Dispute Resolution

Tokyo Disputes Practice

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In This Issue...

- Practice Tip – Understanding Boilerplate Provisions: Term and Termination
- Making a Sealed Offer
- Foreign Manufacturers Legal Accountability Act

Practice Tip – Understanding Boilerplate Provisions

Term and Termination

This April issue of the Tokyo Disputes Practice Newsletter marks the start of our "Practice Tip – Understanding Boilerplate Provisions" series. Each month, we will take a brief, yet insightful, look at common boilerplate provisions and examine why these have become universal terms used in contracts. We begin the series by looking at the rights of a contracting party to terminate a contract when the contract does not expressly provide for a term or a termination right. To read more, see page 4.

Making a Sealed Offer

This is the second part of an article written by Poupak Anjomshoaa that appeared originally in International Disputes Quarterly (Winter 2008), available at http://www.whitecase.com/idq/winter_2008_tips/. The first part of this article appeared in the February 2011 issue of this newsletter.

Tip 1: Make the sealed offer as early in the proceedings as possible

The winner will generally be entitled to its costs up to the date when the offer can be accepted; any costs protection that the loser derives from the offer will apply only to those costs that are incurred after that date. Accordingly, the sealed offer should be made as early in the proceedings as possible to derive maximum protection on costs.

Tip 2: Set out the sealed offer in writing

The sealed offer should be set out in writing in a letter which should be clearly marked "Confidential and Without Prejudice Save as to Costs." The effect of these words (which should be explained in the letter) is that the letter should not be revealed to the tribunal, save with respect to the question of the costs of arbitration after the merits of the substantive claims have been decided.

Tip 3: State the intended cost consequences of the offer

Any ambiguity in the offer may prevent the tribunal from determining the terms of the offer and thus, whether or not the loser has "beaten the offer"; this could render the sealed offer ineffective. The sealed offer letter should therefore contain an express statement as to the intended costs consequences of the offer, so that there can be no argument subsequently as to whether the sum offered was inclusive or exclusive of costs.

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Tip 4: State whether interest and counterclaims are taken into account
For the same reason, to avoid any ambiguity in the terms of the offer, which would risk the tribunal disregarding the offer, the sealed offer should state whether or not it takes interest and any counterclaims into account.

Tip 5: State the period during which the offer remains open for acceptance
The offeree must be given a reasonable period to consider the offer before it is hit by the costs penalty generally attached to a sealed offer. On the other hand, in order to place pressure on the offeree to accept the offer and cease incurring further costs, the offer should not be left open for acceptance indefinitely. Accordingly, the sealed offer should state a reasonable period during which it remains open for acceptance. This will also permit the tribunal to determine the date from which to impose the said costs penalty.

Additional Tips

In addition, the sealed offer should include the date of the offer, the method of acceptance and the deemed date of acceptance, to avoid subsequent argument as to whether it was accepted within the permitted period for acceptance.

Conclusion

In international arbitration, the award of costs is left largely to the discretion of the tribunal and it is difficult to state with confidence exactly how the tribunal will allocate costs between the parties. However, the costs of international arbitration can be significant, with losing parties often having to bear not only their own costs, but also a considerable proportion of the other side's costs. In this context, the sealed offer can provide powerful ammunition for parties to international arbitration who are forced to defend inflated or exaggerated claims.

The cost consequences of sealed offers in England are largely a matter of logic and common sense; they go to the reasonableness of the conduct of the offeree in declining to accept the offer. The reasonableness of the conduct of the parties is also an important consideration for an international arbitral tribunal when exercising its discretion on costs, therefore it is to be hoped that a tribunal in an international arbitration will similarly give effect to a sealed offer made.

Parties who are at the contract negotiation stage may wish to consider drafting their arbitration clauses in such a way as to anticipate the use of the sealed offer mechanism. For those who are already at the dispute stage, there is no harm in making any "without prejudice" offer of compromise in the form of a sealed offer, so that it can be brought to the attention of the tribunal at the appropriate time and used in argument as to whom should be responsible for the costs of the arbitration, where it was reasonable for the offeree to accept the offer.

Foreign Manufacturers Legal Accountability Act

Foreign manufacturers doing business in the US may soon face greatly expanded litigation exposure. Recently-proposed legislation, predicted to be passed by Congress, seeks to subject foreign manufacturers to legal action of any kind in the US.

The proposed Foreign Manufacturers Accountability Act of 2010 (the "Act") could completely change the US litigation landscape concerning foreign imports and could open the doors to litigation against foreign manufacturers who previously were not exposed to litigation in the US. The Act requires a foreign manufacturer or producer of "covered products" to register a US agent to accept service of process for all civil and regulatory actions on behalf of the company. By registering a US agent, the foreign company would consent to the personal jurisdiction of the state or federal court in which the registered agent is located. The Act also prohibits any domestic company from importing covered products from a foreign manufacturer without a registered agent in the US. Therefore, the consent to jurisdiction and service of process is a preliminary condition for a foreign manufacturer to import certain products into the US.

The registered agent must be located in a state with a substantial connection to the importation, distribution, or sale of the products. In addition, foreign manufacturers and producers will be responsible for reporting any voluntary or mandatory recalls or other safety campaigns involving affected products to the appropriate regulatory agency.

The Act makes a foreign manufacturer vulnerable to any type of litigation under US law, including products liability claims. Under US law, the phrase "products liability" refers broadly to claims brought against a manufacturer or other seller of

a product for personal injury or damage caused by the manufacture, construction, fabrication, production, design, or marketing of a particular product.[1] Products liability can also cover consumer fraud claims involving deceptive illegal acts carried out by an individual or corporation to secure unfair or unlawful financial gain at the expense of a consumer or other victim. US procedure allows for "class actions" in which a small group of named plaintiffs may sue on behalf of a potentially enormous group of absent class members – thereby multiplying the potential damages at issue significantly. US courts can also award punitive damages, which is a form of compensation *in excess* of actual damages in order to punish malicious or willful conduct. Punitive damages can be ordered in a products liability action if the defendant acted in reckless disregard for the rights of others.[2]

The Act applies to seven categories of "covered products": (i) drugs, devices and cosmetics, (ii) biological products, (iii) consumer products, (iv) chemical substances, (v) pesticides, (vi) motor vehicles or motor vehicle equipment and (vii) a component of any of the listed products. It directs the agencies that regulate these goods, including the Food and Drug Administration, the Consumer Product Safety Commission, the Environmental Protection Agency and the National Highway Traffic Safety Administration to develop regulations to carry out the new requirements. For instance, the FDA would be responsible for implementing the registration and reporting requirements relating to imported drugs.

The applicability of the Act will depend upon the minimum requirements developed by each agency. The head of each agency will develop requirements according to the following factors: (i) the value of all covered products imported from the manufacturer or producer in a calendar year; (ii) the quantity of all covered products imported in a calendar year; and (iii) the frequency of importation in a calendar year. The minimum requirements required by the Act are still in a state of flux. This presents an opportunity for foreign manufacturers to have the US government consider their views.

The Congressional Budget Office found that the costs associated with the designation of a US agent would not be significant.[3] But, the Act will prevent US companies from doing business with any foreign manufacturer that does not designate a US agent. This prohibition could have a detrimental effect on foreign manufacturers. Currently, industry standards do not require US manufacturers to know the origin of imported components or parts used to manufacture most goods. The Act's passage would most likely require US companies to track the origin of imported goods and immediately cease doing business with and replace any foreign manufacturer that does not comply with the Act.

Currently, the Consumer Product Safety Commission does not have the power to order any company (foreign or domestic) to recall its products and foreign manufacturers may have no legal obligation to participate in US court proceedings.[4]

These perceived regulatory flaws were the focus of class actions against Chinese toy importers in 2007 and more recently, Chinese drywall manufacturers and distributors in 2010. The class action suits against Chinese toy manufacturers centered on various toys produced in China, and imported into the US, that contained lead paint or similarly powerful toxins.[5] These cases highlighted the factual and legal difficulties in pursuing a claim in US courts against a defendant operating in China.[6]

This same issue was confronted by the US courts when thousands of homeowners, mostly in Florida, Virginia, Mississippi, Alabama and Louisiana, claimed that the level of corrosive sulfur gasses emitted from the drywall caused health issues and damaged their homes.[7] Various cases brought against the Chinese manufacturer, Taishan Gypsum, were consolidated in the Eastern District of Louisiana and in April 2010, a federal judge awarded several plaintiffs from Virginia US$2.6 million in damages (approximately US$400,000 per plaintiff).[8] One month later, the same judge awarded US$164,000 to a Louisiana couple who claimed the same damages against a

1 1 Madden & Owen on Prods. Liab. §1:5 (2010).

2 1 Punitive Damages: Law and Prac. 2d § 6:1 (2010).

3 Congressional Budget Office Estimate, H.R. 4678 Foreign Manufacturers Legal Accountability Act of 2010, Dec. 9, 2010 (http://www.cbo.gov/ftpdocs/120xx/doc12016/hr4678.pdf).

4 Aaron Kessler, Special Report: Federal Failure on Chinese Drywall, Dec. 14, 2010 (http://www.naplesnews.com/news/2010/dec/15/special-report-federal-failure-chinese-drywall/).

5 In re: RC2 Corp. Toy Lead Paint Prods. Liab. Litig., MDL No. 1893, 2008 WL 548772 (N.D.Ill. Feb. 20, 2008).

6 Andrew J. Carboy, Tainted Toys from China: Keeping Products Liability Litigation Inside US Borders, Emerging Issues, Dec. 28, 2007.

7 In re: Chinese-Manufactured Drywall Prods. Liab. Litig., 706 F.Supp.2d 655 (E.D.La. 2010).

8 Id.; see also Federal Judge in New Orleans Awards US$2.6M in Chinese Drywall Case, Claims Journal, April 8, 2010 (http://www.claimsjournal.com/news/national/2010/04/08/108871.htm).

different manufacturer, Knauf Plasterboard Tianjin Company.[9] A Florida plaintiff was also awarded US$2.4 million in damages against Knauf and Banner Supply Company, another drywall distributor.[10]

The Chinese drywall class action suits prompted the creation of the Act, and through the Act, Congress seeks to hold foreign manufacturers and producers liable for products sold in US commerce as well as force foreign manufacturers to provide information during the course of an investigation.[11]

The Act may garner support from US companies because the expansion of jurisdiction over foreign manufacturers could provide additional sources of recovery for injured persons and therefore, reduce the share of liability normally carried only by domestic companies. The designation of a US agent provides an avenue for suing foreign entities regardless of the subject matter of the dispute since the consent to jurisdiction applies for all civil and regulatory matters.[12] [13] [14]

There has been some limited discussion on whether the Act complies with US obligations under the World Trade Organization General Agreement on Tariffs and Trade (GATT).[15] GATT stipulates that its signatories do not have the power to impose trade restrictions other than duties, taxes and other charges. The Act's requirement to designate a US agent would greatly expand GATT trade restrictions. Another argument is that the Act attempts to usurp the power of the Hague Convention on Service Abroad of Judicial and Extrajudicial Documents which has the force of law in the US and allows US consumers to pursue cases for defective products. Opponents also point out that the Act unnecessarily widens the requirements of the Consumer Product Safety Improvement Act which requires an importer to certify, based on test results provided by the foreign manufacturer, that products are safe in accordance with US safety norms prior to being sold in the US.[16]

The Act was introduced in the House and Senate in early 2010. As of December 2010, the Act was approved by the House Energy and Commerce Committee and is likely to be passed by the full House. In light of the current prediction that the Act could pass, foreign manufacturers and producers should remain mindful of the potential exposure they face under the current version of the Act and should begin taking steps to anticipate, prevent and/or minimize litigation risk in the US.

Practice Tip – Understanding Boilerplate Provisions

An issue commonly faced by companies is whether and when a contract without an express duration or termination right may be terminated. Generally, under US law, a contract with no set or implied duration is terminable with reasonable notice, but certain contracts may be terminated at any time upon notice. For example, the Uniform Commercial Code (UCC), which governs contracts for the sale of goods in the US, states that a contract without a fixed duration that provides for successive performance is terminable at any time by either party. In the international context, the United Nations Convention on Contracts for the International Sale of Goods (CISG), to which both Japan and the US are contracting states and which automatically applies to cross border contracts for the sale of goods between parties of contracting states unless affirmatively opted out of by the parties, does not mention termination rights for contracts without an express duration and leaves arbitrators and courts to engage in a conflicts of law analysis to find the applicable law. Hence, while, generally, contracts without a definite duration may be terminated by either party on reasonable notice, what is reasonable notice is fact sensitive and must be evaluated on a case-by-case basis in light of the governing law.

9 In re Chinese-Manufactured Drywall Prods. Liab. Litig., No. MDL 2047, 2010 WL 1710434 (Apr. 27, 2010).

10 Curt Anderson, Couple Wins $2.4 Million in Drywall Case, The Ledger, June 18, 2010 (http://www.theledger.com/article/20100618/NEWS/100619790).

11 Id.

12 Keith Whitson, 'Equalizing' the Playing Field with Foreign Manufacturers, Industry Week, Feb. 10, 2010 (http://www.industryweek.com/articles/equalizing_the_playing_field_with_foreign_manufacturers_21021.aspx).

13 US import and export companies lobbying against the Act have argued that other countries could adopt reciprocal measures, subjecting US manufacturers and exporters to jurisdiction in countries around the globe in order to continue selling their goods in those foreign markets. Also, many countries around the world – already hesitant to enforce judgments entered in the US – may be more likely to refuse enforcement if the US expands its jurisdiction over foreign entities. Id.

14 The language of the Act itself also creates some issues. It applies to "foreign manufacturers or producers" but does not define either term. It also requires that several separate studies be completed within one year of the Act's enactment on: (i) the feasibility and advisability of requiring foreign producers of food to register an agent in the US; (ii) the feasible and advisable methods of requiring manufacturers of component parts within covered products to register an agent in the US; and (iii) methods to enforce judgments of any US regulatory proceeding or civil action relating to the Chinese drywall cases. The drafters' decision to include these studies may indicate that the definition of "covered product" is subject to change and the drafters doubt the enforceability of the Act.

15 EU Says Foreign Manufacturers' Liability Act May Violate WTO Rules, Inside US Trade, July 30, 2010 (http://insidetrade.com/Inside-US-Trade/Inside-US-Trade-07/30/2010/eu-says-foreign-manufacturers-liability-act-may-violate-wto-rules/menu-id-710.html).

16 Id.

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