strategies to effectively resolve an international dispute, whether at the stage of negotiating a dispute resolution clause or contemplating taking legal action against a counterparty.

General unfamiliarity with document production

Japan Inc is often unfamiliar with the document production procedure commonly used in international arbitration. In contrast, Japan Inc is more accustomed to the document disclosure available under Japanese civil procedure law, which is very limited. This relative lack of experience in dealing with document production procedures may inform the timeline for document production in arbitration proceedings involving Japan Inc. Also, in general, Japan Inc is to a varying extent unfamiliar with the concept of legal privilege. Legal privilege is not recognised under Japanese law in the way that it is conceived in common law jurisdictions such as the United Kingdom. It is critical for Japan Inc to ensure, with the assistance of international arbitration experts as necessary, that it does not inadvertently disclose documents that are capable of being exempted from disclosure as privileged.

Mediation as an alternative to court litigation or international arbitration?

In domestic Japanese commercial disputes, it is relatively common for Japan Inc to conduct alternative dispute resolution. In most cases, this will be in the form of a court-annexed mediation process. Despite this, mediation is not common for Japan Inc in international disputes and commercial negotiation often takes precedence. Whether developments such as the new Singapore Convention on Mediation, which will make enforcing mediated settlement agreements much easier, will impact how Japan Inc utilises mediation remains to be seen; it is curious that Japan is not one of the founding signatories to the Singapore Convention.

Japan Inc and cross-border investigations: A new age of tackling corporate crises and scandal

Corporate investigations have risen to prominence in the public sphere after a series of major scandals involving major Japanese corporates and public figures. Recent Japanese films such as "*Recall*" (2018) have also lit up the Japanese public's imagination. Despite this recent increase in awareness, challenges remain for Japan Inc to effectively monitor corporate governance and conduct cross-border investigations.

Salaryman to whistleblower?

There has been a fundamental shift in the Japanese labour market which has challenged the post-war social contract binding Japanese companies and their loyal career salaryman. Increasingly, Japan Inc employees are encouraged to speak up. Japanese public prosecutors have also realised the need to offer incentives to potential whistleblowers (as an alternative to traditional interrogation/confession tactics used on primary suspects). The recent introduction of a plea bargaining system in 2018 further encourages Japan Inc employees to speak up. However, Japan Inc's implementation of whistleblower protocols and similar internal mechanisms has been patchy. Undoubtedly the ineffective dealing of whistleblower reports may impede Japan Inc's ability to effectively handle cross-border investigations.

Limited resources and autonomy for crisis management

Except for industries in heavily regulated sectors, such as financial services and banking, the existence of a dedicated investigation or compliance function remains rare in Japan Inc entities. While this is not uncommon in MNCs headquartered outside Japan, the lack of such a dedicated function in Japan Inc means there is often limited in-house experience of practically conducting cross-border investigations and this is exacerbated by Japan Inc's often centralised business operations which lend towards decision-making in Tokyo with limited awareness of dynamic on-the-ground realities in overseas operations. When overhead costs are tightly controlled, it is tempting to cut costs in non-profit generating departments. Compliance in any market can often be seen as a headache rather than a revenue generator. However, the complexity of Japan Inc's

domestic and overseas operations means proper resources and autonomy to conduct compliance oversight and independent investigations is more important than ever before for Japan Inc.

A new, more fraught relationship with Japanese and international media?

If ever there was a cosy relationship between Japan Inc and the Japanese media, it simply no longer exists. Public trust in Japan Inc has eroded after a series of recent corporate scandals which have been widely reported in the media, and in this aspect Japan Inc has not always coordinated legal issues and media communications effectively. There is also an issue for Japan Inc's overseas operations' need to adapt to engaging with overseas media. In any crisis situation, it is imperative for Japan Inc's overseas operations to be able to respond effectively to rapidly unfolding media exposure to protect Japan Inc's reputational risk as well as legal liability. This is particularly the case in emerging markets where controlling the media narrative holds significant sway with how local regulators approach and investigate alleged corrupt or fraudulent conduct on the part of an employee, agent, or contractor of Japan Inc. We find assembling the right team, understanding the facts, and disclosing (and not spinning) the truth as the three key tenets of a media management strategy.

Heightened enforcement risk against senior managers

From an enforcement perspective, Japan Inc's senior managers should be as worried about recent U.S. Foreign Corrupt Practices Act (FCPA) developments as well as those in the Japanese anti-corruption regime. In October 2019 a new precedent in the Hoskins case in the United States means, in theory, a senior manager of Japan Inc will face the reality that even if he/she has never set foot in the United States, he/she may still be caught under the jurisdiction of the U.S. FCPA as an agent of a Japan Inc subsidiary in the United States. If there was any reassurance previously for Japan Inc that overseas bribery has no U.S. nexus and therefore not subject to the rigours of the U.S. FCPA, such reassurance can no longer be relied upon. This U.S. FCPA enforcement risk is further heightened by Japan Inc's propensity to create written investigation summaries and reports for its senior management, which are generally not privileged – such documents would be *low-hanging fruit* for U.S. prosecutors. Japan Inc must therefore consider these realities in the context of assessing corruption enforcement risk against its senior managers.

Renewed business ambition in the Reiwa imperial period?



Some commentators have commented that the new Reiwa imperial era will bring about the presence of a bolder, more ambitious Japan Inc compared to the previous Heisei imperial period. This remains to be seen.

What is clear is that Japan Inc is becoming more ambitious in overseas markets at a time where legal complexity and regulatory scrutiny has never been greater. Japan Inc will have to – and to some extent be forced to – adapt to deal with the prospect of international arbitrations and cross-border investigations, and the complexities that follow.

Contacts



Wataru Kamoto
Partner, Tokyo
T +81 3 5157 8163
wataru.kamoto@hoganlovells.com



Seri Takahashi
Registered Foreign Lawyer, Hong Kong
T +852 2840 5038
seri.takahashi@hoganlovells.com



Wataru Kawai
Associate, Singapore
T +65 6302 7146
wataru.kawai@hoganlovells.com

SEA View

Since April 2019, our monthly periodical has featured investigation, compliance, and regulatory developments in Southeast Asia (SEA). For a 12-month period, one monthly article will showcase our insights on particular developments in the region, liaising with our extensive global network. We draw on the firm's market-leading practices, including our assembled Global Regulatory team, to lead clients' businesses through challenges encountered in and out of SEA. SEA View is horizon spotting in practice.

This month's analysis looks at the future for Japan Inc in the context of international arbitration and cross-border investigations. Our previous articles crisscross within, into and out of SEA discussing themes like crisis management messaging, sanctions, money laundering, competition and the U.S.-Sino trade war. Our growing anthology is available [here](#).

www.hoganlovells.com

"Hogan Lovells" or the "firm" is an international legal practice that includes Hogan Lovells International LLP, Hogan Lovells US LLP and their affiliated businesses.

The word "partner" is used to describe a partner or member of Hogan Lovells International LLP, Hogan Lovells US LLP or any of their affiliated entities or any employee or consultant with equivalent standing. Certain individuals, who are designated as partners, but who are not members of Hogan Lovells International LLP, do not hold qualifications equivalent to members. For more information about Hogan Lovells, the partners and their qualifications, see www.hoganlovells.com.

Where case studies are included, results achieved do not guarantee similar outcomes for other clients. Attorney advertising. Images of people may feature current or former lawyers and employees at Hogan Lovells or models not connected with the firm.

© Hogan Lovells 2019. All rights reserved.