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A Look At Shareholder Remedies In Japan

Law360, New York (June 15, 2016, 11:39 AM ET) -- With support from a growing number of law firms and third-party litigation funders, many investors exposed to fraud and other corporate misconduct are seizing opportunities to test the private remedies and collective action procedures available outside the U.S.


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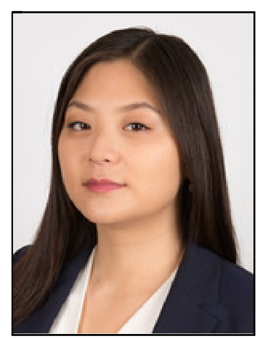
In the wake of a highly publicized vehicle emissions scandal, Germany has been in the spotlight. Various campaigns have developed to organize shareholder claims against Volkswagen under the German Capital Markets Model Case Act, known as KapMuG. Similar recent revelations that Mitsubishi Motors falsified fuel efficiency tests have prompted investors to evaluate whether they can expect similar efforts to pursue recovery in Japan.


Cynthia Hanawalt

Here, we review legislative developments that make Japan an attractive forum for securities litigation, and identify certain hurdles that could derail collective action against Mitsubishi, or another Japanese issuer.

Investor Protections in Japan’s Securities Laws

Investor protection has long been a focus of legislation in Japan, beginning with prohibitions against misleading conduct in the 1948 Securities and Exchange Law (SEL), and including significant reforms to enhance disclosure, internal controls, and civil and criminal penalties for fraud and unfair trading.


Kendra Schramm

In 2004, Japan’s legislature, the Diet, amended the SEL, codifying a private right of action for damages against issuers based on misrepresentation in connection with the purchase of a security on a secondary market. Previously, only primary market purchasers could bring private claims under the SEL.

Two years later, in 2006, the Diet amended 89 laws concerning Japan’s financial and capital markets, including the SEL, which was modernized and renamed the Financial Instruments and Exchange Law (FIEL). Described as a “new legislative framework for investor protection,” the lofty aims of this reform included promoting transparency and fairness through enhanced disclosure and reporting requirements for listed companies. For example, parts of the FIEL and related regulations — unofficially referred to as “J-SOX” because of similarities to the U.S. Sarbanes-Oxley Act of 2002 — impose standards for auditing and certification of internal controls over financial reporting.

Private Remedies Available to Shareholders

In its present form, the FIEL offers private rights of action similar to those available in the U.S. under the Securities Act of 1933 and the Securities and Exchange Act of 1934. Articles 17, 18, and 21 of the FIEL establish claims based on false statements or omissions in the prospectus or registration statement in connection with a public offering or secondary distribution of securities. Articles 21-2 and 22 establish similar claims based on false statements or omissions in public documents, such as an annual report, in connection with securities transactions on a secondary market.

Notably, for claims arising from either primary and secondary market transactions, plaintiffs do not bear the burden of proving scienter or reliance, and there is a rebuttable presumption of damages — defendants bear the burden of disproving loss causation. Issuers are subject to strict liability for misstatements and omissions in offering documents. In all other cases, defendants bear the burden of disproving liability under a reasonable care or negligence standard.

The presumption of damages under the FIEL is based on a calculation conceptually similar to the U.S. approach under Section 11 of the Securities Act of 1933: the difference between the purchase price of the security and either (1) the market value of the security at the time the claim is made, or (2) the sale price of the security, if sold prior to the time the claim is made.

However, this rule is modified for purchases made on a secondary market within one year prior to a public announcement of the false or misleading statement. In such cases, damages are presumed to be the difference between (1) the average market value of the security during the month prior to the announcement date and (2) the average market value of the security during the month after that date. There is limited case law interpreting this rule, but it may apply only when the company itself makes the public announcement.

Collective Proceedings by Investors in Japan

At present, Japan does not allow U.S.-style "opt-out" class actions, where a plaintiff has standing to prosecute claims on behalf of all similarly situated investors unless they have affirmatively requested exclusion from the litigation.

Instead, investors can bring securities claims in Japan using two types of collective actions, variations of which are common outside the U.S. and are sometimes referred to as "opt-in" class actions. Under Article 38 of Japan's Code of Civil Procedure, investors can affirmatively join their claims together in a common proceeding, where each investor is named in the pleadings. Alternatively, under Article 30, a group of investors can delegate authority to a representative plaintiff to litigate on behalf of the group with respect to issues of law and fact common to all of their claims. When multiple actions are filed, consolidation is possible but not guaranteed: each action may be tried separately before a different judge.

These aspects of the legal system make it unlikely that securities litigation in Japan will expand rapidly, given the resources required to pursue individual claims and the difficulties of coordinating and managing collective actions. Further, Japan's courts can be difficult to navigate procedurally, and do not permit electronic filing. Japanese courts also set fees based on the amount of damages demanded in the complaint, so large-scale securities matters can trigger significant additional costs. Investors considering whether to join an opt-in action must also consider the time and internal resources necessary to participate, e.g., review and approve funding and retainer agreements, produce trade data and account statements, authenticate or certify documents, monitor proceedings.

However, opt-in procedures in Japan have not proven to be a complete barrier to collective securities actions, when they are financed on a contingency basis. In such cases, a law firm or third-party litigation funder advances all costs, including attorneys' fees, in exchange for the right to be paid a portion of any future recovery.

Overall, securities litigation has increased in Japan due to the investor-friendly legislation discussed above, though it still accounts for only a few cases each year. Many of the FIEL cases filed to date stem from just a handful of high-profile corporate scandals, involving Seibu Railway, Livedoor, Urban Corp. and Olympus. Within this limited pool of cases, however, there have been significant legal developments and meaningful investor recovery — including an award of ¥9.5 billion (approximately $88.2 million) to six Japanese investors in one Livedoor case in 2008, and a settlement of ¥11 billion (approximately $92 million) recovered by 86 investors, including non-Japanese entities, in one Olympus case in 2015. Olympus has yet to resolve many related claims, including claims by dozens of other non-Japanese institutional investors and pension funds.

Outlook for the Future

Japan is arguably a more attractive forum for future securities actions than the many countries where misrepresentation claims are cobbled together under common law and subject to heavy burdens of proof. In addition, litigation costs are relatively low, because Japan's legal system does not impose extensive discovery obligations or fee-shifting.

However, because there have been so few cases, and even fewer published decisions, there is uncertainty with respect to the merit and value of any potential claim. In the case of Mitsubishi, the company has not yet made any public announcement concerning past disclosures that may have been misleading due to its falsified fuel efficiency tests. It remains to be seen whether a case against the company will be attractive enough to warrant the serious efforts required to prosecute an action on behalf of foreign investors.

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