THE JAPANESE MODEL OF DISPUTE PROCESSING

by

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I. Contemporary Issues in Japan's Commercial Dispute Processing

Japan is currently faced with a wave of 'globalization,' which should be seen as the third wave of massive law reforms following the Meiji modernization and the post-war democratization.[1] Globalization of the Japanese economy means that it has outgrown the traditional 'system'[2] and now requires a new system that reflects global standards. Japanese business and commercial activities, whether in or out of Japan, will inevitably include more cross-border commercial disputes. The current method of commercial dispute processing must be reviewed in the light of globalization. It was severely criticized as a barrier to trade and listed as one of the items to be discussed at the US-Japan Structural Impediment Initiatives in 1992.[3] Transparent and accountable systems, including a dispute processing mechanism, have been demanded not only by foreign governments but also by the maturing Japanese economy itself. Japan has again justified its structural reform on the grounds of compliance with foreign pressure.

Contemporary issues regarding Japanese commercial dispute processing are analytically summarized below. In the light of global standards, access to justice both

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[1] The historical evaluation of Meiji modernization and post-war democratization is debatable. The author believes that these are both revolutionary events based on internal demands and catalysed by foreign pressure. The current campaign for massive reform is also as a result of pressure from foreign investors in the light of the recent Japanese financial crisis following the collapse of the 'bubble' economy and the subsequent Asian financial crisis due to a similar cause.

[2] K. van Wolferen (1989) p. 43.

[3] Second annual report dated 30 July 1992.

in terms of quantity (availability of lawyers) and quality (natural justice) is substandard.

1. Availability of lawyers

Until recently the judiciary had been kept small as a tacit industrial policy. Commercial disputes have been controlled well by the bureaucracy through administrative guidance – wielding supervisory power through business associations and company groups. This tacit policy is reflected in a dearth of practising lawyers (*bengoshi*) and judges as well as the extremely small budget for legal aid. Inadequate access to *bengoshi* is aggravated by a *bengoshi* monopoly on legal practice, including civil and commercial dispute processing, under Article 72 of the Law on Bengoshi.

Furthermore, Article 30 of the Law on Bengoshi prohibits *bengoshi* from working for the business sector as in-house counsel and from holding any post in the bureaucracy. This segregation was intended to ensure the independence of *bengoshi* as legal professionals. However, it is obvious that this provision is now outdated and is a major obstacle to enhancing the transparency and accountability of business activities and public services under the rule of law. This provision has two negative implications: on the one hand, in a vicious circle, *bengoshi* have not realized that disputes relating to business or bureaucracy are their concern unless they are consulted for litigation in court; and on the other hand, neither large business corporations nor the bureaucracy has ever relied on *bengoshi*, who are mostly ignorant of business, until they believe litigation is inevitable even though it may involve sacrificing their reputation.

Consequently, people and companies have been dependent on the bureaucracy. Where administrative dispute processing is not available, they even resort to hiring racketeers to deal with civil and commercial disputes. Alternatively, they simply avoid disputes. Avoidance might have been the most reasonable solution for commercial disputes from an economic point of view during the period of high-speed economic growth. This phenomenon is shown by the sharp decline in the number of ordinary litigation cases received by the courts of first instance between 1985 and 1990 and the sharp increase from 1990 to 1995, a trend which coincides with the

growing 'bubble' economy from the mid 1980s until it 'burst' in the mid 1990s. Thus, the aversion to litigation was long ignored by the government until the adoption of the 1998 Civil Procedure Reform.[4] The capacity of the judiciary, including the availability of lawyers and legal aid, was not addressed by the civil procedure reform. It was left for the ongoing judicial reform initiatives.

Along with the deregulation campaign under the recent administrative and judicial reforms and the Tokyo Big Bang initiatives, appropriate legal aid has recently been demanded and the Law on Legal Aid was finally enacted on 28 April 2000 and came into force on 1 October 2000. On 12 June 2001, the Justice System Reform Council attached to the Cabinet issued recommendations regarding the reform of the whole judicial system to increase its size and capacity as well as improve its quality, so that it could deal with an expected increase in the number and complexity of civil and commercial disputes. For this purpose, it recommended introduction of some features of the common-law style judicial system, such as a law school system emulating that in the US and the participation of citizens in jury trials, as well as the strengthening of legal aid. It proposed lifting the prohibition of *bengoshi* from working for the business sector as in-house counsel and from holding any post in the bureaucracy in Article 30 of the Law on Bengoshi. It also addressed reviewing the *bengoshi* monopoly of legal practice stipulated in Article 72.[5] This issue relates to a more fundamental or philosophical issue on legal practice, that is, natural justice.

2. Natural justice

After the war, Japan partially adopted the adversary system: it introduced, for example, procedures based on the principle of party autonomy and procedures for the cross-examination of witnesses. However, as in the practice of settlement-in-litigation, the paternalistic practices of courts and judges still continue. In particular, as is seen in the practice of argument-and-settlement, the judge is assumed to be an inalienable professional who is a disinterested authority seeking truth and justice. As a wise man, the judge is also expected to persuade the parties to accept the most appropriate terms of settlement. The judge's persuasive power is backed by his decision-making power

[4] The new Code of Civil Procedure in 1996 came into force on 1 January 1998.

and state authority. Élitism, supported by the rank-conscious mentality of the people, underlies confidence in the judge and the court. This sentiment is shared by *bengoshi*, who also consist of a class of legal élite exclusively licensed by the state by means of Article 72 of the Law on Bengoshi. In this context, substantive justice has been sought by the court without due care for procedural justice. The fairness of the procedure has hardly ever been questioned since people's confidence in the fairness of state authority has generally convinced them that a court decision or proposal is fair and thus brings justice. Ideas of natural justice or due process have largely been alien ideas imported after the war. Thus, using Damaska's categorization of 'ideal types,' the Japanese civil practice would, in contrast to the English one, fall under 'inquisitorial' procedure by a 'hierarchical' authority in a 'managerial' state.

However, as discussed above, the mature economy has outgrown the government's control and regulation of economic activities. Foreign investors have demanded freer markets and more open competition in the context of globalization of free-market economies. Learning from the recent financial crisis following the bursting of the bubble economy in Japan, Japanese financial circles have also demanded deregulation of economic activities. Significant changes are under way. The model of a vertical society under a paternalistic state is gradually being transformed into a horizontal and flat society with a self-reliant, responsible private sector. Power is shifting from the state bodies to private entities. Closed communities are being restructured into open forums while the monoculture is now starting to accept cultural diversity. These social changes are also influencing civil justice and dispute processing. As the people's confidence starts to fade in the state authorities – in particular the courts – with regards to dispensing of substantive justice, procedural justice becomes appreciated as the only way to persuade people to reach fair solutions to disputes. The concept of fairness is increasingly being applied to procedural justice in the context of further globalization of commercial activities and dispute processing arising therefrom. What, then, is globalization?

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[5] *See* JSRC's recommendations issued on 12 June 2001.

II. Cultural conflicts in global commercial dispute processing

Not only in Japan, but in almost all other advanced countries as well, business and commerce are now conducted beyond national boundaries. Particularly after the collapse of the Berlin Wall in 1989, the capitalist economy entered a new era of free-market global economy. However, no global law or procedure has yet been realized. International commercial arbitration is developing as a viable way to process cross-border commercial disputes mainly because of its neutrality of jurisdiction and its enforceability through the New York Convention, as well as the efforts towards harmonizing domestic arbitration laws along the lines of the UNCITRAL Model Law on International Commercial Arbitration. Arbitration may provide the common framework for dispute processing. However, even the very concept of arbitration can be differently interpreted by each culture, and it cannot address the cultural conflicts behind the dispute.

Japan, together with China and other East Asian countries influenced by Confucian philosophy, has a conciliatory culture in which mediation or conciliation has long been a preferred mechanism for dispute processing. This culture is in sharp contrast to the Western adversarial culture based on individualism, which views conflict and dispute positively. Here, rules are devised for fair play in processing disputes, to actualize individual rights. In particular, under common law theory, the substantive law providing for rights is found by the courts and crystallized in adjective law. Thus, procedural justice, called either due process or natural justice, is considered to be of universal value.

Globalization of the free-market economy seems mostly to advance common-law driven Western dispute processing as the global standard, since the free-market system entails adversarial dispute processing. The recent Asian financial crisis has accelerated significant structural reforms, including law reform, in Asian countries such as Thailand, Malaysia, Indonesia and Vietnam. In particular, assisted by international organizations and bilateral cooperation agencies – mostly dominated by common law lawyers – massive laws consistent with free-market principles, such as transparency and accountability, have been introduced for the sound development of the economy. Commercial dispute processing, whether domestic or international, is

a prioritized area of such legal reform to enhance free-market systems based on arms-length human relationships. As Weber's rationality theory for capitalism suggests, dispute processing must here ultimately provide predictable binding decisions based on universal law applied to the facts found through due process. Thus, adversarial dispute processing underlying the rule of law is becoming the global standard.

However, the efficiency of adversarial dispute processing, such as arbitration, is now being questioned. In order to ensure procedural fairness and uniformity in the application of the substantive law chosen by the parties, arbitration has, ironically, become inflexible, costly and time-consuming, like litigation. This is a paradox of modern litigious dispute processing. Thus, the mediation or conciliation typically found in the East Asian tradition have recently been taken up as alternatives or complements to the arbitration process – a pattern of ADR. Med-Arb and similar hybrid methods of dispute processing are developing as innovative ways to solve the problem of international arbitration. China,[6] Hong Kong,[7] Korea[8] and Singapore[9] have formally adopted a system of conciliation within the framework of their arbitration. Not only these East Asian countries, but also dozens of other countries and jurisdictions, even including several common law jurisdictions[10] have also incorporated settlement, mediation or conciliation, or a combination thereof, in the arbitration procedure. Common law jurisdictions' traditional hostile attitude to conciliatory efforts by judges and arbitrators is changing.[11] Accordingly, as can be seen in the contrast between the English and Japanese reforms in civil justice and arbitration, the adversarial and conciliatory cultures now seem to be converging on a possible global culture for better global dispute processing through comparative studies.

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[6] Article 41 of the Chinese Arbitration Law.
[7] Section 2B (3) of the Hong Kong Arbitration Ordinance (Amendment No.2 – 1989).
[8] The Korean Commercial Arbitration Board in Seoul endorses the combination of arbitration/conciliation (Tang H., 'Is There an Expanding Culture that Favours Combining Arbitration with Conciliation or Other ADR Procedures?' in Van Den Berg (1998), pp. 103–104).
[9] Section 17 of the Singapore 1994 International Arbitration Act.
[10] *Ibid.*, pp. 103–108. Several US states inserted a set of rules regulating conciliation in their arbitration laws. According to Tang, India, Germany, Slovenia, Hungary, Former CMEA countries, Croatia, Austria, Australia, Canada, The Netherlands, Switzerland, France, the US, Latin America and WIPO have such a combination.
[11] B.M. Cremades (1998), p. 164.

Such a global dispute culture cannot be developed without due care and respect for the local culture in each community. Each culture must learn from each other by means of such a cultural interface. It is clear from the Japanese experience that imported laws and systems need significant adaptation if they are to fit into indigenous institutions and local settings. The locality must be carefully examined and duly respected in order to *create*, not implant, appropriate laws and systems to best suit that locality.

III. A Model for Comprehensive Dispute Processing

What does the Japanese experience in dispute processing imply? The Japanese model of commercial dispute processing should be presented in order to bridge the cultural gaps between the conciliation culture represented by East Asia and the adversarial culture represented by Europe, England and the US.

1. Old model

The traditional Japanese model of civil and commercial dispute processing with third party involvement is a mixture of adjudication and conciliation in which the adjudicator also interchangeably played the role of conciliator. The decision maker usually attempted to seek some consensus from the parties. During the process of persuasion, however, he/she in fact often coerced them to accept the decision. The judge was expected to play the role of conciliator backed by his/her decision-making power in the civil procedure. Typically during rapid economic growth, economic bureaucrats who had the authority to supervise the disputing parties often controlled the dispute, mostly by means of non-binding administrative guidance.

This paternalistic dispute processing may be called a model for *mura* (village community, or metaphorically, a closed human group or relationships). *Mura* can be seen in every corner of Japanese society – closed business communities in the form of business associations, company groups and *keiretsu* (lineage of companies) as well as the closed legal community of a professional élite protected by a *bengoshi* monopoly

of legal practice. In this model, the third party involvement in dispute processing as mediator and umpire protects the community's common interests – harmony and peace of the *mura*. This old model is still largely valid in contemporary Japanese society, although Japan is currently seeking a new model, underlying the ongoing judicial reform.

2. New model

A new model of dispute processing must be compatible with global standards for a free-market economy. This may be defined as a party-controlled model. Although the third party's role is still important, the third party participates in dispute processing not as a superior but as an *equal partner* subject to the party's agreement. As masters of dispute processing, the parties control it with the assistance of lawyers, experts and the third party, who provide an opportunity for dialogue, expertise for the solution and safeguards for natural justice. Even in the case of litigation, the judge's role as mediator should be clearly defined by the parties. The role of the third party must, however, also reflect the public interests, the interests of an open community or society. Any dispute concerns some community or society. Even cross-border commercial disputes concern the global community or society. The participation of this neutral representative of an open community is beneficial not only for guiding the parties to an equitable solution, but also for the voluntary execution of the settlement terms or its decision.

In this sense, the idea of a 'triangle' consensus emerges where the neutral party has the support and confidence of the disputing parties. However, how can the old paternalistic processing be avoided in order to ensure the parties' control over their own disputes? First, it is advisable to separate mediation/ conciliation procedures, in which a third party plays the role of a mediator/ conciliator for settlement, from those procedures for a binding decision. This clear separation also avoids the dilemma of choosing between the effectiveness of mediation/conciliation attempts and the integrity of arbitration and litigation.

Nevertheless, the parties might prefer some hybrid processing for efficiency and credibility. Secondly, therefore, it is up to the parties to define the role of the neutral party and the appropriate procedures. Based on the agreement of the parties,

the third party could play multiple roles interchangeably – as mediator,[12] conciliator, adjudicator,[13] arbitrator or even judge. The role and overall procedures could be variously designed and tailor-made by the parties. Various combinations of techniques for mediation/conciliation and umpiring can be devised as in the conciliation-in-court procedures. However, there is the dilemma of hybrid procedures' concerns about natural justice, and this dilemma must be carefully addressed by defining the neutral party's role and the hybrid procedures. In the event that the arbitrator or the judge has played the role of mediator/conciliator, the right to rebut should not be sacrificed before resuming arbitration or litigation without the parties' informed consent to this risk. The settlement should not be coerced in the name of persuasion.

What is the difference between persuasion and coercion? It depends on who controls the dispute processing. Full disclosure of material information to the parties is essential to process a dispute under the control of the parties. The parties must be able to evaluate the settlement terms proposed by a conciliator, as it is crucial for their satisfaction that they can predict the result of rejecting or accepting the terms. No decision can be made without constraints, such as laws, customs, ethics, or even reputations, which define several choices. The point is whether the constraint is justifiable or not and who decides whether it is justifiable or not.

Thus, thirdly, lawyers are still important actors as advisors. Their participation is necessary to set the parameters of what are justifiable choices and to address natural justice concerns to the parties. On the other hand, non-legal experts should also be encouraged to participate in the process since specific expertise is useful or crucial for processing certain types of disputes, for instance, over highly technical financial derivative products.

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[12] Here 'mediator' is defined as the informal facilitator of party negotiation while a 'conciliator' may be more actively involved by presenting a settlement proposal to the parties.

[13] Here 'adjudicator' is defined as the person who can render a certain decision, which is not final – an unbinding opinion or binding on an interim basis subject to the parties' objection, such as adjudication in lieu of conciliation by the judge in the procedure of conciliation-in-court. In England, The Housing Grants, Construction and Regeneration Act 1996 (which came into force on 1 May 1999) introduced mandatory adjudication, which is binding upon the parties on an interim basis.

IV. New Paradigm: Comprehensive Dispute Processing

Based on the new Japanese model, the concept of Comprehensive Dispute Processing ('CDP') may be proposed as a new paradigm for commercial dispute processing. The widely used concept of Alternative Dispute Resolution (ADR) seems to have recently become inappropriate since in this paradigm mediation/ conciliation is defined as complementary to litigation. As argued by some contemporary commentators, this concept is too narrow to express the whole system of appropriate dispute processing for commercial disputes. For commercial dispute processing, non-confrontational dispute processing has recently become increasingly widely accepted as the principal method for processing a dispute while maintaining the business relationship.

CDP seeks to create a consensus-centred dispute-processing network, linking and co-ordinating independent dispute processing procedures in various institutions as chosen by the parties. The procedures include mediation, conciliation, arbitration and hybrid procedures, such as Med-Arb. For instance, by using the networks for dispute processing prior to the emergence of a dispute, the parties may design their own tailor-made dispute processing as a preventive measure.

Takeshi Kojima advocates a 'total justice system'[14] under which litigation is illustrated by the centre circle of a set of concentric circles, surrounded by the circle of arbitration and mediation/conciliation, which is, in turn, surrounded by the circle of administrative consultation, which is itself surrounded by the outer circle of negotiation for settlement. Within this system, he argues, there is interaction between these concentric circles; on the one hand, by the 'ripple effect' of formal judgments in the centre circle towards the outside circles of voluntary processing (the circle of administrative consultation and in turn the outermost circle of negotiation of settlement) and, on the other hand, by the 'osmosis effect' which in turn lets criteria used for the circles of voluntary processing become reflected in the standards for

[14] T. Kojima, 'Funsðshori Seido no Zentai Kðzð (The Whole Structure of the Dispute Processing System)' in K. Shindð *et al*. (eds) (1984), p. 360.

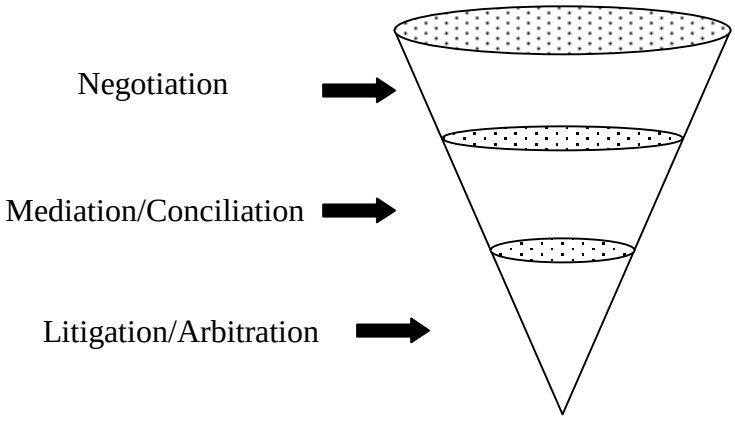
judgments in the centre.[15] Kojima argues that litigation is the centre of this system since it reflects justice.

For lawyers, this model is easily understandable. Litigation should be of central importance to the total legal dispute processing system since it is the final resort (*ultima ratio*) and the ultimate coercive legal solution to disputes. Negotiation, mediation, conciliation and even arbitration cannot escape from the shadow of the law or the court's decision, whether lawyers are involved or not. Thus, it is essential to improve access to civil justice in order to enhance CDP. However, particularly regarding transnational commercial disputes, arbitration is another essential mechanism because it excludes the jurisdiction of a court in principle. International arbitration centres are becoming global courts beyond the limit of state courts and arbitration awards rendered therein are becoming more and more influential in practice. Furthermore, consensus-oriented dispute processing is of central importance in the designing of CDP in contracts for individual business transactions. During the 21st century, international investors and traders will further develop such contract-based dispute processing. From the disputing parties' point of view, as Bühring-Uhle rightly concludes,[16] arbitration and even litigation can be re-defined as a complementary back-up procedure for a future-oriented polycentric voluntary solution for business.

CDP is a single total open system consisting of continuous layers of processing. In this sense, CDP can be illustrated by an image of an inverted cone (see Figure 1 below). The top level (broad part of the cone) is the wide entrance of CDP occupied by the most non-confrontational process, such as negotiation. The middle layer (narrowing towards the apex) is occupied by mediation/ conciliation and a hybrid with confrontational processing, and finally the bottom (the apex of the inverted cone) is occupied by the most confrontational system of litigation and arbitration.

[15] T. Kojima (1992), pp. 513–514.
[16] Bühring-Uhle (1996), pp. 393–394.

Figure 1. Image of CDP



From the point of view of disputing parties, this is a new paradigm for commercial dispute processing. For parties in commercial disputes, disputes normally come about during the course of their business, and in most cases, they will be solved in the course of business negotiation. If the dispute is more complicated, the parties will seek some help from a neutral third party to mediate or conciliate. Most commercial disputes will be processed and settled informally without referring to lawyers. Thus, commercial dispute processing should reflect the normal course of business practice and not be focused on the practice of lawyers.

V. The Bar Associations' Push for CDP

1. Creation of a one-stop shop for dispute processing

The idea of CDP should be articulated by bar associations in Japan as an appropriate means of dispute processing. A new model for CDP can be developed from the practice followed by the arbitration centres of the Japanese bar associations whereby the conciliator is appointed as arbitrator to decide unsettled issues within the specific scope entrusted to him/her by the parties, based on the confidence in the conciliator which has grown during the conciliation process. By clear specification of the entrusted scope by the parties, party autonomy and natural justice will be ensured since the result of arbitration within the scope is predictable.

A network should be developed between the judiciary and independent ADR institutions. The initiatives of bar associations may bring about such a network. The

bar associations can be co-ordinators of CDP or serve as one-stop shops for dispute processing, providing various means of processing, and information about them. The one-stop shop may provide the link between the parties and their choices and the various procedures in different institutions, such as arbitration and conciliation services in the JCAA and the JSE and procedures in specialized institutions for disputes involving construction, intellectual property and financial products, i.e., securities and banking. The shop should also be linked with judicial processing. Without an arbitration agreement, mediation/ conciliation could be wasted since there is no power to impose any binding decision. Thus, litigation should be employed as a back-up for mediation/ conciliation. On the other hand, the court will also benefit from the linkage between the judiciary and independent ADR institutions, such as bar associations' arbitration centres, because it will be able to refer the case to the institutions for mediation or conciliation before or during litigation proceedings without worrying about natural justice issues.

2. Sound competition

On the other hand, sound competition should be encouraged between the various types of processing in various institutions. Each system should be co-ordinated but not unified in order to allow for sound competition, which will improve the quality of the options available to the disputing parties as consumers. Bar associations' arbitration centres will thus have to compete with innovative judicial procedures, such as the development of a specialized court and procedures for conciliation-in-court and the small claims.

Again, for the promotion of such competition, the role of the bar associations is crucial as the professional bodies of *bengoshi*, who are the professionals of dispute processing. Articles 72 and 30 of the Law on Bengoshi should be reviewed with a view to liberalization through granting private business the right to perform dispute processing services and through granting *bengoshi* the right to work in the business and administration sectors to boost dispute processing capacity though self-regulatory business associations and administrative dispute processing. CDP covers not only civil justice, but also a wide range of dispute processing by business communities and administrative authorities.

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