

Setting aside of Arbitral Award — Procedural Public Policy

Tokyo High Court, Decision, August 1, 2018;

Kinyu Sboji (1551) 13 [2018]*X *v.* Y

In February 2008, the Respondent X (Claimant in the first instance proceedings and Respondent in the arbitration) and the Appellant Y (the Respondent in the first instance proceedings and Claimant in the arbitration) concluded a patent cross-licensing agreement (the “Cross Licensing Agreement”), by which X and Y would permit the other to use their patents, and Y would pay X royalties as set out in the agreement. The Cross Licensing Agreement contained an arbitration clause providing for the resolution of all disputes related to the Cross Licensing Agreement through binding arbitration under the Commercial Arbitration Rules of the Japan Commercial Arbitration Association (the “JCAA Rules”), seated in Tokyo, as well as a clause stating that Japanese law is the governing law.

After concluding the Cross Licensing Agreement, X claimed that A (who was not a party to the litigation) had infringed X’s patents, and commenced proceedings in various European courts against A, which ended in settlement. Y commenced arbitration proceedings against X, claiming that the settlement agreement between X and A was a new license (a third party license) for the purposes of clause 6.01 of the Cross Licensing Agreement, and that despite having an obligation to carry out an evaluation of the contents of the contract, X had delayed the neutral evaluation and had also improperly manipulated the evaluation.

On 22 December 2014, the arbitral tribunal rendered an award ordering X to pay Y EUR 5,502,414.40, EUR 4,014,997 and interest from the day proceedings were instituted (although the rate of interest, which Y had claimed at 12% per annum, was set at 5% per annum), as well as costs, and dismissing X’s counterclaim (in its supplemental award dated 4 February 2015). The tribunal’s reasoning was that X had failed to comply with its obligation under Clause 5.03 of the Cross Licensing Agreement to “engage in the cases for patent infringement of the present patents against A in the United States and the important European markets (Germany, France and the United Kingdom)”, and Y was therefore relieved of its duty to pay royalties from 2010 to 2012.

* Translated by Matthew Harnett, Ashurst LLP.

X then initiated the present set aside proceedings before the Tokyo District Court within the relevant limitation period, claiming that there were reasons under Article 44(1)(iv), (v), (vi) and (viii) to set aside the arbitral award.

At first instance (Tokyo District Court decision, 28 March 2018, *Kinyu Shoji Hanrei* [Financial and Business Law Proceedings], No. 1551 (2018), p. 24), the Tokyo District Court set aside the portions of the award allowing Y's claim and dismissing X's counterclaim. The District Court reasoned that because, in deciding whether X had complied with the requirement to engage in litigation under Clause 5.03 of the Cross Licensing Agreement (*i.e.* X's obligation to engage in litigation in the United States and the main European markets (Germany, France and the United Kingdom)), the arbitral tribunal had not decided that "Y had insisted on this obligation to ensure that it was not at a serious disadvantage to its largest competitor (*i.e.* A)". This would have been grounds for a retrial under the Japanese Code of Civil Procedure (being an omission in a judgment serious enough to affect the outcome), and as the award therefore infringed Japanese procedural public policy, the award should be set aside the award under Article 44(1)(viii) of the Japanese Arbitration Act (the award infringes Japanese public policy).

Y appealed, seeking a decision of the High Court that the decision of the District Court should be quashed.

- Held: '1. Set aside Part 1 of the judgment at first instance.
2. Dismiss the Respondent's claims related to the above.
3. The Respondent is to pay the costs of the application and the appeal.'

Upon the grounds stated below:

'The basis for determining whether there has been a breach of law in an arbitration is not the Japanese Code of Civil Procedure, but the Arbitration Act and in particular article 26, which refers to the rules chosen by the parties to the arbitration agreement (here, the JCAA Rules). The fact that an arbitration may breach the civil procedural law of the seat of the arbitration is not by itself an infringement of the rules of the arbitration (Article 44(1)(vi) of the Arbitration Act). This is because the rules of civil procedure are not applied in arbitrations carried out by arbitral tribunals.'

'We may only set aside an arbitral award where there are reasons for set aside under the Japanese Arbitration Act (Article 44(1)(i) to (viii)). Generally, set aside is only permitted where there has been a failure of due process in the arbitration. It is not desirable to take an expansive or analogical interpretation to the

set aside provisions (Article 44(1)(i) to (viii)), and an interpretation within the four corners of the text is appropriate.

As to whether the applicant for the set aside of the arbitral award was unable to defend themselves (per Article 44(1)(iv)), it is possible to set aside an award where an arbitral tribunal (or an individual arbitrator) actively seeks to deprive a party of the opportunity to explain their case to the tribunal. However, an arbitral award cannot be set aside simply because a party is dissatisfied with the time period allowed for submissions by the tribunal (Article 31 of the Japanese Arbitration Act, JCAA Rules 36 and 49). There is a need to prevent the prolonging of the arbitration and the accompanying increase in costs incurred by the parties, and the parties will not have unlimited opportunities to plead their case.’

‘In the present arbitration, the parties agreed that the JCAA Rules would be applicable to the arbitration (with the reservation that they do not infringe the public policy of the Japanese Arbitration Act). Article 25 of the Japanese Arbitration Act provides that “The parties shall be treated equally in an arbitration. The parties shall be given a full opportunity to explain their case in an arbitration.” The Arbitration Act also provides in relation to reasons for set aside and non-recognition of awards that “the applicant was unable to defend themselves in the arbitration” and “the award contains a decision on matters beyond the scope of the arbitration agreement” (Articles 44 and 45). Regardless of the content of the JCAA Rules, when there is an infringement of these provisions, there is scope for setting aside an award as a breach of procedure.

What we must be concerned with is that the standards to interpret these provisions of the Japanese Arbitration Act are not the elaborate theories of interpretation of Japanese civil procedural law, but basic international standards that should be used in the resolution of civil disputes. [...] In the end, at the present time those basic international standards are found in whether Article 25 of the Japanese Arbitration Act, which provides that “The parties shall be treated equally in an arbitration. The parties shall be given a full opportunity to explain their case in an arbitration.”, is in fact followed. The decision as to whether article 25 is in fact followed is entrusted to the wisdom and sensibilities of lawyers, and not to the domestic civil procedural law of the seat of the arbitration.

It is not through the application of detailed standards but through the wisdom and sensibilities of lawyers looking at larger scale standards (such as equal treatment and the guarantee of the opportunity to plead one’s case) that the Arbitration Act fulfils its legislative purpose. It is sufficient to reject a claim seeking the re-examination of the merits of an arbitral award briefly (for example, by finding that “the applicant’s claims in effect are seeking a re-examination of the merits of the arbitral award, and do not constitute a reason to set aside the award”).’

‘In the following paragraphs, we abbreviate the reasons for setting aside an award under article 44(1) of the Arbitration Act as the “sub-article 4

infringement”(inability to defend), “sub-article 5 infringement” (going outside the scope of the arbitration agreement), “sub-article 6 infringement” (breach of procedure) and “sub-article 8 infringement” (breach of public policy).’

Reasons for setting aside the portion of the arbitral award related to clause 5.03 of the Cross Licensing Agreement

‘X’s submissions go no further than criticizing the summary of facts, the interpretation of the contract and the interpretation of the law, as well as the procedure of the arbitration and the method by which the tribunal reached its decision. All of X’s submissions do no more than point at items determined within the exclusive jurisdiction of the arbitral tribunal, and do not align with a reason (sub-articles 4, 5, 6 or 8 infringements) for setting aside the award.’

‘The first instance decision found that there is no provision in the arbitral award regarding “ensuring that there was no significant disadvantage” as per Clause 5.03 of the Cross Licensing Agreement. However, it is clear from the text of the arbitral award itself that the arbitral tribunal considered this point in the decision making process, and so the first instance decision was unreasonable.

Further, the first instance decision found that “ensuring that there was no significant disadvantage” was an important evidentiary fact or circumstantial fact going to whether X had complied with its obligation “to engage in patent infringement litigation with A”. For the arbitral award to omit this point would be “an omission in a judgment serious enough to affect the outcome” under Article 338(1)(ix) of the Japanese Code of Civil Procedure, and therefore breached public policy (a sub-article 8 infringement) and was grounds to set aside the award. However, it is wrong to apply the Japanese Code of Civil Procedure to an arbitration carried out by an arbitral tribunal. In any case, even considered from the perspective of applying the Japanese Code of Civil Procedure to the arbitration, the points raised in the first instance decision would not be “omissions in a judgment serious enough to affect the outcome” under Article 338(1)(ix). Further, even considered from the perspective of applying the Japanese Arbitration Act, the points raised in the first instance decision are not such serious breaches of due process that they would constitute reasons to set aside an award as a breach of public policy under Article 44(1)(viii). We consider that the points raised by the first instance decision do not even reach the level of trifling errors. That is to say, the question raised by the first instance judgment, whether X fulfilled their obligation to engage in litigation (whether X engaged in patent infringement proceedings with A), is no more than a matter of preference as to how the arbitral tribunal enunciates the fact that it has discussed this matter. The first instance decision cannot be applied.’

*Annex 1 Extracts of the Cross Licensing Agreement

Clause 5 Payment of Royalties

[...]

5.03 So that Y is not placed at a serious disadvantage against its greatest competitor (*i.e.* A), where X does not succeed in concluding a licence agreement with A prior to 31 December 2009 in respect of the Patents (such that under that agreement, A is permitted to use (numerous) patents of X in the United States and Europe), and where X does not engage in litigation with A concerning the use of patents in the United States and important European markets (Germany, France and the United Kingdom), Y is exempted from its obligation to pay royalties in the 2010, 2011 and 2012 calendar years.

Clause 6 Most favored party

6.01 At any time after 1 December 2007, should X conclude a license agreement for the Patents (other than where such an agreement fulfils the conditions of clause 6.02) with a third party (a license with a third party who, in the calendar year that the license is agreed, has world-wide reported sales of licensed products or products utilizing licensed products valued in excess of 25% of Y's world-wide reported sales), (a "new license"), X must take the following actions.

- (a) employ appropriate external counsel (who is not actively representing X or Y at that point in time) with experience of intellectual property licensing. This external counsel should be a member of a large scale well-known law firm with offices in various countries. The remuneration contract between X and the external counsel and/or their firm shall contain no provisions concerning compensation or bonuses to be agreed as a result of discussions; and shall not suggest and effect on any relationships as a result of discussions.
- (b) X shall disclose the conditions of the new license and Y's license to the legal counsel (including any side letters and any related agreements or payment terms).
- (c) X shall direct the legal counsel to carry out the works listed in Appendix A to this Contract (and especially for the legal counsel to consider whether, when taking into account the conditions of the new license and this Contract, from a general viewpoint this Contract obliges X to demonstrate to Y that the new license does not place Y at a disadvantage).
- (d) Should the selected external counsel determine that the new license is more beneficial than this license and that including those conditions in this Contract would be beneficial to Y and/or Y's related