# Distribution Q&A: Japan

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Japan-specific information concerning the key legal and commercial issues that arise when appointing a distributor.

This Q&A provides country-specific commentary on *Practice note, Distribution: Cross-border overview*, and forms part of *Cross-border commercial transactions*.

## Regulation and legal formalities

1. Is distribution specifically regulated by national law? Are there any special rules or definitions applicable to:

- Exclusive distribution?
- Sole distribution?

 

- Non-exclusive distribution?
- Selective distribution?
- Is any legislation pending, which is likely to affect distributions?
- Are there any formalities that a supplier must comply with when setting up a distribution network, for example, any registration or disclosure requirements?

**Exclusive distribution**
Distribution agreements are not specifically regulated by the Civil Code or by any other Japanese statute. There is therefore no statutory definition of exclusive distribution, but "exclusive" is generally understood to mean that the appointment excludes the activity of the supplier and the appointment by the supplier of any other distributor in the territory.

Exclusive distribution is generally permissible under Japanese law. See *Question 3* on competition aspects. Part III of the Japan Fair Trade Commission (JFTC) Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act (Distribution Guidelines), briefly defines exclusive distribution (although the English translation refers to "sole" distribution).

**Sole distribution**
There is no statutory definition but "sole" is generally understood to mean that although the distributor will be the only distributor appointed by the supplier, the supplier may itself operate in the relevant territory. Sole distribution is generally permissible under Japanese law. See *Question 3*.

**Non-exclusive distribution**
No specific statute defines or regulates non-exclusive distribution, which is permissible. See *Question 3*.

**Selective distribution**
No specific statute defines or regulates selective distribution. In a selective distribution system, the supplier undertakes to sell its goods only to authorised distributors, selected on the basis of specific criteria. The distributors undertake not to sell the goods to unauthorised distributors. Selective distribution is typically used for luxury or high value goods, which demand a high quality retail format and sales services.

**Pending legislation**
A comprehensive reform of the Civil Code has been undertaken, which will indirectly affect distribution (for example, by introducing enhanced consumer protection) and might affect distribution agreements in the following areas:

- Termination of contracts.
- Assumption of risks.
- Delay in acceptance.
- Statutes of limitations, and so on.

 

The main purpose of the reform is to revamp the Civil Code enacted in 1896, and to make the Code more comprehensive and user-friendly by turning general principles of law derived from court precedents into statute. Most of the amendments adopted in 2017 will come into force on 1 April 2020.

**Formalities**
Setting up a network does not in itself trigger any registration or disclosure requirements. Various licences and permits can be obtained from various authorities if the prospective activity is regulated. For example, licences are required for the importation and sale of alcoholic beverages and for the importation, sale and distribution of cosmetics, pharmaceuticals and medical equipment, while an insurance business licence must be gained for the running of insurance businesses and financial services, and the distribution of insurance products, food-related activities, (depending on the activity) telecommunications and broadcasting.

2. Are there any laws, regulations or case law which apply to agency relationships that might be interpreted in such a way as to apply to a distributor relationship as well?

The distinction between distribution and agency is often blurred in commercial usage. Commercial agents are less common than distributors in Japan. A distributor acts as an independent contractor, buying and selling for its own account, with no authority to enter into commitments on the supplier's behalf. Laws, regulations and case law which apply to agency do not specifically apply to distribution although a number of legal principles in the Civil Code and the Commercial Code apply to both contract types.

## Competition law

3. Are there any national laws or regulations that would affect the following business practices:

- Grant of exclusive territory?
- Tied selling?
- Territorial restrictions?
- Customer restrictions?
- Resale price maintenance?
- Minimum purchase targets?
- Imposition by the supplier of restrictions on the sources of supply to distributors?
- Refusal to deal?

 

See *Question 4* on exclusivity, *Question 5* on resale price maintenance, *Question 6* on minimum purchase obligations and *Question 7* on exclusive procurement.

The main source of antitrust law is the Act on the Prohibition of Private Monopolisation and the Maintenance of Fair Trade (Antimonopoly Act or AMA), which mirrors the US antitrust laws, primarily the Shearman, Clayton and Federal Trade Commission Act. The AMA prohibits agreements and concerted practices unreasonably restraining trade, single-firm and joint monopolisation and unfair trade practices. In addition, the Distribution Guidelines identify specific types of conduct that may impede free and fair competition and breach the AMA.

Unfair trade practices refer to certain business activities listed in Article 2, paragraph 9 of the AMA and include certain types of anti-competitive conducts:

- Concerted boycotts.
- Discriminatory pricing.
- Unjust low-price sales (also covered by specific JFTC guidelines).
- Resale price restrictions.
- Abuse of superior bargaining position (also covered by specific JFTC guidelines).
- Other business activities that are designated as such by the JFTC in its Designation of Unfair Trade Practices (the Designation, a 1982 Public Notice).

Tying or bundling provisions that condition the availability of one product on the distributor also purchasing another product are designated as an unfair practice. Likewise, refusal to deal is targeted by the Designation. Essentially, a firm can freely select its trading partners and decide which firm it does business with. However, a refusal to deal by a single firm is illegal if the firm refuses to deal as a means of ensuring the effectiveness of its illegal conduct under the AMA (for example, to exclude competitors from a market).

Article 3 of the AMA prohibits anti-competitive agreements in restraint of trade (competition must be substantially restrained and contrary to the public interest, but in practice certain activities are illegal per se). Cartels cover agreements between competitors designed to eliminate or restrict market competition through price fixing, limits on production and market or customer allocation. The regulations governing unreasonable restraints of trade apply primarily to horizontal restraints and not to vertical restraints, which are normally regulated as unfair trade practices.

The Designation refers to trading on restrictive terms, including trading with another party on conditions which unjustly restrict trade between the said other party and its own business partners or its other business activities.

The Distribution Guidelines discuss vertical non-price related restraints, and the JFTC takes the view that marketing activities involving restrictions on the products handled by the distributor, distributors' sales territories or customers and so on, are generally lawful unless such restrictions make it difficult for new entrants or competitors to easily secure alternative distribution channels, or result in price maintenance. The Distribution Guidelines were last revamped in 2017 to take into account the increasing globalisation of economic activities, technological innovation and shifts in business models. They apply to distribution on the internet as well as in brick-and-mortar stores and, as a sign of times, cover "platformers" defined as enterprises operating and offering a so-called platform serving multiple user groups (such as consumers and enterprises offering their products) and in which a level of use by one

 

user group influences that of another user group and vice versa. Platforms include shopping malls, online market places, online travel booking services and video game consoles.

4. Is there specific competition or anti-trust law regulation of exclusive and selective distribution? Describe briefly.

Article 3 of the AMA prohibits anti-competitive agreements in restraint of trade. An exclusive distribution agreement risks falling within Article 3 since it prevents the supplier from supplying other distributors. Similarly, a provision in a distribution agreement preventing the distributor from buying competing goods might restrict competition. However, an agreement containing restrictions on competition will not fall within Article 3 if its object is not to restrict competition and if it does not have a sufficiently significant effect on competition.

In its Distribution Guidelines, the JFTC affirms the legality of the selective distribution system, as long as the selection criteria are based on plausibly rational reasons from the standpoint of the interest of consumers, and the criteria are equally applied to other distributors who want to deal in the product. The validity of the selective distribution system created by suppliers of luxury or high value goods in particular has been challenged and the landmark decisions on sales method restrictions are two Supreme Court decisions involving cosmetics manufacturers, Shiseido and Kao. Shiseido and Kao require their dealers to perform face-to-face sales/counselling sales involving trained staff who are able to provide explanations on the suitability, usage and characteristics of the goods. The Supreme Court upheld the argument of the cosmetics manufacturers and validated their resale methods, confirming they were not acting in breach of the AMA on restrictive terms as long as the restrictions had some justification given the nature of the products (brand image and prevention of skin trouble) and they were equally applied to other distributors. In those circumstances, a manufacturer is entitled to require its distributors not to on-sell products to a distributor who is not bound by an agreement with the manufacturer and would not apply the resale method.

5. Are there any national provisions relating to the imposition of minimum or maximum prices?

A supplier is only permitted to impose fixed resale prices on an agent and not on a distributor.

Resale price maintenance (RPM) is treated as an unlawful unfair trade practice (with the exception of very limited circumstances where proper justification exists) as it restricts the distributor's ability to determine its resale prices and it reduces or eliminates competition. The JFTC revised its Guidelines in 2015 to add that the Antimonopoly Act provides that RPM without "justifiable grounds" is illegal as an unfair trade practice. RPM can be lawful on an exceptional basis on condition that it has "justifiable grounds." Justifiable grounds might only exist within a reasonable scope and for a reasonable period of time, in cases where RPM has actual competitive effects, promotes

 

inter-brand competition, and increases product demand thus benefiting consumers, and these competitive effects could not have been achieved through less restrictive alternatives. RPM continues to be outright illegal but it may be allowed where the public benefits outweigh public detriments. For example, RPM may have competitive effects when some dealers are "free riding" on others by underinvesting in the supply of associated retail services necessary to support the sale of products and are accordingly only seeking to compete on price without providing those services.

It is otherwise permissible for the supplier to recommend resale prices to the extent it is only a recommendation. A manufacturer may not use certain expressions in relation to a suggested resale price (true price (*seika*), set price (*teika*) or the price alone). Non-binding indicative expressions such as reference price (*sanko kakaku*) or manufacturer's suggested retail price, together with the manufacturer's clear message to distributors that the suggested resale price is given solely for their reference and that each distributor should determine its resale price independently, are legally acceptable. A supplier may not impose a maximum resale price.

## 6. Can a supplier impose minimum purchase obligations or targets on a distributor?

Minimum purchase obligations or targets are generally permitted, including as a termination event. A non-exclusive distributor is unlikely to agree to a minimum purchase obligation as it will involve too great a commercial risk. The Distribution Guidelines provide that the fact for a supplier, in exchange for granting an exclusive distributorship of the products covered by a contract, to set a minimum volume or value of products to be purchased or sold, presents, in principle, no problem under the AMA.

Depending on the circumstances and on the terms of the arrangement, minimum purchase obligations or targets can still give rise to certain competition law issues. Quantity-forcing on the buyer is a weaker form of non-compete, where incentives (for example loyalty or fidelity rebates and discounts) or obligations agreed between the supplier and the buyer make the latter concentrate its purchases to a large extent with one supplier. The possible competition risks of single branding are foreclosure of the market to competing and potential suppliers and a softening of competition with a direct impact on inter-brand competition.

## 7. Can a supplier impose exclusive purchase obligations on a distributor?

According to the Distribution Guidelines, there is in principle no problem under the AMA if a supplier requires its sole distributor to buy the product covered by the contract exclusively from the supplier or from the parties it designates.

 

However, there should be no abuse and "trading on exclusive terms" is defined in the Designation as an unfair trade practice (unjustly trading with another party on condition that the said party shall not trade with a competitor, thereby reducing trading opportunities for said competitor). See *Question 6*.

8. Are there any laws or regulations relating to restrictive covenants or covenants not to compete during the distribution agreement? To what extent is it possible to continue the restrictions after the agreement has expired? In particular, to what extent does the geographical extent and or the length of time of the restriction affect its enforceability?

It is possible to include non-compete provisions which will be in force during and after the term of the agreement. However, if such restrictions are likely to have an adverse effect on competition in a market by restricting the freedom of one party, they may be in breach of the AMA.

Restrictions continuing after the term of the agreement are more likely to cause problems. The position of the JFTC is expressed in Part III of the Distribution Guidelines on "sole" (the expression used in its English translation but actually meaning "exclusive") distributorship. Restrictions on handling competing goods during the term of the contract is acceptable from an AMA perspective, provided that the supplier does not restrict the handling of competing goods already being handled by the sole distributor.

Restrictions on the handling of competing goods after the termination of the agreement are possible. However, if a supplier prevents its sole distributor from handling competing goods after termination and this would curb the business activities of the sole distributor and obstruct entry into the market, there may be a problem under the AMA. If the restriction is justified (such as by the need to protect business secrets and confidential information), it should not fall foul of the AMA.

9. Is the supplier free to impose on the distributor an obligation to buy and keep a full stock of each of the products comprised in the range of products which are the subject of the distribution agreement?

The arrangement is not prohibited per se. According to the Distribution Guidelines, marketing activities which involve restrictions on products handled by a distributor, or distributors' sales territories or customers (vertical non-price restraints), are generally not illegal unless such restrictions result in making it difficult for new entrants or competitors to easily secure alternative distribution channels, or result in resale price maintenance. That can happen where the supplier is an influential manufacturer within the meaning of the Distribution Guidelines. See *Question 6*.

10. Where a distribution network involves trading online how is this regulated?

This is a broad subject. In this context, the emphasis is primarily placed on the protection of online buyers to cover sales practices, advertising, product quality and other aspects of consumer transactions.

Several laws protect online buyers, including:

- Act against Unjustifiable Premiums and Misleading Representations.
- Personal Information Protection Act.
- Act on the Settlement of Funds.
- Act on General Rules for the Application of Laws.
- Act on Special Provisions to the Civil Code Concerning Electronic Consumer Contracts and Electronic Acceptance Notice.
- Act on Specified Commercial Transactions.
- Act on Regulation of Transmission of Specified Electronic Mail.
- Antimonopoly Act.

The Ministry of Economy, Trade and Industry (METI) has published Interpretative Guidelines on Electronic Commerce and Information Property Trading to explain how these laws and regulations and the Civil Code are applied and interpreted with respect to the various types of legal issues that may arise in the e-commerce context.

## Intellectual property

11. Does a distributor enjoy an implied licence to use the supplier's intellectual property rights in performance of its obligations under the distribution agreement?

The distributor would generally enjoy an implied licence to use the supplier's trade mark simply for marketing, advertising and selling products bearing the trade mark, although the grant to the distributor of the right (and its limits) to use the trade mark in Japan for marketing and sale of the products is generally dealt with in international distribution agreements.

 

Such an implied "licence" assumes, among other things, that the distributor does not tamper with the labelling and packaging of the products displaying the trade mark and does not deface or remove the trade mark. For other IP rights (copyright, patents and so on), an implied licence would be more unusual, and the meaning of "use" and any corresponding implied licence needs to be carefully assessed on a case-by-case basis.

12. Is registration of intellectual property licences possible? Does this give any added protection?

It is possible to register IP licences covering trade marks, patents, utility models and design rights with the Japan Patent Office. Licences can be exclusive (*senyo-jisshi-ken*) or non-exclusive (*tsujyo-jisshi-ken*).

Registration of an exclusive licence gives added protection to the licensee, as the licensor may no longer use the licensed right or grant a licence to a third party in Japan without the licensee's consent.

Registration of exclusive and non-exclusive licences used to be necessary to assert rights against a third party infringing the licensed rights, but this is no longer required, except for trade marks.

13. If the supplier is based abroad, does the distributor need to be registered as owner or user of the trade mark to be able to import goods bearing the trade mark?

No, this is not legally required. The supplier is generally the registered owner of the trade mark in Japan.

14. Does the distributor become entitled to any rights in a trade mark (or any other intellectual property right) by virtue of selling the trade-marked products in its territory?

No, a distribution agreement does not operate to vest in the distributor any right, title or interest in a trade mark, and the distributor is generally not entitled to rights in other IP only by virtue of sales.

 

15. Are there any competition law or anti-trust implications of licensing intellectual property rights?

Yes, there are implications under the AMA and the Guidelines for the Use of Intellectual Property under the Antimonopoly Act (addressing primarily patent and know-how licensing agreements).

Article 21 of the AMA validates the exercise of rights under the Copyright Act, the Patent Act, the Utility Model Act, the Design Act or the Trademark Act. However, the Guidelines advise that when acts considered to be the lawful exercise of rights under these laws deviate from or run counter to one of the purposes of the Intellectual Property System (the legal framework protecting technology-related intellectual property) they can be caught by the AMA since these acts would no longer constitute the proper exercise of rights under these laws.

The Guidelines discuss a number of competition concerns in this context, such as private monopolisation, inhibiting the use of technology, limiting the scope of use of technology, imposing conditions on the use of technology and unreasonable restraints of trade.

16.Can the supplier impose restrictions on the use of the supplier's confidential information by a distributor either during or after the expiration of the distribution agreement?

Yes.

## Employment law

17. Is there a risk that distributors may be treated as employees of the supplier?

This is generally not the case in Japan. There is no case law involving legal entities being requalified as employees. For an individual or sole proprietor acting as distributor, the Labour Standards Law of Japan defines a worker as a person employed at an enterprise or place of business who receives wages (that is, wages, salary, allowances, bonuses and any other payment to the worker from the employer as remuneration for labour, regardless of its name)

 

therefrom, without regard to the kind of occupation. The individual would have to be placed under the supervision (orders and directions) of the employer with regard to the method, quantity and quality of work. The person will not be recognised as an employee if there are elements showing that they are an independent contractor. These include:

- Ownership of goods and equipment.
- Amount of compensation and method of determination thereof.
- Conduct of business at one's own risk.
- Employment of other workers.

If these elements are lacking, the individual could be classified as an employee.

18. Could employment liabilities of an outgoing distributor be transferred to a new distributor or to the supplier itself?

No, assuming the outgoing and new distributors are not related companies and there is no sham or fraudulent arrangement, for example to streamline the workforce.

## Tax

19. Will a foreign supplier who appoints a distributor directly in the national territory be regarded as carrying on business for tax purposes in that territory?

No, the supplier will not be regarded as carrying on business in Japan merely as a consequence of the appointment.

Depending on the circumstances, a permanent establishment (PE) risk may exist, if the distributor operates as a "fixed place of business" through which the business of the supplier is wholly or partly carried on, or if the distributor is acting as a dependent agent, in other words as a person who, in view of the scope of its authority or the nature of its activity, involves the supplier to a particular extent in business activities in Japan.

 

20. Are any withholding or other taxes levied in the territory on remittance monies? When and by whom are they payable?

Consumption tax (CT) is paid by consumers when they purchase goods and services. The rate is currently 8% and is due to be increased to 10% in October 2019. Foreign companies providing goods or services in Japan may be under a statutory obligation to charge CT and pay over any CT due to the Japanese tax authorities. Situations triggering CT payment include where goods are delivered within Japan and where the foreign trader imports goods into Japan. There is however a temporary exemption system for SMEs (that may sometimes be relied upon by MNCs).

21. Will there be any difficulties in a domestic distributor making payment to a foreign supplier, either in local currency or in the currency of the supplier's country? Are there any exchange controls in operation?

Payments for goods can generally be made in Japanese Yen or foreign currency, without any specific forex restriction.

## Product liability

22. To what extent is it possible to exclude liability as between the distributor and supplier for the supply of defective goods or services? To what extent can a distributor be indemnified against product liability claims?

Legal and natural persons may seek compensation for injuries caused by a defective product. They can do so through one of several legal avenues, including a breach of contract claim or tort claim under the Civil Code.

Claims can also be brought under the Product Liability Act (PLA). Under the PLA, a plaintiff may seek compensation for damages caused by a defective product. The plaintiff must prove that the product was defective and that the defect caused the damage. The PLA imposes liability on the manufacturer (broadly defined as any person who manufactures, processes, or imports the product as a business, or any person holding themselves out to be a manufacturer of a product by putting their name, trade mark or other feature on the product) of a product for personal injury or property damage caused by a defect in the product, regardless of whether it was domestically produced or imported by the manufacturer.

 

The PLA is not generally applied to importers and distributors (wholesalers and retailers). Even if importers and distributors are potentially liable, it does not exonerate the foreign manufacturers who can be sued in Japan. Because there are often difficulties in suing a foreign manufacturer, a plaintiff may prefer to sue the local distributor as an easy way to seek monetary damages. The distributor can in turn seek liability from the original manufacturer.

Although manufacturers, in principle, cannot exclude their liability for personal injuries that may result from defective products, they can contractually exclude or limit their liability to distributors. To that extent, their contract can exclude liability for loss of profits, reputational damage and so on.

## The distribution agreement

23. Are any particular formalities required in relation to distribution agreements?

No, offer and acceptance is the basic rule. The agreement can be verbal (although this is not advisable) or executed as a private deed, without the need to complete any particular formality. A distributor does not have to be registered in this capacity, and no local share ownership or interest in the distributor is required.

24. Is it possible to incorporate the supplier's standard conditions of sale into the distribution agreement? What do such standard conditions normally cover?

Yes, it is possible. There is nothing Japan-specific about conditions that can be incorporated, and it is generally a matter of bargaining power between the parties to the distribution agreement.

25. Does national law impose any obligations on the supplier or the distributor? Are there any obligations of either party which are typical due to local custom?

Not directly as a supplier or distributor under a "distribution agreement", as national laws do not expressly provide a definition of distribution agreement.

 

A number of legal provisions would still apply to the supplier (obligations to compensate for breach of contract under Article 415 of the Civil Code; breach of warranty against latent defects under Article 526 of the Commercial Code or Article 570 of the Civil Code; obligations to deal in good faith with the distributor without abusing its rights under Article 1 of the Civil Code). Some of these obligations would equally apply to the distributor.

In the same vein, an abuse of a superior bargaining position is an unfair practice under the AMA, for example in a situation where a party makes use of its superior bargaining position over another with whom it maintains a continuous business relationship to unjustly cause the other party to provide money, service or other economic benefits. A party in a superior bargaining position does not necessarily have to be a dominant firm or a firm with significant market power.

26. Are any terms implied by law as to the supplier's title to the goods? Is any specific wording necessary and do buyers normally impose a higher standard than is implied by law?

Under the Civil Code, a person in possession of an object is presumed to have a lawful right to it (*Article 188*). Representations, warranties and indemnities can certainly be entrenched in the distribution agreement but this is not fixed market practice.

27. What term is commonly agreed for a distributorship? Does national law regulate the length of notice periods?

Distribution agreements are usually entered into for a specific term. Typically, the term can be two to three years, but this is far from systematic, and the initial term can also be as short as one year.

The agreement is often automatically renewed at the end of the initial term for a further period of one year, unless either party gives notice to the other to terminate the agreement. The law does not regulate the length of notice periods. The courts may decide a contractual notice period is too short in view of the length of the relationship, for example in relation to agreements that are automatically renewed, or in the case of an indefinite term contract where notice can be given at any time (as a party cannot be bound for ever).

As a rule of thumb, a one year notice may generally be deemed reasonable for long term relationships, but this needs to be considered on a case-by-case. The courts have established certain rules protecting distributors against abuses of rights in cases of non-renewal or termination even where a contract is ended in accordance with its terms. However, judgements are not always consistent. Depending on the circumstances, a distributor may have a claim for unlawful termination or non-renewal. Several factors will be considered by the court, including:

 

- Whether there is good cause or the trust relationship has broken down between the supplier and the distributor.
- The duration of the relationship.
- The number of past renewals and whether renewals are automatic or negotiated.
- The length of notice of termination or non-renewal.
- Whether the distributor has had the opportunity to recoup its investments.
- The level of dependence of the distributor's business on the supplier's products and granted exclusivity.
- Any promises or communications by the supplier creating reasonable expectations of continuous business.
- The amount of compensation.

28. What events will be regarded in law as justifying termination of the distribution agreement? Do any statutory obligations arise on termination? What provision is usually made in the agreement for termination?

There is no automatic compensation at the end of term, or if there is just cause for termination or sufficient prior notice is given.

Damages awarded for unlawful termination or non-renewal of a distribution agreement are usually limited to the loss suffered by the distributor as a result of the termination or non-renewal, including, among other things, expected profits and compensation for investment which has not been recouped and cost of dedicated workforce redundancies.

Generally, in case of wrongful termination or non-renewal, compensation can be between six months to a year of profit (gross or net profit, or gross margin; judgements lack consistency) although there can be aggravating factors.

Under the Civil Code, it is not clear whether the supplier can cancel orders where delivery takes place after termination. However, in principle, a clause expressly providing that the supplier can cancel orders where delivery would take place after termination is valid and enforceable.

29. What rights does the distributor have to compensation on termination of the distribution agreement or discontinuation of supply of the products? How is compensation for termination / discontinuation of supply calculated?

 

See *Question 27* and *Question 28*. Even in the absence of formal termination, in case of discontinuation of supply by the supplier, compensation could in principle be claimed by the aggrieved party and calculated based on the same rules (although the quantum of damages will generally be different). Under Article 415 of the Civil Code, if an obligor fails to perform consistent with the tenor of its obligation, the obligee is entitled to claim damages arising from such failure. Damages for failure to perform an obligation consist of the damages that would ordinarily arise from such failure. The obligee may also demand compensation for damages arising from any special circumstances, as long as the obligor did foresee, or should have foreseen, such circumstances at the time of failure to perform the obligation. A plaintiff seeking monetary damages must prove the damage caused and reasonable causation between the failure to perform and the damage suffered. Comparative negligence is taken into account (*Article 418*).

30. Where the distributor holds stock or money or other property belonging to the supplier, can the supplier assert its rights of ownership against third parties:

- In the event of insolvency of the distributor?
- In the event that the distributor has dishonestly disposed of them to third parties?

There are several different types of insolvency proceedings in Japan, but the main ones are Civil Rehabilitation, Corporate Reorganisation and Bankruptcy.

Retention of title (*shoyu-ken-ryuho*) can be used by a supplier of goods to secure the payment of the purchase price from a distributor. The supplier retains ownership until receipt of payment in full from the distributor. If the supplier seeks to rely on a retention of title clause to recover goods (or where goods have been entrusted on a consignment basis (*itaku*)), it is important to act as early as possible to secure and recover the goods and to claim rights over the goods in a timely manner and to the correct person (who may be the appointed trustee, administrator or liquidator). Informal recovery outside the formal procedures may be negotiated with the trustee if the retention arrangement is not a sham subject to avoidance rights (see below). However, even in this case, it is strongly advisable to file a claim within the prescribed time limits to preserve the supplier's rights (see below).

Except as otherwise provided by law, creditors can only enforce their claims using the applicable insolvency procedure. To do so, creditors must file, within a certain period, a proof of claim to report the content and amount of their claim, which will be determined and confirmed in the course of a claim investigation procedure.

If money belonging to the supplier is kept by the distributor, this monetary claim will be treated in principle as an unsecured claim.

If the distributor fraudulently transfers to a third party goods that belong to the supplier, the supplier may rely on provisions of the Civil Code on bad faith possession of property and return obligations owed by the bad faith possessor (*Articles 190 and 191*), which include the return of the "fruits" (derived benefits) and payment of compensation if the property has been damaged.

 

If the distributor has fraudulently disposed of its own property, the supplier will be able to claim in accordance with the applicable insolvency procedure. Each type of insolvency procedure includes rules to avoid or set aside the debtor's inequitable payment of debts, creation of security interests, sale of property at a low price, and other dubious transactions made after the debtor was in financial difficulty. On the commencement of bankruptcy proceedings, the trustees or supervisors can avoid acts conducted before the commencement of the procedure which are harmful to creditors. When this right is exercised, the receiving parties must return what they received (or otherwise compensate).

A typical example is a transfer of property with the aim of concealing it. Such a transaction can be avoided if either:

- The debtor knows that the transaction is detrimental to creditors.
- The transaction is detrimental to creditors and is executed after the debtor suspends payments to its creditors or a petition for Civil Rehabilitation, Corporate Reorganisation or Bankruptcy is filed.

However, if the beneficiary of such a transaction did not know (and can prove it), at the time of the transfer, that it would harm the creditors, the transfer cannot be avoided. Gratuitous acts performed by a debtor within six months before the suspension of payment may also be avoided.

## 31. What limitations and exclusions of liability might be appropriate?

Limitations and exclusions of liability are generally permissible between supplier and distributor. However, a provision that limits liabilities or provides an exemption from liability for damages may be invalid as repugnant to public order and morals. As such, a clause exempting a person from liability for damages intentionally or negligently caused is deemed to be invalid. In addition, a clause that partially limits liability for damages caused intentionally or by gross negligence has been determined to be invalid as violating public order and morals. Limiting liability in the case of negligence is generally valid.

Under Japanese law, the parties are only liable for foreseeable damages and not for unforeseeable damages. This limitation is often simply restated. More robust limitations on liability clauses can go further to limit foreseeable losses, such as those arising out of certain types of claims (losses arising from negligence and breach of conditions in the sale of goods such as the requirements that goods are of satisfactory quality and that they are fit for any purpose made known to the supplier, losses arising from infringement or disclosure of confidential information, or loss of profit, for example), or putting a cap on the total losses the party can be liable for. Certain liabilities simply cannot be limited or excluded, and a clause that purports to do so will therefore be void. This is the case for fraud by a contracting party. Moreover, the contracting parties may in principle not limit their liability for injury or death caused by a lack of reasonable care. There are also antitrust rules dealing with the abuse of superior bargaining power that seek to prevent and punish conduct whereby the dominant party takes advantage of its market power to exploit its trading partners (small-and-medium enterprises). Guidelines of the JFTC define the abuse as the acts of imposing on the trading partner any disadvantage, unjustly in light of normal business practices.

 

32. Could any terms be implied under local law which regulate the supplier's ability to increase prices to the distributor during the term of the agreement?

The parties to a distribution agreement can agree that prices will be reviewed and/or that price increases will be notified by the supplier to the distributor from time to time. The limit to this right is the obligation to act in good faith (which in practice may be of little comfort as the principle is vague and not easy to enforce except in case of manifest abuse) and reasonably.

33. Are bank or parent company guarantees, letters of credit or other forms of security common practice in your jurisdiction?

There are a number of methods used to settle payment in Japan: cash in advance, letter of credit, promissory note, open account and consignment sales. A major factor in determining the method of payment is the degree of trust in the buyer's ability and willingness to pay. Because of the protection they offer, irrevocable letters of credit payable at sight are commonly used for settlement of international transactions. Another payment method widely used in Japan is the promissory note (*yakusoku tegata*). Promissory notes are IOUs with a promise to pay at a later date, typically within 90 to 120 days.

34. Would it be permissible to include a clause (referred to as a retention of title clause in common law jurisdictions) to ensure the supplier retains ownership (title) of the products until payment has been received from the buyer?

Retention of title clauses are valid and enforceable in Japan, although not widely used in distribution agreements. Where the seller sells certain goods designated under the Installment Sales Act (sold in three or more instalments over two or more months), the seller is presumed to retain title to the goods until payment. Retention of title clauses are commonly used in the context of instalment payments for movable property. If the buyer resells the goods to a

 

good faith third party buyer that is unaware of the title retention arrangement, the third party acquires title to the goods and the seller loses it.

35. Are there any local laws, rules or practices in relation to set-off?

A distribution agreement can regulate the exercise of set-off between the parties to it as they deem fit. The parties can choose to allow or prohibit set-off. Under Japanese law, the debts of two parties must be due and payable to be eligible for statutory set-off. In bankruptcy, civil rehabilitation, corporate rehabilitation or special liquidation proceedings, creditors can exercise their set-off rights subject to certain exceptions and limitations (for example, based on timing) under the law applicable to each type of proceedings.

36. Will any customs duties be payable under the agreement for any products that are received by a distributor in your jurisdiction? Would the supplier or the distributor typically be responsible for paying any customs duties?

Goods imported into Japan are subject to customs duties and CT. In addition to CT, certain other internal taxes (liquor tax, tobacco tax and so on) are also applicable to dutiable imported goods.

The harmonised classification schedule annexed to the Customs Tariff Law sets out the classification and the corresponding customs duty rate (called the general rate) for particular products.

The actual rate, however, is not necessarily the general rate. The Temporary Tariff Measures Law sets out a temporary rate for certain products, which prevails over the general rate. In addition, when the customs duty rate in the World Trade Organization Concession Schedule (so-called WTO rate) or the rate applicable under an Economic Partnership Agreement (so-called EPA rate) is lower than the general rate (or temporary rate), the WTO rate or EPA rate is applied. For designated developing countries, the Customs Tariff Law and the Temporary Tariff Measures Law also provide a preferential rate which is applicable to certain products and lower than the above rates.

Most customs duties are assessed at ad valorem rates, which are applied to the dutiable value of the imported goods. Some items, including certain alcoholic beverages and cereals, however, are dutiable at a specific rate, and others are dutiable at a compound rate such as a combination of both ad valorem and specific rates. However, a large number of products are not subject to customs duties. The importer/distributor usually pays for the customs duties.

 

37. Are there any compliance obligations on either party under your local laws?

Although it is not common practice to refer to these laws in a distribution agreement, the bribery of domestic and foreign officials, as well as commercial bribery, is prohibited under Article 198 of the Penal Code (bribery of Japanese public officials) and Article 18 of the Unfair Competition Prevention Act (bribery of foreign public officials).

38. Should the distributor be solely responsible for compliance with import licensing laws?

Generally, the local importer (which can often be the distributor) will be responsible for compliance with import licensing laws.

A person wishing to import goods must declare them to the Director-General of Customs and obtain an import permit after the examination of the goods. The formalities start with the lodging of an import declaration and end with issuance of an import permit after the necessary examination and payment of customs duties and excise tax. These measures are taken to ensure compliance with the requirements for the control of foreign exchange and other regulations concerning the importation of goods. Declaration must be made by lodging an import (customs duty payment) declaration describing the quantity and value of goods as well as any other required particulars. Import declarations must, in principle, be made by the person importing the goods. Usually, a customs broker files the declaration as proxy for importers/distributors.

Certain items may require a Japanese import licence. These include hazardous materials, animals, plants, perishables, and in some cases articles of high value. Import quota items (alcohol for industrial use, leather, rice and rice flour, wheat) also require an import licence.

39. Is the supplier, distributor or both parties responsible for ensuring products can be sold in the defined territory:

- before the start of the start if the agreement;

 

- and (ii) during the term of the agreement?

Both the supplier and distributor have the obligation to ensure the products can be sold in Japan. Many domestic and imported products alike are subject to product testing and cannot be sold in Japan without certification of compliance with prescribed standards. Knowledge of, and adherence to, these standards and their testing procedures is fundamental.

Product requirements in Japan fall into two categories:

- Technical regulations (or mandatory standards).
- Non-mandatory voluntary standards.

Compliance with regulations and standards is also governed by a certification system in which inspection results determine whether or not approval (certification/quality mark) is granted. Regulated products must bear the appropriate mandatory mark when shipped to Japan in order to clear Japanese Customs. Regulations may apply not only to the product itself, but also to packaging, marking or labelling requirements, testing, transportation and storage, and installation. Compliance with "voluntary" standards and obtaining "voluntary" marks of approval can greatly enhance a product's sales potential.

Japanese law requires labels for products in many categories. Generally, labeling for most imported products is not required at the customs clearance stage, but at the point of sale. Consequently, Japanese importers commonly affix a label to imported goods after they have cleared customs.

40. Would it be common practice in your jurisdiction for a supplier to include a clause / clauses stating that it makes no warranty or representation:

- as to the validity or enforceability of trade marks; or
- as to whether the trade marks infringe any third party intellectual property rights?

In most cases, large international suppliers would already have taken steps to register their trade marks in Japan. Including these clauses is not common practice but may happen, especially in an environment where trade mark searches can be made challenging due to the concurrent existence of several scripts (Chinese, Japanese and Latin). This would naturally depend on the relative bargaining strength of the parties. Also, an unregistered trade mark can be protected under the Unfair Competition Prevention Act if the owner satisfies the following conditions:

- It is a well-known or famous trade mark among consumers in Japan.
- Third party use creates some confusion.

 

41. In your jurisdiction, to what extent can a distributor incur personal liability to a customer?

A distributor can incur personal liability to a customer under different legal avenues. A claim based on breach of contract can be made by a customer who is party to a contract/sale transaction with the distributor. For instance, a plaintiff can bring a product liability claim against a seller who is their counterparty in a sale and purchase contract, either for breach of contract or breach of implied statutory warranties under the Civil Code, provided that there is a direct contractual relationship between the injured party and the seller of the defective product.

Under the PLA, a person classified as a manufacturer can be held liable for a fault or defect. The PLA defines a manufacturer as:

- Any person who manufactures, processes, or imports a product as a business.
- Any person holding themselves out to be the manufacturer of a product by putting their name, trade name, trade mark or other indication on the product, or any person who puts their name on the product in a manner that misleads others into believing they are the manufacturer.
- Any person who puts their name on a product and who, in light of the manner in which the product has been manufactured, processed, imported or sold, or any other relevant circumstances, may be recognised as a "substantial manufacturer" (de facto manufacturer).

Unless they fall within any of these categories, the PLA does not provide any cause of action against distributors or sellers of a product. Claims against these persons must be brought under the Civil Code on other grounds (breach of implied statutory warranty, breach of contract or tort as mentioned above).

Generally, Japanese business entities are subject to various laws and product safety standards, which vary depending on the industry or product segment. Japanese importers/distributors of foreign products, in general, cover product liability risk through the product liability clause in their own liability insurance. The covered items and exemptions may vary from underwriter to underwriter and among industry segments.

42. Does the law in your jurisdiction dictate which governing law and jurisdiction will apply to the distribution agreement?

 

A distribution agreement can be governed by the law of the jurisdiction selected by the parties at the time of the conclusion of the agreement (*Article 7, Act on General Rules for the Application of Laws*). The Japanese courts will in principle recognise a choice of foreign law. Likewise, the Japanese courts will generally recognise a choice of foreign jurisdiction in a distribution agreement, provided there is a written agreement or an agreement executed by electronic means.

In the absence of a choice of law in a distribution agreement, the formation and effect of the agreement is governed by the law of the place with which the agreement is most closely connected at the time of its conclusion (*Article 8(1), Act on General Rules for the Application of Laws*). If only one of the parties is required to provide a characteristic performance under a distribution agreement, the law of the habitual residence of the party providing said performance shall be presumed to be the law of the place with which the agreement is most closely connected (*Article 8(2), Act on General Rules for the Application of Laws*).

43.Does the agreement need to be in a language other than English for it to be valid and enforceable?

The distribution agreement may be in the English language or any other language, as there is no requirement that the agreement should be in the Japanese language. However, since Japanese must be used in court, to enforce rights under an agreement before a Japanese court, it will be necessary to have it translated into Japanese.

44. How does this agreement need to be executed to ensure that it is valid and enforceable? Does it need to be registered with any authority in your jurisdiction?

**Execution formalities**
The agreement may be signed by hand or sealed using the registered seal (chop; supplemented by an official seal certificate) of the distributor (registered in the name of a representative director in the case of a joint stock corporation (*kabushiki kaisha*)). The agreement is not required by law to be notarised or apostilled.

**Registration formalities**
The distribution agreement does not need to be filed or registered with any authority in Japan.

 

45. Are there any clauses in the distribution agreement that would not be legally enforceable or not standard practice in your jurisdiction?

It would be necessary to consider the whole circumstances surrounding the transaction including public policy under the Civil Code and competition law aspects, but there is no clause that would be per se invalid or unenforceable. There is probably no such thing as standard practice with respect to the form or substance of distribution agreements in Japan, as they vary significantly in size and contents, the trend being towards lengthier, increasingly sophisticated and comprehensive contracts, especially in an international business transaction context.

46. Are there any other clauses that would be usual to see in a distribution agreement and/or that are standard practice in your jurisdiction?

It is fairly standard practice to have a clause dealing with so-called "anti-social forces" (organised crime) pursuant to which one or both parties warrant that they have no dealings with organised crime or do not employ people connected to organised crime. The clause typically includes termination rights and indemnities.

## Brexit

47. From the point of view of your jurisdiction, what points do you anticipate might arise in relation to a distribution agreement which either:

- contains an express choice of English law as the governing law; or
- has a UK-incorporated supplier or distributor as a party and is governed by the laws of your jurisdiction, if, during the life of the agreement, the UK were to cease to be a member of the European Union?

 

Post-Brexit, it is very likely that most courts, including Japanese courts, will uphold the parties' choice of English law as the governing law. To that extent, the choice of law will be unaffected by Brexit.

Suppliers and distributors who are contemplating entering into or are already parties to distribution agreements will need to be wary of the contractual impact of changes in law arising out of Brexit may have, bearing in mind the way in which change in law is dealt with under the agreement. A contractual provision referring to English law as the governing law would be construed as meaning English law including applicable EU law. Following Brexit, this would no longer be the case, except for EU law transposed or incorporated into English law, and the legal framework may be different a few years down the road. Most likely, the term "English law" would be construed by the English (and other) courts as meaning English law as in force from time to time, in the absence of a provision to the contrary. This could lead to a different outcome to what the parties had previously expected, although the substance of English contract law is unlikely to change drastically in the short and mid-term.

Contracts which the parties chose to be governed by Japanese law will in principle be unaffected by Brexit (unless the distribution agreement is performed in England and certain provisions of English law are passed post-Brexit that apply as a matter of public policy and may not be contracted out).

48. In relation to any points identified in *Question 47*, would you recommend that any adjustment should be made now to the standard document if it were to be used as an agreement governed by the law of your jurisdiction, in order to address those points in advance?

One recommendation would be to include a specific clause giving the parties the right to renegotiate in good faith or terminate, which would be triggered by specific Brexit-related events of a certain magnitude or materiality.

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