Lisa A. Rickard
President

May 2, 2012

Mr. Jin Matsubara
Minister of State for Consumer Affairs
Sanno Park Tower, 2-11-1 Nagata, Chiyoda
Tokyo 100-6178
Japan

Dear Minister Matsubara:

I am writing on behalf of the U.S. Chamber Institute for Legal Reform ("ILR") to express our grave concerns with the consumer class action bill prepared by the Consumer Affairs Agency ("CAA") called "Litigation System Relating to Recovering Damages for a Consumer Class" (the "Class Action Scheme"). If enacted by the Diet, the Class Action Scheme would negatively affect the administration of civil justice in Japan, as well as the broader Japanese economy, and likely would do little, if anything, to benefit the consumers it is supposedly designed to protect.

We understand that the CAA may soon introduce the Class Action Scheme to the Diet for action during this legislative session. As discussed below, we have significant concerns with the Class Action Scheme, and we respectfully request that the Japanese government not act on it at this time without further analysis, including a cost-benefit analysis. Given that consumer redress is a complex issue, the Japanese government should seek further feedback and information from stakeholders, particularly from those countries that experience litigation abuse in connection with class actions.

I. ILR's Expertise with Class Action Laws.

ILR is a not-for-profit public advocacy organization affiliated with the U.S. Chamber of Commerce, the world's largest business federation, which represents the interests of more than three million businesses of all sizes and sectors, as well as state and local chambers and industry associations. ILR's mission is to ensure a simple, efficient and fair legal system. Since ILR's founding in 1998, it has worked diligently

ph (202) 463-3107 fax (202) 463-5302 lrickard@uschamber.com 1615 H Street, NW Washington, DC 20062-2000

to limit the incidence of litigation abuse in U.S. courts, and has participated actively in legal reform efforts in the United States and abroad. Many of ILR's members have business interests in Japan, and ILR is deeply committed to the orderly administration of justice in Japan.

For more than a decade, ILR has studied the effects of class action litigation and the ramifications of class action schemes for civil justice systems. ILR has published numerous articles on class actions and has participated in public symposia about them. ILR has also engaged in substantial advocacy efforts in the United States and in a number of countries around the world regarding legislation governing class actions. ILR has been recognized as an expert and constructive partner in reform efforts relating to class actions. A number of European governments have consulted or are consulting ILR when legislating in this area.

II. The Dangers of Class Actions.

We recognize that the CAA likely had only the best intentions in preparing the Class Action Scheme and likely thought it would protect consumers. Nevertheless, we believe that the Class Action Scheme will have a number of negative unintended consequences for consumers and for the administration of civil justice in Japan.

Class action litigation is inherently more vulnerable to abuse than individual lawsuits because it aggregates the claims of numerous litigants in a single proceeding. When numerous claims are aggregated in this way, the overall amount in dispute increases – as does the cost of the dispute itself. As a result, a defendant in a class action frequently faces both litigation exposure and costs far exceeding the exposure and costs it faces in an individual lawsuit. This can often compel defendants to settle class actions rather than seek adjudication on the merits, regardless of the validity of the claims at issue. Indeed, many defendants often agree to settle class actions on sub-optimal terms rather than take their chances at trial. This is true even when the defendant has meritorious defenses, or when the claims of the class members lack validity. At the same time, because class actions aggregate numerous individual claims – without individualized proof – they can include weak or non-meritorious individual claims along with valid claims, without any effective mechanism to litigate them individually.

In these respects, class actions are *inherently* coercive: because the mere act of filing a class claim can threaten a defendant – even an innocent defendant – with ruinous economic harm, the availability of a mechanism to aggregate claims into a class action can lead to a flood of abusive litigation.

For these reasons, and based on ILR's years of study of class actions, we do not believe that such aggregate litigation should be introduced at all in Japan. Nevertheless, if the CAA wishes to press ahead with procedures to facilitate aggregate litigation, it should take a precautionary approach that includes requiring claimants who wish to engage in class actions to exhaust all other options first, thus making class actions an absolute last resort. Alternative dispute resolution schemes may provide a suitable alternative to class actions in some cases. The European Commission's Directorate General for Health and Consumers has recently proposed legislation aimed at ensuring access to such schemes and, in our view, the principle that out-of-court dispute resolution mechanisms should be available, and should be considered before court proceedings are commenced, applies as much to aggregate litigation as any other form of litigation. As noted above, we also believe that the Japanese government should analyze the costs and benefits of class actions as a means of consumer redress and compare it to other options to achieve consumer protection, including enhanced public enforcement of consumer-protection laws and mechanisms for collective alternative dispute resolution.

Should the Japanese government, after performing this thorough analysis, still determine that it wishes to implement a class action regime, it should take steps to mitigate as much as possible the risk that class actions will be abused. Ultimately, the abuse of class action procedures is driven largely by financial incentives. Legal culture and social conventions may mitigate the risk of abuse to some degree, but ultimately, those considerations will not deter parties from bringing dubious claims if there is a prospect of financial reward. The principal factor in determining a class action mechanism's vulnerability to misuse and subversion is the extent to which it is profitable for parties to pursue frivolous litigation. Concrete measures that alter the risk-reward calculus of commencing litigation are thus the most important protections against such activity; a party who will be forced to bear significant costs if his or her claim is unsuccessful and who will receive only a modest return if he or she wins is unlikely to bring claims or lawsuits that lack merit.

For these reasons, the key to preventing litigation abuse is establishing and maintaining structural "safeguards" – i.e., procedures that discourage litigation abuse by raising the cost of, or reducing the potential return from, such behavior. Various safeguards have a proven record of preventing abuse in aggregate litigation. Four of the most important are: (1) precise class certification standards; (2) standing requirements for representative claimants; (3) rules limiting funding mechanisms; and (4) rules that provide closure to successful defendants. We respectfully submit that if Japan does move forward to implement a class action scheme, it should incorporate these safeguards, which we discuss in further detail below. Moreover, because the Class Action Scheme does not include any of these safeguards, we respectfully urge the Diet not to act on it at this time. In addition, as we discuss below, the Class Action Scheme

apparently would have general retroactive effect, and for this additional reason as well, we ask the Diet not to adopt the Class Action Scheme.

III. Precise Certification Standards.

As noted above, class actions pose a serious risk that they will be abused by claimants and attorneys filing non-meritorious claims. This is why we do not believe that enacting the Class Action Scheme is appropriate, but if the Japanese government nonetheless decides to do so, then we respectfully submit that it should implement safeguards to mitigate the dangers class actions pose. As we noted above, safeguards are carefully tailored procedures that discourage parties from bringing invalid claims by raising the cost of doing so. One of the most effective safeguards against abuse of class actions is a "certification" standard that sets forth a detailed procedure by which a court can assess whether a proceeding is appropriate for aggregate adjudication or can serve as a test case for future common claims. In the United States, the federal Class Action Fairness Act of 2005 made most class actions subject to the jurisdiction of the federal courts, which have relatively stringent certification standards, and thereby divested the state courts, which tend to have looser standards, of jurisdiction. By moving class actions from courts with looser standards to courts that have more stringent and precise standards, this law greatly diminished the incidence of class action abuse in the United States.

Based on the U.S. experience, we believe that any class action regime should impose the following four requirements:

A. Predominance of Common Issues/Cohesiveness

This requirement is intended to ensure that before a class action is permitted to proceed on its merits, a court must determine that all of the claims of the proposed class members can be adjudicated fairly in a single proceeding and established through common proof. More specifically, courts must decide whether the proposed class action comports with the principle that "trial for one can serve as trial for all" – i.e., the relevant facts and law as to each class member's claim are such that adjudicating the representative claimant's claim (or significant issues related to that claim) *necessarily* resolves the claims (or the same significant issues) for the class members.

B. Adequacy

"Adequacy" means that a court evaluates any qualified representative organization that seeks to act as a representative claimant to assure that it is willing and able to represent the class adequately. This safeguard protects potential class members by ensuring that any qualified representative organization that purports to speak for them and compromise their rights shares the same interests they do and is motivated and

informed about the suit. Among other things, an adequacy requirement will help ensure that a representative is not seeking to file a lawsuit in order to extort a fast "sweetheart" settlement for itself and its attorney, or to advance any particular agenda, while casting aside the interests of the potential class members.

C. Typicality

"Typicality" means that the claims asserted by or on behalf of the representative claimant must be typical of the claims of the class. This safeguard is intended to ensure that only those claimants who advance the same factual arguments may be grouped together in a class action. The typicality requirement protects class members by ensuring that the representative claimant's incentives align with those of the class members – and that it can fairly represent their interests.

D. Numerosity

"Numerosity" means that a class action should not proceed unless there are so many potential claimants that no other form of dispute resolution would be practical. This safeguard does not require establishment of a specific numerical threshold for classes; rather, it requires courts to assess whether any purported class action involves a sufficiently large number of potential claimants under the circumstances to make individual proceedings impractical.

We are concerned that the Class Action Scheme does not include an adequate certification requirement. Thus, we believe that phase-one representative suits brought under the Class Action Scheme will not adequately define the class of consumers who may be eligible for compensation in the second phase of a class action, the result of which is that the courts will not be able to establish the criteria for common proof to be applied to the class claims. We therefore respectfully suggest that, to the extent the Japanese government decides to move forward with class actions, it should amend the Class Action Scheme to include a certification procedure as outlined here.

IV. Standing Requirements for Representative Claimants.

When a class action scheme, like the bill being prepared by the CAA, provides for class actions to be brought by representative claimants, one important safeguard against abuse is a set of strict requirements governing who may act as a representative claimant.

As we understand the Class Action Scheme, it divides class actions into two phases. In the first phase of a class action, a representative case will be commenced by a qualified representative organization ("QRO") on behalf of a defined class of claimants. The Class Action Scheme does not, however, set forth the criteria the government will use to qualify consumer organizations to commence class actions. The bill thus provides

no assurance that QROs will have the ability to represent consumers adequately, and to place consumers' interests above their own, as would be required under the certification procedure discussed above. Similarly, nothing in the proposal limits the number of consumer organizations the government can qualify to commence class actions.

In addition, nothing in the Class Action Scheme appears to constrain any relationships between QROs and law firms, including law firms having ownership interests in QROs and *vice versa*. Given that lawyers are the persons who ultimately decide whether to file and how to prosecute class actions, and given that they stand to reap the monetary rewards of doing so through attorneys' fees, any class action scheme providing for representative cases to be brought by QROs should strictly limit the types of relationships law firms and QROs may have with each other.

Moreover, as a conceptual matter, placing the decision to initiate class actions in the hands of consumer organizations – even those "qualified" by the government – may lead to abuse. Unlike individual claimants, consumer organizations have no personal stake in seeking redress for injuries and do not seek to vindicate any individual rights. Rather, representative organizations would use litigation to advance their core mission: advocating for the interests of particular groups, interests or causes, and in some cases seeking money from public and private sources to do so. Empowering such organizations to threaten businesses with substantial liabilities that could force them to change their business practices or to offer a substantial settlement, as in phase one of the Class Action Scheme, would pose a serious risk of litigation abuse. This risk is heightened, moreover, where QROs are allowed to fund their own operations from the proceeds of class actions brought by them – including settlement proceeds. In such circumstances, QROs would have a direct financial incentive to file phase-one lawsuits – even based on legally invalid claims – seeking to coerce a large settlement from a defendant, and thereby fund their own operations.

For these reasons, we again respectfully urge the government not to move forward with the Class Action Scheme. If, after studying the costs and benefits of class actions and alternative means of redress, the government still wishes to press ahead with a class action scheme, we believe any such scheme should include stringent standards that organizations must satisfy before becoming qualified as QROs to commence litigation on behalf of potential class members.

V. Rules Limiting Funding Mechanisms.

Another important safeguard against class action abuse is a set of rules governing how such cases are funded, which the Class Action Scheme does not appear to contain. ILR believes that funding mechanisms for class actions should be tailored to mitigate the risks of lawsuit abuse while still providing access to justice. We therefore respectfully

urge the government to assess carefully how class actions in Japan will be financed. Class actions are as a rule complex, time-intensive and costly. Accordingly, any class action scheme in Japan should rule out funding mechanisms that involve "investors" seeking to profit from lawsuits.

Two examples of such problematic investments in lawsuits, which we believe should not be permitted – or, at the very least, should be regulated strictly – in any class action scheme are attorney contingency fees and funding by third-party litigation finance ("TPLF") companies.

With respect to contingency fees, ILR believes that such fees should not be permitted in the context of class actions. Contingency fees incentivize attorneys to bring potentially lucrative claims, regardless of merit, and then to prosecute the litigation and structure any settlement in a way that maximizes their own return, rather than the compensation to the claimants. Moreover, particularly in a phase-one representative case, because the claimants' lawyer is the only person on the claimants' side with a significant interest in the case, the lawyer is typically willing to agree to any terms offered by the defendant that will reimburse the attorney's investment and provide him or her a profit. For this reason, the "sweetheart settlement" problem – where the claimants' attorney negotiates with defendants for large fees and very little in the way of claimant recovery – is heightened in class action cases where attorneys are paid on contingency. All of these problems are prevalent in United States class actions – where claimants' attorneys typically work on contingency.

With respect to TPLF, experience has shown that such funding encourages the filing of frivolous litigation and exerts undue settlement pressure on defendants by providing claimants – here, QROs – with the resources to continue litigating claims regardless of merit. These dangers are exacerbated in class action proceedings, which already exact substantial leverage against defendants based on their sheer size and the potential for enormous exposure (regardless of merit).

TPLF also worsens another fundamental problem with representative litigation – that it is generally controlled by the QRO and its attorneys rather than by class members. When a third-party funder is involved in class action proceedings, the consumers (who generally have only a small stake in the outcome) are squeezed out of the picture, and the lawsuit essentially becomes a collaboration among the lawyer, the QRO and the funder. Thus, the funding company will have the power to steer the direction of the litigation, and it will have every incentive to do so in a way that serves its pecuniary interests, rather than the claimants'.

In Australia, where third-party funding of class actions is so common that class actions are considered investment vehicles, many judges, scholars, defense lawyers and

other critics have expressed serious reservations about the practice. Recently, Federal Court Chief Justice Patrick Keane gave an interview to *The Australian Financial Review* in which he expressed his concerns, especially those about excessive fees charged by TPLF companies and their support for non-meritorious claims.

For these reasons, we respectfully urge the Japanese government to study the problems inherent in financing class actions and to consider prohibiting investments – through contingency fees or TPLF – in such cases. If a blanket prohibition is not possible, such funding mechanisms should at the very least be regulated to prevent abuses.

VI. Rules Providing For Closure.

As we understand the Class Action Scheme, after a QRO is successful in a phase-one representative lawsuit, then, in the second phase of the class action, claimants meeting the class definition have the option of joining the class. Most importantly, however, phase-two claimants are not bound by the phase-one result when the QRO loses. In such circumstances, if the QRO has not been successful in its phase-one case, nothing prevents another organization from bringing its own case, with a slightly different class definition.

Thus, the Class Action Scheme does not provide any mechanism for a defendant that is successful in phase-one litigation to achieve closure by preventing copycat litigation. When a phase-one QRO loses its representative case, nothing in the law would prohibit a second (or a third, or a fourth) QRO from also bringing a phase-one class action against the same defendant. Once any QRO is successful in phase one, the defendant will be subjected to enormous liability in phase two, regardless of how many prior phase-one cases it had won. This feature of the Class Action Scheme thus poses additional risks of abuse – especially considering that the proposal does not limit the number of consumer organizations that can act as QROs or provide standards for their qualification; the members of a QRO that loses a phase-one case could form a new consumer group and petition the government for qualification in order to have a second chance suing the same defendant. For these additional reasons as well, we respectfully urge the Japanese government to consider mechanisms that would provide closure to defendants who are successful in phase-one representative litigation should Japan decide to move forward with class actions.

VII. Retroactivity.

An additional problem with the Class Action Scheme is that, if enacted by the Diet, it will have retroactive effect. The Class Action Scheme is no mere procedural change to Japanese law, however. Rather, if enacted, it would constitute a significant departure from existing law and would subject Japanese businesses to significant liability

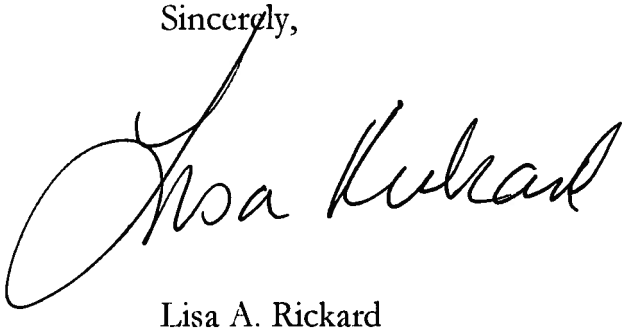
for possible past conduct. We are unaware of any other recently enacted class action scheme that would have general retroactive effect, as the Class Action Scheme does. Such retroactivity would be highly unusual and, for the reasons discussed in this letter, would invite abuses. Given the substantial changes the Class Action Scheme would effect in Japan, it should have only prospective application.

VIII. Conclusion.

For all of the reasons we have discussed in this letter, we respectfully urge Japan not to adopt the Class Action Scheme. Although intended to benefit consumers, we believe that the bill, should it become law, would harm consumers, defendants and the administration of civil justice in Japan.

Nevertheless, should the government determine to move forward with class actions, we respectfully urge the government to analyze the costs and benefits of doing so, particularly as compared to other mechanisms for consumer redress (like public enforcement and alternative dispute resolution), and to seek expanded public comments from all stakeholders – especially those that would be most affected by the change in law. After this process, if the government still wishes to implement a class action regime in Japan, it should include the safeguards discussed in this letter, and should have only prospective effect, so as to minimize – as far as possible – the risks inherent in class action litigation.

Sincerely,



Lisa A. Rickard

cc: His Excellency, Mr. Ichiro Fujisaki, Ambassador of Japan to the U.S.
Mr. Yukio Edano, Minister of State for Economy, Trade and Industry
Mr. Toshio Ogawa, Minister of State for Justice
Mr. Shozaburo Jimi, Minister of State for Financial Services