

Interpretative Guidelines on  
Electronic Commerce and Information Property Trading  
(Tentative Translation)

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Ministry of Economy, Trade and Industry (METI)

## Introduction

Any laws and regulations stipulated herein are based on the technology that is available at the time of enactment and/or amendment thereof. For this reason, any new advances in technologies can bring about a change to the background facts of disputes which the governing laws and regulations had assumed. As a result, the flexible interpretation of laws and regulations may be required in response to such advances and also the creation of new laws and regulations may be needed for any matters which cannot be adequately addressed by such interpretations.

The emergence of the internet has resulted in the creation of new models of economical activities such as electronic commerce. However, since most of the existing laws, including the Civil Code, were established before the emergence of such new technologies, the interpretation of the application of the existing laws concerning electronic commerce are not necessarily clear. There is still no legal environment for electronic commerce in which the parties can participate in complete security. Normally, when there is any vagueness in the interpretation of existing laws, reasonable rules for interpretation may be naturally found through court precedents. However, the judicial system reforms necessary in order to meet the requirements of the new era have just began and for the time being, it is difficult to simply expect that court precedents will promptly accumulate because of such reforms.

These interpretative guidelines are intended to explain how the relevant laws and regulations including the Civil Code are applied and interpreted with respect to various types of legal problems in the field of electronic commerce and to promote facilitation of transactions by enhancing predictability for the parties involved. It goes without saying that it is the court which issues the final decision on how the existing laws are applied in each individual and specific case; however, we hope that these interpretative guidelines serve as a guide for the specific interpretation of laws and may also assist in the formation of new rules.

METI puts forward its specific interpretations of laws and regulations in these interpretative guidelines according to the proposal made by the Rules Establishment Subcommittee of the Information Economy Committee of the Industrial Structure Council, chaired by Professor Nobuhiro Nakayama of the University of Tokyo. In preparing the proposal, METI received advice on various issues concerning electronic commerce from consumer groups, trade associations, and observers from government agencies including the Cabinet Office, the Ministry of Justice, the Fair Trade Commission and the Agency for Cultural Affairs. We hope that these guidelines will function to facilitate the interpretation of laws and regulations concerned with electronic commerce into the future.

Furthermore, these interpretative guidelines should be amended flexibly in accordance with the transaction practices relating to electronic commerce, the technological trend relating thereto, and developments in international consensus on appropriate rules. Also, we intend to present practical interpretations of specific cases as well as basic concepts. For this purpose, we have sought opinions on specific cases from a wide range of business people and consumers who are actually engaged in electronic commerce. Some specific cases are given in these interpretative guidelines, but if there are any other appropriate examples in addition to such cases, please contact the address below:

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## Part 1: Electronic Commerce

This part discusses various problems arising from the nature of electronic commerce which is a new mode of business using computer networks including the internet.

### 1. Problems concerning the Conclusion of Contracts

#### (1) Conclusion of Contracts (Arrival of Electronic Notice of Acceptance)

[Issue]

When does a notice of acceptance specifically arrive, at which time is an electronic contract executed (Article 4 of the Electronic Contract Law)?

[Approach]

#### (I) E-mail

For e-mail, a notice of acceptance (“*shôdaku-tsûchi*”) arrives at the time when: (i) the e-mail has been recorded in the-mailbox of the designated mail server or in the-mailbox usually used by the intended recipient (offeror; “*môshikomi-sha*”); and (ii) the e-mail is legible.

#### (i) Notice of acceptance recorded in a mailbox of e-mail server of the intended recipient (offeror)

Cases where contract is concluded

- After the notice of acceptance was recorded in a mailbox, it became irretrievable due to a system failure or similar event.
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Cases where contract is not concluded

- The notice of acceptance had not been recorded in a mailbox due to the inoperativeness of the recipient’s (offeror's) mail server.
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#### (ii) Legibility of e-mail recorded

Contracts not concluded

- The notice of acceptance transmitted/received cannot be read e.g. a garbled e-mail.
- When the notice of acceptance is transmitted as an attached file, the recipient (offeror) cannot decode nor read it. (For example, if the notice is written using application software that the recipient (offeror) does not have.)
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## **(II) Internet browser windows**

When using internet browser windows, a contract is completed when a notice of acceptance is displayed on the monitor screen of the offeror.

[Explanations]

### **1. Conclusion of contract ; arrival of notice of acceptance**

In principle, a notice of acceptance given by electronic means (including e-mails) to a contract offer can reach the opposite party in an extremely short period of time. Therefore, Paragraphs 1 of Article 526 and Article 527 of the Civil Code do not apply where a notice of acceptance of a contract offer is given electronically between remote parties. Instead, the contract is concluded at the time the notice of acceptance reaches the opposite party (Article 4 of the Law Concerning Exceptions to the Civil Code Related to Electronic Consumer Contracts and Electronic Notices of Acceptance (hereinafter referred to as “the Electronic Contract Law”) and Paragraph 1 of Article 97 of the Civil Code).

A statement may say, for example, that “this e-mail is only to confirm the receipt of the contract offer and does not constitute an approval of such contract offer. We will send you an official notice of approval if the order is accepted after we check our stock”, which specifies that approval of the contract offer will be given separately. In this case, the e-mail only confirms the receipt of the contract offer which is not considered a notice of approval.

### **2. Meaning of “arrival”**

The Civil Code does not expressly define the time of arrival. In general, “arrival” (“*tôtatsu*”) has been construed to mean the time when an expression of intention (“*ishi-hyôji*”) reaches the opposite party in an objective state which the opposite party can clearly identify. Specifically, this refers to the situation where it is possible for the other party to identify an expression of intent, or the expression of intent is communicated to the recipient (Judgment of the Supreme Court of Japan, 1<sup>st</sup> Petty Bench, April 20, 1961, 15-4 Saikôsaibansho Minji Hanreishû (“Minshû”) 774; Judgment of the Supreme Court of Japan, 3<sup>rd</sup> Petty Bench, December 17, 1968, 22-13 Minshû 2998).

When a notice of acceptance is given electronically, it is deemed to have arrived at the opposite party at the time the opposite party can access the electromagnetic record of the information pertaining to the notice. For example, when a notice is transmitted by e-mail, the information conveyed by the notice reaches the opposite party at the time it has been recorded in the-mailbox of the-mail server used by the intended recipient (offeror) in a readable condition. More practically, this can be summarized as follows:

- (A) In cases where the information and telecommunications equipment used by the recipient for receiving notices is designated in its mail address or the like, or in cases where there is specific information equipment instead of designated information equipment, that is reasonably believed to be regularly used by the recipient for receiving notices concerning the type of transactions in question, a notice of acceptance is deemed to have reached the opposite party at the time when it has been recorded by the information and telecommunications equipment.
- (B) Except for the cases mentioned in (A), it is understood that a notice of acceptance is deemed to have reached the recipient not at the time when it has been recorded by the information and telecommunications equipment but rather at the time when the opposite party downloaded the information. (It is not necessary for the recipient to read its contents.)

If a notice of acceptance has not been recorded because the offeror's mail server was inoperative, the notice has not reached the offeror because he cannot access the notice.

On the other hand, if a notice of acceptance is lost for any reason after it was recorded, the notice did reach the recipient at the time it was recorded.

### **3. Meaning of “readable condition”**

Where a transmitted notice of acceptance is illegible, the notice is deemed not to have reached the recipient. Whether a notice of acceptance is illegible is determined on a case by case basis according to a variety of factors not limited to bugged texts and characters. For example, a presenter (accepter) is at not fault where a recipient fails to utilize the proper character codes to view the text received. Whether a notice of acceptance is in a legible condition should be determined on the assumption that the offeror intended to communicate the acceptance in a legible form. Where a notice of acceptance is contained in a file created using a specific application software (such as the latest version of a word processing package) which the offeror does not possess, and thus cannot decode into a legible form, it does not seem reasonable to require the offeror to obtain the particular software in order to read the



information therein. Instead, the acceptor has the responsibility to transmit the information in such a way that the offeror can decode it into a legible form. Therefore, when it is impossible for the offeror to decode and read a notice of acceptance, in principle, it should be deemed that the notice has not reached the offeror.

#### **4. Internet browser windows**

In the case of internet sales, orders may be placed and acceptances be made via the internet browser window. Specifically, requisite information including the product name, number of units, and name and address of the offeror is inputted according to the organizational format of the browser window. When this information is sent, the expression of intent to order is transmitted; after the notice of order is saved on the web server of the recipient, confirmation that the contract has been concluded with the offeror is automatically displayed in the browser window.

While notice of approval is transmitted via the browser window, the arrival of such expression of intention should be considered in the same manner as an expression of intent transmitted via e-mail is considered. Specifically, the time of arrival is when the expression of intention comes to the knowledge of the recipient (offeror) or when the expression of intent has been communicated to the recipient (offeror) in a legible form. More specifically, the time when a notice of acceptance appears on the monitor screen of the offeror, after the order data having been recorded on the web server and having reached the recipient. Furthermore, it would be sufficient that the notice of acceptance appeared on the recipient's (offeror's) screen; it is unimportant whether the recipient (offeror) actually acknowledged the acceptance. On the other hand, where a notice of acceptance is not displayed on the screen of the recipient (offeror) due to a transmission error or similar situation, such notice is generally deemed not to have arrived.

Incidentally, a statement may say, for example, "thank you for your order. We will send you an official notice of approval if the order is accepted after we check our stock", which specifies that approval of the contract offer will be given separately. In this case, the statement only confirms the receipt of the contract offer which is not considered a notice of approval.

Following the display of a notice of acceptance in the browser window, e-mails are sent in some cases to confirm the conclusion of a contract. Additionally, in these cases, contracts are deemed to be executed at the time that notice of acceptance is displayed, rather than at the time when the e-mail arrives. Where a notice of acceptance is not displayed on the monitor screen, if an e-mail is sent to confirm the conclusion of a contract, the contract is deemed to be executed at the time the e-mail arrives.

## (2) Effectiveness of Website Terms of Use

### [Issue]

Websites which provide various online transactions (such as internet trading, internet auction, intermediary services and/or information provision services on the internet) generally post a document which includes the terms and conditions for transactions such as “terms of use”, “terms and conditions” or “terms of service” etc. (hereinafter collectively referred to as the “Website Terms of Use”). Would such Website Terms of Use legally bind users?

### [Approach]

With regard to websites which intend to engage in transactions of sales of goods or provision of services, the Website Terms of Use (a document which includes the terms and conditions for the transactions such as “terms of use” (“*riyô-kiyaku*”), “terms and conditions” (“*riyô-joken*”) or “service contract” (“*riyô-keiyaku*”) and the like. Hereinafter collectively referred to as the “Website Terms of Use” (“*Website riyô-kiyaku*”)) shall have binding force if the details thereof will be incorporated into the terms and conditions of the trade contract executed between such user and the website operator (“*site-un'ei-sha*”) concerned.

(Cases where the Website Terms of Use is deemed to be incorporated in the terms and conditions)

- The Website Terms of Use is always and clearly shown on the screen when engaged in online transactions and requires the user to agree to the Website Terms of Use by clicking the “Agree” button as a condition to effect the transactions.

(Cases where it is doubtful to deem that the Website Terms of Use has been incorporated into the terms and conditions)

- Although the Website Terms of Use is posted on the website where users can easily navigate (for example the link to the Website Terms of Use is distinctly placed on the screen of the application form for transactions), the users are not required in such website click the “Agree” button to the Website Terms of Use.

(Cases where the Website Terms of Use is not likely to have been incorporated into the terms and conditions)

- The Website Terms of Use is only posted on the website at a place where it is hard to notice and the users are not even required to click the “Agree” button to the Website Terms of Use for the use of such website.

If any change is made to the content of the Website Terms of Use, the revised Website Terms of Use will only be applicable to the transactions executed after such change and not to any transactions executed before such change. In order to claim the validity of any change made to the Website Terms of Use against a user who engaged in transactions before such change, the website operator should obtain the consent of such user to the revised Website Terms of

Use, after giving notification of the fact of the change to the Website Terms of Use and identifying the changes made in a clear and understandable manner.

Although the content of the Website Terms of Use is deemed to be incorporated into the terms and conditions of a contract between the user and the operator of the website, if in breach of Article 8 and Article 9 of the Consumer Contract Act or other compulsory provisions, the validity of the Website Terms of Use shall be denied to the extent thereof. Also, even if not in breach of the regulations, any illegitimate provisions of the Website Terms of Use which are beyond the reasonable expectations of the user may be deemed invalid, in light of judicial precedents concerning regulations on regular transaction agreements or the effects of the provisions of the Consumer Contract Act which invalidate any provisions which unilaterally diminish consumer protections.

Every website has its own title for the Website Terms of Use, such as “Terms and conditions” (“*riyô-joken*”), “Terms of use” (“*riyô-kiyaku*” or “*riyô-kisoku*”), “Informed consent” (“*go-dô-i-jôkô*”), “For the users” (“*go-riyô-ni-atatte*”) and the like, however, such titles have no effect on the validity of the Website Terms of Use, except in special circumstances.

[Explanations]

## **1. Identification of problems**

Websites which provide various online transactions for consumers, such as internet trading, online financial services, internet auction, intermediary services and/or information provision services on the internet, often post a Website Terms of Use. The Website Terms of Use is posted on the website in various ways, such as by simply putting a link on the front page of the website, or by requesting the user to click the “Agree” button to the Website Terms of Use when applying for a particular transaction. It is unusual to execute a contract for an online consumer transaction simply through the website. Rather, it is typical that the seller (business entity) enters into transactions with consumers subject to the Website Terms of Use. For this reason, we must answer under what circumstances will the Website Terms of Use bind consumers.

## **2. Requirements for Website Terms of Use to be accepted as a contract between user and website operator**

### **(i) Contractual relationships**

The reason the Website Terms of Use is legally binding is because the Website Terms of Use is incorporated into the contract which has been executed between the user and the website operator. Therefore, in order for the Website Terms of Use to be legally

binding, there must be some kind of contractual relationship between the user and the website operator. The sales transaction (such as internet trading and the like) is the most typical type of transaction and it forms the foundation for the creation of the contractual relationship. However, various types of transactions which provide services such as information services through the internet or internet auctions may also be considered as having created a contractual relationship between the parties.

The binding force of the terms of use (end-user license terms and conditions) for downloading information assets such as software or music should be considered pursuant to the Website Terms of Use.

If there is no contractual relationship between the user and the website operator, the Website Terms of Use would have no binding force as a contract. Provided, however, that the details of the Website Terms of Use may be considered in some cases, upon determining the responsibility for unlawful acts and the extent thereof.

**(ii) Users applying for transactions after agreeing to the Website Terms of Use.**

The Website Terms of Use would only be contractually effective if the users entered into the transactions with the website operator with the intention to enter into the transactions pursuant to the Website Terms of Use. For this reason, users would not be bound by the Website Terms of Use if such users used the website without knowing about the Website Terms of Use.

In the past, cases regarding general conditions of contract such as in a transportation agreement (for example, Judgment of Osaka High Court, June 29, 1965, 16-6 Kakyûsaibansho Minji Saibanreishû (“Kaminshû”) 1154; Judgment of Kyoto District Court, November 25, 1955; 6-11 Kaminshû 2457 (concerning motor carrier transportation agreement)), the disclosure (e.g. representation) of the terms and conditions was a prerequisite to ruling that the terms and conditions had binding force. However, the court held that terms and conditions are deemed to be incorporated into a contract for transactions concerning the carriage of passengers or cargo transports if such terms and conditions are disclosed to the customers appropriately, so long as it is the established business practice when entering into transactions for such transportation agreements or other similar agreements. Therefore, under Japanese laws, the court may rule, in some cases that as long as the Website Terms of Use has been posted and was clearly disclosed to the users, such Website Terms of Use is deemed to be incorporated into the relevant online contract even though the users had not clicked the “Agree” button on the screen.

However, an internet transaction is still a new kind of transaction. Therefore, it is hard to assess at this point whether an established business practice exists regarding transactions executed pursuant to the Website Terms of Use posted on a website. Among the court cases (ex. Ticketmaster Corp v. Tickets.com Inc. (C.D.Ca., March 27, 2000), Specht v. Netscape Communications Corp. 150 F. Supp. 2d 585 (S.D.N.Y., July 5, 2001), aff'd. 306 F. 3d 17 (2d Cir., Oct. 2002)) in the United States, where internet technology is in its most advanced form, a case exists in which the court held that it cannot be assumed that a user who has initiated a transaction has agreed to the Website Terms of Use simply because the Website Terms of Use were posted on the website. Rather, the judge stated that a system would have to be in place (such as a system in which the user can enter into transactions only if such user clicks the "Agree" button to the Website Terms of Use) which can confirm the consent of the user to the Website Terms of Use, as a prerequisite to finding that the Website Terms of Use have been incorporated into the terms of contract.

For this reason, if a system, in which a transaction is commenced only after the user has consented to the Website Terms of Use by clicking the "Agree" button to the Website Terms of Use, is not established, the Website Terms of Use may not have binding force on the user. The Website Terms of Use may be deemed invalid, in principle, when the website has simply not provided an "Agree" button, and also when the user cannot make out the Website Terms of Use because the link to the Website Terms of Use is too small to identify and is difficult to locate by a user who has been notified of their existence.

Furthermore, if the contractual terms of a transaction which are described on the Website Terms of Use are considered common-sense in light of the established business practice, the consent of the user may be deemed to be present relatively easily. However, the consent of the user would have to be explicitly proven with respect to provisions (such as a provision on international arbitration or a provision that withholds the unilateral termination right of the seller (business entity; "*jigyô-sha*") in internet trading) which may impose disadvantages on the user and which the user normally expects not to be present (as described below, if the user is a consumer, such illegitimate provisions may be deemed invalid in some cases under the Consumer Contract Act).

**(iii) Validity of long and complicated Website Terms of Use**

Paragraph 1 of Article 3 of the Consumer Contract Act provides that a business entity must make efforts to ensure that its contracts with consumers are "clear and simple". This provision only prescribes the "duty to make efforts" and if the terms of the transaction or the conditions are complicated, the Website Terms of Use would likely

also become long and complicated. The validity of the Website Terms of Use incorporated into the transaction contract would not be denied immediately just because the contents of such Website Terms of Use are long and complicated. However, if the provisions which are unfavorable to the user are hidden because of the use of long and complicated sentences and the consumer cannot easily understand the contents, the validity of such unfavorable provisions which are “concealed by long and complicatedly phrased sentences” may be denied. In order to judge whether the Website Terms of Use is “clear and simple” for website users to understand, there would be a comprehensive consideration of the overall explanations of the Website Terms of Use provided to the users on the website, including the contents of the Website and the supplemental remarks concerning the conditions of transaction (e.g. explanations on flow of transactions, charts and/or illustrations).

### **3. Amendment to the Website Terms of Use**

The following is a discussion on each type of Website Terms of Use stipulating the terms and conditions for single transactions such as internet trading and the terms and conditions for continuous transactions (such as online banking or internet auction) which are entered into between certain users (online member or subscriber).

#### **(i) Amendment to the Website Terms of Use stipulating the terms for one shot transaction**

As described above, the Website Terms of Use does not itself have the legal binding force, and only becomes effective when it is incorporated in the contract stipulating the terms and conditions for a transaction between the user and the website operator. Therefore, if the Website Terms of Use having a legal binding force (which means the Website Terms of Use which is incorporated in the contract) is changed, such amended Website Terms of Use would not be applicable retroactively to the transactions which are entered into before the changes are made and would only be applicable to the transactions entered into after the changes are posted on the website.

Also, if the users are not notified on the changes to the Website Terms of Use, it is likely that such users who have used such website in the past would apply for transactions based on the previous Website Terms of Use. For this reason, if the website operator does not notify the users on the changes of Website Terms of Use in an appropriate method (e.g. by setting an adequate period of notice on the changes in the front page of the website to notify the users and posting the change tracking so that the users can view the changes), question as to the binding force of the terms and conditions of the Website Terms of Use after the changes (especially if such changes are made to be much

more unfavorable to the users than they were before) may arise due to falsification of contract or in accordance with the principles of good faith, as for the users who were not aware of the changes to the Website Terms of Use.

**(ii) Amendment to the Website Terms of Use stipulating the terms for continuous transaction**

As described above, the Website Terms of Use may be deemed to have legal binding force if it is incorporated into a contract and if it stipulates the terms and conditions for the transaction between the user and the website operator. Once the contract is formed, the terms thereof may not be changed, in principle, unless upon mutual agreement of the parties. Therefore, the Website Terms of Use, stipulating the terms of a continuous transaction and which constitutes the terms and conditions between the parties, is not automatically legally binding on website users who have entered into the transactions based on the Website Terms of Use before the changes were made. In order to apply the amended Website Terms of Use to the existing website users, it is necessary for the business entity to notify the existing website users in an easily comprehensible manner of the amended part of the Website Terms of Use and to obtain the consent of such website users to the contents of the amended Website Terms of Use (or to enter into a transaction based on the amended Website Terms of Use). Also, where a continuous transaction contract is formed based on the current Website Terms of Use which do not reflect the changes, the existing website users who do not agree to the changes to the Website Terms of Use shall not be legally bound by the changes, and the business entity would be bound by the terms and conditions stipulated in the original Website Terms of Use which does not include any changes.

Unless otherwise specifically and clearly agreed by the website user that the terms and conditions stipulated in the amended Website Terms of Use would apply retroactively to the transactions which were previously entered into by and between the parties before the changes were made, the amended Website Terms of Use would only apply to the individual transactions executed after the changes became effective, even though the website user has agreed to the changes to the Website Terms of Use.

**(iii) Verification of terms and conditions upon transaction if the Website Terms of Use is amended**

If any dispute arises between the user concerning the applicable terms and conditions of the Website Terms of Use, it is highly possible that the website operator would be found to have a duty to verify the contents of the Website Terms of Use with the user at the time of the relevant transaction or the time of amendment. This is because the website

operator prepares the information including the Website Terms of Use on the website, maintains the server and is in the position to easily trace the changes made to the Website Terms of Use, and because in an electronic consumer contract, it is common that the electromagnetic record, which becomes evidence for the details of the Website Terms of Use, is not preserved for users, which is not ordinarily the case in a contract executed in written form. Especially, if the website operator desires to apply a certain provision of the Website Terms of Use, such website operator would be held fully responsible to verify that such provision existed at the time the parties agreed to enter into the transaction. Also, in the event the users claim, without showing any specific evidence, that the old Website Terms of Use had included such provisions that were favorable to the website operator, it is likely that claims by the users regarding the provisions would be admitted as the users have no paper-based contract of the transactions and it is additionally highly likely that such claim by the users be admitted as fact if the website operator, who should be able to easily produce the contents of the Website Terms of Use and a record of its changes, does not submit appropriate evidence against such fact. It is necessary to at least preserve a record of the changes in order for the website operator to verify the contents of the old Website Terms of Use. However, if the website users claim that the record of changes have been falsified, such record of changes may not have adequate probative force if there is no physical evidence to counter the possibility of falsification of the record of changes. In order to verify that the record of changes have not been falsified, the operator may utilize the “time stamp service” (service that provides proof that the electronic document had existed at a certain time and that there has been no alteration of such document) every time such operator makes changes to the Website Terms of Use.

#### **4. Regulations of Consumer Contract Act etc.**

Even if the Website Term of Use which is incorporated into the terms and conditions of a contract is legally binding, any provision in such Website Terms of Use that violates the compulsory provisions or that is contrary to public order and public morals would be held invalid. The following is a discussion on the Consumer Contract Act as the Act contains the most important compulsory provisions in relation to the Business-to-Consumer Electronic Commerce.

##### **(i) Regulations on provisions limiting the liability of business entity**

Article 8 of the Consumer Contract Act prescribes that any provision is invalid which fully discharges a business entity from its liabilities for default, unlawful act or compensatory damages such as liability to comply with the warranty against defects.



Correspondingly, a partial limitation of liability (e.g. setting an upper limit for compensatory damages) is not deemed outright as invalid under the Consumer Contract Act. However, the discharge and/or limitation of any partial liability which was caused by the intention and/or gross negligence of the business entity (of representative or employee) is prescribed as invalid under Article 8 of the Consumer Contract Act.

The validity of any limitation of liability on physical damages has been very narrowly interpreted<sup>1</sup> since the period before the Consumer Contract Act came into force. It is expected that Article 10 of the Consumer Contract Act, which prescribes that any provision which unilaterally detracts from the benefits of consumers shall be deemed invalid, will operate to strengthen the court to combat any restrictions on liability for bodily injuries. Therefore, it is clear that a business entity would not be fully discharged from the liabilities associated with bodily injuries or death and consequently any provision which partially limits the liability of such business entity could be found invalid.

**(ii) Invalidation of excessive amount of damages against Consumers**

Under Paragraph 1, Article 9 of the Consumer Contract Act, it is prescribed that if the termination charges “which exceed the average amount of damages incurred by such business entity following the termination of similar consumer contract” are levied upon the termination of a contract between consumers, the amount of such termination charges exceeding the average amount of such damages would be found invalid. Accordingly, this provision bans the business entity from gaining any benefits from imposing termination charges on customers. In relation to the termination of reservations at restaurants, Judgment of Tokyo District Court, March 25, 2002, 1152 Kinyû-shôji Hanrei 36, held that an agreement on termination charges, which exceeded the actual amount of food and beverages consumed, invalid and ruled that the amount of damages should be limited to 30% of the actual amount of food and beverages which would have been consumed. Also, the non-refund of any part of a tuition payment

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<sup>1</sup> For example, Judgment of the Osaka District Court, May 9, 1989, 1308 Hanrei Jihô 28, allowed a limitation of liability for air transportation itself, however, the court did not allow a similar limitation on damages relating to bodily injuries or death on the ground that the maximum amount of liability (up to 600 Million Yen) stipulated in the Domestic Conditions of Carriage ( “*kokunai-ryokaku-unsô-yakkan*” ) was too low. As seen in the internationally acclaimed Warsaw Convention with respect to the limitation on liability for air transportation, even though in the air transportation industry, a limitation of liability is generally accepted, yet nevertheless any limitation on bodily injuries or death to passengers is strictly limited. Therefore, in Japan any limitation on bodily injuries or death should not be permitted.

made in advance in case of termination of enrollment at a private English school or for other classes or the non-refund of tuition by a private university when an enrollee declines admission before entering, the amount of such payments which exceed the average amount of damages would be found invalid under the Consumer Contract Act<sup>2</sup>. Therefore, even though the provision of termination charges is prescribed in the Website Terms of Use, if such termination charges exceed the average amount of damages incurred by the website operator upon occurrence of termination, the amount in excess of such average amount will be found invalid.

Also, Paragraph 2, Article 9 of said Act prescribes a ceiling of 14.6% per annum as the default interest amount applicable to consumers.

**(iii) Invalidation of other provisions which unilaterally damage the benefits of consumers**

Article 10 of the Consumer Contract Act prescribes, dissimilarly to the Civil Code, that the Commercial Code and other laws which are automatically incorporated into contracts (unless specifically overridden in the contract), are more consumer friendly in that they will nullify any contractual clauses which limit the rights of consumers and which create additional obligations on the part of the consumer and which unilaterally detract from the benefits enjoyed by consumers. The following lists the possible types of clauses which could be found invalid:

- i) Clauses restricting the right of a consumer to terminate a contract, as stipulated by Article 570 of the Civil Code among other articles, to terminate contracts due to defects and non-performance of the business entity, or clauses expanding the rights of business entities to terminate contracts.
- ii) Arbitration clauses under which the right to appoint arbitrators belongs only to the business entities
- iii) Clauses which deem a the silence of a consumer to constitute an implicit expression of intention, such as a “negative option” where a consumer is deemed to consent unless he keeps silent for a certain period; such silence should not be deemed to constitute implicit expression of intention under general trade practices.
- iv) Clauses placing an additional burden of proof on consumers or eliminating the burden of proof for business entities

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<sup>2</sup> After the Consumer Contract Act came into force, the courts have ruled that special clauses on nonrefundable tuition are invalid.

- v) Clauses restricting the exercise period of legal rights of consumers

**(iv) Regulations on general contractual conditions**

If the Website Terms of Use is legally binding because it is incorporated into a contract, such Website Terms of Use shall fall under the general contractual conditions (“*yakkan*”) category such as in transportation agreements or insurance clauses. With respect to clauses of regular transaction agreements, the judicial precedents, in which the unreasonable clauses were held as invalid for being contrary to public policy (“*kôjo-ryôzoku*”), have had an impact on to what extent the contents of clauses can be restricted. Therefore, any unreasonable clauses within the Website Terms of Use could be similarly ruled invalid.

The essence of the jurisprudence on this point of law is similar to the purpose of the provision of Article 10 of the Consumer Contract Act “which prescribes, dissimilarly to the Civil Code, that the Commercial Code and other laws which are automatically incorporated into contracts (unless specifically overridden in the contract), are more consumer friendly in that they will nullify any contractual clauses which limit the rights of consumers and which create additional obligations on the part of the consumer and which unilaterally detract from the benefits enjoyed by consumers.”.

(3) Incorrect Price Indication and the Legal Responsibility of the Party Declaring its Intentions

[Issue]

A product, on which an incorrect price was indicated, was displayed and sold on an electronic commerce site. A potential purchaser declared his/her intention to purchase such product at such incorrect price through a system on the internet. Will the seller, who became aware of the incorrect price indicated on the product, be required to sell it at the incorrect price as indicated? Would the conclusion be different under each of the following circumstances?

- If the potential purchaser was aware that that price indicated was incorrect or if most users of the site would be aware that the indicated price was incorrect.
- If the transaction is so constituted that, as in the case of an internet auction, the act of the potential purchaser as well as of the seller would determine the final price in such electronic commerce.
- Whether or not the seller is a business entity.
- If it is expressly indicated that an expression of intent to accept the offer received from the purchaser would be sent separately by an automatic response.
- If the website regulations provide the timing for the conclusion of a contract.

[Approach]

In electronic commerce, where the seller mistakenly indicates an incorrect price for a product that is lower than the correct price, the seller would not be obligated to sell it at such incorrect price if the purchase agreement for that product has not been concluded yet, or if, although the purchase agreement has been concluded, the contract is invalid on the ground that such incorrect price is a declaration of intent due to a miscomprehension.

In the following section, we will first analyze an issue peculiar to cases involving the indication of an incorrect price. The issue is whether the purchase agreement is invalid because the seller mistakenly indicated an incorrect price and therefore declared his/her intention under a miscomprehension (*sakugo*). Secondly, we will analyze whether or not a purchase agreement has been concluded.

If the seller was grossly negligent, he/she is not entitled to argue that his declaration of intention is invalid on the basis of his miscomprehension. In many cases, the seller will be regarded as grossly negligent if he/she indicated an incorrect price. However, where the potential purchaser was aware of the incorrectness of the indicated price or where most

browsers of the website could have been aware of the incorrectness of the indicated price, the seller may, even though he/she was grossly negligent, be able to argue that the purchase agreement is invalid on the basis of his miscomprehension.

With respect to whether or not a purchase agreement has been concluded, generally, displaying a product on a website with incorrect price information merely constitutes an inducement for an offer (*moushikomi-no-yuuin*) to execute a contract, and thus no contract has been concluded at such time. In principle, the timing for the conclusion of a contract would be the time when an e-mail containing a notice of acceptance (*shodaku tsuchi*) from the seller reaches the potential purchaser who clicked the button to offer (*moushikomi*) to purchase the product after browsing the website, or when a notice of acceptance appears on the potential purchaser's browser after the data on the acceptance has reached the offeror, responding to the data on the offer recorded on the web server.

However, where the e-mail from the seller is an automatic response e-mail and it is expressly indicated that a notice of acceptance would be sent separately, such e-mail is merely an acknowledgement of the order and would not be considered to be a notice of acceptance.

Example of cases where a contract may be invalid due to miscomprehension

- If the potential purchaser was aware of the incorrectness of the indicated price for the product.
- If most browsers of the website could be aware that the indicated price is incorrect.

Example of cases where no purchase agreement has been concluded

- Where an automatic response mail from the seller is sent in response to the potential purchaser's order, and the e-mail expressly indicates that the seller will declare his/her intention to accept the order separately.
- Where an e-mail "confirming the order" is sent by the seller, the terms and conditions for the website expressly provide that the e-mail indicating that "the ordered product has been dispatched" constitutes a notice of acceptance.

[Explanations]

**1. Where a purchase agreement has been concluded, could the seller argue that the agreement is invalid on the basis of his/her miscomprehension?**

A contract is concluded when the declarations to offer and accept are identical. The issue is, where the contract has been concluded at an incorrect price, whether the party declaring its intention can argue that the contract is invalid on the basis of his/her miscomprehension.

**(1) Incorrect price indication and invalidity on the basis of a miscomprehension**

Even where a contract has been concluded, the contract is valid only if certain conditions for it to take effect are met. If the contract is not valid, the seller will not bear any obligations to sell the product at the incorrectly indicated price.

A declaration of intent, as a juristic act, is invalid if there is a miscomprehension with respect to any material elements of such juristic act. However, if the party who made such declaration was grossly negligent, such party is not entitled to argue that it is invalid (Article 95 of the Civil Code). In regard to an incorrectly indicated price, it would be possible for a seller who accepted the order without gross negligence to argue that his/her declaration of such intention is invalid on the ground that it includes a "miscomprehension of a material element" (*youso-no-sakugo*).

"Miscomprehension" (*sakugo*) herein means a situation where, due to an erroneous perception or judgment of the party that expresses its intention, a divergence occurs between the intention reasonably presumable from the actually expressed intention and the party's genuine intention. "Miscomprehension of a material element" in this case means miscomprehension with respect to any material part of the declaration of intent. More specifically, a miscomprehension with respect to a material element consists of cases where, (1) the party would not have declared its intention if there had been no such miscomprehension and; (2) a reasonable man would not, in light of general commercial practice, have made such declaration without such miscomprehension (Great Court of Cassation (equivalent to the Supreme Court) Judgment of October 3, 1918, *Minroku* 24-1852, etc.).

The reason why a party who erroneously declared its intent due to its gross negligence is not entitled to argue that such declaration of intent is invalid is that there is no need to protect such grossly negligent party. "Gross negligence" herein refers to cases where a party was extremely careless in erroneously declaring its intent and any reasonable person with normal care would not have made such a mistake (Great Court of Cassation (equivalent to the Supreme Court) Judgment of November 8, 1917, *Minroku* 23-1758, et.al).

Generally, the sales price of a product would be a main part of the declaration of intent in selling a product, and thus an incorrect indication of price is generally considered as a "miscomprehension of a material element." In electronic commerce, in order to avoid indicating an incorrect price, it would suffice to input the price information carefully into the system. Sellers are thus generally considered to be grossly negligent when indicating an incorrect price, except under very limited circumstances.

**(2) Where the potential purchaser was aware that the indicated price is incorrect or if most browsers of the website would be aware of such incorrectness**

As mentioned in 1. (1) above, a seller who indicated an incorrect price would generally be considered to be grossly negligent. However, there are cases where the seller, even though he/she is grossly negligent, is entitled to argue that his/her declaration of intent is invalid on the basis of his/her miscomprehension. For example, if the potential purchaser was aware that the price indicated for a product was incorrect, the seller (the party declaring its intent) may claim that its declaration of intent was invalid on the basis of his/her miscomprehension. More specifically, it is highly probable that the seller may reasonably claim that his/her declaration of intent is invalid on the basis of its miscomprehension by arguing that the purchaser was aware of that the indicated price was incorrect, where a price, one digit less than the market price, was erroneously indicated for products such as large-sized TVs, of where the rough price range in the market would be relatively familiar to general consumers, or where the purchaser obviously made an offer to buy a product after browsing an anonymous message board on a website discussing the incorrectness of the indicated price. The reason for this is that there is no need to protect the counterparty if such counterparty was aware of the incorrectness of the price indicated by the party declaring intentions, considering that the protection of the counterparty is the purpose of barring a grossly negligent party from claiming the invalidity of his/her declaration of intentions on the basis of his/her miscomprehension. However, in the case of an internet auction, the problem should be analyzed from a different perspective.

**(3) In the case of transactions such as an internet auction where, in electric commerce, the act of the potential purchaser as well as of the seller determines the final sales price.**

There are various forms of transactions in electronic commerce. One of them is an internet auction where the seller merely provides the opening price and the final bid price will be determined by the bid of the successful bidder.

We need to analyze the various types of internet auctions on a case-by-case basis. Where the intention of the participants in the transaction is to follow the conditions at the closing of the bidding period (closing of the auction), we may reasonably argue that a purchase agreement has been concluded between a seller and a successful bidder who has satisfied the bidding conditions provided by the seller at the closing of the bidding period (See "Conclusion of sales contracts in internet auctions" herein).

If a purchase agreement is considered to have been concluded at the closing of the internet auction, the issue is whether the seller, who erroneously indicated a lower opening price than

he had initially intended, could claim the invalidity of his/her declaration of intent on the basis of his/her miscomprehension.

In an internet auction site accessed by a considerably large number of users, the successful bid price for the product is considered to be the market price in the group of people that consists of the users of such internet auction site. Generally, the more frequently a website is accessed by users, the closer the market price in the group of people would be to the real market price. If so, even if the seller is barred from claiming the invalidity of his/her declaration of intent, the seller's economic risk arising therefrom would only be that the seller, who wished to sell a product in any event at a list price exceeding the market price in the group of people ends up, contrary to his/her expectations, concluding a purchase agreement at the market price and consequently he/she loses potential sale proceeds in an amount equivalent to the difference between his/her list price and the market price. In light of the need for the protection of bidders in an auction, the exhibitor shall not be entitled to claim the invalidity of his/her declaration of intent on the basis of miscomprehension merely because the bidder was aware of the incorrectness of the indicated opening price, although this matter should be considered on a case-by-case basis. In such cases, there would generally be no "miscomprehension of a material element" and thus the declaration of intentions would not be held invalid on the basis of a miscomprehension.

#### **(4) Whether or not the seller is a business entity**

In discussing the invalidity of a declaration of intent due to a miscomprehension, whether or not the party making such declaration is a business entity might be a factor in determining whether such declaration was made due to gross negligence. Generally, if the seller is a business entity, it would be more difficult to deny gross negligence, as compared to the case of an individual.

## **2. Whether or not and a purchase agreement has been concluded in electronic commerce**

### **(1) The conclusion of a purchase agreement in electronic commerce**

The seller is not obliged to sell the product to the potential purchaser at an incorrectly indicated price until a purchase agreement has been concluded. However, once a contract has been concluded, the parties thereto are bound to the contents thereof, unless there are special circumstances such as the agreement not meeting certain conditions necessary for it to be effective. Thus the seller is generally obligated to sell the product at the incorrectly indicated price.



Under the Civil Code, in order for a contract to be concluded, the declarations of intent to offer and to accept must be identical. The potential purchaser browsing the website would declare its intent to offer (*moushikomi*) to conclude a contract by, for example, clicking the order button in accordance with the purchase order system on the website. When a declaration of intent to order is made, the seller would declare his/her intention to accept the offer by e-mail etc. In this regard, a notice of acceptance that is delivered by electronic means such as by an e-mail would basically reach the counterparty almost instantly and thus, if a notice of acceptance is delivered electronically such as by e-mail to a counterparty not physically present, Article 526, Paragraph 1 and Article 527 of the Civil Code (*hasshin shugi*) will not be applicable. Instead, such contract shall be concluded at the time the notice of acceptance reaches the offeror, i.e., the potential purchaser (Article 4 of the Electronic Contract Law and Article 9, Paragraph 1 of the Civil Code).

It is reasonable to consider the notice of acceptance dispatched on the website in the same way as the time-reached theory applicable to the declaration of intentions, and the time-reached theory applicable to the acceptance notice in the case of e-mails. Thus, the time a contract is considered to have been concluded shall be the time the notice of acceptance appears on the offeror's browser after the data on the acceptance has reached the offeror, responding to the data on the offer recorded on the web server. The notice of acceptance has "reached" the offeror, only if the notice of acceptance appears on the display, irrespective of whether the offeror actually confirmed this notice or not (See "Conclusion of Contracts" herein).

In regard to the indication of an incorrect price, generally, displaying a product whose price is incorrectly indicated on the website is considered an invitation for an offer to conclude a contract. At this moment, no contract has yet been concluded, and thus the seller is not obligated to sell the product to potential purchasers at the incorrectly indicated price. Where a potential purchaser clicks the purchase order button after browsing the website, the contract is considered to have been concluded, in principle, at the time when the seller's notice of acceptance reaches the potential purchaser or when the notice of acceptance appears on the offeror's browser after the data on the offer has reached the offeror, responding to the data on the offer recorded on the web server.

The aforementioned argument is a general theory that is not based on any specific circumstances. Therefore, we should note that, each specific case should be examined on a case-by-case basis.

**(2) If the automatic response e-mail to the offer made by a potential purchaser expressly indicates that a declaration of intent to accept would be given separately.**

Notwithstanding 2. (1) above, where the automatic response mail includes a statement such as the following "This mail is not a notice of acceptance but an acknowledgement of receipt of your purchase order. We will check our stock and send you a formal notice of acceptance if we can accept your order," expressly stating that an acceptance of the offer of a contract would be given separately, such response e-mail aims merely to acknowledge the receipt of the offer, and thus this would not constitute a notice of acceptance (See " Conclusion of Contracts " herein). In this case, no contract has been concluded yet, and thus the seller is not obligated to sell any product to the potential purchaser at the incorrectly indicated price.

After the notice of acceptance appears, an e-mail to confirm the conclusion of a contract may be sent separately, but even in this case, the time such contract is concluded would be the time when the notice of acceptance appears on the offeror's browser, not when the subsequent e-mail reaches the offeror. On the other hand, where no notice of acceptance appears on the browser, if an e-mail confirming the conclusion of the contract was dispatched to the offeror, the contract has been concluded at the time such e-mail reaches the offeror (See " Conclusion of Contracts " herein.).

**(3) If the terms and conditions for the website provide the timing for the conclusion of a contract.**

In many websites conducting electronic commerce, the terms and conditions for transactions are indicated in the form of rules on, conditions for, or agreements on the transactions on the websites (hereinafter collectively referred to as the "Terms and Conditions"). The Terms and Conditions may provide the timing for and effectiveness of the conclusion of a contract.

For example, the Terms and Conditions may indicate, "If the customer orders a product, the customer's order shall constitute an offer to conclude a purchase agreement for the product on our website. The customer will receive a 'confirmation of order' e-mail from our website which acknowledges our receipt of and the contents of your order. The website's acceptance of the customer's offer for a contract shall take effect at the time when a 'notice of dispatch of the ordered product' is sent by e-mail from our website to inform the customer about the dispatch of the product." In this case, the issue is whether the parties to the transaction are bound to the Terms and Conditions.

In this regard, where the Terms and Conditions clearly appear on the browser every time for each transaction and the customer is required, as a precondition for entering into such transaction, to express his/her consent to the Terms and Conditions by clicking the Agree button, such Terms and Conditions would be included in the contents of the contract and thus they are binding the parties thereto. On the other hand, where the Terms and Conditions are posted at an inconspicuous location on the website and the customer is not required to click an

Agree button to express his/her consent thereto in connection with the use of the website, such Terms and Conditions will not be binding on the parties to the transaction (See "Effectiveness of Website Terms of Use" herein).

Where, in light of the aforementioned criteria, the Terms and Conditions would be binding on the parties to the transaction, another issue would be whether the Terms and Conditions may designate the timing for the conclusion of a contract.

Generally, the Terms and Conditions would not have any binding effect on the timing for the conclusion of a contract. This should instead be reasonably determined by analyzing the declarations of intent to offer and accept that constitutes the purchase agreement. However, as a rule, if the Terms and Conditions set forth the timing for the conclusion of a contract, it will affect the user's intent in connection with such user's declaration of intent. If the parties to a transaction are considered to have given prior consent to the Terms and Conditions, such parties may be considered to have entered into the transaction after agreeing upon the timing for the conclusion of the contract designated in the Terms and Conditions.

Based on the aforementioned argument, we could conclude that, where the Terms and Conditions are binding on the parties thereto, the timing for the conclusion of a contract is likely determined in accordance with the provisions therein. In the aforementioned example, the contract has been concluded at the time the "notice of dispatch of the ordered product" has been sent to the potential purchaser, as provided in the Terms and Conditions. Until a contract has been concluded, the seller is not obligated to sell the product at the incorrectly indicated price.

(4) One-click Billing and Obligation to Perform the Contract

[Issue]

With respect to “one-click billing”, if one is charged on the basis of a contract concluded with “one-click,” does he bear any legal obligation to pay such bill?

[Approach]

**(I) One-click billing**

One-click billing occurs where, after clicking a URL indicated in an e-mail or website (including blogs and track back links) received on a mobile phone or a personal computer, the browser indicates that the user has subscribed for a pay service and such user who clicked will be charged the bill. This is typical fraudulent billing for the purpose of swindling money under the pretext of consideration for services. We will herein discuss whether the person charged on the basis of such “one-click billing” shall bear any contractual obligation to pay the bill.

**(II) Where no contract has been concluded**

If the one-click does not constitute an offer to enter into a contract, then no declaration of intent to make an offer exists, and thus no contract has been concluded. Accordingly, there is no legal obligation to pay the bill because there is no basis for billing.<sup>1</sup>

Example of cases where no contract has been concluded

Cases where the one-click cannot be considered as an offer to enter into a contract:

- An e-mail indicating a certain URL which simply appears to be an advertisement (such as "Click now and access the movie as much as you like!")
- An e-mail indicating a certain URL which appears as if it were sent by an acquaintance with a view to introducing a certain website (for example, an e-mail beginning with "How have you been?," "Reference is made to the website I talked about yesterday," followed by a certain URL thereafter).
- An e-mail indicating a URL which appears to be guidance for canceling or withdrawing from membership from a pay service, where there are no pay services to withdraw from (an e-mail beginning with "click here to withdraw from the membership," "click here if you do not need to be registered", followed by a certain URL)

<sup>1</sup> The Tokyo District Court Judgment of January 30, 2006 (p.52 of *Hanrei Jiho* No.1939) is a case where the claim of a victim of one-click billing demanding compensation for mental suffering against the website operator was accepted.

This case ruled that, given the structure of the website at the time the plaintiff accessed it (where the user was automatically registered as a member and then billed merely by clicking an image), no contract had been concluded between the plaintiff and the defendant, and further, that the defendant's undue billing constituted a tort against the plaintiff. The court then ordered the defendant to pay 300,000 yen as compensation for the plaintiff's mental suffering.

- A website has a button which indicates "Entrance" or "See \_\_\_\_". If you click this button in order to move on to the next page, you will be automatically registered, even though there is no indication anywhere that clicking this button leads to an offer to execute a contract
- A question appears on the browser such as that "Do you want to accept the contract?", followed by two buttons offering a choice of "Yes" and "No", and in spite of a single click on the button "No", this automatically leads to registration

Example of cases where no contract has been concluded

(Cases where the Terms and Conditions are designed to appear at a difficult-to-find location on the browser)

- In the case of a URL indicated on a mobile phone, where the URL is indicated at the top of the browser, while the Terms and Conditions are found only by scrolling all the way to the bottom thereof
- Where certain material information is indicated in a hard-to-find manner such as where the color of the text and the frame's scroll bar are the same as the background color or where such important notice is indicated in extremely small letters

(Cases where it is difficult to know that a single click will lead to an offer to execute a contract)

- Cases where the Terms and Conditions provide that the clicking constitutes an offer to execute a contract, while no such notice appears before clicking the button. Instead, a question such as that "Are you of an age of 18 or above?" is posed, and the button merely offers a choice of "OK" or "Cancel".

### **(III) Cases where a contract will be invalidated on the ground of miscomprehension**

Where the offeror has misunderstood of the elements of a contract, the offeror may reasonably argue that the contract is invalid on the ground of his/her miscomprehension, unless the offeror was grossly negligent (Article 95 of the Civil Code). However, if the business entity operating the one-click billing system deliberately anticipates that the offeror would make an error by clicking through the system, it is highly likely that the offeror will be allowed to argue that his/her declaration of intention is invalid on the grounds of miscomprehension, irrespective of whether he/she was grossly negligent. Protecting the position of the counterparty is the purpose of barring the grossly negligent offeror from asserting the invalidity of his/her declaration of intention on the ground of miscomprehension. However, the business entity operating the one-click system has deliberately anticipated such miscomprehension and thus they need not be protected. Furthermore, in an electronic consumer contract, if the offeror erroneously clicked the purchase order button even though he/she had no intention of accepting the contract, the offeror may assert the invalidity of his/her declaration of intention on the ground of miscomprehension, irrespective of whether the offeror was grossly negligent, unless the business entity took measures to confirm the contents of the acceptance (Articles 2 and 3 of the Electronic Contract Law).<sup>2</sup>

If the contract is valid on the ground of such miscomprehension, there is no legal obligation to pay any bill, because there is no basis for billing.

<sup>2</sup> For specific details of confirmation measures taken by business entities, see "Mistake Caused by Customer's Erroneous Operation" herein.

Example of cases where a contract may be invalid on the ground of miscomprehension

- The offeror erroneously clicked the purchase order button although he/she had no intention of making an offer (assuming that the business entity took no measures to confirm the contents of the order)
- The price of services expected by the offeror was different from the actual price provided for in the contract.
- The contents of services expected by the offeror were different from those of the services actually provided.

**(IV) Cases where a contract is invalid because some provisions therein do not comply with the Consumer Contract Law**

If a contract contains provisions that do not comply with any of Articles 8 through 10 of the Consumer Contract Law, those provisions are invalid. Therefore, there is no legal obligation to pay any bill charged pursuant to those invalid provisions.

Example of provisions that are invalid because they do not comply with the Consumer Contract Law

- "If the effective rate of interest exceeds 14.6% per annum in the following cases, such provisions are invalid to the extent the effective rate of interest is in excess of 14.6%."
- "If we do not receive any payment, we will charge you an amount \_\_ times the total amount payable"
- "In the case of a delayed payment, pursuant to the Terms and Conditions, we will charge overdue interest in the amount of \_\_\_\_ yen plus delay damages equivalent to \_\_\_\_ yen per day from the due date."

Example of provisions that may be invalid because they do not comply with the Consumer Contract Law

- A bill states something like "In the case of a delayed payment, we will charge \_\_\_\_ yen in penalties"
- A provision that unilaterally imposes restrictions on withdrawal from the membership and cancellation of the contract

**(V) Where a contract may be invalid because the content of the contract itself does not comply with the public order**

A contract containing contents that do not comply with the public order is invalid (Article 90 of the Civil Code). If a contract is invalid, there is no legal obligation to pay any bill charged pursuant to those invalid provisions.

Example of cases where a contract may be invalid because it does not comply with the public order

- In light of commercial practice, the amount of consideration payable is so outrageous for the services provided that it does not comply with the public order
- The transaction in itself is illegal, such with as the sale of obscene items or images infringing copyrights

## **(VI) Where a contract may be canceled due to fraud**

If a business entity operating the one-click business entity misleads the offeror into declaring an intention to offer to execute a contract, taking advantage of his/her miscomprehension, the offeror is allowed to claim for cancellation of the contract on the grounds of fraud (Article 96 of the Civil Code).

## **(VII) Where a contract may be canceled because the offeror is a minor**

If the offeror is a minor, in principle, the offeror may cancel the contract and the effectiveness of the contract may be denied (Article 5 of the Civil Code). However, there are cases where the contract may not be canceled on the ground of "fraudulent means" set forth in Article 21 of the Civil Code, depending on the way the offeror responded to the confirmation of age on the screen. If a contract is canceled, the contract will lose effect retroactively (Article 121 of the Civil Code), and thus there is no legal obligation to pay any bill, because there is no basis for billing.

### Example of cases where an offeror may cancel a contract because that the offeror is a minor

- It had not been confirmed whether the offeror was a minor or not prior to the one-click.
- When the browser merely requires a click of "Yes" or "No" to the question, "Are you of age" or "Are you 18 or older?" (See "PART 1: 1 (5) Expression of Intention by a minor", [1. Approach] (Case where a minor would be permitted to rescind))

### [Explanations]

#### **(1) Problem Identification**

One-click billing is a kind of fraudulent billing whereby the business entity attempts to swindle money by billing the offeror, misleading him/her into believing that the contract has duly been concluded. In many cases, the contract has not been concluded or the contract is invalid or may be canceled. The person who clicked once, feeling that he/she is involved due to his/her own act of clicking, tends to pay such bill because he/she believes that the contract has been duly concluded.

We will herein analyze cases where there would be no legal obligation to pay the bill.

#### **(2) Where no contract has been concluded**

A contract is concluded if the declarations of intention to offer and accept are identical. An offer means a declaration of intention to conclude the contract if the counterparty declares its intention to accept the offer as it is. However, in the case of one-click billing, there are cases

where the one-click may not be regarded by users as an offer to conclude a contract. In this case, no declaration of intention to offer to conclude a contract exists, and thus no acceptance thereof exists. Therefore, no contract has been concluded in such a case.

Typically, there are cases where there is no indication anywhere that clicking the button will lead to an offer to execute a contract. Also, even where such indication does exist, if such indication is placed at a hard-to-find location on the browser, then a court may find that an offer to conclude a contract does not really exist.

### **(3) Cases where a contract will be invalidated on the ground of miscomprehension**

Where the offeror has misunderstood of the elements of a contract, the offeror may reasonably argue that the contract is invalid on the ground of his/her miscomprehension, unless the offeror was grossly negligent (Article 95 of the Civil Code). However, if the business entity operating the one-click billing system deliberately anticipates that the offeror would make an error by clicking through the system, it is highly likely that the offeror will be allowed to argue that his/her declaration of intention is invalid on the grounds of miscomprehension, irrespective of whether he/she was grossly negligent. Protecting the position of the counterparty is the purpose of barring the grossly negligent offeror from asserting the invalidity of his/her declaration of intention on the ground of miscomprehension. However, the business entity operating the one-click system has deliberately anticipated such miscomprehension and does not need to be protected. Furthermore, in an electronic consumer contract, if the offeror erroneously clicked the purchase order button even though he/she had no intention of accepting the contract, the offeror may assert the invalidity of his/her declaration of intention on the ground of miscomprehension, irrespective of whether the offeror was grossly negligent, unless the business entity took measures to confirm the contents of the acceptance (Articles 2 and 3 of the Electronic Contract Law).

Separately from the effectiveness of the contract, if a vendor or service provider attempted to force a customer to conclude a purchase agreement or a service contract against his/her will, the Minister of Economy and Trade is authorized, pursuant to Article 14 of the Specified Commercial Transaction Law, to order that certain measures be taken, if the business method is unfair and the interests of the purchaser may be impaired.<sup>3</sup>

Therefore, the order provided for in Article 14 of the Specified Commercial Transaction Law may be applicable to cases where the business entity conducting the one-click billing is a vendor or service provider that handles products, etc. designated under the ordinance and regulated under the Specified Commercial Transaction Law, if, for example, the website browser where the one-click billing takes place does not (1) indicate that clicking a button

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<sup>3</sup> See "Duty to Design an Easy-to-Understand Application Screen for Internet Trading" herein.



leads to an order for a payable service in a manner easily noticed by the consumers or (2) take measures to ensure that consumers can confirm the contents of their offer and correct them if necessary at the time of dispatching the order.

**(4) Cases where a contract is invalid because some provisions therein do not comply with the Consumer Contract Law**

If a contract is classified as a consumer contract (Article 2 of the Consumer Contract Law), any contractual provisions that do not comply with any of Articles 8 through 10 of the Consumer Contract Law is invalid.

In one-click billing, there are cases where the business entity, at the time of billing, may make a claim for timely payment by threatening that a large amount of damages or fees for delay would be charged in the case of delayed payment by the customer. However, Article 9, Item 2 of the Consumer Contract Law provides that, with respect to a consumer contract, any pre-agreement or provision on penalties is invalid to the extent it exceeds 14.6%. Further, Article 10 of the Consumer Contract Law provides that any provision unilaterally undermining the consumer's interests is invalid.

**(5) Where a contract may be invalid because the contents of the contract are incompatible with public order**

If the contents of a contract are incompatible with public order, such contract is invalid (Article 90 of the Civil Code). If the service charge for viewing images is an outrageously large amount in light of commercial practice, it may be considered as an act of extortion of profit and thus not complying with public order. In addition, where the transaction contemplated in the contract is in itself illegal, such as in the case of a sale of obscene items (Article 175 of the Criminal Law) or images to which copyrights have not been properly handled by licensing, such contract may be invalid on the ground of non-compliance with public order.

**(6) Where a contract may be canceled on the ground of fraud**

If a business entity operating the one-click business entity misleads the offeror into declaring an intention to offer to execute a contract, taking advantage of his/her miscomprehension, the offeror is allowed to claim for cancellation of the contract on the grounds of fraud (Article 96 of the Civil Code).

Whether the business entity operating the one-click billing is regarded as having deceived the offeror could be judged by conducting a detailed analysis of the wording or layout of the

e-mails or websites that induced the offeror into executing the contract as well as the wording or layout used for billing.

**(7) Where a contract may be canceled because the offeror is a minor**

If the offeror is a minor, in principle, the offeror may cancel the contract and the effectiveness of the contract may be denied (Article 5 of the Civil Code). However, there are cases where the contract may not be canceled on the ground of "fraudulent means" set forth in Article 21 of the Civil Code, depending on the way the offeror responded to the confirmation of age on the screen.<sup>4</sup>

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<sup>4</sup> See "Expression of Intention by a Minor" herein.

(5) Effects of Expression of Intention by a Spoofer on the Victim

[Issue]

When might the victim of “spoofing” (internet identity theft) have to bear any responsibility?

[Approach]

**(I) Problems concerning settlements in internet trading**

In Internet trading, spoofing (“*nari-sumash-koi*”) poses the most significant problems at the settlement stage. In particular, when the consumer buys a product from one party and provides consideration to another, for example, through credit card or Internet banking settlements. Complex problems can arise due to the legal relationships existing between the multiple parties.

The main problems concern (i) whether a contract had actually been executed between the person whose identity was stolen and the seller (e.g. was a legal relationship created between them?) and (ii) whether a settlement agency (a credit card company or bank) can request the victim of identity theft to pay a fee or whether a remittance made according to the instructions of the spoofer is valid (i.e. what is the status of the legal relationship between the identity theft victim and the settlement agency).

**(i) Was a sales contract formed between the identity theft victim and the seller?**

**(A) Cases where there is no prior agreement on how to identify users (one shot transaction)**

When there exists no prior agreement on how to identify users, the expression of intention by a spoofer does not belong to the identity theft victim. Thus, no contract has been formed between the identity theft victim and the seller.

However, where the requirements prescribed by the Civil Code for an apparent representation (“*hyoken-dairi*”) are met: (a) a plausible appearance; (b) the counterparty acted without fault and in good faith; and (c) the identity theft victim is at fault, there are cases which have held that the expression of intention by a spoofer belongs to the principal as the requirements for apparent agency have been fulfilled (Articles 109, 110, and 112 of the Civil Code), and consequently a contract was formed.

Example of Cases where identity theft victim was found a party to the contract

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Example of Cases where identity theft victim is unlikely to be considered as a party to the contract

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(B) Cases where there exists a prior agreement about how to identify users (continuing transactions)

In the case of continuing transactions, a prior agreement is usually reached about how to identify users, such as through specific IDs or passwords. In this case, if the identification method agreed upon is properly effected, in principle a contract exists between the identity theft victim and the seller<sup>5</sup>.

However, in cases where, although a user (identity theft victim) had agreed to the identification system provided by the vendor, the user was not aware of the degree of system security and where the security level is considerably lower than what the person would have reasonably expected, then the effects of the prior agreement could be denied. In addition, a prior agreement may be considered invalid if the user is a consumer and if the consumer exclusively bears the risks of being bound to the contract irrespective of whether the user acted without fault. In such cases, the rule in (A) will apply.

Example of Cases where a prior agreement may be considered invalid

- Where the agreement stipulates that the effects of an expression of intention by a spoofer belong to the identity theft victim (consumer) irrespective of whether the identity theft victim (consumer) is actually at fault, so long as the other party (seller) properly verifies the personal identification information, (e.g.) ID or password.
- A prior agreement on a personal identification method was reached without any agreement on a concrete security system. Due to the sub par security system established by the seller, there existed a strong likelihood of leakage of information related to personal identification.
- There are no cautionary notice or preventive measures against setting a personal ID or a password that third parties may be able to predict with relative ease.

Example of Cases where a prior agreement may be considered valid

- Data is transmitted after being encoded by SSL and the comprehensiveness of the security system established by the seller is so complete that there exists very little likelihood of data leakage.
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<sup>5</sup> Where a large quantity of IDs and passwords are leaked from the business entity's server or where the employees working for the business entity brought out such IDs or passwords, the business entity may not be entitled to claim the effect of such pre-agreement on the identification method against the principal.

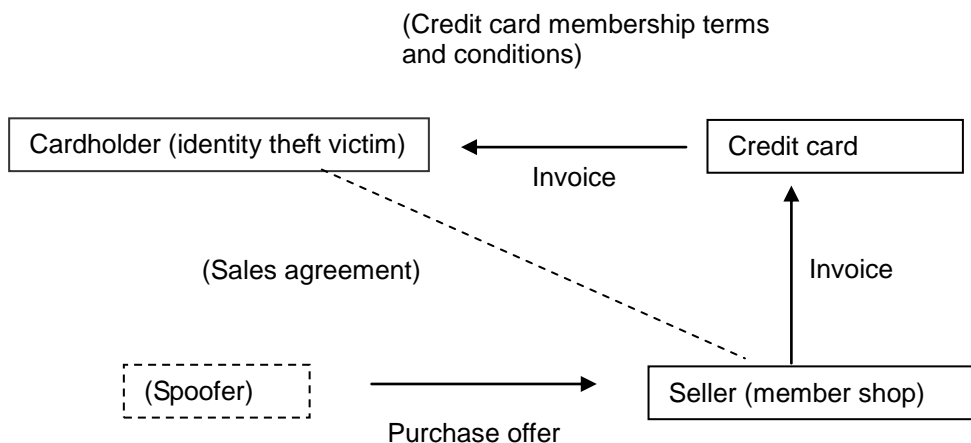
(ii) **Do victims of identity theft have an obligation to pay settlement institutions?**

(A) Credit card

When the payment method is a credit card, such as in internet trading, the transaction is conducted by inputting the credit card number, expiry date, and other details. When spoofing is committed in such cases, is the identity theft victim (card holder) obliged to pay the fraudulently charged amount?

According to existing credit card membership terms and conditions, an identity theft victim (card holder) is not obliged to pay the fraudulently charged amount or damages, except where the test for an apparent representation relationship has been fulfilled or where the identity theft victim (card holder) is at fault, for example, because of a violation of credit card membership terms and conditions.

According to existing regulations and practices, the following relationships hold:



(a) Cases where the identity theft victim is at fault

In these cases, the victim was obliged to pay the fraudulently charged amount or damages.

The credit card company or the insurance provided by the card membership agreement usually indemnify the victim. However, in cases where the victim was aware of the spoofing or was unaware due to gross negligence, or where the victim was deemed to be seriously at fault by allowing a relative to use the card, the victim will not be indemnified. Where the card is used by an unauthorized third party, the card company will investigate the case and may refrain from invoicing the victim.

Example of Cases where the identity theft victim is responsible

- The relative or cohabitant of the cardholder used his card.
- A person, to whom the cardholder lent his card, used it.
- A cardholder disclosed his credit card information, such as the card number and expiration dates, to other persons, and subsequently such information was improperly used.
- In addition to the credit card, the spoofer was aware of the appropriate ID, password, or similar verifying information that should have been kept secret from others.

(b) Cases where the identity theft victim is not at fault

In these cases, the victim is not obliged to pay the fraudulently charged amount or damages.

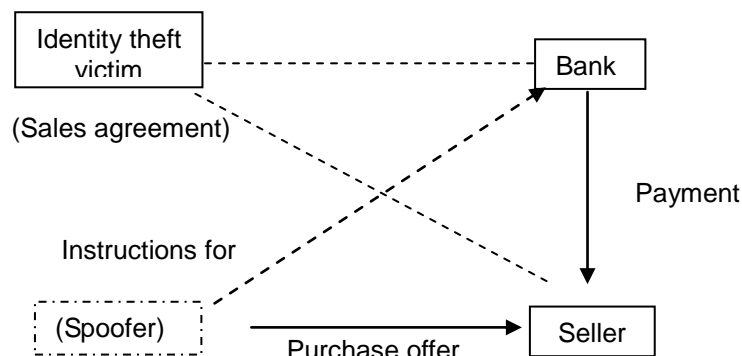
Example of Cases where the identity theft victim is not responsible

- Although the credit card number and the expiry date were fraudulently used, the identity theft victim had properly managed and stored the credit card, credit card number, and other sensitive information.
- Information necessary for credit card transaction was leaked from a member shop and was improperly used.
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(B) Internet banking

Where a customer uses an internet banking system as a method of settlement, a spoofer, in addition to deceiving the seller in the internet trading transaction, steals the identity of the customer from the instruction of remittance to the bank.

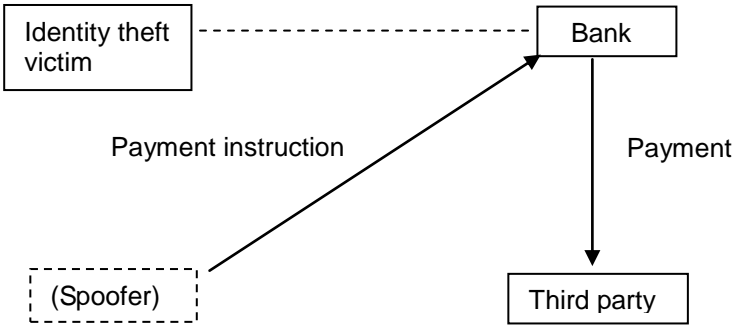
According to banking practices, if a customer agrees to a personal identification method which is incorporated as a general clause into a contract (banking clauses) and if the agreed identification method had been used at least one time previously, a remittance is valid so long as the personal identification method is properly performed even when effected by a spoofer. The validity of these clauses is judged by assessing the level of the security system of the bank. Based on existing technology, the following relationships will hold:



<p><u>Example of Cases where a disclaimer in the banking clauses is considered valid</u></p> <ul style="list-style-type: none"> <li>• Multiple passwords are used for personal identification, and data is transmitted after being encrypted using SSL.</li> <li>•</li> <li>•</li> </ul>
<p><u>Example of Cases where a disclaimer in the banking clauses is considered invalid</u></p> <ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> </ul>

**(II) Fund Transfer problems in Internet Banking**

A problem occurs when a spoofer, falsely representing himself as another person, orders a fund transfer through internet banking. Is the fund transfer made from the account of the identity theft victim valid?



According to banking practice, if a prior agreement on a method of personal identification which is incorporated as a general clause into a contract (banking clauses) and if the agreed identification method is properly performed, a fund transfer made even according to the instructions of a spoofer are treated as valid. The validity of these clauses is judged by assessing the level of the security system of the bank. Based on existing technology, this problem is considered as follows:

<p><u>Example of Cases where a disclaimer in the banking clauses is considered valid</u></p> <ul style="list-style-type: none"> <li>• Multiple passwords are used for personal identification, and data is transmitted after being encrypted using SSL.</li> <li>•</li> <li>•</li> </ul>
<p><u>Example of Cases where a disclaimer in the banking clauses is considered invalid</u></p> <ul style="list-style-type: none"> <li>•</li> <li>•</li> </ul>

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### **(III) The Relationship between the Principal and a Members-only Paid Website**

If a spoofer uses a service provided on a members-only paid website, falsely representing himself as a registered member of the site, will such member (victim of the spoofer), be obligated to pay any fees charged by the business entity providing the service on the website?

In regard to this type of service, generally, the terms and conditions would, at the time each user is registered as a member of the site, set forth the method of identification used by the business entity providing the service.

In this case, as explained in (I) above, if the pre-agreed method of identification was employed by the spoofer, the victim will generally be obligated to pay any charges etc. However, such pre-agreement on the method of identification might not be considered effective if the victim, entered into such pre-agreement unaware of the level of security of the service provider's identification system, and such level is considerably inferior to a reasonably expected level.

[Explanations]

#### **1. Problem identification**

In electronic commerce, where parties carrying out a transaction never meet face-to-face, it is easy for an unauthorized person to make a transaction by wrongly using the name of another. Developments in electronic signatures, authentication methods, and other systems which specialize in verifying personal identification methods are expected to reduce the danger of spoofing. However, when an act of spoofing is committed, are there any cases where the identity theft victim, is legally responsible for the transaction executed by the spoofer?

This section will discuss problems in internet trading (especially problems in the settlement stage), where spoofing is likely to cause many problems in electronic commerce and internet banking as well as the problems arising in respect of paid websites on the internet.

#### **2. Problems in internet trading**

In internet trading, spoofing poses the greatest risk at the settlement stage.

In particular, when a consumer buys a product from a seller and pays the fee to another, as is common in credit card or internet banking settlements, complex problems can arise concerning the legal relationships between the multiple parties.



The problems concern (i) whether a contract is formed between the identity theft victim and a member shop (seller) (i.e. whether a sales agreement was executed between the victim and the seller); and (ii) the legal relationship between the victim and the settlement agency (credit card company or bank) (e.g. whether a settlement agency can request the victims to pay for the fraudulently charged amount or whether a fund transfer ordered by the spoofer is valid).

**(1) Legal relationship between the victim of the identity theft and the seller**

(i) Principles (Cases where there is no prior agreement)

Except when a third party has the power to represent the principal, the effects of an expression of intention made by a third party do not belong to the principal. However, the Civil Code has provisions on apparent representation (Articles 109, 110, and 112). These provisions can attribute the effects of an expression of intention made by a third party, with no power of representation, to the principal if the following requirements are met: (X) the third party appears to legitimately have the power of representation; (Y) the counterparty acted without fault and in good faith; and (Z) the identity theft victim is at fault. Requirements (Y) and (Z) ensure a balancing of the concerns of the counterparty and the victim by considering factors affecting both sides. The principle of apparent representation applies where the counterparty to a transaction believed that an unauthorized agent had the power of representation. Consequently, apparent representation does not directly apply to cases of simple spoofing. However, case law has held that Article 110 of the Civil Code should apply to cases where an agent (who, as determined by the court, had certain basic powers of representation) performed an unauthorized act as a principal and the counterparty believed in good faith that it was the act of the principal (Judgment of the Supreme Court of Japan, 2<sup>nd</sup> Petty Bench, December 19, 1969, 23-12; 2539 *Minshu* 2539).

In electronic commerce, it should be possible to attribute the effects of an expression of intention made by a spoofer to the identity theft victim, if, on application of the clauses for apparent representation, the spoofer was given certain basic powers of representation or the victim was at fault.

(ii) Cases where there is a prior agreement

Parties who have a continuing legal relationship often conclude in advance a special agreement (basic agreement), which stipulates the requirements to have the effects of an expression of intention made by an unauthorized agent attributed to the principal, including the method of identifying the principal. As long as the identity of the principal is verified according to the prearranged method, for example, the provision of a

password, the effects of an expression of intention made by the unauthorized agent will belong to the principal. If such basic agreements are always considered valid, the following problems will arise.

Under the principle of “Freedom of contract” (“*keiyaku-jiyu*”), contracts between parties at arm’s length, as in a Business-to-Business transaction, should be valid as concluded.

However, where a user is not aware of the sophistication of the verification system utilized by the seller, and where the actual sophistication of the security system is considerably lower than the user would reasonably expect, the validity of the prior agreement may be denied. For example, if a prior agreement is formed on the assumption that the level of the security system is reasonable, then it will be difficult for the seller to assert that the effects of a transaction made by an unauthorized person should be attributed to the principal by virtue of the prior agreement (thus demanding the conclusion of the transaction), if such system is proved insufficiently secure. A security system in this context means not only the narrow sense, such as the use of a firewall and the encryption of any transmitted data, but also the manner in which customer information is managed, including a system that may prevent users from setting a password that may be easily predicted by third parties if it is used as a method of identification.

Where the user is an actual consumer, he may himself/herself be unable to fully evaluate how reasonable a security system is. Further, the security system is usually unilaterally specified by the seller; the consumer has no choice. In such cases, therefore, prior agreements which declare that the effects of a transaction made by an unauthorized person are always attributed to the principal, irrespective of whether the principal is at fault, may be judged invalid under Article 10 of the Consumer Contract Act or Article 90 of the Civil Code.

## **(2) Legal relationship between the identity theft victim and a settlement agency**

### **(i) Credit card**

The sales agreement between the identity theft victim (card holder) and the seller (member shop) is separate from the credit card agreement between the card holder and the credit card company. Therefore, the settlement between the card holder and the credit card company should be examined separately from the validity of the sales agreement.

When credit cards are used for settlements in internet trading, settlements are usually made by entering the credit card number, the expiry date, and other details. When

spoofing is committed in this situation, the question arises whether the card holder is obliged to pay the fraudulently charged amount under the membership terms and conditions concluded between the card holder and the credit card company.

Under most of the existing credit card membership terms and conditions, the card holder is not obliged to pay a fraudulently charged amount except where an apparent representation relationship exists or where the card holder is considered to be at fault, such as, where the card holder violated the credit card membership terms and conditions.

Summarized below are some common credit card membership terms and conditions.

A card holder has a duty to manage and keep his credit card and PIN number carefully. If he fails to fulfill his duty to be a good administrator or is otherwise at fault, he must indemnify the credit card company for the amount improperly charged. A card holder must also indemnify the credit card company for fraudulent charges on his credit card, if his card was improperly used after being carelessly lost or stolen. Even where the card holder is obliged to indemnify the credit card company, those payments are usually covered by the credit card company or by insurance included in the card membership agreement, except where the card holder was aware of the spoofing or whose ignorance was a result of gross negligence or who was seriously irresponsible, or where his card was not properly used by his family member or affiliate.

In conclusion, unless the card holder has failed to fulfill his duty to be a good administrator or is otherwise at fault, he is not obliged to indemnify the credit card company for any fraudulent charges. Conversely, where the card holder has failed his duty to be a good administrator or is otherwise at fault, he must indemnify the credit card company for any fraudulently charges. In practice, however, the card holder is not actually required to make any indemnity payments unless he is seriously culpable, for example, where he was aware of its fraudulent use or was only unaware of the fraud because of his gross negligence. In transactions where signatures are not required, such as internet transactions, if the card is used by an unauthorized third party, the card company will investigate the case and may refrain from invoicing the card holder.

(ii) Internet banking

Where a customer uses an internet banking system as a method of settlement, a spoofer, in addition to deceiving the seller in the internet trading transaction, steals the identity of the customer from the instruction of remittance to the bank.

According to current banking practice, if a prior agreement exists regarding how personal identity is verified and, if that personal identity authentication method is

properly performed, the bank is not held responsible for a fund transfer made according to the instructions of a spoofer.

Judgment of the Supreme Court of Japan, 2<sup>nd</sup> Petty Bench, July 19, 1993, 1489 *Hanrei Jiho* 111, is the leading case regarding the validity of clauses in general contractual conditions (banking clauses) concerning fund transfers to an unauthorized person. This judgment confirmed the legitimacy of these banking clauses, stating, “In cases where a person other than the account holder withdrew an amount from the account of the account holder using a bank-installed ATM, so long as the genuine cash card received from the bank by the depositor was used and the correct PIN number was entered, the bank is exempted from any responsibility by the disclaimer clause except where there exist any special circumstances such as the inadequate management of the PIN number by the bank.”<sup>6</sup> It is noteworthy that this judgment refers not only to the disclaimer clause but also to the security of the remittance system adopted by the bank at the time when the accident occurred.

If a similar accident occurs in the future, the validity of the disclaimer in the banking clauses would be determined by evaluating whether the sophistication of the security system has caught up to the generally accepted standard at the time the subsequent accident occurs.

Assuming that current technology is employed, it is highly likely that any clause will be judged valid if multiple passwords are used in the personal identification method and if data is transmitted after being encrypted by SSL.

### **3. Problems in internet banking**

If a third party, fraudulently using the account of another person, instructs the bank through internet banking to perform a fund transfer, is the fund transfer, fraudulently ordered from the account and executed by the bank, valid?

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<sup>6</sup> “The Act on Protection of Depositors against Unauthorized Withdrawal of Money with Forged or Stolen Cards by Mechanical Process” (the so-called “Depositors Protection Act”, “*gizo card nado oyobi tounan card nado wo mochiite okonawareru fuseina kikaishiki yochokin haraimodoshi nado kara no yochokinsha no hogo ni kansuru houritsu*” in Japanese), which came into effect in February 2006, provides that a financial institution that issued a cash card shall, in principle, indemnify the whole of a depositor’s damages if his/her deposit is withdrawn or borrowed with such card, whether forged or stolen, as a result of its unauthorized use with an automatic cash dispenser (ATM). However, if the depositor is considered slightly negligent, 75% of his/her damages will be indemnified. If the depositor is considered grossly negligent, the depositor shall not be indemnified at all.

#### **(1) Cases where no prior agreement exists**

Article 478 of the Civil Code applies to any payment made to a person who has no authority to receive it. According to this provision, the payment is valid if (i) the person appeared to be the creditor; and (ii) the payor did not know through no fault of his own that the payee was not the creditor. This applies to electronic fund transfers as well.

#### **(2) Cases where a prior agreement exists**

As mentioned in [Explanations] 2.(2)(ii) above, according to common banking practices, if a prior agreement regarding personal identification is incorporated into the general contractual conditions (banking clauses), and if the identification method is properly performed, the bank is not held responsible for any fund transfer made according to the instructions of a spoofer. The validity of this banking clause has already been discussed.

#### **4. Problems in Paid Websites**

Where a spoofer uses services provided on paid websites such as internet auctions or internet games, which are reserved for pre-registered members, will the principal, the victim to the spoofer, be obligated to pay the charges etc. for the business entities providing such services on the website?

Generally, those who wish to use this type of service will, at the time they are registered as members of the website, pre-agree with the service provider on the method of identification in the terms and conditions. The effectiveness of such pre-agreement can be analyzed by the analogical reasoning referred to in [Explanations] 2 (1) (ii) above. In this case, if the service provider uses the method of identification that was pre-agreed on by the members of the website, the principal (the victim to the spoofer) will be obligated to pay the charges etc, even if a spoofer used the service by misrepresenting his/her identity. Therefore, for example, where there is a pre-agreement between the parties on the method of identification based on the assumption that the service provider's system is reasonably and sufficiently secure, if such system is actually less secure than expected and consequently an unauthorized spoofer carried out a transaction, the seller will not be entitled to demand that the principal perform the obligations accruing from the transaction on the grounds that they belong to the principal on the basis of the pre-agreement on the method of identification. For details concerning the security system and the effectiveness of the pre-agreement with consumers, see [Explanations] 2 (1) (ii).

(6) Responsibilities of Verification Authority against Spoofing

[Issue]

If an act of spoofing is attributable to the inadequate verification method employed by an electronic signature verification authority (“*Denshi-shomei-ninshô-kikan*”), what responsibility does the verification authority have to persons who suffer damage as a result of relying on the certificate of verification?

(Example) Based on a flawed personal identification method, an electronic signature verification authority issued a certificate of electronic verification to a third party who misrepresented himself as another person (principal). Although the innocent party to the transaction, who received the certificate from the spoofer, believed that the spoofer was indeed the principal, the transaction is not attributed to the principal causing the innocent party to suffer damage. What, if any, responsibility does the certification authority have to that innocent party?

[Approach]

**(I) Cases of inadequate personal identification**

**(i) Principle: Tort liability**

Where an electronic signature verification authority issues an electronic certificate without adequately verifying the identity of the person, if a counterparty receives and relies on the certificate but ultimately suffers damage because the spoofer’s transaction is not attributed to the principal (nominee of the electronic signature), the verification authority is tortiously liable to the innocent recipient of the certificate. In this case, the counterparty (recipient) must prove negligence of on the part of the verification authority (an inadequate identification method).

(Cases where identification of a nominee is sufficient)

- Where an identification of a nominee is made with ordinary due care, based on a laminated personal identification card issued by the governmental authorities bearing an official seal stamped at the border of the identifying photograph with the appropriate seal impression.
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(Cases where identification of a nominee is insufficient)

- Where an identification of a nominee is made with a personal identification card which appears obviously counterfeit.
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**(ii) Exception: Contractual liability**

Since there is usually no contractual relationship between the verification authority and the counterparty (recipient), the verification authority, in principle, bears no contractual liability.

However, in cases where a verification authority shows the terms applicable to the recipient (hereinafter referred to as the “Recipient Terms”) or the Certification Practice Standards (CPS) where a verification authority provides a certification, and the recipient consents to the Recipient Terms/CPS, a contractual relationship might be formed between them. The requirements of a contractual relationship between a verification authority and a recipient are similar to the requirements in a contractual relationship created according to a Website Terms of Use agreement (e.g.) accessibility to the provisions of the agreement terms (See [Issue] “(2) Effectiveness of Website Terms of Use”); there are many arguments for additional requirements. If a contractual relationship is formed, the verification authority must abide by the Recipient Terms/CPS. In such case, if the identification procedure of the verification authority does not follow the procedures specified in the Recipient Terms/CPS, it will be contractually liable for any failure. In this case, the verification authority bears the burden of proving that it is not at fault.

Cases where a contractual relationship is formed

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Cases where no contractual relationship is formed

- Where the recipient is not required, upon examining the effectiveness of the certificate, to agree to the terms of the CPS etc., which are simply presented to the recipient.
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**(II) Validity of a disclaimer of a verification authority**

Verification authorities do attempt to limit their liability to compensate innocent parties by inserting disclaimer clauses into Recipient Terms /CPSs. The validity of these clauses will be discussed.

**(i) Where no contractual relationship exists between the recipient and the verification authority**

The disclaimer clause does not bind any of the parties concerned.

**(ii) Where a contractual relationship exists between the recipient and the verification authority**

In principle, the disclaimer clause binds the parties concerned.

However, in consumer contracts, the disclaimer clause of a verification authority is invalid if it totally exempts or partly exempts the verification authority from any liability to compensate damages to an innocent party which resulted from the non-performance of an obligation or from a tort, or where the verification authority acted illegally or breached the contract deliberately or with gross negligence (Article 8 of the Consumer Contract Act). There are naturally other cases where the validity of a disclaimer clause can be called into question due to various factors.

Cases where the disclaimer is considered valid
<ul style="list-style-type: none"><li>•</li><li>•</li><li>•</li></ul>
Cases where the disclaimers is considered invalid
<ul style="list-style-type: none"><li>•</li><li>•</li><li>•</li></ul>

[Explanations]

**1. Tort liability**

Where an electronic signature verification authority issues an electronic certificate without adequately verifying the identity of the person, and another party receives and relies on the certificate but ultimately suffers damage because the spoofer's transaction is not attributed to the principal (the electronic signature nominee), the certification authority is tortiously liable to the innocent certificate recipient.



Conversely, where the transaction is attributed to the principal, the certification authority is tortiously liable to the principal, who has suffered damage in principle.

In the case of tortious liability, the party suing for damages must prove negligence on the part of the certification authority.

## **2. Contractual liability**

There is usually no contractual relationship between the certification authority and the recipient or the principal. Therefore, the certification authority bears no contractual liability in principle. However, some commentators argue that in cases where a verification authority shows the applicable terms to the recipient (hereinafter referred to as the “Recipient Terms”) or the Certification Practice Standards (CPS) when the verification authority provides the recipient with a certification, and the recipient consents to the Recipient Terms/CPS, a contractual relationship might be formed between them. If a contractual relationship is formed, the verification authority must abide by the Recipient Terms/CPS. In such case, if the identification procedure of the verification authority does not follow the procedure specified in the Recipient Terms/CPS, it will be contractually liable for any failure. In this case, the verification authority bears the burden of proving that it is not at fault.

## **3. Validity of the disclaimer**

As damages in the electronic commerce business can be significant, some Recipient Terms/CPSs include disclaimers for the verification authorities (e.g. “The verification authority shall not compensate any recipient for damages resulting from reliance on the validity of an electronic certificate issued above the sum of ¥1,000,000”). On this point, one must first examine whether there is a contractual relationship (or a disclaimer agreement) between the recipient of an electronic certificate and the verification authority. Furthermore, even if there is such a relationship or agreement, the disclaimer of a verification authority is invalid if it totally exempts or partly exempts the verification authority from any liability to compensate damages to an innocent party which resulted from the non-performance of an obligation or from a tort, or where the authentication authority acted illegally or breached contract deliberately or with gross negligence (Article 8 of the Consumer Contract Act). There are naturally other cases where the validity of a disclaimer can be called into question due to various factors.

(7) Expression of Intention by a Minor

[Issue]

When a party to an electronic contract is a minor, in principle, he can deny the validity of the contract by revoking his expression of intention (Article 4 of the Civil Code). However, depending on how the minor responds to the age confirmation screen, are there cases where the minor is not permitted to rescind his expression of intention by Article 20 (fraudulent means) of the Civil Code?

(Example) In internet trading, if a minor buys a product by submitting a false date of birth in order to pretend that he is of age, can he avoid paying the price by repudiating the contract?

[Approach]

In an electronic transaction, if a minor intentionally enters a false date of birth at a company's age confirmation screen, and if, as a consequence, a company supposes that he is of age, the minor may be deprived of the right to rescind his expression of intention by Article 20 of the Civil Code.

Case where a minor might not be permitted to rescind

- A company actively confirms the age of anyone entering transactions and warns that parental consent is required for minors to conclude contracts.
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Case where a minor would be permitted to rescind

- The screen simply asks, "Are you of age?" and prompts the minors to click on "Yes".
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[Explanations]

**1. Principle**

A minor may rescind an expression of intention given without parental consent (Article 4 of the Civil Code).

In face-to-face transactions, it is fairly easy for a counterparty to assess whether an offeror is a minor by his appearance, e.g. by physical appearance, or by asking him to present an identity card. In electronic transactions, there exists a greater risk than in other types of transactions that minors can enter into contracts irrespective of their minor status. In consideration of the sanctity of contract, some argue that laws regarding the legal capacity of minors should apply more narrowly in electronic transactions. However, this is a common problem found in all types of remote transactions. Therefore, there is no reason to treat electronic transactions as exceptions.

## **2. Restriction on the right to rescind**

Article 20 of the Civil Code provides that if a minor uses a fraudulent means to make a counterparty to a transaction believe that he is of age or has the consent of his guardian, he may not rescind his expression of intention. The use of a fraudulent means is not limited to cases where a minor actively misleads a counterparty to mistakenly acknowledge his capability. This includes cases where a person whose capacity is limited causes the counterparty to form a mistaken belief or to strengthen a mistaken belief by using speech or behavior that is usually considered deceptive (Judgment of the Supreme Court of Japan, 1st Petty Bench, February 13, 1969, 23-2 Minshû 291).

Therefore, in general, where a company engaged in electronic commerce has taken reasonable measures to confirm the age of its customers, for example, by providing an age confirmation screen, if a minor intentionally inputs a false age and thus causes the company to mistakenly believe that he is of age, he may be deprived of his right to rescind.

The fact that a minor responded that he is of age is just one factor in determining whether a fraudulent means was employed. Other factors normally considered are the character of the transaction, the nature of the product, and the screen configuration (whether the screen is intentionally designed to draw out specific answers).

At any rate, it is difficult to completely eliminate the possibility that a minor will repudiate the contract on the grounds of incapability. Therefore, the company should adopt reasonable identification methods in light of the cost of establishing an identification system and the value of each transaction.

(8) Validity of Agreement on Court Jurisdiction

[Issue]

An agreement stipulating the court with jurisdiction has to be made in writing (Paragraph 2, Article 11 of the Code of Civil Procedure). If an online transaction agreement is not made in writing, is it valid?

[Approach]

An online agreement stipulating the court with jurisdiction is valid.

[Explanations]

An agreement stipulating the court with jurisdiction used to be considered invalid, unless it was in writing (Paragraph 2, Article 11 of the Code of Civil Procedure). Therefore, no clause stipulating the court with jurisdiction in the online contract used to be valid.

The amendment of the Code of Civil Procedure in 2004 stipulated a new provision, Article 11 Paragraph 3, pursuant to which the agreement on the competent court by electronic method shall also be deemed to be in writing. Thanks to this explicit provision, an online agreement on the competent court concluded after April 1, 2005<sup>3</sup>, when the amendment became effective, shall be valid. The agreement on the court with jurisdiction can include, among the things, which Japanese jurisdiction can exercise power, and which court in Japan has jurisdiction over the case at first instance.

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<sup>3</sup> According to Article 4 of the supplementary provisions to the amended Code of Civil Procedure, Article 11, Paragraph 3 of the Code of Civil Procedure (including the cases where it is applied mutatis mutandis pursuant to Article 281, Paragraph 2 of the same) shall not be applicable to any agreement on competent court or on waiver of the right for appeal except the final one that was executed before the enforcement of this amended Code of Civil Procedure.

(9) Validity of Arbitration Agreement

[Issue]

If an arbitration agreement in an online transaction is not made in writing, is it valid?

[Approach]

An arbitration agreement in an online transaction is valid.

[Explanations]

Under the Arbitration Law enacted on March 1, 2004, an arbitration agreement must be made in writing (Paragraph 2, Article 13 of the Arbitration Law<sup>4</sup>). However, it also provides that an arbitration agreement completed by electromagnetic record shall be deemed to have been completed in writing (Paragraph 4 of said Article<sup>5</sup>).

Therefore, an arbitration agreement completed in an online electromagnetic record (e.g. exchanging e-mails), where no written form exists, is considered a valid online transaction.

A consumer has the right to terminate the arbitration agreement incorporated into a consumer contract (“Consumer Arbitration Agreement”) as defined by the Consumer Contract Act (Supplementary provision of the Arbitration Law<sup>6</sup>)

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<sup>4</sup> Paragraph 2, Article 13 of the Arbitration Law: The arbitration agreement shall be in the form of a document signed by all the parties, (e.g.) letters, telegrams, or other types of document exchanged between the parties (including those sent by facsimile devices or other communication devices for communication between remote parties, which provide the recipient with a written record of the transmitted content).

<sup>5</sup> Paragraph 4, Article 13 of the Arbitration Law: When an arbitration agreement is made by way of electromagnetic record (records produced by electronic, magnetic or any other means unrecognizable by natural sensory functions and used for data-processing by a computer)

<sup>6</sup> Paragraph 2, Article 3 of Supplementary Provision of the Arbitration Law: Consumer may rescind an arbitration agreement based on his or her legal status as ‘a consumer’. (*translation omitted*)

## 2. Transaction Types unique to Electronic Commerce

### (1) Responsibilities of Cybermall (On-line Shopping) Operator

[Issue]

Are there cases where a cybermall (on-line shopping) operator will be liable to his/her customers for any damage arising from their transactions with a cyber shop administered by the cybermall operator?

(Example) A customer discovers that the product he/she purchased from a shop in a cybermall is defective. The shop has disappeared and the consumer cannot reach the shop. Can he/she demand compensation for damages against the cybermall operator?

[Approach]

#### **(I) Principle: cybermall operator is not responsible**

In principle, the cybermall operator is not liable for damages arising from any consumer transactions with individual cyber shops.

#### **(II) Exception: cybermall operator can still be held responsible**

Where (i) the appearance of the cybermall unavoidably misleads its consumer to believe that the business of the cyber shop is conducted by the cybermall operator himself/herself (presence of an appearance); (ii) the cybermall operator is somewhat responsible for the aforementioned appearance (fault); and (iii) the cybermall consumer executing the transaction had misidentified the cyber shop operator without gross negligence (no gross negligence); the cybermall operator may be liable to the customer, since Article 14 of the Commercial Code might be applied *mutatis mutandis* to the cybermall operator.

In addition, under exceptional circumstances, the cybermall operator may be liable to the customers (i.e. in tort).

Example of cases where the cybermall operator might be held responsible

- Where the customer might reasonably misidentify the cybermall operator as the seller when he/she made the purchases on the cybermall operator's website.
- Where the cybermall operator proactively gives assurances to the quality of a specific product sold by a cyber shop in a feature page with an interview excerpt about such product, and the customer believed in such advertisement and purchased the product. Subsequently, the customer incurred damages arising from the defects in the product.
- The cybermall operator, who is well aware of the frequent occurrence of serious accidents arising from defective products sold on the cyber shop, but unreasonably neglected the issue for a long time, and consequently customers who purchased the same products incurred damages arising from similar accidents.
- 

Example of cases where the cybermall operator will not be held responsible through the analogical application of Article 14 of the Commercial Code:

- Where the cybermall made a disclaimer on his/her or its website which appears on the screen whenever a customer purchases a product and notify the customer that the cybermall operator is not the seller.
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Example of cases where the cybermall operator will not be held responsible for guaranteeing:

- Where the cybermall operator posts advertisements of products and/or cyber shops without stating his/her opinions on their quality.
- Where the cybermall indicates that "this product sells well" or discloses the "ranking" such as the "top 3 for the former half of this year" among products or cyber shops, based on data such as the sum of sales proceeds or popularity votes from the customers.
- Where the cybermall operator shows a customer the products relating to his/her preference and/or products which he/she has purchased based on the total purchase transactions records, etc. without stating the operator's opinions on their quality
- 

[Explanations]

## 1. Problem identification

If a customer suffers any damage from a transaction with a cyber shop operated in a cybermall, he has recourse against the shop by virtue of the existing contractual responsibilities. Does the customer have any form of recourse against the operator of the cybermall as well? Generally, the cyber shop will be liable as the seller for specific transactions between the cybermall operator and its customers. Therefore, the cybermall operator will not be liable for damages arising from the customer's transactions with individual cyber shops. However, where the customers who purchased the products from a cyber shop are likely to misidentify the cybermall operator as the seller, we need to reconsider cases where the cybermall operator may bear certain liability.

## **2. Application of Article 14 of the Commercial Code by analogy**

A judicial precedent exists on point. The case involved a consumer who purchased an item from a tenant shop in a supermarket. The court ruled that since the supermarket fostered an appearance that the shop was operated by the supermarket, by concluding a tenancy agreement with the shop, the company operating the supermarket was as legally responsible as a person who permits another person to use his name, by the analogical application *mutatis mutandis* of Article 14 of the Commercial Code (Judgment of the Supreme Court of Japan, 1<sup>st</sup> Petty Bench, November 30, 1995, p.2972 of *Minshu* Vol.49-9).

The requirements of Article 14 of the Commercial Code are as follows: (i) there must exist an appearance that makes potential customers believe that the nominee operates the business; (ii) the nominee is at fault for allowing the perpetration of the aforementioned appearance by permitting another party to use his name, and (iii) the counterparty believed without gross negligence that the nominee is the operator of the business. In the above mentioned judgment, requirement (ii) was not met; however, the judgment held that any party which allows another to make the aforementioned appearance should be held responsible by virtue of applying *mutatis mutandis* Article 14 of the Commercial Code by analogical interpretation of Article 14 of the Commercial Code.

By analogy to the relationship between a supermarket and its tenant, in the relationship between a cybermall operator and a cyber shop if (i) an appearance exists which caused the customer of the cyber shop to unavoidably mistake the cybermall operator as the seller; (ii) the cybermall operator is complicit in the presentation of the aforementioned appearance; and (iii) the customer had misidentified the identity of its operator without gross negligence when the customer conducted the transaction, then the cybermall operator could be held responsible through the analogical application of Article 14 of the Commercial Code.

Contrastingly, if the cybermall website displays a message, in a form usually recognizable to customers, stating that “each individual cyber shop is operated with self-responsibility by an entity completely independent of the cybermall operator. Except as otherwise expressly stated, is not managed or operated by the cybermall operator or any of its affiliates”, then such a message would be considered a powerful ground for refusing to attribute any responsibility for a transaction to the cybermall operator.

Whether a cybermall operator is held responsible by analogy through the application of Article 14 of the Commercial Code would be judged on the appearance of the cybermall and the way the cybermall is operated and also in consideration of other factors such as the extent



to which the cybermall operator was involved in the business of the cyber shop in question (for example, how sales proceeds are collected, the explicit or implicit permission to use a trade name and the like) to determine how blameworthy the cybermall operator is.

### **3. Other circumstances leading to the cybermall operator's responsibility**

Even where Article 14 of the Commercial Code is not applied *mutadis mutandis* to the cybermall operator, the cybermall operator may be liable to its customers for their damages arising from specific transactions with the cyber shop.

Firstly, under special circumstances, the cybermall operator may be liable for tort and/or for breach of duty of care regarding customers (breach of contractual obligations which derives from the cybermall service agreement). A typical example is in the case where the cybermall operator is aware of the frequent occurrence of serious accidents arising from defective products sold by the cyber shop. Yet it unreasonably neglects the issue for a long time, and consequently a customer who purchased the same products incurs damages arising from similar accidents.

Secondly, the cybermall operator may be liable to customers as a surety in some cases. A typical example is where the cybermall operator not only introduces or provides information about a certain product but also guarantees its quality. Where the cybermall operator posts advertisements of products and/or cyber shops without stating his/her opinions on their quality, the operator will not generally bear the aforementioned liability. Similarly, any of the following acts on its own will not be sufficient to serve as a basis for the operator's liability, because the operator does not give any opinion on the quality of the products in the following cases: (i) to indicate that "this product sells well"; (ii) simply to indicate the "ranking" such as the "top 3 for the former half of this year" of products or cyber shops, based on the data, such as the sum of sales proceeds or a popularity votes from customers; or (iii) simply to show a customer the products relating to his/her preference and/or products which he/she has purchased based on the total purchase transactions records, etc. without stating the operator's opinions on their quality.

## (2) Internet Auctions

In general, internet auctions represent a form of electronic commerce in which people submit bids for products offered on a website during a certain bidding time, where at the end of the bidding time the most valued bid wins.

Transactions in internet auctions may be categorized in forms such as “Business-to-Business,” “Business-to-Consumer,” and “Consumer-to-Consumer.” The form of the transaction is categorized as “Business-to-Business” if both the Exhibitor and the bidder are business entities. The “Consumer to Business” relationship may be formed theoretically but not practically. Also, in such case, the “Business entity” (*“jigyô-sha”*) means the Exhibitors or bidders and does not refer to the brokers who provide the internet auction system (“Auction Operator”).

The Auction Operators (*“auction jigyo-sha”*) participate in transactions in many different ways. In some cases, the Auction Operators may not be involved in the transactions at all, while in other cases, they may be substantially involved in transactions by advertising and endorsing a particular seller or by becoming the actual seller on behalf of the Exhibitors. The successful tender price may go up (or down in reverse auctions) depending on the bids submitted by potential purchasers.

In addition, it seems that some Auction Operators act as brokers of both internet auctions in which the transaction price fluctuates depending on the bids submitted by the potential purchasers and the fixed-price sales on the same website. There are also services ranging from sales of products limited to particular brand products to sales of products having no limitations.

As described above, the business models of e-commerce internet auctions come in many forms and accordingly the legal issues which may arise in connection therewith vary in each case.

**(A) Responsibility of Auction Operator to Users**

[Issue]

Should an Auction Operator bear any liability to a user (including Exhibitors and bidders) who incurs losses in the course of internet auctions, such as non-payment or the non-delivery of goods?

In addition to the above mentioned, what liability does the Auction Operator have to the users?

[Approach]

**(I)** In principle, the Auction Operator bears no liability in any transactional problems between users, if the Auction Operator is not directly involved in transaction; where the Auction Operators simply provide the brokering sales system for individuals.

In exceptional circumstances, if the successful bidders, who have purchased the stolen items, experience claims demanding the return of such items by the original owner and this is attributable to the Auction Operator because it did not stop the bidding although such Auction Operator had been ordered to suspend the bidding by the police commissioner etc., the Auction Operator may be obligated to indemnify the successful bidders.

**(II)** If the Auction Operator is substantially involved in transactions between users beyond simple provision of the brokering system, the Auction Operator may be liable to that extent of his further involvement.

[Explanations]

**1. Problem identification**

As described above (see Part 1, 1(2)), there are various types of internet auctions and the degree of involvement by the Auction Operator in the transactions between the users differs for each type. In general terms, the more the Auction Operator is involved substantially in the transactions, the higher the possibility that the Auction Operator will be responsible for any problems arising from the transactions between the users. If so, specifically for what types of auctions could the Auction Operator be held responsible?

In addition, while the terms of use often provide that Auction Operators may not participate in sales transactions between auction participants, what effect would the limitation of liability prescribed in such rules have?

Other than the troubles arising in connection with the transactions between the users, the responsibility of Auction Operator for maintenance and/or management etc. of systems, for example, may become an issue.

## **2. Legal relationship between Auction Operators and users**

The legal relationship between Auction Operators and users shall be subject to the relevant terms of use, in principle. In internet actions, such agreement is acknowledged by clicking the button “I Agree”, usually upon online registration as a user, after confirming the terms (See [Issue] of “1. (2) Effectiveness of Website Terms of Use” concerning the validity of the terms of use). Also, the system often prompts the users to click an “I Agree” button as to the terms of use upon each internet auction transaction.

If such agreement is concluded, the legal relationships between the users and Auction Operators are governed by such terms of use, in principle. The terms of use usually specify under which circumstances Auction Operators may be held responsible.

However, if the user is a consumer, the Consumer Contract Act applies. If the Consumer Contract Act is applicable, the provisions are invalid which fully (Subparagraph 1, Paragraph 1 of Article 8 of the Consumer Contract Act) or partially (Subparagraph 2 of said Paragraph; however, liabilities raised from the intentional acts or gross negligence of such Auction Operator, its agents, or employees are not discharged at any rate) discharge an Auction Operator from its liability for losses incurred by consumers based on the non-performance of such Auction Operator. For example, if the Auction Operator is substantially involved in the transactions between the users as described in (4) below, any provision which fully discharges such Auction Operator from its liability relating to the transactions may be invalid under Article 8 of the Consumer Contract Act. The liability of the Auction Operators is categorized below based only on the type of transaction where the provisions of the terms of use have been eliminated.

## **3. Liability of Auction Operators who simply provides the sales brokering system for individuals and is not directly involved in the individual transactions**

As specified above, there are various forms of internet auctions. In general terms, the Exhibitors and the successful bidders (in some cases, including the other bidders) take full responsibility for the actual sales, in the internet auctions in which Auction Operators simply provide the sales brokering system for individuals and are not directly involved in the internet

actions. As a result, Auction Operators are normally regarded as having no liability in this regard. In other words, in internet auctions, regardless of “Business-to-Consumer”, “Business-to-Business” or “Consumer-to-Consumer” types, Auction Operators serve as a broker in the transactions by providing the system, however, such Auction Operators are not regarded as a party to the actual sales. In such case, the internet Auction Operators, in general, simply provide the site enabling internet auctions (including fixed-price transactions), and are not directly involved in the formation of any individual transactions. Therefore, Auction Operators are regarded, in principle, as having no liability in regard to transaction-related problems between users (in many cases, there is a provision in the terms of use that the Auction Operator will not be involved in the sales contracts between the auction users and therefore, the Auction Operator is not responsible).

Nevertheless, since an Auction Operators actively supports the infrastructure for the brokering of sales information, in certain cases its scope of the responsibility for the brokerage can be enlarged. In other words, since an auction business provides a venue for transactions, it may be deemed to have a certain obligation to act with due care, although there is no legal consensus on this point. For example, where information is provided by the police commissioner etc. to the effect that goods exhibited on the internet auction site are stolen, an Auction Operator that disregards this information may, based on a violation of the duty to act in good faith and with due care, have an obligation to indemnify the successful bidder who purchases the stolen goods which must be returned to the victim.

#### **4. Liability of Auction Operators who is substantially involved in the transactions between individuals utilizing the auction system**

As described above, in the type of auctions in which Auction Operators simply provide the sales brokering system for individuals and are not substantially involved in individual transactions, Auction Operators do not have any liability related to any specific transactions. However, in the actual internet auction business, Auction Operators may act beyond their capacity as system provider in some cases. The liability of internet Auction Operators in such cases needs to be reviewed separately and specifically in each case by evaluating its capacity and the extent of its involvement. The following is a discussion of some typical cases:

##### **(i) Cases in which Auction Operators actively support the exhibition of a user and receive fees or bidding commissions**

For example, if Auction Operator receive an offer by the user on the phone concerning the exhibition of brand products, which are afterwards shipped to the Auction Operator, and the Auction Operator carries out the exhibition on behalf of such user and receives

fees or bidding commissions in connection with the exhibition, the Auction Operator is regarded as an Exhibitor and not simply as a provider of the auction site. If the Auction Operator acts as exhibit agent on behalf of the actual Exhibitor while the Auction Operator is in a position where it can confirm whether the exhibitions are counterfeits, the Auction Operator may be held responsible to the purchaser for the occurrence of troubles, irrespective of the provisions of the terms of use. In such cases, if the products provided for auction exhibition fall under “used goods” defined under the Antique Dealings Law, the Auction Operator may be subject to the regulations of said Law (For more information, see [Issue] of “(H) Internet auctions and the Antique Dealings Law”).

**(ii) Cases in which an Auction Operator in some manner endorses a particular seller**

If an Auction Operator endorses a particular seller or promotes the sales of a particular seller, or endorses the exhibition of particular goods, the Auction Operator may be held liable in regard to transaction-related problems between users, depending on the form of such endorsement and/or promotion. For example, if an Auction Operator not only posts an advertisement on its website after having collected a certain fee from a particular seller, and also further introduces such seller by displaying its featured pages, where the Auction Operator post interviews etc., and features the particular products of the exhibitions of such seller as a “best buy” or “price buster – recommended products”, it cannot be denied that the Auction Operator will be held responsible for some problems associated with sales.

**(iii) Cases in which an Auction Operator itself is a seller**

In internet auctions held for special events, the name of an Auction Operator may be indicated as the seller of products provided for sale by an individual who wishes to sell his product indirectly through the Auction Operator. However, any monies received in connection with the sale of the product received by the Auction Operator must be promptly transferred to the individual who had his goods sold. In such case, the Auction Operator takes on the responsibilities of the seller, in principle.

**5. Liability of Auction Operator in issues other than problems between users, such as the maintenance and/or management of the system**

Most internet auction sites collect commissions. Regardless of whether such commissions are charged, it can be interpreted that a legal relationship is created between Auction Operators and users (Exhibitors and/or successful bidders etc.) concerning the utilization of the internet auction system provided by the Auction

Operators. This is because in internet auctions, users cannot exhibit goods or participate in biddings unless the users utilize the systems provided by the Auction Operators. Therefore, it is interpreted that the Auction Operators are held responsible to maintain and/or manage the functions of the internet auction system which serves as the infrastructure for the exchange of information between individuals.

**(B) Legal Relationships between Auction Users (exhibitors and successful bidders)**

[Issue]

What is the legal relationship between auction users (exhibitors and successful bidders)? If the goods delivered differ from those specified in the exhibit information of an internet auction, does the successful bidder have the right to nullify the contract or change the terms thereof?

[Approach]

**(I) Cases in which a sales contract has no legal effect**

If there is material discrepancy in the intentions of the seller and the buyer “to sell” or “to buy”, such parties may claim for the invalidation of the contract, unless there has been gross negligence resulting in the discrepancy which is attributable to the party who wishes to invalidate the contract. Also, the contract may be rescinded (“*torikeshi*”) if the parties committed fraud or were compelled to execute the contract. Furthermore, the contract may be terminated (“*kaijo*”) in the event of default or if any latent defects are found in the products.

**(II) Cases in which the buyer may request the goods received be exchanged for other goods**

If there are any defects in the delivered goods which are traded in the market, the buyer may demand the exchange of such goods for defect-free products.

**(III) Cases in which the buyer may claim from the seller monetary compensation**

If the subject item of the transaction is in any way defective or if some obligations have not been performed as required by contract, the buyer may claim a reasonable amount of damages.

[Explanations]

**1. Problem identification**

When a successful bid for goods is accepted in an internet auction, a sales contract is concluded between the exhibitor and the successful bidder at the time a bid is successful.



Specifically, under the sales contract, the seller (exhibitor) and the buyer (successful bidder) bear their own respective obligations (principally, the seller shall deliver the goods as specified in the exhibit terms and conditions and the buyer shall pay the bid amount subject to the bidding terms and conditions). In general, both the exhibitor and the successful bidder have actual intentions to engage in the transaction based on the terms and conditions at the time the bid was successful. Assuming that a contract is not deemed to have been entered into at the time a bid is successful, the parties are not necessarily bound by the terms and conditions thereunder because the details of the terms and conditions of such contract are decided by the negotiations between the parties after the time of bidding.

However, the legal relationship between the parties in the transactions using the internet auction is no different from that of the existing transactions and therefore, the principles of a general sales contract are applied to such transactions. In other words, if the actual intentions of the parties are found to be different from the sales contract formed, a party may claim that such contract be nullified; that the goods be exchanged with other goods; and that the party be compensated by the other party. The following paragraphs will explain when a party may submit the aforementioned claims in line with the principles of a general sales contract.

## **2. Cases where a sales contract may be nullified**

A sales contract arising from an internet auction bid may be nullified when a party claims that the contract was invalid, when the parties claim to rescind the contract although the contract was validly executed and when the parties claim to terminate the contract although the contract was validly executed. If such contract is deemed to never have been formed, the buyer may claim for the return of the amount already paid and the seller may claim for the return of the products delivered.

See below for detailed explanations.

### **(i) Cases where a sales contract may have no legal effect**

In principle, a contract is deemed to have been formed when the intentions of the seller and buyer “to sell” or “to buy” are presented and accepted each of the respective parties. If the intentions presented to the other parties differ in material respects to the actual intentions of such parties (“fundamental mistake”), such parties may claim, in principle, that the contract was never actually formed (Article 95 of the Civil Code). In general, material discrepancy means that the discrepancy (mistake) concerns the expression of intention and in which case it can be clearly deduced that in accord with the judgment of a normal person the party made no such intention (to sell or to buy) by virtue of the

existence of the discrepancy. What constitutes a material discrepancy differs in each case.

For example, if there is discrepancy in the year when the product was made, and if it is especially important for the buyer that the product has been made in that particular year, and where the buyer would not have participated in the bidding if it had known that the product was not made in that year, then the buyer may claim that a discrepancy exists in a material aspect. In the example, the year in which the product was made need not have any particular significance as shown above in the other cases.

However, if an intention is erroneously communicated due to the gross negligence of the communicating party, such party may not claim for the invalidation of the contract on the basis of their mistake. What constitutes gross negligence differs in each case, but in general, a party is deemed to be grossly negligent if such party operates significantly without the commonly expected due care depending on the status of such party, types of acts and/or purposes etc.

**(ii) Cases in which a sales contract may be rescind**

As described above, a sales contract under which a seller is responsible to deliver the subject product and a buyer is responsible to pay the charged amount is formed when the intentions of the parties “to sell” or to “buy” match each other (and no discrepancy is found in material aspects). However, even if no discrepancy is found in such intentions, a contract may be rescinded if such intentions are made due to compulsion or fraudulently. In the first case, if a party is compelled to agree to a contract in order to avoid the disclosure of his personal information on the internet, and in the latter case, if a seller intentionally posts false information about the product in order to deceive a buyer. Also, if a minor is a party to a sales transaction, such transaction may be rescinded unless the minor obtains the consent of his guardian (e.g. parents). However, for example, if a minor buys stationery with the money given to him by his guardian for that purpose, the minor may use the money for the purpose the guardian intended. Also, in some cases, a minor may dispose of its assets at its own discretion (such as an allowance) without the consent of his legal representatives. In such case, a sales transaction may not be rescinded even though the minor does not have the express consent of his guardians.

**(iii) Cases where a sales contract may be terminated**

In some cases, a seller or buyer may terminate and nullify a contract notwithstanding that the contract does not fulfill either requirements (i) nor (ii) above. For example, a buyer may terminate a contract: if a seller defaults; if a buyer does not perform its obligation; if any latent defects (“*kashi*”) are found in used goods purchased; according

to a provision prescribed in the terms and conditions of contract (e.g. exhibition terms and condition) permitting termination in certain circumstances; or, if both parties agree to the termination. If the contract is terminated, each party is responsible to return the other party to its pre-contract state; the party who received goods must return them and the who received payment for the goods must repay the paid amount.

(A) Cases where a seller defaults

If a seller and a buyer have concluded a sales agreement for certain goods, and if the goods delivered to the buyer differ from those specified in the sales agreement, the buyer may claim for the delivery of goods as specified in the sales agreement. Under the sales contract, the seller bears an obligation to deliver the goods as specified in the sales agreement. In general, if the goods delivered to a buyer differ from those specified in the description of the goods in the sales agreement, the buyer may claim for the termination of the contract due to the default of the seller to perform its obligation to deliver the goods as specified in the description. As described above, if a seller or a buyer fails to perform its obligations under a sales contract, the other party may terminate such contract.

(B) Cases where latent defects are found in a specific good purchased

As described in (A) above, if a good offered for exhibition is an unspecified good and replacements for such good are easily available in the market, a seller is liable to deliver defect-free goods complying with the description and a buyer may claim for the delivery of defect-free goods. On the other hand, if the seller decides to handle the goods after having specified certain characteristic of such goods (namely “specific goods”), regardless of whether replacements of such goods are available in the market, the seller is deemed as having performed its obligation to deliver goods even though the seller delivers a defected good as it is. The seller bears no further obligations to procure and deliver a replacement for such good. For example, if a seller is an individual and if a buyer can easily acknowledge that the seller is vending only the item on display by exhibiting the unused good with a corresponding description such as “unopened and as-is good received as a Christmas gift”, the seller bears no obligation to procure and deliver a replacement for such good because the deal is based on the characteristic of such good, although it is physically possible to procure its replacement in the market. In such case, the buyer may claim for the termination of a contract (or for compensation) if the buyer cannot perform the purpose of the sales contract due to a defect in the subject item, for example,

where, the buyer was not aware of such defect upon conclusion of the sales contract (hereinafter referred to as “liability for defects” under Article 570 of the Civil Code. A judicial precedent has held that liability exists for defects in sales contracts for unspecific goods if any defect is found after the receipt of such goods (Judgment of the Supreme Court of Japan, December 15, 1961).

- (C) Cases where a provision prescribed in the terms and conditions of contract (e.g. exhibition information) exist which stipulates that a contract may be terminated under certain circumstances

Some sales contracts stipulate the terms and conditions for the termination of contract in advance; while others may stipulate that a product is “returnable if you are not completely satisfied” or returnable under other circumstances. In such case, the parties may terminate the contract as long as such party satisfies the terms for termination of contract.

- (D) Cases where the parties agree to the termination

Furthermore, if the parties agree to the termination ex post facto, the contract may be terminated.

### **3. Cases where the goods may be exchanged for other goods**

If the deal does not concern specific goods, and if the goods can be replaced with other goods available in the market, the seller is responsible to deliver the product free of defect in accordance with the description thereof and the buyer may demand to exchange a defective product with a non-defective product as described in the exhibit information (description). If the delivered product does not match the description in the agreement, the buyer may demand that the seller exchange such product for a product which satisfies the description specified in the agreement.

### **4. Cases where the goods may be repaired**

If the goods on exhibition are unspecific and can be replaced with other goods available in the market, the seller bears the responsibility to deliver goods free of defect in accordance with the description and the buyer may demand that the seller deliver the goods which both comply with the description and are free of defect. If the delivered product does not match the trade description, the buyer may demand that the seller exchange such goods for goods which match the

trade description and may at the same time demand that the goods received from the seller be repaired (“claim for full performance”).

## **5. Cases where damages may be compensated**

If the goods on exhibit are special and cannot easily be easily replaced by other goods in the market, the seller is deemed to have fulfilled its delivery duty even if the seller delivers such “as-is” defective products. In such case, the buyer may claim compensation (liability for defect goods, Article 570 of the Civil Code) although it may not terminate the contract. A judicial precedent ruled that a liability for defects exists in a sales contract for unspecific goods if any defects are found after the receipt of such goods (Judgment of the Supreme Court of Japan, December 15, 1961).

Also, regardless of whether the goods are specific and/or unspecific, if a party suffers damages because of the nonperformance of the counterparty of its duties (delivery duty, payment duty, etc.), such suffering party may claim a significant amount of compensation.

## (C) Conclusion of Sales Contracts in Internet Auctions

[Issue]

When are sales contracts concluded in internet auctions?

[Approach]

The timing for the conclusion of contracts in the course of internet auctions is determined on a case by case basis because there are various types or forms of internet auctions. Such timing for the conclusion of a contract is determined based on the intention of the parties as reasonably interpreted after taking into account the nature of each transaction.

Cases where a contract is deemed to have been concluded at the time of the acceptance of the successful bid

- The exhibitor provides a good for exhibition based on the premise that such good will be sold, irrespective of the bidders, based on the terms and conditions of sales stipulated in the description, while the successful bidder is participating in the bid on the premise that it would purchase the good at the successful tender price in accordance with such exhibition terms and conditions. In other words, the exhibitor and the successful bidder are engaged in internet auction based on the premise that such exhibitor and the successful bidder will be bound by the conditions of transactions at the time of the acceptance of the successful bid.

Cases in which a contract is not deemed to have been concluded at the time of the acceptance of the successful bid

- The exhibitor and the successful bidder acknowledge that the description of goods by the exhibitor in the internet auction site is simply an advertisement or publicity and the parties engage in the internet auction based on the premise that the parties will not be bound by the conditions of transactions (successful tender price, description of good, etc.) at the time of the acceptance of the successful bid and that the conditions of transactions may be negotiated freely by the parties after the internet auction is closed.

[Explanations]

### 1. Problem identification

When a successful bid for goods is accepted in an internet auction, a sales contract is concluded between the exhibitor and the successful bidder at the time the bid is successful. The legal relationship between the auction users is governed by the sales contract. In other words, under the sales contract, the seller (exhibitor) and the buyer (successful bidder) bear their own respective obligations (principally, the seller shall deliver the goods as specified in the exhibit terms and conditions and the buyer shall pay the amount bid subject to the bidding terms and conditions).

On the other hand, the terms of use in the auction sites are stipulated in various forms depending on each business model (e.g., “a successful bid does not constitute the conclusion

of a sales contract but only entitles the successful bidder to a priority right for negotiation”, “the parties are obliged to execute a sales contract concurrently upon a successful bid” or “the parties are responsible to execute the contract in accordance with good faith principles”). In the meantime, as a preventive measure against troubles, it is desirable to clearly specify the details of contract regarding the shipping charges or other terms in the exhibition information, even though this is not often done.

Therefore, at which stage of the transaction is a contract considered to have been concluded by the parties? If a contract is deemed to have been concluded at the time of the acceptance of the successful bid, the exhibitor becomes obliged to deliver the goods as stipulated in the exhibition information and the successful bidder becomes obliged to pay the tender price. In the meantime, if the auction system only acts as an information intermediary simply posting information on sales and purchases (for example, “Buy & Sell Bulletin Board”), a contract is not formed at the time of the acceptance of the successful bid. However, a contract may be formed without being bound by the terms and conditions which are prescribed upon the successful bid depending on the negotiations between the parties after the acceptance of the successful bid. In other words, the issue related to the timing for the conclusion of a contract relates closely to what rights or obligations arise between the parties under the sales contract or to which expression of intention should the parties refer to when considered with the invalidation due to mistake. Should the parties be bound by the terms and conditions at the time of the acceptance of the successful bid?

Also, if a provision concerning the timing for conclusion of a contract is prescribed in the terms of use, should the parties be bound by such provision concerning the conclusion of a contract?

## **2. Timing of conclusion of contract in internet auction**

A sales contract is concluded when the intentions of the buyer (to apply for a contract) and the seller (to accept such application) accord with each other. The timing of such accordance is determined by a reasonable interpretation of the actual intentions of the parties. There are various forms of internet auctions and it would be difficult to determine whether a contract is formed. However, in general, if it is likely that the parties intended to participate in the transaction based on the premise that they would be bound by the terms and conditions prescribed at the end of the bidding time (at the end of auction), then it can reasonably follow that a sales contract has been formed between the successful bidder who satisfied the bidding terms and conditions which were presented by the exhibitor at the end of bidding time.

In some cases, the Auction Operators particularly prescribe a provision in the terms of use which designates the time at which a sales contract comes into effect. For example, in some

cases, it is stated that a sales contract will only come into effect after negotiations have been held between the exhibitor and the successful bidder following the end of the auction. In such case, the terms of use usually do not specify at what stage, after the successful bid, the contract comes into effect. In general, such description in the terms of use may not fix the timing of the conclusion of contract; rather the time the contract is executed can only be determined by identifying the offer made and its acceptance which form the basis of the sales contract. Therefore, although the terms of use may prescribe that the contract comes into effect at the time the auction ends, it does not necessarily mean that such terms of use has binding force. Notwithstanding the above, the specification of timing in the formation of a contract in the terms of use generally has an impact on the intentions of the users. Therefore, it should be taken into consideration when interpreting the intentions of the parties. As a result, if it is determined that the user had no intention to execute a contract at the time the auction ended, it would be held that the contract had not come into effect at the closing of the auction.



**(D) Effectiveness of Special Clause “No Claim, No Return” Policy**

[Issue]

In some cases, in internet auctions or other individual transaction, a seller stipulates a “No Claim, No Return” policy regarding the exhibition items. A buyer may bid and/or make a successful bid for the items after having agreed to that policy. In such case, could the successful bidder or the buyer complain about or return the purchased item?

[Approach]

Posting a special “No Claim, No Return” clause does not always mean that it has legal effect. The validity of the clause will be judged in light of good faith principles.

Cases where a special “No Claim, No Return” clause may be valid

- If there is a posting which says “this junk item is sold on a NO CLAIM, NO RETURN basis”, the exhibitor may be discharged from any responsibility even if such item is inoperative.

Cases where a special “No Claim, No Return” clause may be invalid

- If the exhibitor had known of any dent or stain affecting the product but had not mentioned such to the bidders, such special clause is not valid and the exhibitor may not be discharged from liability for defect.
- If a “No Claim, No Return” clause is posted and the bidder for whatever reason misunderstands material matters relating to the transaction because of a deficiency in the description of the goods or items, such clause may be ruled inoperative due to the material misunderstanding.

[Explanations]

“No Claim, No Return” is language an exhibitor may use (such as “all sales final - ‘no refunds or returns’”) in the description of a product on exhibition in internet auctions. The issue is whether the bidder and/or successful bidder, after agreeing to such policy, may not request a refund or return (termination, returns etc.) the product. Especially, if the goods delivered differ from their description or if while no discrepancy existed between the description of the product and the product actually delivered, but where the buyer would not have participated in the bid had it known of circumstances which were not specified in the description, can the buyer still claim against the seller for the invalidation or termination of the contract?

In general, if a seller posts the language “No Claim, No Return” regarding any goods on exhibition, it is interpreted that the seller has expressed its intention that only those bidders who agree that “the seller accepts no claims or returns concerning the product” should be able to participate in the bid. This is considered a special clause which discharges the seller from

any liability for defect (Article 572 of the Civil Code). The discharge from liability for defect means that the seller (exhibitor) should have no liability for any latent defects in the tendered product. Descriptions such as “this junk item is sold on a ‘No Claim, No Return’ basis”, or “we offer this used and antiquated product on a no claim no return basis” are some typical examples we can find on websites. In some cases, “No Claim, No Return” is itself simply indicated. In principle, it is valid to prescribe such special clause.

However, a special clause between users cannot serve as a justification for any act that is against the principle of good faith and therefore, a seller shall not be discharged from liabilities if the exhibitor itself is aware that all or part of the items on exhibition belong to others or that the quantity of products are insufficient, that the item on exhibition has any defects (e.g. any dents or stains which are not stated in the description of such product), and where the seller still engages in the transaction without notifying the bidders and/or successful bidders thereof. In such event, the termination of a contract or compensation for damages may be claimed on the grounds of liability for defect or error etc. (or fraud, as the case may be), even though the “No Claim, No Return” clause had been indicated.

**(E) Internet Auctions and the Specified Commercial Transactions Law**

[Issue]

Where persons sell goods through internet auction sites, do Article 11 (Display of required items in advertisements) and Article 12 (Prohibition of misleading advertisements) of the Specified Commercial Transactions Law apply?

[Approach]

Business entities who sell “specified products” as defined in the Law Concerning Specified Commercial Transactions (hereinafter referred to as the “Specified Commercial Transactions Law”) are subject to obligations to display certain items in advertisements (Article 11) and to the prohibition of misleading advertisements (Article 12). In internet auction sales, these provisions apply to businesses, whether legal entities or individuals, engaged in transactions which are to be repeated and are continuous with a view to profit.

[Explanations]

Online transactions of “specified products” where an offer is accepted via the internet, including auctions, fall in the “correspondence sales” (“*tsushin-hambai*”) category defined in the provisions of the Specified Commercial Transactions Law. Therefore, business entities who sell “specified products” (Paragraph 4, Article 2 of the Specified Commercial Transactions Law and Schedule 1 of the Ordinance for Enforcement of the Specified Commercial Transactions Law) through internet auctions are subject to the obligations to display certain items in advertisements (Article 11) and to the prohibition of misleading advertisements (Article 12) as stipulated in the Specified Commercial Transactions Law. Furthermore, in the event of a violation, violators are subject to administrative dispositions and penalties.

Under the Specified Commercial Transactions Law, a “Dealer” (*hanbai-gyosha*) means a person performing sales as a business. ‘As a business’ here means performing transactions repeatedly and continuously with a view to profit. Whether a transaction is ‘with a view to profit’ will be determined objectively. For example, buying products for the purpose of resale is regarded as an act with a view to profit.

The judgment of whether or not such transactions are undertaken ‘with a view to profit’ or are ‘repeated and continuous’ shall be based on other factors as well, including whether the transactions occur by means other than internet auctions. For example, where a business

entity exhibits the products dealt with in the course of its business at an auction, whether on the internet or at an actual physical venue, in principle this will fall within the definition of a Dealer, regardless of the total quantity of products or the bidding price. For example, when an individual engaged in business uses internet auctions to exhibit goods one single time and the business also sells those products at an actual physical venue, these transactions are considered to be performed by a Dealer.

In addition to the aforementioned cases, those who exhibit products in an internet auction in the manner described below will, regardless of the mode of transactions outside the internet, in principle fall within the definition of Dealers.

Internet auctions provide a method that enables individuals, who in the past had only been consumers, to become Dealers; however, when an individual is deemed a “Dealer”, such individuals may be subject to the Specified Commercial Transactions Law.

1. The following applies to all categories of commodities sold through internet auction sites

Although individuals entering into an internet auction<sup>7</sup> normally sell in large quantity items that are unnecessary or are collected for the purposes of a personal hobby, where such sales are performed under the following situations and assuming that no special circumstances exist, those individuals are likely to fall within the definition of a Dealer, where they engage in repeated transactions with intent to gain profit. Note that this does not mean that the numbers indicated below are the minimum requirements for such seller to be a Dealer. Different criteria may apply depending on the type of commodities, but generally speaking, those who trade numerous new items, especially the ones completely identical in maker and designation number, are likely to fall within the definition of a Dealer.

- (1) Cases where the number of commodities in sale reaches 200 during the last one month or 100 at any one time, excluding sales of items collected for the purposes of leisure, such as trading cards, figures, used music CDs, photographs of an idol, etc, for the purpose of disposal or exchange.
- (2) Cases where the aggregate bidding price during the last one month reaches 1,000,000 JPY. However, where expensive items are sold that cost more than 1,000,000 JPY, such as automobiles, pictures, antiques and pianos, other factors

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<sup>7</sup> This interpreting guideline is hereby established based on the characteristics of internet auctions, and thus shall not be applied to other types of transactions under the Specified Commercial Transactions Law.

such as the mode of sales, that is, the number and type of items in sale at the same time, should be taken into consideration.

- (3) Cases where the aggregate bidding price during the last one year reaches 10,000,000 JPY.

2. The following applies to some specified categories of commodities sold through internet auction sites.

More detailed analysis of transactions in internet auctions dealing with certain types of products enable us to make more specific and accurate analysis. The following are examples of cases where the seller is normally deemed to be a Dealer. The analysis here focuses on products that frequently result in consumers' claims.

The chart below (hereinafter, the 'Chart') is a list of items classified into some categories which frequently result in consumers' claims.

- (1) (Electric household appliances)

Where 5 or more of the same items are for sale at the one time. 'Same items' here means the items generally referred to by the same term, such as cameras, personal computers and TVs, but this is not limited to cases where they come from or have the same maker, function, or designation number.

- (2) (Components of a bicycle and a bike)

Where 3 or more of the same items are for sale at the one time. 'Same items' here means the items generally referred to by the same term or emblem, such as wheels, bumpers, but this is not limited to cases where they come from or have the same maker, or product name. Plural items sold as a set shall be counted as a single item.

- (3) (CD, DVD, and PC software)

Where 3 or more of the same items are for sale at the one time. 'Same items' here means items completely identical in maker, product name, and contents.

- (4) (Brand-name items)

Where 20 or more brand-name items are for sale at the one time.

- (5) (Ink cartridges)

Where 20 or more ink cartridges are for sale at the one time.

(6) (Health food)

Where 20 or more packages of health food are for sale at the one time.

(7) (Tickets etc.)

Where 20 or more tickets are for sale at the one time.

Of items sold through internet auctions, those mentioned above are not exhaustive. Rather, these are some of the examples where the seller provides items frequently subject to consumers' claims, and such seller is likely to be deemed to be a Dealer. It is important to note that whether or not the internet auction operator falls within the category of a 'Dealer' should be determined based on objective facts on a case-by-case basis, including in cases where non-listed items are sold. More specifically, even though the number of items sold at the one time does not reach the minimum specified above, such seller may, depending on certain circumstances, fall within the category of a Dealer, especially if the sales are repeated more frequently and the seller does not stock the items for resale.

In addition, note that the discussion above is based on the assumption that the business entity operating the internet auction prevents an individual seller from obtaining plural IDs, by ensuring that they properly manage the information of the seller, including his/her bank account, credit card number, e-mail address, mobile phone information etc.<sup>8</sup>.

Categories of products that frequently result in consumers' claims

(1) Electric household appliances	<ul style="list-style-type: none"><li>• Photograph appliances [Schedule 1-16]</li><li>• Receptors for radio or TV, electric refrigerators, air conditioners, and other electric household appliances, lighting apparatus, appliances for preventing short-circuit, and voltage controllers [Schedule 1-22]</li><li>• Telephones, interphones, facsimiles, and portable wireless devices for emergency, and wireless items for amateurs [Schedule 1-23]</li><li>• Electric (including desktop) calculators and their components and accessories [Schedule 1-25]</li></ul>
(2) Components of a	<ul style="list-style-type: none"><li>• Including the items listed below, their components and accessories</li><li>• Automobiles and bikes with a prime mover (including a motor-bike) and</li></ul>

<sup>8</sup> The government, public authorities, and business entities are expected, in accordance with the argument here, to inform those involved in such transactions of their requirement for proper presentation whenever they may fall within the category of a Dealer.

bicycle and a bike	their components and accessories [Schedule 1-26]
(3) CD, DVD, and PC software	<ul style="list-style-type: none"> <li>• Electromagnetic recording media, disks for a record player, or any media in which sound, image, or programming is recorded by electromagnetic or optical method. [Schedule 1-51]</li> </ul>
(4) Brand-name items	<ul style="list-style-type: none"> <li>• Among the items below, those that are counterfeited in large quantity and include trademarks registered in the Japan Patent Office)</li> <li>• Watches [Schedule 1-14]</li> <li>• Ties, scarves, portable bags, bags, umbrellas, walking sticks, sunglasses (except for the ones used for correcting eyesight) and other portable belongings, accessories such as rings, necklaces, cuff links etc, smoking tools, and makeup sets. [Schedule 1-36]</li> </ul>
(5) Ink cartridge	<ul style="list-style-type: none"> <li>• Among the items below, the ink cartridge used for printers</li> <li>• Office tools such as mechanical pencils, fountain pens, ball-point pens, inkstands, rulers etc, and seals, vermilion ink pads, albums, and tools for drawing pictures.</li> </ul>
(6) Health food	<ul style="list-style-type: none"> <li>• Processed goods of animals and plants taken by human beings but normally not for daily meals. [Schedule 1-52]</li> <li>• (excluding ‘medicine’ defined in Article 2 Paragraph 1 of the Pharmaceutical Law (Act No. 145 of 1960)) [Schedule 1-1]</li> </ul>
(7) Tickets etc,	<ul style="list-style-type: none"> <li>• The right to attend a facility for sport or relaxation [Schedule 2-1]</li> <li>• The right to enjoy a movie, a drama, music, watch sport, or photographs or to see works of art such as pictures and sculptures.</li> </ul>

The numbers in this Chart refer to those of the specified products or services listed in Schedule 1 & 2 in the Order for Enforcement of the Specified Commercial Transactions Law.

**(F) Internet Auctions and the Premiums and Representations Act**

[Issue]

Does Article 4 (Prohibition against misleading representations) of the Premiums and Representations Act apply to the sale of goods provided by individuals through internet auctions?

[Approach]

When business entities participate in internet auctions and sell goods to consumers, Article 4 of the Premiums and Representations Act is applied.

[Explanations]

There are cases where business entities participate in internet auctions and sell goods to consumers. Such cases constitute a Business-to-Consumer transaction using the internet, so Article 4 of the Act against Unjustifiable Premiums and Misleading Representations (hereinafter referred to as the “Premiums and Representations Act”) applies, and the misleading representations described in each subparagraph of the same article are prohibited<sup>9</sup>.

(Reference)

When a business offered wristwatches for sale to general consumers on an internet auction site on at least 52 occasions between March and August 2002, the Fair Trade Commission deemed these representations to be in violation of the provisions of Subparagraph 1, Article 4

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<sup>9</sup> The definition of a “business entity” (*“jigyô-sya”*) differs for each law. The meaning of “business entity” under the Premiums and Representations Act is the same as “person engaged in a commercial business, industrial business, financial business, or other business” stipulated in Article 2 of the Act concerning Prohibition of Private Monopolization and Maintenance of Fair Trade (hereinafter referred to as the “Antimonopoly Act”). Not only legal entity but also individuals may be regarded as businesses. The term “business entity” under the Specified Commercial Transactions Law applies to cases in which a person is engaged in sales on a repeated and ongoing basis with a view to profit, whereas the meaning of “business” under Paragraph 2, Article 2 of the Electronic Contract Law and “as a business” (*“gyô-to-shite”*) under Subparagraph 1, Paragraph 1, Article 2 of the Trademark Law covers instances where the same act is conducted on a repeated and ongoing basis absent any requirement of a profit objective.



(Misrepresentation of the quality of products) under the Premiums and Representations Act, and issued a warning to the business involved.

**(G) Internet Auctions and the Electronic Contract Law**

[Issue]

Does Article 3 of the Electronic Contract Law (Exception for contract invalidity due to mistake in expression of intention) apply to sales contracts concluded between exhibitors and successful bidders in internet auctions?

[Approach]

Article 3 of the Electronic Contract Law is considered in principle not to apply to Consumer to Consumer auctions.

[Explanations]

When a consumer makes an offer to a business entity through a website in accordance with the procedures displayed on the website by the business entity, Proviso to Article 95 of the Civil Code will not apply to the offer and the consumer can invalidate an unintended application for contract or an expression of intent which differs from his true intent, if the customer makes an offer unintentionally or makes an offer which is different from his actual intention; except for cases where the business entity has taken steps to secure the confirmation of the consumer of his actual intention and its contents, or where the consumer himself indicates that it is not necessary to have an opportunity to confirm the intent to apply or the contents of the application (Article 3 of Electronic Contract Law).

The aforementioned law applies to Electronic Consumer Contracts which are concluded between consumer and business entities, so-called “Business to Consumer” transactions. This law addresses the gap between consumers and business entities in the context of electronic commercial transactions.

Currently, the parties to a transaction (exhibitors and bidders) are on even grounds in most of the Consumer to Consumer auctions. Therefore, the aforementioned laws would not apply to the sales contracts between the exhibitors and bidders.

## (H) Internet Auctions and the Antique Dealings Law

[Issue]

Must business entities engaging in internet auctions obtain licenses as used goods merchants (“*kobutsu-shō*”) or used goods market operators (“*kobutsu-shijō-shu*”) to comply with relevant laws?

[Approach]

Internet Auction Operator need not obtain a license as a used goods merchant or used goods market manager, unless they engage in internet auctions in the sale or exchange of used goods on their own or under consignment or if they manage a market for the sale or exchange of used goods between businesses.

[Explanations]

1. Whether a license is required for a used goods merchant or used goods market operator

Under the Antique Dealings Law, a license must be obtained (1) where a person is engaged in the sale or exchange of used goods, or the sale or exchange of used goods under consignment, (except those who simply sell used goods or repurchase goods sold from the buyers) (Subparagraph 1, Paragraph 2, Article 2) and (2) where a person is engaged in the business of operating markets for used goods (defined as markets for purchases and exchanges by used goods merchants; Subparagraph 2 of the same paragraph). In case (1) the license is obtained from the prefectural Public Safety Commission in charge of the business premises of the used goods merchant. In case (2) the license is obtained from the Public Safety Commission in charge of the location of the used goods market operated by the used goods market operator (Paragraph 3 and Paragraph 4 of Article 2, Article 3).

Unless Auction Operators sell or exchange used goods by themselves or have consigned them to somebody else, or unless they operate a market for the sale or exchange of goods between used goods merchants, it is deemed not necessary to obtain a license as a used goods merchant or used goods market operator under the foregoing laws. In other words, Auction Operators who are not parties to internet auctions are neither “used goods merchants” nor “used goods market operators”.

However, persons who participate in internet auctions to engage in the sale of used goods must duly obtain a license as a used goods merchant.

## 2. Summary of the Amended Antique Dealings Law

The Law for the Partial Amendment of the Antique Dealings Law, which was legislated to prevent the sale of stolen goods in internet auctions (2002 Law No. 115), was enacted on September 1, 2003. This law defined those who engage in auction brokerage businesses (specifically designated as those who uses electronic information processing systems specified by relevant ordinances) of used goods as “used goods auction brokers” (excluding used goods market operators) (“*kobutsu-seri-assen-gyô*”) and applies certain regulations (Subparagraph 3, Paragraph 2, Article 2). Internet auctions are designated as used goods auction brokers (Article 3, Amended Enforcement Ordinance of the Antique Dealings Law)<sup>10</sup>.

The Amended Antique Dealings Law could be summarized as follows:

- (1) Persons engaged in a business of used goods auction broker shall submit a written notice thereof to the public safety commission (Article 10-2, Paragraph 1).
- (2) A used goods auction broker shall promptly notify the police when suspicions arise that goods offered on the internet auction site are stolen (Article 21-3).
- (3) When a used goods auction broker attempts to obtain applications for assistance from persons attempting to sell used goods, said operators shall endeavor to take measures to confirm the honesty of the solicited persons, and when assisting persons attempting to sell used goods, shall endeavor to prepare and keep records thereof (Article 21-2, 21-4).
- (4) A used goods auction broker can obtain certification from the public safety commission attesting that the methods of conducting business conform to the standards designated by the National Public Safety Commission on the rapid discovery and prevention of the sale of stolen goods. A used goods auction broker, who has obtained certification from the public safety commission, can display such certification. Except where the certification has been duly obtained, no one shall display such certification or put forth any misleading similar display (Paragraphs 1-3 of Article 21-5).

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<sup>10</sup> The “auction method” (“*seri-no-hôhō*”) stipulated under Subparagraph 3, Paragraph 2, Article 2 of the Amended Antique Dealings Law is defined as the method by which an electronic information processing system consists of computer and telecommunication wires; where the computers of the exhibitor, the bidders and the auction operator are connected to each other; where the communication including goods information provided by the exhibitor and price information provided by the bidders are electronically and automatically transmitted and disclosed to common users (Article 3, Enforcement Ordinance, Amended Antique Dealings Law).

- (5) A used goods auction broker located in a foreign country (limited to cases where the persons to whom assistance is provided are located in Japan) shall be treated in the same way as operators engaged in a used goods auction broker under (4) (Article 21-6).
- (6) A used goods auction broker provides assistance to a person offering goods, which are reasonably suspected as being stolen property, the Superintendent-General of the Tokyo Metropolitan Police Department, the chief of the Prefectural police headquarters, or the chief of a police station can order a used goods auction broker to stop the auction involving the applicable used goods (Article 21-7).
- (7) The chief of the prefectural police headquarters or the like can request necessary reports in regard to stolen goods from a used goods auction broker when deemed necessary (Paragraph 3, Article 22).

(3) Liability of Business Entities Handling Electronic Commerce for Mediating Transmission of Illegal Information Through Hosting Services

[Issue]

If certain information that may defame the exhibitor is posted in the evaluation column of an auction site, and the exhibitor requested the operator of the auction site to delete such information, what civil liability will the auction site operator bear for deleting or not deleting such information?

[Approach]

**(I) Liability for not deleting the information**

If a business entity participating in electronic commerce (the "provider") by hosting<sup>7</sup> or using a message board for information sent by users fails to delete illegal information sent by users or otherwise those who post messages thereon, such business entity may be held liable for tort (Articles 709 and 719 of the Civil Code), provided the transmission of such information apparently infringes another person's rights and it is easy to prevent the transmission of such information (i.e., "delete" it). However, according to Article 3, Paragraph 1 of the Law Concerning the Limitation of Liability to Compensate for Damages for Specified Telecommunication Service Providers and Disclosure of Information of the Sender<sup>8</sup> (hereinafter, the "Provider Liability Limitation Law"), the provider does not bear any civil liability for not deleting the information except under certain circumstances, which are stated in the same paragraph.

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<sup>7</sup> This service involves lease a portion of memory space in a computer (server) that transmits information to the internet. This service is also called "rental server" and telecommunication businesses provide this service by using their own facilities.

<sup>8</sup> The following are annotations to the Provider Liability Limitation Law and guidelines on each type of infringement thereunder:

- (i) Annotations to the Provider Liability Limitation Law  
[http://www.soumu.go.jp/joho\\_tsusin/top/denki\\_h.html](http://www.soumu.go.jp/joho_tsusin/top/denki_h.html)
- (ii) Guidelines on Provider Liability Limitation Law
  - Guidelines on libel and privacy
  - Guidelines on copyrights
  - Guidelines on trademarks

<http://www.telesa.or.jp/consortium/provider/index.htm>

Example of Cases where the provider may be held liable

- A large amount of information that obviously constitutes illegal copies of another person's copyrighted works was posted on a message board, followed by the request of the copyright holder who properly proved his status as the copyright holder to delete such information, the provider nevertheless left it as it was for an unreasonably long time.
- Certain information that defames the exhibitor was posted in the evaluation column in the auction site, and the exhibitor formally requested that the provider operating the site delete it. Even after the fact of such defamation became apparent, the provider nevertheless failed to delete such information.
- Where the provider transmitted illegal information by himself/herself.

Example of Cases where the provider would not be held liable

- Where the provider was not aware of the transmission of the illegal information

**(II) Liability for deleting the information**

If there is a contractual relationship between the operator and the sender of the information, whether or not the operator may delete such information depends primarily on the contents of the contractual provisions. Where the transmission of certain information is prohibited by the contract, the provider shall not be held liable for deleting such information. On the other hand, where the provider bears contractual obligation to host the transmission of such information, the provider may be held liable for mistakenly deleting such information, if the transmission of such information was lawful. However, the provider would not bear any civil liability for mistakenly deleting lawful information under certain circumstances as provided for in Article 3, Paragraph 2 of the Provider Liability Limitation Law.

Example of Cases where the provider may be held liable

- The provider deleted more information than necessary

Example of Cases where the provider would not be held liable

- In the case of an anonymous message board available for anyone, where no contractual relationship exists between the business entity operating the message board and the sender of the information, such business entity shall bear no obligation to host the transmission of any information posted by such sender.
- Where a person claimed that his/her rights were infringed and the provider then inquired for the opinion of the sender of the information, who did not express objection to deleting the information within seven (7) days of the date of receipt of inquiry, and the provider deleted such information to the extent necessary.

[Explanations]

**1. Liability for not deleting the information**

## **(1) Liability in tort**

The business entity which hosted the posting of illegal information such as defamatory statement or materials infringing copyrights is considered to have fomented the dissemination of illegal information and thus it becomes an issue of whether the provider would be held liable to the victim of such illegal information in tort (Articles 709 and 719 of the Civil Code). The scope of this liability, which used to be focused on entities operating hosting services and the operators of message boards, will be extended to business entities operating electronic commerce by hosting the transmission of information dispatched by others or by using message boards, and still further to the participants therein.<sup>9</sup>

If these business entities neglect to delete information when they are under an obligation to delete illegal information, they may be held liable to the victim of such illegal information in tort. A judicial precedent involving a university hosting students' websites as well as other numerous cases where message board operators were sued after neglecting to delete illegal postings will serve as a reference.

These judicial precedents are largely divided into (a) judgments that argue that the provider bears a broad obligation to delete illegal information immediately in the event the provider becomes or should become aware of the dissemination of such illegal information<sup>10</sup> and (b) judgments that argue that the provider bears obligations to delete illegal information under limited circumstances such as that the business entity transmitted such information itself or that the infringement of rights is obvious.<sup>11</sup>

These two standards are very different. However, we should note that, in many judgments that argue based on standard (a), the justification for such stern judgments was generally that the operators of anonymous message boards fomented and promoted the posting of illegal information by declaring that they would never preserve the access log. By contrast, it is unlikely that the stern standard of (a) will be applicable to ordinary business entities that, in the absence of the aforementioned circumstances, take a neutral position towards the contents of the information they host.

## **(2) Exemption from liability pursuant to the Provider Liability Limitation Law**

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<sup>9</sup> For example, the operators of auction sites (information on exhibited items that infringes trademarks, with such information appearing in the evaluation column for exhibitors and successful bidders), blog service providers (information posted by the blog creator), and blog creators (viewers' comments posted on the blog site). As discussed later, these business entities fall under specified telecommunication service providers under the Provider Liability Limitation Law.

<sup>10</sup> Case of animal hospital (1st instance: Tokyo District Court Judgment of June 26, 2002, Appeal: Tokyo High Court Judgment of December 25, 2002), Case of DHC (Tokyo District Court Judgment of July 17, 2003)

<sup>11</sup> Case of Tokyo Metropolitan University (Tokyo District Court Judgment of September 24, 1999), Case of *Shogakukan* 1st instance (Tokyo District Court Judgment of March 11, 2004), Case of *Shogakukan* Appeal Judgment (Tokyo High Court Judgment of March 3, 2005)



Pursuant to Article 3, Paragraph 1 of the Provider Liability Limitation Law, a business entity shall bear civil liability for neglecting to delete information only when at least one of (i), (ii) or (iii) below is met.

- (i) If (a) the deletion of information is technically possible; and (b) the business entity knew that the dissemination of information would cause certain infringement of rights
  
- (ii) If (a) the deletion of information is technically possible; and (b) not only is the business entity aware of the dissemination of the information, but the infringement of rights arising from such dissemination of information should have been reasonably known to such business entity
  
- (iii) If the business entity transmitted the information itself

"Specified telecommunication," designated for the general public, is exempted from liabilities under the Provider Liability Limitation Law. Generally, hosting websites and message boards are considered to be specified telecommunication.<sup>12</sup> Note that this law is applicable only to cases where the infringement of rights is caused by the act of dissemination of information in itself, and thus it does not apply to cases where a purchaser suffers economically as a result of a fraudulent auction (the dissemination of fraudulent information on the exhibited items in an auction will not in itself cause any damage, and it is not until those who misbelieved such information enter into transactions that actual damages arise). Further, this law has no penal provisions. The exemption from liabilities under this law applies only if the act of dissemination of information in itself constitutes defamation or infringement of copyrights or privacy.

The most notable aspect with respect to the scope of exemption is that, according to this law, the business entity is liable for damages only if it was aware that the information had been disseminated. Thus, a business entity would not be held liable for damages if it was actually unaware that the information had been disseminated.

## **2. Liability for deleting the information**

### **(1) Contractual liability**

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<sup>12</sup> "Specified telecommunication business" does not include cases where access to such telecommunication is limited to specified people.

If there is a contractual relationship between the operator and the sender of the information, whether such information may be deleted depends primarily on the provisions of the contract. Where the transmission of certain information is prohibited by the contract, the provider shall not be held liable for deleting such information.

If a business entity that is contractually obligated to provide certain hosting services to the sender of the information based on a membership agreement with him/her, for example, deletes certain lawful information at another person's request, such entity will not be considered to be performing its contractual obligations (to provide hosting services). In this case, the provider would not be entitled to receive consideration for hosting services and may further assume liability for damages for the non-performance of contractual obligations.

On the other hand, if there is no contractual relationship between the business entity and the sender of the information, the business entity would not be obligated to provide any hosting services and thus it will not be held liable (in tort) for deleting information except under special circumstances. Generally, the operator of an anonymous message board will delete postings for reasons such as that it does not fit the purposes of the board. However, such deletion is reasonable and falls within the scope of the message board operator's rights and power. Therefore, in such cases, the sender who posted such information is generally not entitled to pursue any legal liability against the operator of the message board.<sup>13</sup> For your information, there are no publicly disclosed judicial precedents where the liability of any business entity for deleting the information became an issue of dispute.

## **(2) Exemption from Liability under the Provider Liability Limitation Law**

Article 3, Paragraph 1 of the Provider Liability Limitation Law provides for the following conditions under which a business entity shall bear civil liability for mistakenly deleting lawful information. Accordingly, the provider shall not bear any civil liability for mistakenly deleting lawful information if at least one of (i)' and (ii)' is met.

- (i)' If (a) the business entity deleted the information to the extent necessary; and (b) there is good reason for it to believe that the dissemination of such information would unduly infringe another person's rights.

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<sup>13</sup> The report on the "Study concerning the handling of illegal and harmful information on the internet" announced by the Ministry of Internal Affairs and Communications in 2006 reviewed this issue in detail and it states the following (p.18):

Generally, the prevention measures taken by the operators of anonymous message boards against the transmission (deletion) of the postings (uploaded information) would not constitute a serious infringement of rights. In addition, as it would be reasonable and necessary for the operator to delete certain information, even if the operator exercises its power to control the message board, it does not constitute an abuse of rights except where such anonymous message board involves some public aspects, because such deletion of information does not constitute an infringement of the poster's rights or legally protected interests.

- (ii)'            If (a) the business entity deleted the information to the extent necessary; and  
(b) a person claimed that his/her rights were infringed and the provider, for the purpose of determining whether or not to consent to the deletion of the information, inquired for the opinion of the sender of the information, who did not express objection to deleting the information within seven (7) days of the date of receipt of inquiry.

With respect to (i)' above, generally, a business entity will not be held responsible in cases where the business entity deleted certain information based on requests from the Human Rights Organs of the Ministry of Justice<sup>14</sup> or from a credit survey agency referred to in the guidelines relating to copyrights and those relating to trademarks.<sup>15</sup>

With respect to (ii)' above, in practice, this generally functions as a relief for business entities. A business entity would not bear any civil liability even if it deletes certain information, so long as it has inquired for the opinion of the sender of the information, and confirmed that no response has been made within the prescribed period of time.

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<sup>14</sup> The basis for the request for deletion derives from Article 14, Paragraph 1, Item 1 of the Rules Concerning the Investigation of Cases of Human Rights Infringement. Considering that the request for deletion would be made based on a judgment rendered by those who have professional knowledge in the infringement of human rights, if the operator of a message board who believed such organization's judgment is unlikely to be held responsible on the basis of (i)' (b).

<sup>15</sup> An organization that has a reputation for possessing professional knowledge and experience in matters involving copyrights and trademarks confirms the identity and the rights of the person claiming himself/herself to be a victim and the existence of infringement of copyrights or trademarks. Therefore, if the operator of a message board deleted certain information, believing in such organization's judgment, it is unlikely to be held responsible on the basis of (i)' (b). For your information, as of July 2006, the credit survey agency for copyrights was comprised of Japanese Society for Rights of Authors, Composers and Publishers ("JASRAC") and ten (10) other associations, and the credit survey agency for trademarks was comprised only of Union Des Fabricants Tokyo.

#### (4) Prize Offers on the Internet

[Issue]

Are prizes offered to consumers on internet websites subject to the provisions of the Premiums and Representations Act, which regulate premiums provided in connection with transactions?

[Approach]

##### **I. Prize offers on the internet**

Prize offers made on a commercial transaction site do not constitute the provision of an economic benefit associated with a transaction, subject to the Premiums and Representations Act (therefore, they are called as “*open kenshō*”, prize offer open to public); even though the prize offer is located on the commercial websites (e.g. offeror assumes that the users found the offer on the commercial transaction websites; the prize offers were announced on the websites; offeror accepted applications from users on the website).consumers are free to move from one website to another

Nevertheless, if a person cannot apply for a prize offer unless he purchases a product or service on the commercial transaction site, or if a purchase increase the odds of winning a prize, such prize offers are deemed to be associated with a transaction and therefore it will be subject to the Premiums and Representations Act.

##### **II. Prize offers from internet service providers and the like**

Prize offers made on the websites of businesses that provide services to connect to the internet, such as internet service providers, telephone companies, and the like, are not regarded as associated with transactions, provided that the persons eligible to apply for the offer are not limited to the present users of the connectivity service provided by the same entity. Thus, such offers as *open kenshōs* are not subject to the Premiums and Representations Act.

[Explanations]

##### **1. Problem identification**

In connection with the rapid increase in electronic transactions made at commercial transaction sites on internet websites, prize offers are widely used to consumers on internet websites. It is often difficult to determine whether such offers are subject to the provisions of

the Premiums and Representations Act which regulates premiums provided in connection with transactions. For that reason, the Fair Trade Commission has expressed their opinion on how prize offers made on the internet should be treated.

(<http://www.jftc.go.jp/pressrelease/01.april/010426.pdf>)

The contents are as follows:

## **2. Summary of regulations on prize offers**

The Premiums and Representations Act regulates premiums (Article 3), defining a premium as either (1) a means of attracting customers; (2) a prize provided in association with a transaction; or (3) an economic benefit (Paragraph 1, Article 2). Furthermore, a “contest” is defined as the system by which a beneficiary of the premium is selected and/or the premium amount is determined (1) through use of a lottery or other random selection; or (2) through judging the superiority or correctness of certain acts (Restrictions Concerning the Provision of Premiums by means of Prize Offers; Notice of the Fair Trade Commission, No. 3, March 1, 1977).

Accordingly, premium offers, which provide an economic benefit according to the result of a lottery or otherwise, associated with a transaction as a means of soliciting customers, are subject to the provisions of the Premiums and Representations Act. As used herein, “associated with a transaction” means that a premium is provided in connection with a transaction; e.g. where only a purchaser of certain goods can obtain premiums; where a premium is provided to the answerer of a quiz posted on the label of certain goods; and where a premium is provided to those who entered the offeror’s store.

Under the Premiums and Representations Act, the maximum value of a premium provided by means of a prize offer shall not exceed twenty times the price of the transaction involving the prize offer (however, when the applicable amount exceeds ¥100,000 yen, the limit shall be ¥100,000 yen). In addition, the total value of premiums provided by means of prize offers shall not exceed two percent (2%) of the planned total value of the transactions involving such prize offers (Restrictions Concerning the Provision of Premiums by Means of Prize Offers; same notice as above).

Where an offer is made to provide an economic benefit through the selection of a specified person by means of a lottery, or to otherwise solicit general consumers in an advertisement, and where such offer is not associated with a transaction (meaning that such prize offers or prizes do not constitute a premium governed by the Premiums and Representations Act), such prize offers as “*open kenshōs*” are subject to the provisions of the Act concerning Prohibition of Private Monopolization and Maintenance of Fair Trade (hereinafter referred to as the

“Antimonopoly Act”). In this case, the maximum value of the economic benefit is ¥10 million yen. There is no regulation on the total value of the prize (Regulation of Unfair Transaction Methods When Providing Economic Benefits by Means Of Drawing or the Like in Advertisements; Circular Notice of the Bureau Chief of the Fair Trade Commission, No. 5, July 2, 1971).

### **3. “*Open kenshō*” in the internet**

Internet websites are exceptional because they are open to all and can be used as a means to notify about and to handle applications for so-called “*open kenshō*.” Such websites are already extremely widespread. Moreover, consumers can freely move between pages on a website. As a result, even where a prize is offered on one webpage of a commercial transaction website or even where the webpage offering the prize cannot be viewed unless the commercial transaction site itself is visited, any and all attempts by persons to respond to the prize offers are not directly tied to the purchase of a product or service.

Accordingly, with respect to prize offers made on websites, even if the applicable website is constructed as specified above, this does not constitute the provision of an economic benefit associated with a transaction. Therefore, such prizes as *open kenshōs* are not subject to the Premiums and Representations Act. However, if a person cannot apply for a prize offer unless he purchases a product or service on a commercial transaction website, or if the purchase of a product or service facilitates or increases the likelihood of obtaining the prize (for example, where hints or correct answers to a quiz concerning a prize offer can only be obtained by purchasing a product or service), the offers are regarded as associated with a transaction and therefore subject to the provisions of the Premiums and Representations Act.

### **4. “*Open kenshō*” by internet service providers**

As long as persons other than those contracting with the company operating a website are able to visit the appropriate website to apply for prize offers, any prize offers made on the internet by internet service providers, telephone companies, or similar companies offering connectivity services required to gain internet access are not regarded as associated with transactions, provided that the actual eligibility for such offers is not restricted to current users of the connectivity service offered by the same entity. Thus, any offer complying with the foregoing is not subject to the Premiums and Representations Act (instead they are regarded as an “*open kenshō*”).

### 3. Consumer Protection

#### (1) Mistake caused by Consumer's Erroneous Operation

[Issue]

In Business-to-Consumer electronic transactions, if the company has not taken measures to reconfirm the consumer's offer, such as by reconfirmation of the details of an offer, any contract executed by the consumer's erroneous operation is invalid in principle (Article 3 of the Electronic Contract Law). Conversely, if the company has taken reconfirmation measures and there exists gross negligence on the part of the consumer, the company can assert the valid formation of a contract. What specifically are these reconfirmation measures?

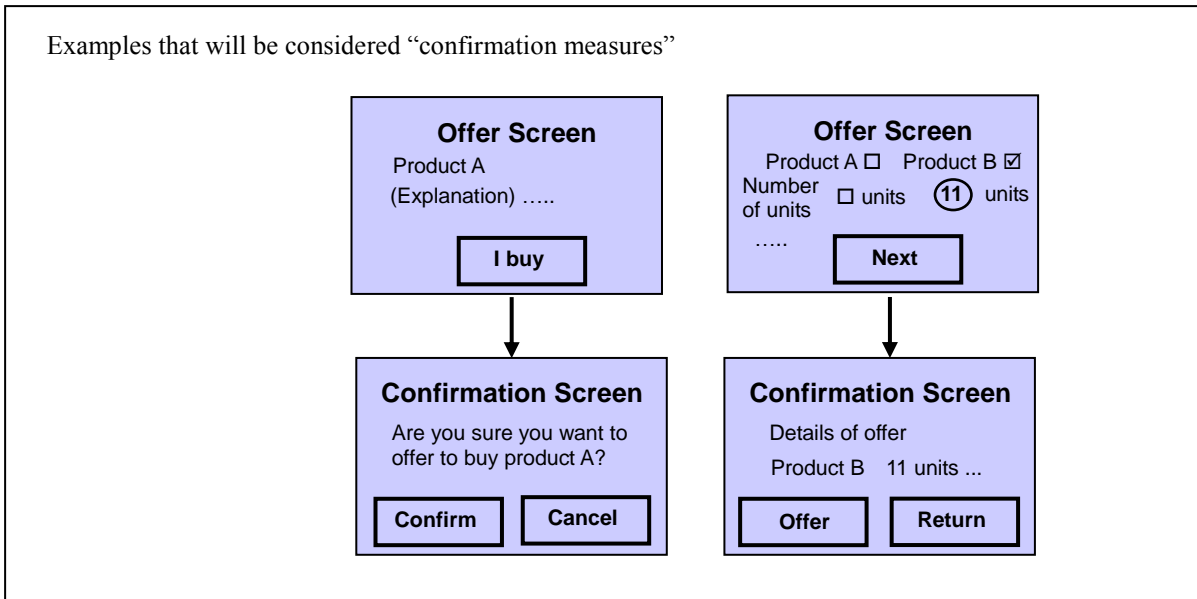
[Approach]

#### **(I) Remedy for consumer's erroneous operation**

In Business-to-Consumer electronic transactions, an expression of intention by a consumer caused by the erroneous operation of the computer by the consumer, which corresponds to a mistake of an essential element (“*yôso-no-sakugo*”), is invalid, except where (i) the business entity has taken measures to confirm the consumer's intention, e.g. by presenting an opportunity for consumers to confirm the content of offers before the consumer makes his final offer; or (ii) the consumer has expressly abandoned any need for confirmation (Article 3 of the Electronic Contract Law). In cases (i) and (ii), if there is gross negligence on the part of the consumer, the business entity can assert the formation of a contract (Proviso of Article 95 of the Civil Code).

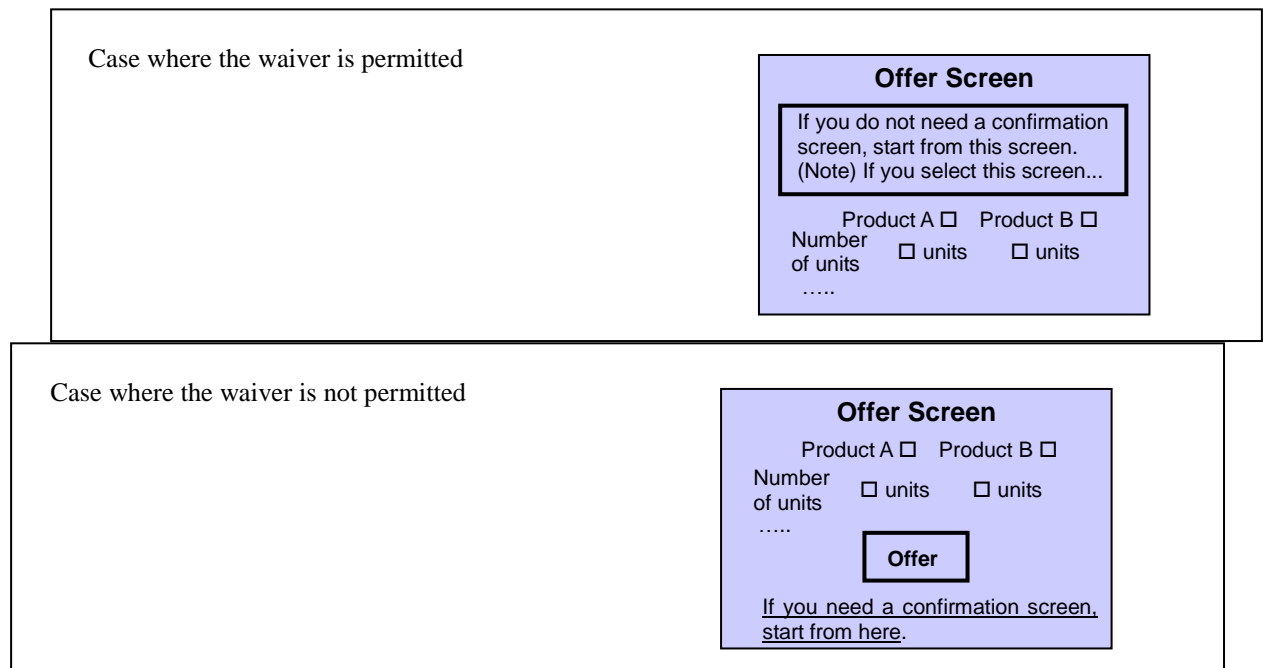
#### **(II) Confirmation measures to be taken by the business entity**

Confirmation measures must constitute a substantial query which confirms that the consumer had an actual intention to offer and that the consumer intended to offer what he inputted into the computer. For example, the business entity needs to construct a webpage on which (i) the consumer can clearly understand that he makes an offer by clicking a certain transmission button; or (ii) the concrete contents of his offer are plainly displayed to the consumer and on which the consumer is given an opportunity to revise an offer prior to making the final offer.



### (III) Consumer’s waiver of an opportunity to confirm

If the consumer waives any opportunity to confirm an offer, such waiver must be explicitly expressed. Whether said waiver language is properly formulated will be assessed according to strict criteria. For example, any waiver will not be admitted if the consumer were forced to provide it by the business entity or if the business entity intentionally induced the consumer to do so.





[Explanations]

### **1. Special measures concerning invalidity due to mistake**

Where a consumer can enter into a contract with a business entity by following the procedure displayed on its website, if he makes an unintentional offer (for example, where he mistakenly sends an offer although he has no actual intention to make an offer) or if he makes an offer in which the contents do not correspond to his actual intentions (for example, where he acted without revising his first offer where the first offer does not correspond with his actual intention, and where he intended to make a change), then he can assert the invalidity of the offer which was not intended or which is different from his actual intention. The proviso to Article 95 of the Civil Code is not applicable except where the business entity has taken measures to give the consumer an opportunity to confirm his intention to make the offer and to confirm the contents of the offer, or where the consumer voluntarily waives such opportunity (Article 3 of the Electronic Contract Law).

An example of an unintentional offer is where a consumer mistakenly presses a button executing a contract instead of pressing the cancellation button. An example of the contents of an offer being different from what is intended is where the consumer presses the offer button after mistakenly entering 11 units instead of 1 unit.

### **2. “Request for confirmation”(“*kakunin-wo-motomeru-sochi*”) in Article 3 of the Electronic Contract Law**

If the business entity has taken measures to ask the consumer to confirm his intention to make an offer and the contents of the offer are on the screen, then the main part of Article 3 of the Electronic Contract Law does not apply. In such cases, under the proviso of Article 95 of the Civil Code, the business entity can assert gross negligence on the part of the consumer in submitting an unintentional offer or in making an offer containing inaccurate contents (proviso to Article 3 of the Electronic Contract Law).

The confirmation measures must include substantially asking the consumer to confirm whether he wishes to make the stated offer and whether he wishes to make the stated offer for the products/services inputted.

For example, such measures will have to involve a screen:

- On which the consumer can clearly recognize that by clicking on a certain button, he is expressing his intention to make an offer; and

- That gives the consumer an opportunity to make any necessary corrections to the offer contents displayed before he presses the transmission button to finalize his intentions.

### **3. “Explicit waiver” in Article 3 of the Electronic Contract Law**

When the consumer expressly waives the need for the confirmation measures mentioned above, the main part of Article 3 of the Electronic Contract Law does not apply. For that reason, under the Proviso to Article 95 of the Civil Code, the business entity can assert that there has been gross negligence on the part of the consumer in making an unintentional offer or making an offer for mistaken contents (proviso to Article 3 of the Electronic Contract Law).

An “Explicit waiver” (“*ishi-no-hyōmei*”) is the act of the consumer which positively communicates to the business entity that, by his own decision he does not need to be given any confirmation measures. Whether this explicit waiver has been made will be carefully scrutinized. This explicit waiver will be invalid if the business entity forces the consumer or intentionally induces him to consent to the waiver. Other examples of this explicit waiver include cases where the business entity displays the message: “The consumer is deemed to have consented to waive confirmation measures” or in which the consumer cannot buy a product unless he clicks the button: “I expressly waive confirmation measures”. In short, an intention to abandon the need for confirmation measures must be expressed clearly and be based on the voluntary decision of the individual consumer.

With respect to the explicit waiver, the business entity bears the burden of proof.

(2) Duty to Design an Easy-to-Understand Application Screen for Internet Trading

[Issue]

In internet trading, what specifically is an “inducement to have the customer request a contract by being contrary to the customer's wishes”, which is regulated by Article 14 of the Specified Commercial Transactions Law?

[Approach]

In internet trading, a business entity is subject to administrative penalties where (I) there are no measures which enable customers to understand easily that an application will result in the formation of a fare-paying contract, or (II) there are no customer-friendly measures which enable consumers to confirm and/or to revise the content of his offer easily.

(I) Display indicates an offer for a contract for value

Cases in compliance

[Screen example 1]

- Step 1: Select product

Product	Unit price	Quantity	Subtotal
Product (1)	¥1,000	1	¥1,000

- Step 2: Enter personal information

- Step 3: Display final confirmation screen

Order conbusiness

Finalize your order after checking its contents. (This is the last step.)

Confirm that the contents shown below are correct. Actual order is placed after you click the “Finalize order” button.

Receiver's address  
Keizai Taro  
1-3-1, Kasumigaseki, Chiyoda-ku,  
Tokyo 100-8901

Payment method  
... card xxxx-xxx  
Expiry date: 06/2002

Product	Unit price	Quantity	Subtotal
Product (1)	¥1,000	1	¥1,000
Delivery charge			¥200
Consumption tax			¥60
Total			¥1,260

Delivery: Home delivery service

[Return to Top \(Order is not finalized\)](#)

- Step 4: Completion

[Screen example 2]

### Order form

○ Choose the product you want

(1)

(2)

○ Receiver's address

Name:

Postal code:  -

Prefecture:

Address:

Tel:

E-mail address:

Cases possibly not in compliance

[Screen example 3]

(Page 1)

**Application Form**

- Application procedure
- About return
- Payment method

(Page 2)

- About gift
- Application  
 Product A  Product B   
 (Please check)  
 Product 01  Product 02  Product 03   
 .....  
 .....  
 Product 13  Product 14  Product 15   
 (Please check)

(Page 3)

Applicant:

E-mail:

Postal code:

Address:

Tel:

- Payment method  
 Bank transfer  Postal transfer   
 Cash on delivery (COD)   
 (Please check)
- Delivery charge  
 When payment is made by bank transfer or postal transfer, delivery charge is ¥00, irrespective of area. When payment is cash on delivery, delivery charge will vary according to area. (See attached table.) A ¥xx COD charge is added to the delivery charge.

## (II) Opportunities for confirmation and correction

Cases not in compliance

[Screen example 4]

**Order Confirmation**

The following e-mail will be sent:  
 If these contents are OK, please click on "Order with these contents". If you want to correct the contents, return to previous page by using the browser button.

- Products you order

Product	Unit price	Quantity	Subtotal
Product (1)	¥1,000	1	¥1,000
Delivery charge			¥200
Consumption tax			¥60
Total			¥1,260

- Customer
  - Name:
  - Address:
  - Tel:
  - E-mail:
- Receiver
  - Same as customer
- Payment method
  - Cash on delivery

Cases possibly not in compliance

[Screen example 5]

<Screen 1>

Product name ●●●	Image <div style="border: 1px solid black; width: 40px; height: 40px; margin: 0 auto;"></div>	Product description	¥ 5,340
			<input type="button" value="Next"/>

<Screen 2>

Cash on Delivery  
Enter receiver's address.

Name:

Company:

Address:

Postal code:

Tel:

E-mail:

[Screen example 6]

This is the order form.  
Fill out all the blanks and click on the "Apply for product"

☆Name:

☆ Name in kana:

☆Address: Postal code:

Prefecture:

Address:

☆Tel:

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Order I

- Product A  ¥10,000
- Product B  ¥15,800
- Size

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Order II

- Product A  ¥10,000
- Product B  ¥15,800
- Size

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◇ Price  yen

◇ Consumption tax  yen

◇ Total  yen

◇ Payment method

Thank you for your order.

[Explanations]

## **1. Regulation under Article 14 of the Specified Commercial Transactions Law**

Where a business entity induces customers to apply for sales contracts or service contracts against the will of the customers, and where such inducement is considered likely to harm the fairness of trading and the interests of customers, the Minister of Economy, Trade and Industry (METI) may instruct the business entity to take necessary measures (Article 14 of the Specified Commercial Transactions Law).

In internet trading, an “inducement to have a customer request a contract contrary to the will of the customer specifically refers to (i) cases where there are no measures which enable the customer to understand easily that the application results in the formation of a fare-paying contract (Subparagraph 1, Paragraph 1 of the Regulations for the Enforcement of the Specified Commercial Transactions Law) and (ii) cases where there are no customer-friendly measures which enable consumers to confirm and/or to revise the content of his offer easily (Subparagraph 2, Paragraph 1 of the Regulations).

## **2. Guidelines concerning “Inducement to Have the Customer Enter into a Contract Contrary to the Customer’s True Intent”**

The METI has stipulated guidelines concerning “Inducement to Have the Customer Enter into a Contract Contrary to the Customer’s True Intent”. The guidelines include the following interpretative standards:

### **(1) Indication of offer (Subparagraph 1)**

(i) Cases not considered subject to Subparagraph 1:

(A) Cases where a screen entitled “Order Confirmation” (final confirmation screen) is always displayed at the final stage of an offer and where the offer is made only after the button “Order with these contents” etc. is clicked on the screen.

(B) Cases where, in the absence of the final confirmation screen, the following measures are taken to remind customers overtly that this action is the final step in making an offer:

(a) The text on the final offer button reads: “I want to order (buy or apply for) the above product”.

- (b) A message near the final offer button reads: “Do you want to order (buy or apply for)...?” near the final offer button. In addition, the text on the final offer button reads “Yes”.
- (ii) The following cases are likely to fall under Subparagraph 1:
  - (A) Cases where the text of the final offer button only reads “Send”, instead of “Order (or “Buy” or “Apply for”)”; and where no further text on the offer button is displayed.
  - (B) Cases where text misleads the customer to believe the transaction is “free of charge”, such as where the word “Present” is located near the final offer button.

**(2) Opportunities for confirmation and correction (Subparagraph 2)**

- (i) Cases which meet both of the following requirements I and II are generally considered not to be subject to Subparagraph 2:
  - I. Where either of the following measures is taken at the final application stage to enable customers to easily confirm the contents of their offers:
    - (a) At the final offer stage, the offer contents are displayed on the screen.
    - (b) Where although the offer contents are not displayed, a button with the text “Confirm the contents of the order” is displayed and customers can confirm the offer contents by clicking such button; otherwise, a button with the text “For confirmation, please return to the previous page by clicking the ‘back button’ of the browser”.
  - II. Where the customer can easily revise the offer content after the confirmation procedure described in I., such as:
    - (a) At the final application stage, buttons, such as “Change” and “Cancel”, are provided which enable customers to make corrections by clicking on those buttons.
    - (b) Where a statement exists such as “For corrections, please return to the previous page by clicking on the ‘back button’ of the browser”.
- (ii) Each of the following case is subject to Subparagraph 2:

- (A) At the final offer stage, the offer contents are not displayed on the screen and where no button, such as “Confirm the contents of the order”, or other means are provided to allow the consumer to confirm the order contents and where no explanation is given to the effect that the customer can return to the previous page by clicking the ‘back’ button of the browser.
- (B) At the final offer stage, no button, such as a “Change” button, or other means are provided to make corrections and the screen presents no explanation to the effect that customers can return to the previous page by clicking the ‘back’ button of the browser.
- (C) Where the final offer stage induces the customer to make a final offer without confirming the contents of the offer due to the confusing structure of the system (unless otherwise amended by the consumer with complete attention): e.g., the configuration of the final offer stage webpage makes it nearly impossible to determine for how many units the user is making an offer

Reference Note:

Public guidelines exist concerning what webpage layouts pertain to the respective cases mentioned immediately above (Guidelines on “Actions to Have the Customer Request a Contract Contrary to the Wishes of the Customer” in internet trading).

(<http://www.meti.go.jp/kohosys/press/0002003/index.html>)



(3) Regularization on Representations in Web Advertising

**(A) Regulation under the Premiums and Representations Act**

[Issue]

Which Web advertisements are prohibited as misleading representations defined by Article 4 of the Premiums and Representations Act?

[Approach]

The representations of the contents of products or of services and the transaction conditions displayed by business entities on their websites are regulated by the Premiums and Representations Act.

Examples of misrepresentations

- Representing that computer anti-virus software has a “100% detection rate and can detect any virus,” despite the fact that it cannot possibly detect all viruses.
- When the date, on which the information is updated, is not disclosed, such as when a product is deceptively presented to consumers as a “new product”, despite the fact that it is no longer a new product.
- Websites which state that “a free 30 minutes” is available without making it clear that the free 30 minutes can only be used once site is used for 60 minutes or more misrepresenting to consumers that the site can be used unconditionally free of charge.
- Misrepresenting that Company Y internet service provider is “always less expensive than Company Z,” even though the speed of Company Y’s service is slower than that of the service offered by Company Z, misleading consumers to believe that Company Y more cheaply offers the same service as Company A.

[Explanations]

**1. Misleading representations defined by Article 4 of the Premiums and Representations Act**

“Representations”, defined by Paragraph 2, Article 2 of the Act against the Premiums and Representations Act, and regulated by the law include advertisements of equipment used for information processing, including the internet. That is, representations displayed by business entities at their websites of the contents of products or services and their transaction conditions are also regulated by the Premiums and Representations Act.

**(1) Representations for product and service transactions conducted directly through the internet**

(A) Representations concerning products and services in the internet transaction

(i) Problems under the Premiums and Representations Act

Business-to-Consumer e-commerce can by its nature lead consumers to a mistaken understanding when making product or service choices or when placing orders. Therefore, potential exists that consumers can suffer much harm in e-commerce transactions. Accordingly, there is a greater need for businesses to appropriately disclose information to consumers concerning product or service content or the terms of sale, than in transactions that taking place in person.

(ii) Cases where the Premiums and Representation Act applies

- Using expressions such as “Lose 5-6kg comfortably! Fast dieters can normally lose up to 3 or 4 kilograms in one week. Eat as much as you like! Original preparation formulated by our specialists based on medical studies uses natural ingredients that are good for dieting,” to emphasize efficacy and results without any adequate scientific basis and presenting the information in a manner that makes it appear academically authorized.
- Where strict conditions for product returns exist and where in fact almost no products can be returned, a business: does not clearly display the relevant conditions for product returns; states that “customers may return the product at any time even if it is not defective”; represents that users can unconditionally return the product.

(iii) Points of concern

- Business entity should not make disclosures concerning product efficacy without adequate bases when advocating the virtues of a product or service which may cause general consumers to form a mistaken understanding.
- Business entity should accurately and clearly disclose the specific details of their terms of sale such as the selling price, shipping charges, and the product returns policy, etc.

(B) Disclosure manner

(i) Problems under the Premiums and Representations Act

When information that concerns a product or service contents or terms of sale is available through a link, for example, when by clicking on text, you can receive more information

about the product (collectively referred to below as “hyperlink text”), yet is not clearly disclosed, consumers may overlook the hyperlink text. The result is that the consumer may not be exposed to information which may be material to his product decision. In addition, because a company can easily change the disclosure contents on its webpage, if the date is not disclosed on which the information was last updated, it will be difficult for consumers to know when the company first made the disclosed information available.

(ii) Cases where the Premiums and Representation Act applies

- When a business claims “no shipping charges” apply, whereas information disclosed in a link about the product delivery conditions state that “products will only be shipped free of charge to delivery locations within the Tokyo metropolitan area” – for example, when the hyperlink text is shown in unusually small text – consumers may overlook the relevant hyperlink text. By not clicking on the relevant hyperlink text, they will be exposed to the information concerning the relevant delivery conditions. As a result, consumers will come to the erroneous conclusion that products will be delivered unconditionally and free of charge.
- When the date, on which the information was updated, is not disclosed, for example, when a website asserts that a product is “new” with expressions such as “New Product” or “Latest Model,” consumers will wrongly believe that the product or service is the latest version.

(iii) Points of concern

(When hyperlinks are used)

- In order to ensure that consumers know to which information a link leads, businesses should describe the link contents with expressions which clearly communicate the relevant subject matter.
- To prevent consumers from overlooking links, businesses should consider functions such as text size and color to appropriately highlight them.
- The relevant text and links should be placed near related information in a way that ensures consumers will not overlook them.

(Time/Date when the information is updated)

- On each occasion a business entity changes information disclosed on a respective webpage, it should accurately and clearly disclose the date of the most recent change.

## **(2) Disclosures for internet information service transactions**

### **(i) Problems under the Premiums and Representations Act**

Because internet information provider services complete their transactions using the internet, such businesses must appropriately provide consumers with information such as whether they provide their information free of charge, the transaction terms and conditions such as a payment for long-term contracts, and information related to the download procedures used to purchase their products.

### **(ii) Cases where the Premiums and Representation Act applies**

- Information provider sites which merely display “30 Minutes No Charge” without clearly disclosing that the free 30 minutes are conditional upon the consumer using the site for an hour or longer.
- Graphic image provider sites where an advertisement leads the consumer to believe that he is entering a one-month contract, e.g. “First step is the first month”, even though the consumer is entering an ongoing contract which includes the charging of a monthly fee in the month after the first free one.
- On websites selling downloadable website creation software, presenting statements such as “Easy to download,” without clearly showing that a specified version type of OS is required, despite the fact that the program will not function on a computer without the appropriate OS version installed.

### **(iii) Points of concern**

- When an internet information provider service charges service fees, the business should accurately and clearly disclose that a fee will be charged.
- In situations involving long-term agreements such as those that charge monthly user fees, businesses should accurately and clearly disclose that, and how, the fee will be charged.
- Businesses should accurately and clearly disclose information concerning the type of OS, type of CPU, memory requirements, necessary hard disk capacity, and other operating environment conditions essential to utilizing their software.

## **(3) Internet connection service transactions**

### **(i) Problems under the Premiums and Representations**

For internet connection services such as DSL and TS1 which enable consumers to utilize broadband telecommunications, the most important factors in selecting a service include transmission speed, the start date for the provision of services and the service charges, etc., thus businesses must properly provide this type of information to consumers.

(ii) Cases where the Premiums and Representation Act applies

(Internet service providers that enable consumers to use broadband telecommunications)

- It is misleading to represent services by simply stating “8Mbps maximum transmission speed” without disclosing that the maximum transmission speed is not guaranteed and without clear indication that transmission speeds will be slower depending on transmission facility conditions or interference from other circuits. Such misrepresentation may lead consumers to believe that they will always receive broadband service at the maximum transmission speed.
- It is misleading to represent that “You will be able to start using the internet from home in less than 10 days” despite the fact that the provision of services almost never begins within 10 days from the application for service because of delays in line connections, etc.
- It is misleading to represent that a company’s service is “Always less expensive than Company A” without indicating that their applicable service transmission speed is slower than that provided by Company A. Consumers could be misled to believe that the company is providing a similar service to Company A but at a lower price.

(iii) Points of concern

- Businesses should accurately and clearly disclose the fact that their broadband telecommunications speeds may be affected by the quality of the telecommunication facilities or by the interference of other circuits.
- When companies may be unable to begin providing services by the date indicated because of delays for whatever reason, they should accurately and clearly disclose this fact.
- When disclosing service charge comparisons, businesses should make their comparisons against services which are legitimately equivalent in transmission quality according to commonly comparative factors and which are available at the same time.

## **2. Announcement of guidelines**

In an effort to promote the sound development of Business-to-Consumer e-commerce and consumer transactions, the Fair Trade Commission summarized the relevant issues under the

Premiums and Representations Act with respect to representations in Business-to-Consumer e-Commerce, issuing a document entitled “Problems and Points of Concern under the Premiums and Representations Act Concerning Representations in Business-to-Consumer E-Commerce,” setting forth points of concern regarding representations by businesses.

(<http://www.jftc.go.jp/pressrelease/02.june/02060501.pdf>)

## **(B) Regulations under the Specified Commercial Transactions Law**

[Issue]

How do Articles 11 and 12 of the Specified Commercial Transactions Law apply to web advertisements?

[Approach]

In accordance with the advertising regulations of the Specified Commercial Transactions Law, a business entity which sells products specified by the law over the internet must (I) present certain matters (Article 11); and (II) is prohibited from using misleading advertisement (Article 12).

### **(I) Duty of representation**

Matters that must be represented

- Sales price, delivery charge, etc. of the product, service, etc.
- Time and method of payment of the price of the product, service, etc.
- Time of delivery of the product, service, etc.
- Return of the product, service, etc., if returnable, and the conditions to returning it.
- Name, address, and telephone number of the vendor (and the name of the representative or business manager if the vendor is a corporation).
- Date of expiry of the effective period of an offer, if any.
- Description and the amount of any money that the purchaser has to pay in addition to the price of the product, service, etc.
- Contents of the clauses, if any, of the vendor's responsibility for any latent defect in the product.
- Contents of special sales conditions, if any, of the product, service, etc., such as a limited sales quantity.
- E-mail address, if advertising is by e-mail.
- If advertising is by e-mail, the method by which consumers, who do not want e-mails, can notify the vendor of their wishes. When the vendor sends unsolicited e-mail advertisements, in other words absent a consumer request or without obtaining their consent therefor, the vendor shall, following the term “[Business]” at the head of the subject space and in the e-mail text, indicate his name and the e-mail address at which consumers may contact the vendor to request removal from the e-mail list.
- When the vendor sends advertisements by e-mail without being requested by consumers or without obtaining their consent, the vendor must write “Unapproved Advertisement\*” (“*mi-shōnin-kōkoku*”) at the head of the subject space and in the text of the e-mail.

## **(II) Prohibition of misleading advertisements**

Matters prohibiting exaggerated advertisement

- Performance, quality, and efficacy of a product; contents and effectiveness of a service; contents of rights, effectiveness of the service pertaining to rights.
- Special agreements on the delivery of a product and on the taking of delivery and return of a product after the transfer of its title.
- Involvement of the national government, local governments, and other public entities in products, rights, services; in vendors and service providers; in the business conducted by vendors and service providers (Examples: Endorsements such as “Certified by XX Ministry” or “Recommended by XX Prefecture” for products, business entities, and others).
- Country of origin, place of production, and manufacturer
- Matters shown in (I) above

[Explanations]

### **1. Regulations on advertisement under the Specified Commercial Transactions Law**

Transactions concluded through online applications over the internet fall under the category of correspondence sales as defined in the Specified Commercial Transactions Law. Therefore, business entities that sell “specified products, rights, or services” defined in the law (Paragraph 4, Article 2 of the law and Schedules 1 to 3 of the Ordinance for Enforcement of the Specified Commercial Transactions Law) must advertise in compliance with the advertising regulations under the Specified Commercial Transactions Law (Articles 11 and 12). If they violate the regulations, they will be subject to administrative or other penalties.

### **2. Duty of representation**

When vendors advertise, they must present the following matters (Article 11 of the Specified Commercial Transactions Law and Article 8 of the Regulations for Enforcement of the Specified Commercial Transactions Law):

- Sales price, delivery charge, etc. of the product, service, etc.
- Time and method of payment of the product price or service, etc.
- Time of delivery of the product, service, etc.
- Return of the product, service, etc., if returnable, and the conditions to returning it.



- Name, address, and telephone number of the vendor (and the name of the representative or business manager if the vendor is a corporation).
- Date of expiry of the effective period of an offer, if any.
- Description and the amount of any money that the purchaser has to pay in addition to the price of the product, service, etc.
- Contents of the clauses, if any, of the vendor's responsibility for any latent defect in the product.
- Contents of special sales conditions, if any, of the product, service, etc., such as a limited sales quantity.
- E-mail address, if advertising is made by e-mail<sup>11</sup>.
- If advertising is by e-mail, the method by which consumers, who do not want e-mails, can notify the vendor of their wishes. When the vendor sends unsolicited advertisements by e-mail, in other words absent a consumer request and without obtaining their consent therefore, the vendor shall, following the term “Business entity” at the head of the subject space and in the e-mail text, indicate the name and e-mail address of the vendor at which consumers may contact the vendor to request removal from the e-mail list.) (Furthermore, if a consumer notifies a business that consumer no longer desires to receive e-mail advertisements, the vendor is prohibited from sending subsequent e-mail advertisements to the consumer (Article 12-2 of the Specified Commercial Transactions Law).
- When the vendor sends advertisements by e-mail without being requested by consumers or without obtaining their consent, the vendor must write “Unapproved Advertisement \*” (Note) at the head of the subject space and in the text of the e-mail.

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<sup>11</sup> When a person (limited to for-profit entities or individuals engaged in business) sends e-mails to advertise or promote himself or a business (hereinafter referred to as “Specified e-mail”) to persons other than those specific persons who have granted their consent to the sender to receive said e-mails, the sender shall, at the head of the subject space and in the e-mail text, indicate that the e-mail is a Specified e-mail by indicating “Unapproved Advertisement \*” along with his name, address, telephone number, the e-mail address used to send the e-mail, the e-mail address used to receive e-mails requesting removal from the e-mail list, and the like (Article 3 of the Law on Regulations of Transmission of Specified Electronic Mail).

In advertising on personal computer screens, etc., such as at home pages on the web, it is desirable that all of the above matters be displayed for confirmation without necessitating any screen scrolling or switching to other screens. In particular, the vendor's name, address, and telephone number (and the name of the representative or business manager if the vendor is a corporation) should be displayed in such a way that consumers can easily be recognized when an advertisement is initially displayed on the screen. If vendors cannot be displayed in this manner for unavoidable reasons, measures should be taken in advance to enable the consumers to effortlessly move from the beginning of the advertisement to the part where these matters are explicitly shown or require the consumer to go through the screen, which shows these matters, in order to reach the screen on which one can enter a purchase contract.

### **3. Prohibition of misleading advertisements**

When advertising, vendors must not present the following matters in a manner which is substantially different from what they are in actuality or in a manner which will cause a consumer to believe that the subject of the advertisement is better or more advantageous than it really is (Article 12 of the Specified Commercial Transactions Law and Article 11 of the Regulations for Enforcement of the Specified Commercial Transactions Law):

- Performance, quality, and efficacy of a product; contents and effectiveness of a service; contents of rights, and effectiveness of the service pertaining to rights.
- Special agreements on the delivery of a product and on the taking of delivery and return of a product after the transfer of its title.
- Involvement of the national government, local governments, and other public entities in products, rights, services; in Vendors and service providers; in the business conducted by Vendors and service providers. For example, endorsements such as “Certified by XX Ministry” or “Recommended by XX Prefecture” for products, business entities, and others.
- Country of origin, place of production, and manufacturer
- Matters shown in 2 above

**(C) Regulations under the Pharmaceutical Affairs Law and the Health Promotion Law**

[Issue]

How will the Pharmaceutical Affairs Law and the Health Promotion Law apply to the advertisements of health foods, pet-related products, cosmetics, etc. posted on a website?

[Approach]

**(I) Regulations on Indication of Medical Efficacy**

Pursuant to Article 68 of the Pharmaceutical Affairs Law (Law No. 145 of 1960), it is prohibited to advertise drugs unless authorized by the Minister of Health, Labour and Welfare. If the advertisements of food indicate any medical function or efficacy such as prevention and curing of diseases), such food may be deemed an unauthorized drug, in which case such advertisements will constitute a violation of Article 68 of the Pharmaceutical Affairs Law. (Of course, Article 68 does not apply to foods like vegetables, fruits, sweets and prepared foods, etc., which are undoubtedly recognized as food by their appearance or form, etc., or to food for special dietary use containing indications of the specified usage, as authorized under of Article 26 of the Health Promotion Law (Law No. 103 of 2002).) Since the scope of restrictions under the Pharmaceutical Affairs Law extends to drugs designed for animals as well as for human beings, the advertisements of pet foods indicating their effects on animal health is also prohibited by the Pharmaceutical Affairs Law, if these pet foods are deemed as drugs designed for animals due to such indication of medical efficacy.

Further, with regard to the advertisements of food, Article 32-2 of the Health Promotion Law prohibits significantly incorrect or misleading indications such as “effective for maintenance and promotion of health” or “effective for making a human body more beautiful and charming, for changing physical appearance and for maintaining healthy skin or hair”.

**(II) Electronic Message Boards**

Where an electronic message board is set up for discussion of human or pet health foods, messages posted thereon are likely to contain information concerning the medical efficacy thereof. If a business entity that sells health foods sets up an electronic message board on its website expecting the postings of messages concerning medical efficacy of its product, and proactively utilizes the posted messages concerning medicinal efficacy in a manner prohibited under the Pharmaceutical Affairs Law, such electronic message board may be held as an

advertisement of medical efficacy and thus be in violation of the Pharmaceutical Affairs Law.

Example of cases where setting up an electronic message board is likely to constitute a violation of the Pharmaceutical Affairs Law

- A business entity that conducts corresponding sales of health food might set up an electronic message board for its consumers to post comments on the product, with proactive intent to utilize, for advertising purposes, these messages containing word-of-mouth comments on the product's medical efficacy. If such business entity manipulates the message board so that only positive comments affirming the product's medical efficacy, such as its ability to cure diseases, are left on the message board, while other comments which are negative or useless for promotion of sales are deleted, and the consequence will be that only positive comments are listed on the message board. The business entity thereby utilizes the electronic message board for advertising medicinal efficacy of its products in violation of the Law.

Example of cases where setting up an electronic message board is unlikely to constitute a violation of the Pharmaceutical Affairs Law

- If a business entity that sells health food sets up an electronic message board in order to support customers by providing a place for interactive communication, but on the condition that no message referring to the medical efficacy of its products will be permitted, and the message board operator actually deletes comments on such matters, if any, then the business entity does not violate the Law.

### **(III) Establishment of a New Website Regarding the Efficacy of Components of Health Foods**

If a manufacturer or distributor of health food, etc. sets up a link to another website explaining its medical efficacy or its components, or otherwise arranges for another website with references to such matters to link the company's own website, such act may constitute a violation of the Pharmaceutical Affairs Law and the Health Promotion Law, since such act is substantially equivalent to indicating the medical efficacy on its own website<sup>12</sup>.

Furthermore, where a manufacturer or distributor of health food, etc. establishes a new website under the name of such third party as the company's business manager or one of its

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<sup>12</sup> In connection with the Health Promotion Law, the following refer to the illegality of such links:

“The Indications in Internet Advertisements which Cause Legal Issues Under the Health Promotion Law (Example)” (“*kenkou zoushin hou jo mondai to naru internet koukoku hyouji (rei)*” in Japanese, Ministry of Health, Labour and Welfare, January 2004)

<http://www.mhlw.go.jp/topics/bukyoku/iyaku/syoku-anzen/hokenkinow/dl/7f.pdf>;

“Guideline for Inspection and Guidance, etc. for Prohibiting False and Exaggerated Advertisements, etc. and Ensuring Appropriate Advertisements Regarding Effects on Maintenance and Promotion of Health, etc. of Products to be Distributed as Foods (Guideline)” (“*shokuhin to shite hanbai ni kyousuru mono ni kanshite okonau kenkou iji zoushin kouka nado ni kansuru kyogi kodai koukoku nado no kinshi oyobi koukoku nado tekiseika no tame no kanshi shidou nado ni kansuru shishin (Guideline)*” in Japanese, Ministry of Health, Labour and Welfare *Yaku-Shoku-Hatsu* No. 0829007, August 29, 2003)

<http://www.mhlw.go.jp/topics/bukyoku/iyaku/syoku-anzen/hokenkinow/7.html>.

employees, with reference to the medical efficacy of major components contained in such health food, etc., the manufacturer or distributor violates the Pharmaceutical Affairs Law and/or the Health Promotion Law. Where a new website indicates its product name or the contact details of the distributor of its product, etc., even if such new website is not linked to the original website designed for sales of such health food, the act of establishing the new website may constitute a violation of the Pharmaceutical Affairs Law and/or the Health Promotion Law on the ground that it may be held as an advertisement of the medical efficacy of such health food, etc.

**(IV) Cosmetics and Soaps, etc. Manufactured or Imported by a Business Entity not Authorized under the Pharmaceutical Affairs Law**

Pursuant to Article 12, Paragraph 1 of the Pharmaceutical Affairs Law, the manufacturing and importation of cosmetics (including bath products such as soaps and shampoos) are, as it is the case with drugs, reserved for business entities authorized by the Minister of Health, Labour and Welfare. Although the Pharmaceutical Affairs Law does not set forth any penal provision directly applicable to the act of advertising cosmetics manufactured by unauthorized manufacturers, such advertisement of products manufactured or imported without authorization may be regarded as aiding and abetting a violation of Article 12, Paragraph 1 of the Pharmaceutical Affairs Law, for which penalty is set forth in Article 84, Paragraph 1, Item 2 of the same.

**[Explanations]**

If the advertisements of food indicate any medical efficacy such as diagnosis, prevention or curing of human or animal diseases, or effects on the structure and function of human beings or animals, such food may be deemed as an unauthorized drug, in which case such advertisement will constitute a violation of Article 68 of the Pharmaceutical Affairs Law, which provides for imprisonment of up to two (2) years or a fine of up to two million (2,000,000) yen. (As stated, Article 68 does not apply to foods like vegetables, fruits, sweets and prepared foods, etc., which are undoubtedly recognized as food by their appearance or form, etc., or to food for special dietary use containing indications of the specified usage, as authorized under of Article 26 of the Health Promotion Law.)

Pursuant to the letter “Guidance and Regulations on Unapproved or Unauthorized Drugs” (*Yaku-hatsu* No. 476 as of June 1, 1971) by the Ministry of Health, Labour and Welfare<sup>13</sup>, a food (except for products like vegetables, fruits, sweets and prepared foods, etc., which are undoubtedly recognized as food by its appearance or form, etc., and the food for special dietary use indicating the specified usage authorized under Article 26 of the Health Promotion Law) shall be in principle held as an unapproved drug if it falls under one of the following categories:

- (A) Foods containing substances “exclusively used as drugs” (i.e. hormones, antibiotics, analgesic antipyretics and components of a drug requiring a doctor's prescription) as their major components. For example, when the side effects arising from a diet food made in China caused serious injuries, this health food was held as an unapproved drug in violation of the Pharmaceutical Affairs Law, on the ground that it contained medicinal components such as thyroid hormone; and
- (B) Foods which do not contain any substances “exclusively used as drugs” but fall under any of the following categories:
  - The advertisement or package of the food, etc. indicates medicinal efficacy;
  - The food is placed in a container typically used for drugs, such as an ampule-shaped container; or
  - Dosage or administration are indicated in a wording typically used for drugs, such as “after each meal”.

Since the Pharmaceutical Affairs Law also restricts the advertisement of drugs designed for animals as well as for human beings, the advertisement of pet foods indicating their effects on animal health is also prohibited by the same Law, if these pet foods are held as drugs designed for animals according to the above-mentioned criteria.

Further, with regard to the advertisements of food, Article 32-2 of the Health Promotion Law prohibits significantly incorrect or misleading indications such as “effective for maintenance and promotion of health” or “effective for making a human body more beautiful and charming, for changing physical appearance and for maintaining healthy skin or hair”. Moreover, if a food contains certain components exclusively used as drugs, or if its advertisement indicates medicinal efficacy, and it is thus held as a drug according to the aforementioned “Guidance and Regulations on Drugs without Approval or Authorization” (*Yaku-hatsu* No. 476, June 1,

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<sup>13</sup> “Guidance and Regulations on Unapproved or Unauthorized Drugs” (“*mushounin mukyoka iyakuhin no sidou torishimari ni tsuite*” in Japanese, *Yaku-hatsu* No. 476, June 1, 1971) is available at the following website:

<http://www.mhlw.go.jp/topics/bukyoku/iyaku/syokuten/dl/13.pdf>.

1971), such food will be subject to, in addition to the restrictions under the Health Promotion Law, Article 68 of the Pharmaceutical Affairs Law prohibiting the advertisement of unapproved drugs, etc. and Article 66 of the same, which prohibits false or exaggerated advertisements. In addition, an advertisement of cosmetics is subject to Article 66 of the Pharmaceutical Affairs Law prohibiting false or exaggerated advertisements.

In connection with the advertisement of health foods, pet foods and cosmetics, etc., the posting of the personal experience and opinions of consumers regarding their medical efficacy is a particularly sensitive issue. Even where such posting is a correct report of facts, if its contents have reference to medicinal efficacy (i.e. curing of allergy, recovery from diseases, removal of wrinkles, etc.) it will constitute a violation of Article 68 of the Pharmaceutical Affairs Law prohibiting the advertisement of unapproved drugs, etc., and thus such posting will be illegal. Moreover, even where such advertisement is technically in the form of a collection of “personal experiences” of consumers, etc., if, for example, such “personal experiences,” etc. presented by the advertiser are fictitious or a collection of remarks favorable for advertising purposes, and the food or cosmetic seller has exclusively selected favorable comments on the maintenance or promotion of health, while eliminating negative comments, such postings of personal experiences may be held as false and exaggerated advertisements, which is prohibited under Article 32-2 of the Health Promotion Law.

The products with false or exaggerated advertisements are generally expensive and therefore will impose considerable economic burden on consumers if continuously used for a long time. In addition, consumers of such products may suffer damages to health due to their side effects as well as loss of opportunities for appropriate medical care, especially if they trusted the false or exaggerated advertisement. Therefore, such illegal advertisings may lead to civil liability for compensation of damages to consumers who have believed in such advertisement as well as to the penal and administrative sanctions.

**(D) Regulations under the Money Lending Business Law and Other Relevant Laws**

[Issue]

What regulations will the Money Lending Business Law and other relevant laws impose on money lenders' website advertisements and financial instruments transactions, such as currency forward contracts or commodity futures?

[Approach]

Article 15 of the Money Lending Business Law (Law No. 32 of 1983, "*kashikin gyō hō*" in Japanese) requires money lenders to indicate their trade name, interest rate of loans, etc. when they advertise the conditions of loans, irrespective of whether or not they advertise on a website. Furthermore, Article 16 of the same prohibits money lenders' advertisements their business from indicating the conditions of loans in a materially incorrect manner, or misleading others to believe that such conditions are significantly more favorable than the actual conditions.

In connection with the advertisement of financial instruments such as a currency forward contract, all the items stipulated in Article 37 of the Financial Instruments and Exchange Law (Law No. 25 of 1948, "*kinyū shūhin torihiki hō*" in Japanese), Article 16 of the Cabinet Order for Enforcement of the Financial Instruments and Exchange Law (Cabinet Order No. 321 of 1965, "*kinyū shūhin torihiki hō sekōrei*" in Japanese), and Articles 73 through 76 of the Cabinet Office Ordinance Regarding Financial Instruments Businesses (Ordinance No. 52 of 2007, "*kinyū shūhin torihiki gyō nado ni kansuru naikaku furei*" in Japanese), and other relevant laws, must be specified in writing, including the risk of loss exceeding the amount of consignment guarantee money, the ratio of the transaction amount to the amount of consignment guarantee money (to the extent the amount of consignment guarantee money is leveraged), etc. Similarly, in regard to the commodity futures, the items stipulated in Article 213-2 of the Commodity Exchange Act (Law No. 239 of 1950, "*shūhin torihiki shō hō*" in Japanese), Article 10-2 of the Cabinet Order for Enforcement of the Commodity Exchange Act (Cabinet Order No. 280 of 1950, "*shūhin torihiki shō hō sekōrei*" in Japanese), and Article 100-2 of the Ordinance for Enforcement of the Commodity Exchange Act (Ordinance No. 3 of 2005, "*shūhin torihiki shō hō sekō kisoku*" in Japanese) must be indicated in writing. In addition, in the commodity market, it is prohibited to make an exaggerated advertisement with respect to the expected profits, etc. procured through transactions, etc.

[Explanations]



## **1. Regulations under the Money Lending Business Law**

Article 15, Paragraph 1 of the Money Lending Business Law and Article 12 of the Ordinance for Enforcement of the Money Lending Business Law require the following items to be indicated in the advertisement:

- (A) Trade name, and registration number of money lending business of the money lender;
- (B) Interest rate of loan;
- (C) Method and term of repayment and number of payments to be made;
- (D) If the amount of damages (including penalty charges) is set, ratio of such amount of damages to the principal amount; and
- (E) Matters relating to collateral (if collateral is required).

In addition, Article 15, Paragraph 2 of the Money Lending Business Law prohibits money lenders from indicating in their advertisements any contact details other than “the contact address specified in the register of the money lending business.”

Furthermore, Article 16 of the same prohibits money lenders from displaying the following advertisements:

- (A) Indications or explanations of the interest rate or conditions of loans that are materially incorrect or that mislead others to believe that such conditions are significantly more favorable than the actual conditions;
- (B) Indications or explanations which mislead others to believe that a certain product designed for soliciting persons in need of financial resources is the main product of such money lenders;
- (C) Indications or explanations attempting to loan money to persons who owe money to other money lenders or to persons lacking the financial capacity for repayment;
- (D) Indications or explanations which induce persons in need of financial resources to take out loans by overemphasizing the easiness to do so;
- (E) Indications or explanations attempting to induce beneficiaries of public pension or allocation, etc. to take out loans; and
- (F) Indications or explanations which lead others to misidentify the loan’s actual interest rate.

## **2. Regulations under the Financial Instruments and Exchange Law**

Where a financial instruments firm, such as a securities company, investment fund, investment advisory and brokerage company, or investment management company, advertises

the contents of its transactions<sup>14</sup>, such firm must indicate all of the following items, as required by Article 37 of the Financial Instruments and Exchange Law, Article 16 of the Cabinet Order for Enforcement of the Financial Instruments and Exchange Law and Articles 73 through 76 of the Cabinet Office Ordinance Regarding Financial Instruments Businesses, and other relevant laws:

- (A) Trade name of the firm;
- (B) The fact that the firm is a financial instruments firm<sup>15</sup> and its registration number;
- (C) The breakdown and total of the commission, trust charge, expenses and other consideration (except the consideration for securities or rights relating to derivatives, etc.) payable by customers for the relevant transactions, the maximum amount thereof, or its calculation method;
- (D) In the case of transactions that require the deposit of consignment guarantee money, the amount thereof and its calculation method;
- (E) If there is a risk of loss exceeding the amount of consignment guarantee money in a derivatives transaction, etc., that fact and the ratio of the transaction amount of such derivative transaction, etc. to the amount of consignment guarantee money (if calculation of such ratio is impossible, that fact and the reasons thereof);
- (F) If there is a risk of loss arising directly from such indicators as the interest rate, exchange rates or stock index, such indicators and the fact that fluctuation thereof may result in loss, and the reasons thereof;
- (G) If there is a risk of loss as referred to in the preceding item that exceeds the amount of consignment guarantee money, the indicator(s) which may directly lead to such loss, the fact that there is a risk of such loss, and the reasons thereof;
- (H) In regard to over-the-counter derivative transactions such as foreign exchange margin trading, where there is a difference between the selling price and buying price indicated by a financial instruments firm, etc., that fact;
- (I) Disadvantageous facts for customers in relation to other important matters; and

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<sup>14</sup> If a securities company advertises names of certain fund products, such advertisement will fall under the advertising of contents; however, the image advertising of a company will not in itself fall thereunder.

<sup>15</sup> This term refers to financial instruments firms and financial institutions, such as banks registered to conduct a type of business requiring authorization, etc., including the intermediary business for documents concerning financial instruments transactions (Article 33-2 of the Financial Instruments and Exchange Law).

- (J) If the firm is a member of the Financial Instruments Firms Association, that fact and the name of the specific association.

### **3. Regulations under the Commodity Exchange Act**

In cases where a futures commission merchant advertises the contents of his, her, or its business of accepting consignment of commodity transactions, all the following items must be indicated, as required by Article 213-2 of the Commodity Exchange Act, Article 10-2 of the Cabinet Order for Enforcement of the Commodity Exchange Act and Article 100-2 of the Ordinance for Enforcement of the Commodity Exchange Act:

- (A) Trade name of the futures commission merchant;
- (B) The fact that the merchant is a futures commission merchant;
- (C) The breakdown and total amount of consideration payable by customers under whatever titles including but not limited to commission, remuneration and expenses in connection with the consignment contract or, alternatively, the maximum amounts thereof, or the outline of their calculation method (if it is impossible to indicate them, that fact and the reasons thereof);
- (D) In the case of transactions which require the customers to deposit a clearing margin, etc., the amount thereof and its calculation method;
- (E) If the transaction amount under the consignment contract is significantly larger than that of the clearing margin, etc. to be deposited by customers for the transaction, that fact, and the ratio of such transaction amount to such clearing margin, etc. (if such calculation is impossible, that fact and the reasons thereof);
- (F) The fact that transactions under the consignment contract involve a risk of loss incurred by customers due to the fluctuations in the commodity market and, furthermore, that the amount of such loss may exceed that of the clearing margin, etc., and the reasons thereof; and
- (G) If the futures commission merchant is a member of the Commodity Futures Association of Japan, that fact and the name of the specific association.

#### (4) Acquisition of Personal Information via the Internet

[Issue]

What legal problem will arise when the business entity acquires personal information from the users via the internet?

[Approach]

Where the internet is used for business, the entity performing the business (“business entity,” or *jigyo-sha* in Japanese) commonly directly acquires certain personal information from the users via the internet and uses it in the form of a database.

Where the business entity acquires personal information by which individuals can specifically be identified directly from users via the internet through, e.g., membership registration, such business entity is under an obligation to specify and clarify to the maximum extent possible the ultimate purpose for which such personal information is used. It might be considered illegal to acquire personal information from users without disclosing such fact, e.g., where a business entity checks, by using cookies, certain available information such as website browsing history against personally-identifying information registered when they subscribed for a membership etc. without their knowledge. This is because such conduct does not comply with Articles 17 and 18 of the Act on the Protection of Personal Information (“Personal Information Protection Act”) or may constitute a tort or other cause of action under the Civil Code on the grounds of invasion of privacy. Additionally, it might also be illegal to acquire personal information from children using a website, taking advantage of their lack of judgment or comprehension and of their parents’ ignorance of such fact. This is because such conduct does not comply with Article 17 of the Personal Information Protection Act, or may constitute a tort under the Civil Code on the grounds of invasion of privacy.

In addition, the acquisition of sensitive information, including but not limited to physical and mental disorder, or criminal records which would lead to social discrimination in a form where particular individuals may be identified might be illegal on the grounds of invasion of privacy unless such individuals specifically give consent thereto and such acquisition is reasonably needed.

Furthermore, the use of spyware programs installed against the will of the user by which his/her personal information is acquired and transmitted to third parties might be considered illegal because such conduct constitutes the acquisition of personal information by improper means.

Example of cases where the acquisition of personal information might be illegal

- A business entity utilizes personal information obtained when users subscribed for a membership or conducted internet trading, etc., or users' website usage history including browsing or searching history that is tracked by, e.g., a cookie, but such tracking was not disclosed to the users in such a manner that they could become aware of it.
- A business entity collects information (e.g. amount of allowance, private school and after-school lessons and the name of the commuting school) by using a website designated for elementary school pupils with the intent of assessing their family's economic conditions under the pretext of a questionnaire for application for a prize offer, and then uses such information for marketing without disclosing such purpose in such a manner that the targeted elementary school pupils can become aware of it.
- A business entity acquires a user's personal information such as its ID or password by using a spyware program installed without the user's permission whereby the user's personal information can be obtained by the operator and transmitted to third parties.

Example of cases where collecting information about individuals may be considered lawful

- With respect to e-learning services designated for elementary school pupils for which contracts are executed with the consent of their parents, a business entity operating such services acquires pupils' personal information that is reasonably related to the test results or otherwise to the purpose of e-learning.
- A business entity providing assistance in computer use instructs its customers to install, pursuant to the executed agreement, software for remote support and arrange so that the information related to operating procedures or files on the computer will automatically be transmitted to such entity for the purpose of instructing how to use the computer and detecting errors.

Example of cases which will not fall under the acquisition of personal information

- In regard to advertisements for which fees will be paid in accordance with performance, an advertisement agency tracks the website usage history of users who clicked on banner advertisements by using a cookie in order to confirm whether or not they purchased products from the advertiser's website, but the agency has no information that could identify particular individuals.

[Explanations]

**1. Problem identification**

In internet businesses such as internet trading, information retrieval sites, reference material request services, questionnaire and market surveys and mail magazines, business entities often obtain personal information directly from users via the internet, and further utilize such information by compiling a database.

In the real world, as a rule, personal information is acquired in such a way that individuals can themselves understand and control any personal information obtained by others (e.g., by filling in documents themselves). However, on the internet, personal information including users' website usage history is often obtained in such a manner that they cannot easily recognize the fact that their personal information was obtained.

In addition, since it is difficult for parents to constantly monitor their children's use of the internet, parents' personal information may be obtained without their knowledge from their children who lack proper judgment.

Further, users' personal information may be obtained through software called spyware that has been installed without their permission, and eventually such information will be used for purposes such as marketing.

As described above, there are many problems peculiar to the acquisition of personal information via the internet that will not arise in the real world. Therefore, this section discusses the legality of the acquisition of personal information via the internet.

## **2. Applicable laws**

Article 15 of the Personal Information Protection Act provides that "A business entity handling personal information shall specify the purpose for which such personal information is used to the maximum extent possible in handling personal information." Article 18 of the same Act imposes on such business entity an obligation to expressly specify the purpose for which the personal information will be used when it is obtained directly from the object person in writing, including electronically, and, where such personal information has been obtained in some other way, to disclose or notify such person of the purpose.

Under the Personal Information Protection Act, even where certain personal information is acquired via the internet, if such personal information is collected in a form where particular individuals cannot be identified (e.g. collecting information such as website browsing history by using a cookie), the business entity is not obligated to disclose or notify the purpose for which the personal information will be used. However, even where a business entity collects information by which particular individuals cannot be identified, if it cross-checks, by cookie, such information against personally-identifying information registered when they subscribed for a membership etc. for purposes such as marketing without notifying them of such fact in a manner comprehensible to ordinary people, the conduct of such business entity might be held illegal on the ground of non-compliance with Article 18 of the Personal Information Protection Act.

In addition, Article 17 of the Personal Information Protection Act provides that "Any business entity handling personal information shall not obtain personal information by deception or an otherwise unjust method." The definition of "unjust method" would be determined on a case-by-case basis in light of common practice as well as the purpose of the Personal Information Protection Act. The following methods may fall under the definition of "unjust method."

**(1) Acquisition of personal information by falsifying the intention or purpose of such acquisition**

This is an acquisition of personal information by “deception”. Therefore, it will clearly be considered illegal.

In regard to websites designated for children, their faculty of judgment should be taken into consideration in order to determine whether or not the business entity “falsifies the fact or purpose of acquiring personal information”. Therefore, even conduct which would be considered harmless for ordinary websites designated for adults might pose problems in those designated for children. For example, if the business entity proactively publicizes the purpose of acquiring personal information highly seductive to children such as an invitation to a prize-competition, while nominally indicating the essential purpose of such acquisition in a manner understandable only to adults, the children will likely enter their personal information without understanding the purpose for which it will be utilized. Accordingly, the aforementioned act of acquiring personal information, taking advantage of children's lack of judgment, might fall under the acquisition of personal information by “deception.” Where certain personal information that is irrelevant to the purpose of the website, such as their parents’ occupation or income or their family’s hobbies is derived from children, the legality of the method of acquisition of personal information may be questioned. This is because it is inappropriate to collect information through the website from children, rather than from their parents, without any reasonable needs for it, and moreover it is difficult for children to understand the purpose or seriousness of having their personal information acquired.

**(2) Acquisition of personal information from the object person while concealing the fact of such acquisition**

The act of acquiring certain personal information directly from users in a secret manner is highly likely to be considered illegal on the grounds of “unjust methods,” as prohibited in Article 17 of the Personal Information Protection Act in light of common practice as well as of non-compliance with Article 18 of the same, provided that it would be reasonably possible to acquire it after disclosing the fact of such acquisition of personal information. For example, where a product is sold and delivered to the consumer with an IC tag which can perceive information from remote places, personal information of the purchaser may be obtained without his/her knowledge<sup>16</sup>.

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<sup>16</sup> “Guidelines for Privacy Protection with Regard to RFID Tags (IC Tag)” Ministry of Economy, Trade and Industry and Ministry of Internal Affairs and Communications (June 8, 2004)

Whether or not a certain method is categorized as an “unjust method” depends on the degree of significance of confidentiality in connection with the personal information obtained. For example, where a business entity acquires sensitive personal information including physical and mental disorders, or criminal records and any other information which will lead to social discrimination in a form where particular individuals could be identified, such acquisition of personal information might be held illegal, unless the object person gives express consent thereto and the acquisition of such information is reasonably needed.

Further, leaking such personal information or disclosing it to third parties without the consent of the object person might constitute a tort under the Civil Code on the grounds of invasion of the right to privacy<sup>17</sup>. Even where the personal information is not leaked to any third parties, if the moral rights of the object person were infringed due to the acquisition of his/her personal information by an act which does not comply with the Personal Information

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<sup>17</sup> The following is the major judicial precedents which affirmed the liability for tort for leaking personal information or providing it to third parties;

- (i) NTT Telephone Directory Case (Tokyo District Court Judgment dated January 21, 1998, p.102 of *Hanrei Jiho* Vol. 1646)

NTT had published names, telephone numbers and addresses of the Plaintiffs in the telephone dictionaries issued and distributed by NTT although they had requested NTT not to do so. With respect to this matter, the Plaintiffs claimed that they suffered mental damages due to the invasion of their privacy and filed an action against NTT with the Tokyo District Court, demanding, in addition to the compensation of damages for mental suffering, that NTT distribute advertisements to the recipients of such telephone directories by NTT, asking them to dispose of them on the ground of the moral rights. The Tokyo District Court ruled that NTT was liable for tort on the ground of invasion of privacy rights and ordered NTT to pay 100,000 yen as compensation for mental suffering.

- (ii) Case of Leakage of Basic Resident Register Data of Uji City (Kyoto District Court Judgment dated February 23, 2001, Osaka High Court Judgment dated December 25, 2001, Final Appeal Rejected by the Supreme Court (*Jokoku-Fujyuri-Kettei*) dated July 11, 2002)

Uji-shi planned to develop a medical examination system for babies by utilizing data in the basic resident register of which Uji-City was in charge. For this purpose, the development business was consigned by Uji-City to a private company, which further consigned the same to another company all the way down. Then, a part-time employee of the consignee (three-step consignments between Uji-City) made unauthorized copies of the data in the basic resident register and sold them to name-list distributors, who further resold them to other distributors. With respect to this matter, three inhabitants in Uji-City claimed that they had suffered mental damage due to the aforementioned leakage of data and filed an action against Uji-City with the Kyoto District Court, demanding compensation of damages for mental sufferings and attorney's fee. The Court finally ruled that Uji-City is liable for invasion of privacy rights and ordered Uji-City to pay 15,000 yen (10,000 yen as compensation for mental sufferings and 5,000 yen as attorney's fee) for each person.

- (iii) Case of Lecture of President Jiang Zemin at Waseda University (Tokyo High Court Judgment on March 23, 2004, p.104 of *Hanrei Jiho* Vol. 1855)

When President Jiang Zemin gave a lecture at Waseda University, Waseda University submitted a list of attendants of the lecture which described their student ID numbers, names, addresses and telephone numbers to the police for the convenience of security. With respect to this matter, the Supreme Court ruled by its judgment that submission of such list constitutes an invasion of the attendants' privacy rights (Supreme Court Judgment dated September 12, 2003, p.973 of *Minshu* 57-8) on September 12, 2003. The case was reversed down to the High Court from the Supreme Court rendered the final judgment that ordered Waseda University to pay 5,000 yen for each person as compensation for mental sufferings in consideration of the reasonableness of the purpose of disclosure and relatively low significance in terms of privacy of the targeted personal information.



Protection Act, the acquisition of personal information in itself might constitute a tort. Whether or not such acquisition of personal information constitutes a tort under the Civil Code on the grounds of invasion of the right to privacy rights depends on the degree of significance of confidentiality in connection with the acquired personal information. For example, where a business entity acquires sensitive personal information including but not limited to physical or mental disorder, criminal records which will lead to social discrimination in a form where particular individuals could be identified, such acquisition of personal information might be held illegal on the grounds of invasion of the right to privacy.

### **(3) Acquisition of personal information via the information retrieval site.**

In connection with information retrieval sites, retrieved information would include such items as search words entered from a user's computer or his/her website usage history or IP address as well as cookie information which could identify the accessed browser. While the history of search words and browsing history imply the user's personal interests and thus they are highly private matters, cookie information or IP addresses alone generally are not enough to identify particular individuals. Therefore the acquisition of such information is in itself unlikely to pose serious problems in connection with the privacy or protection of personal information.

However, where customers ask a specific company to send them certain information or materials concerning real estate or secondhand cars by entering their personal information based on their search results, or where customers purchase products by entering their personal information after searching for them on a website, or where customers utilize the information retrieval site after logging into it by entering their IDs and passwords, which have links to the acquired personal information when they were registered as members, it is technically possible to check out the user's personal information against their history of search conditions or search words or contents browsing history.

If the operator of the information retrieval site acquires individual users' log information such as a history of search conditions or search words or contents browsing history in a form where particular individuals can be identified without disclosing the fact of such acquisition to them, such acquisition of personal information might constitute not only a tort on the grounds of invasion of users' rights to privacy, but also might not comply with the obligation to notify users of the purpose of use etc. and to properly acquire the personal information under Articles 18 and 17 of the Personal Information Protection Act, respectively. The reason for this is as follows:

- (i) It is difficult for general users to expect that information such as their search conditions or search words or browsing history will be acquired as personal information;
- (ii) It is likely that general users do not wish to have their search words or browsing history known by someone else; or
- (iii) For the purpose of search services, it is not necessary to preserve the log of search words or contents browsing history in a form where particular individuals can be identified.

#### **(4) Acquisition of personal information via online shopping sites**

As a rule, no problem will arise if a business entity operating an online shopping site acquires information pertaining to the clients who purchased products such as their addresses, names or credit card information or their buying history within the scope of the purposes specified and disclosed to the users. Further, it would generally be reasonable for a retailer to analyze such personal information and use it for the purpose of individual marketing (e.g. sending e-mails to or publishing advertisements to individual clients based on each client's buying trends).

However, as mentioned in (3) above, users do not necessarily expect that their browsing or searching history in connection with the products, in addition to their purchase records, will be obtained as personal information. Therefore, if the business entity wishes to obtain such information by using cookies, etc., it must disclose the fact of the acquisition of such personal information by notifying the users to that effect, specifically indicating the purpose for which such information will be used.

#### **(5) Acquisition of personal information via spyware programs**

The user's personal information and the like may be acquired through certain programs installed without the user's permission. Such programs are sometimes called spyware. By its nature, unlike other application software installed intentionally by users, it is generally difficult for users to detect the operation of or delete spyware.

As mentioned above, it is not desirable, in light of the "Prohibition on acquisition of personal information by unjust methods" as referred to in Article 17 of the Personal Information Protection Act, to obtain any personal information without the knowledge of the object person. In this context, it is highly likely that obtaining personal information in secret by using a program the operation of which is hard to detect and which cannot be deleted easily by users would be considered illegal.

In particular, it is clearly illegal to steal personal information including IDs and passwords through a program installed without a user's permission, such as keylogger software (i.e. spyware that records and transmits key input information). Keylogger software is notorious for being abused in internet banking and in order to steal IDs and passwords.

In connection therewith, although it would generally be lawful to acquire users' personal information by using certain programs installed upon their consent, if they are not substantially considered as having given such consent, such acquisition of personal information is highly likely to be held illegal.

For example, some programs designed to acquire certain personal information are incorporated into other piece of software such as freeware (free software). Such freeware and incorporated information acquisition software is installed upon the consent of the user once the user has clicked the Agree button on his/her browser, and has consented to the acquisition of his/her personal information referred to in the license agreement for the freeware. There is a question of whether such information acquisition would be considered illegal or lawful.

In this case, some may argue that such acquisition is not illegal because the object person has given consent to it. However, we should consider the following points, (i) the agreement on the acquisition of personal information is by nature completely different from that of license agreement, and thus the user generally cannot expect that such provisions on the consent to the acquisition of personal information is referred to in the license agreement; (ii) most users would not give consent thereto if they were aware of the provision on the consent to acquisition of personal information by spyware; and (iii) it would be, considered on the whole, somewhat fraudulent and unexpected by the users for such provision referring to consent to the acquisition of personal information to be inconspicuously placed in the license agreement.

In this case, the business entity should contrive ways of drawing the attention of users to the existence of the provision on the acquisition of personal information by, for example, indicating "Agreement on the License and Consent to the Provision of the Acquisition of Personal Information" instead of "License agreement." If the business entity fails to do so, it would be generally difficult to consider the user's clicking on the Agree button as his/her consent to the acquisition of personal information.

## 4. Cross-Border Transactions

### (1) Applicable Law Where the Governing Law is not Specified by the Parties

#### [Issue]

Where business entities conduct transactions via the internet across borders, such transaction shall be governed by the law specified by the parties. However, if the parties do not specify any governing law, how should the applicable law be determined?

#### (Examples)

1. Where products are sold between business entities across borders, how should the governing law applicable to the transaction be determined?
2. In the case of purchase and sale of software by means of downloading between business entities across borders, how should the governing law applicable to the transaction be determined?

#### [Approach]

Pursuant to Article 7 of the Act on the General Rules of Application of Laws (*Ho no tekiyo ni kansuru tsusokuho*) (the “Act on the Application of Laws”) which came into effect in January, 2007, transactions that are conducted between business entities across borders via the internet shall be governed by the law specified by the parties.

#### Example of a clause which determines the governing law applicable to a contract

- “All the matters pertaining to this Agreement shall be governed by the laws of France.”

On the other hand, where the parties did not specify the governing law, Article 8, Paragraph 1 of the Act on the Application of Laws provides that the transaction shall be governed by “the law which governs the place most closely related with the transaction.”

On this note we must determine what “the law which governs the place most closely related with the transaction” is. Article 8, Paragraphs 2 and 3 of the Act on the Application of Laws provides that, where one party to a contract is to grant “the characteristic benefit” in a transaction, the law which governs the place of the party’s permanent residence shall be presumed to be the law which governs the place most closely related with the transaction, except in cases where the subject matter of the transaction is an immovable estate, and these transactions will not generally be completed merely on the internet.

In addition, under the Act on the Application of Laws, where such party has a business location for the transaction, the law which governs the place of such business location shall be presumed to be the law which governs the place most closely related with the party. If the business locations extend across two or more countries, the law which governs the place of principal business locations shall be presumed to be the law which governs the place most closely related with the party.<sup>18</sup>

### **(I) Purchase and sale of products between business entities across borders**

One example, in a cross-border purchase and sale conducted between business entities, the seller is the party granting “the characteristic benefit.” Therefore, where a purchase and sale of products is conducted between business entities across borders, the law which governs the place of the seller’s permanent residence shall be presumed to be the law which governs the place most closely related with the transaction. Therefore, if the seller has a business location for the transaction, the law which governs the seller's business location shall be presumed to be the law which governs the place most closely related with the transaction. In the situation that the business is located across two or more countries, the law which governs the place of principal business location shall be presumed to be the law which governs the place most closely related with the transaction. By way of example, where a Japanese business entity sells products to a foreign business entity via its own website, the Japanese law shall be presumed to be the law which governs the place most closely related with this transaction. On the other hand, where a Japanese business entity purchases products from a business entity in a foreign country via its own website, the law of that country shall be presumed to be the law which governs the place most closely related with this transaction.

### **(II) The purchase and sale of software by means of downloading between business entities across borders**

The aforementioned rules shall also apply to cases where business entities conduct a purchase and sale of software by means of downloading across borders. More specifically, where a

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<sup>18</sup> <Act on the Application of Laws >

Article 7 (Choice of Applicable Law by the Parties)

The formation and effect of a juristic act shall be governed by the law which governs the place specified by the parties at the time of act.

Article 8 (Where the Applicable Law is not Specified by the Parties)

- (1) Where no applicable law is specified under the preceding Article, the formation and effect of a juristic act shall be governed by the law which governs the place most closely related with the act at the time of such act.
- (2) For the purpose of the preceding paragraph, where only one party is to grant the characteristic benefit of the juristic act, the juristic act shall be held most closely related with the law which governs the place of his/her permanent residence (i.e. where a business location is related to the act, the law which governs such business location, or the principal business location if there are more than one business locations in different jurisdictions).

Japanese business entity sells software to a foreign business entity via its own website, the Japanese law shall be presumed to be the law which governs the place most closely related with the transaction. On the other hand, where a Japanese business entity purchases software from a business entity in a foreign country via its own website, the law of such country shall be presumed to be the law which governs the place most closely related with the transaction.

[Explanations]

### **1. Cross-border transactions on the internet between business entities and international private laws**

The spread of the internet has encouraged business entities to conduct cross-border transactions with one another. These transactions have resulted in an increasing number of cross-border disputes. The contracts, of which interpretation becomes an issue for settlement of such disputes, are not necessarily interpreted in accordance with the Civil Code or the Commercial Code of Japan. That is, transactions with a foreign business entity may be governed by of a foreign country in which such business entity is located or by the civil and/or commercial code of another country.

It becomes important to understand the criteria for determining which civil and/or commercial code will be applicable to the transaction. Previously, the law serving as criteria for determining the civil and/or commercial code applicable to cross-border issues is generally called the “international private law.” Article 3 of the Rules concerning the Application of Acts (“*hourei*” in Japanese, hereinafter, the “Law Application Principles Act”) served as the international private law of Japan. However, at present the Act on the Application of Laws (“*hou no tekiyou ni kansuru junsokuhou*” in Japanese, hereinafter, the “Act on the Application of Laws”) which came into effect as of January 1, 2007 sets forth which civil and/or commercial code shall be applicable to cross-border transactions.

We should note, however, the Act on the Application of Laws determines which civil and/or commercial code shall be applicable to cross-border disputes from an in-country perspective, in other words, on the exclusive assumption that such disputes are brought into a court of Japan. Therefore, where disputes are brought into a court in a foreign country, the civil and/or commercial code applicable to them will be determined pursuant to the international private law of the country. Consequently, the applicable civil and/or commercial code might be different pursuant to the international private law of a foreign country.

Based on the aforementioned principle, the following section will discuss, the assumption that any disputes are brought into a Japanese court, and additionally examine which civil and/or commercial code will be applicable pursuant to the international private law of Japan.

## **2. Where the governing law has been specified by the parties**

Firstly, where the parties have specified a governing law at the time of the transaction, Article 7 of the Act on the Application of Laws provides that such law governs the contract.

Therefore, irrespective of whether the subject matter of the transaction is a tangible or an intangible object such as software available if it is downloaded it from the server on the internet, the transaction shall be governed by the civil and/or commercial code that governs the place specified by the parties in a contractual provision on the governing law.

In addition, even where no governing law was specifically agreed upon, the court commonly held that, pursuant to Article 7, Paragraph 1 of the Law Application Principles Act, the governing law was, all things considered, implicitly specified by the parties to a contract (p.616 of Judgment of the Supreme Court, April 20, 1978, *Minshu* Vol. 32-3).<sup>19</sup> Now, the Act on the Application of Laws is flexibly applicable to cases where no governing law was specified by the parties, as is more fully described in the following sections. We should note, however, the parties need not necessarily specify the governing law expressly. In other words, the parties may be regarded as having implicitly specified the governing law, considering such circumstances such as whether the foreign website has a Japanese version or whether the price is indicated in Japanese yen or such website refers more or less to consumer protection laws of Japan.

## **3. Where no applicable law is specified by the parties**

Which law will govern the transaction if no governing law is specified by the parties?

Article 7, Paragraph 2 of the Law Application Principles Act provides that, in this case, the transaction shall be governed by “the law which governs the place of the act.” Further, Article 9, Paragraph 2 of the same provides that the formation and/or effect of a contract shall be determined by the law which governs the place from which the notice of offer was dispatched (provided, however, if the receiver is unable to identify such place at the time of acceptance of the offer, the offeror's domicile shall be considered as the place of the act).<sup>20</sup>

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<sup>19</sup> <Law Application Principles Act>

Article 7

With respect to the formation and effect of a juristic act, the governing law shall be determined based on the will of the parties thereto.

<sup>20</sup> <Law Application Principles Act>

However, there have been potential disputes arising from the lack of clarity as to which party's act should be regarded as an "offer." Moreover, some theories have disapproved the idea that the governing law shall be determined based on the place of the act, because the place of conclusion of a contract is not necessarily closely related with the contract.

Article 8 of the Act on the Application of Laws, while providing that, where no governing law is specified, the "law which governs the place most closely related with the contract" (Paragraph 1), set forth provisions to presume the "law which governs the place most closely related with the contract" (Paragraphs 2 and 3). More specifically, except in the cases where the object matter of the transaction is an immovable, "the law which governs the place of permanent residence of the party" who is to grant "the characteristic benefit" shall be presumed to be the law which governs the place most closely related with the transaction. Further, where the party granting the characteristic benefit has a business location for the transaction, the "law which governs the place of such business location" shall be presumed to be the law which governs the place most closely related with the transaction. If the business locations extend across two or more countries, the "law which governs the place of principal business location" shall be presumed to be the law which governs the place most closely related with the transaction.

Therefore, in the case of transactions via the internet between business entities, the location of the server etc. will not be a decisive factor in determining the law applicable to such transaction.

#### **4. "Party" who is to grant the "characteristic benefit"**

The "characteristic benefit" herein means the benefit which distinguishes a certain type of contract from others. In the case of purchase and sale of products, whether tangible or intangible, the seller of products is the "party" who is to grant the "characteristic benefit." More specifically, in the case of purchase and sale of software available if it is downloaded from server on the internet, the seller of such software is the "party" who is to grant the "characteristic benefit."

Therefore, where a Japanese business entity sells products, whether they are tangible objects or software, to a foreign business entity via its own website, the Japanese law shall be presumed to be the law which governs the place most closely related with the transaction.

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#### Article 7, Paragraph 2

Where the will of the parties is not clear, the law which governs the place of the act shall govern.

#### Article 9, Paragraph 2

With respect to the formation and/or effect of a contract, the place from which a notice of offer was dispatched shall be considered as the place of the act. Where the recipient of such offer is not, at the time of his/her acceptance of the offer, aware of the place from which the offer was dispatched, the place of the offeror's domicile shall be deemed as the place of the act.



On the other hand, where a Japanese business entity purchases products from a business entity in a foreign country via its own website, the law of such country shall be presumed to be the law which governs the place most closely related to the transaction.

## **5. Where the applicable law is not determined based on the aforementioned presumption**

It is, above all, the “law which governs the place most closely related” that shall be applicable pursuant to Article 8 of the Act on the Application of Laws. The basis for application of the law which governs the place of permanent residence or business location of the “party” who is to grant the “characteristic benefit” derives from the idea that such law governs the place most closely related with the transaction. Therefore, if any law other than above is considered as the law which governs the “law that governs the place most closely related” with the transaction, the governing law shall not be determined in accordance with the presumed assumption.

## **6. Formalities of Contract**

The requirements for conclusion of a contract consist of substantive and stylistic requirements (e.g. whether or not the contract must be in writing or sealed, etc.). The aforementioned explanation is true to the substantive requirements for conclusion of a contract.

In regard to the stylistic requirements (so-called formalities), where a cross-border transaction is substantively governed by a foreign law which is unfamiliar to the parties, the parties may, pursuant to the foreign law, carelessly conclude a contract which does not meet the necessary stylistic requirements. In order to prevent the parties from suffering from unexpected damages in such cases, Article 10 of the Act on the Application of Laws as well as Article 8 of the Law Application Principles Act provides that, with respect to the stylistic requirements, a contract shall be held valid, if either one of the requirements of the applicable foreign laws or the law which governs the place of the act (under the Act on the Application of Laws, either the law which governs the place where the notice of offer or acceptance is dispatched) is met. The business entities conducting cross-border transactions on the internet should pay attention to this point.<sup>21 22</sup>

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<sup>21</sup> <Law Application Principles Act>

Article 8

The formalities of a juristic act shall be governed by the law which provides for the effect of such act.

Notwithstanding the provision of the preceding paragraph, in regard to the requirements for formalities of a juristic act, the law which governs the place of the act shall govern, except for the juristic acts that create or dispose of real rights and/or registerable rights.

<sup>22</sup> <Act on the Application of Laws>

Article 10 (Formalities of a Juristic Act)

(1) The formalities of a juristic act shall be governed by the law applicable to the formation of the act (where an amendment referred to in the preceding Article was made after such juristic act, the law applicable prior

## **7. Legal capacity of the party, etc.**

In the case of transactions on the internet, attention should also be paid to the law that governs the legal capacity and the corporate entity of the parties.

Where the business entity conducting transactions on and via the internet across borders is a natural person, the provision on their legal capacity must be discussed. Article 4 of the Act on the Application of Law provides that the legal capacity of a person shall be determined by the law which governs his or her home country except in cases where all the parties involved are located in the same jurisdiction. In an exceptional case, even if the legal capacity of the person who has performed a juristic act is restricted under the law which governs his or her home country, but not restricted under the law which governs the place of the act, he/she shall be regarded as having full legal capacity.

Therefore, if business entities enter into a transaction in the territory of Japan, where all the parties are located in the same jurisdiction, then the legal capacity of the transacting business entities shall be determined by the laws of Japan, as Japan is the place of the juristic act. By contrast, if the parties to a transaction entered into via a server placed in Japan but are located in a number of jurisdictions, then the legal capacity of the consumer shall be, pursuant to the basic principle, determined by the law which governs the business entity's home country, as all the parties are located in different jurisdictions.

Alternatively, despite the fact that the Act on the Application of laws is silent on this matter, it has been consistently held that where the business entity conducting transactions on the internet across borders is a legal entity, the matters pertaining to internal rules in the legal entity shall be governed by the law of the place where it was established. Therefore, whether or not a contract was concluded by a person who was authorized to represent a legal entity shall be determined by the law which governs the place of its establishment, irrespective of the governing law applicable pursuant to the provisions of Article 7 of the Act on the Application of Laws.

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to such amendment shall govern).

- (2) Notwithstanding the preceding paragraph, the formalities that meet the requirements of the law which governs the place of such juristic act shall be held effective.
- (3) For the purpose of the preceding paragraph, where a declaration of intention is addressed to a person located in a different jurisdiction, the place from which the declaration of intention was dispatched shall be presumed to be the place of the act.
- (4) Paragraphs 2 and 3 of this Article shall not apply to the formalities of a contract concluded between parties situated in different jurisdictions. In this case, notwithstanding Paragraph 1 of this Article, a contract shall be held valid, if either one of the requirements of the law which govern the place from which the notice of offer or acceptance was dispatched meets.
- (5) Paragraphs 2, 3 and 4 of this Article shall not apply to the formalities of the juristic acts that create or dispose of real rights to movables or immovables, or other registerable rights.

(2) Consumer Protection Laws and Regulations Applicable to Cross-border Transactions

[Issue]

Where a consumer in Japan enters into a transaction with a foreign business entity via the internet, will the consumer protection laws and regulations of Japan be applicable to the consumer?

(Examples)

1. Where a consumer in Japan purchased goods from a foreign business entity on the internet, will the consumer protection laws and regulations in Japan applicable to the consumer?
2. Where a consumer in Japan downloaded and purchased music data from a foreign business entity on the internet, will the consumer protection laws and regulations in Japan applicable to the consumer?

[Approach]

Pursuant to Article 11, Paragraph 1 of the Act on General Rules of the Application of Laws (“*hou no tekiyou ni kansuru junsokuhou*” in Japanese, hereinafter, the “Act on the Application of Laws”), where a consumer who is a permanent resident of Japan enters into a transaction with a foreign business entity via the internet, the consumer can be protected under the consumer protection laws and regulations of the jurisdiction which have been pre-agreed upon by and between the parties. In addition, the consumer will also be protected under certain mandatory clauses set forth in consumer protection laws of Japan, providing that the consumer had expressly declared to the business entity that such clauses shall take effect in the transaction.

In addition, Article 11, Paragraph 2 of the Act on the Application of Laws provides that, notwithstanding the provision of Article 8 of the same Act, where the parties to an agreement have not specified a governing law, the law that governs the place of the consumer’s permanent residence shall be the governing law for the agreement. Therefore, where a consumer whose permanent residence is in Japan enters into a transaction with a foreign business entity via the internet without specifying the governing law, the transaction shall be governed by the laws of Japan and thus the consumer will be protected under the consumer protection laws and regulations of Japan.<sup>23</sup>

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<sup>23</sup> <Act on the General Rules of Application of Laws >

Article 11 (Special Rules for Consumer Contracts)

- (1) Regarding the formation and effect of a contract (excluding labor contracts; hereinafter referred to in this Article as “consumer contract”) between a consumer (i.e., an individual, excluding those cases where the party acts as a business or for a business; hereinafter same in this Article) and a business entity (i.e., a juridical person (*hojin*) or

**(I) Where a consumer in Japan purchased products from a foreign business entity**

In principle, where a consumer who is a permanent resident of Japan purchased goods from a foreign business entity via the internet, such consumer can be protected under the consumer protection laws and regulations of Japan. However, if a foreign law had been specified as the governing law by the parties, the consumer must declare to the business entity that certain mandatory clauses set forth in the consumer protection laws and regulations of Japan shall take effect in the transaction.

**(II) Where a consumer in Japan purchased music data from a foreign business entity**

The principle described in (I) above, will also apply to cases such as a consumer whose permanent residence is in Japan downloads and purchases music data from a foreign business entity on the internet.

[Explanations]

**1. Cross-border transaction on the internet with consumers and international private law**

The wide use of the internet has encouraged consumers to enter into cross-border transactions, which in the past would have been unimaginable. As a result of these cross border transactions, consumers are beginning to be involved in radically new type of cross-border disputes. Where consumers in Japan enter into transactions with a foreign business entity, a question arises as to whether Japanese consumers will be offered the same protection as they would have in the case of intra-country transactions, under consumer protection laws and regulations of Japan.

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other corporate association (*shadan*) or financial foundations (*zaidan*), or an individual in those cases where the party acts as a business or for a business; hereinafter same in this Article), even where by choice under Article 7 or variation under Article 9, the applicable law would be a law other than that of the consumer's permanent residence, when the consumer indicates to the business entity his or her intention that a particular mandatory rule within the law of the consumer's permanent residence should apply, this mandatory rule shall also apply to the matters covered by the rule concerning the consumer contract's formation and effect.

- (2) Notwithstanding Article 8, where no governing law has been specified, the formation and effect of a consumer contract shall be governed by the law of the consumer's permanent residence.

The Rules concerning the application of laws (“*hourei*” in Japanese, hereinafter, the “Law Application Principles Act”) does not set out any special provision on the law applicable to transactions with consumers. Article 7 of the same Act is consistently held applicable to such transactions in the same way as transactions between business entities. However, where a foreign law held as applicable law pursuant to the provision, it is not clear, whether consumer protection laws and regulations of Japan are still applicable to such transaction in addition to the applicable foreign law. In connection to this, Article 11 of the Act on the Application of Laws which was enforced in January, 2007 clearly provides special rules on consumer contracts. Note, however, that, this rule is applicable exclusively to contracts executed between a business entity and a consumer, where the difference between the parties in bargaining power is significant, not to contracts executed between consumers.

Moreover, we should note that at an inter-country level, both Law Application Principles Act (“*hourei*” in Japanese) and the Act on the Application of Laws set forth which governing law shall be applicable to specific cross-border disputes when they are brought into Japanese courts. More specifically, where such disputes are brought into a court in a foreign country, the applicable law shall be determined pursuant to the international private law of the country. Therefore, the applicable law may be different from the law applicable in Japanese court.

Therefore, for example, if a Japanese business entity performs transaction with a consumer in a foreign country via the internet, and a dispute arising from this transaction is brought into a court in the consumer's home country, the law applicable to the dispute in the country shall be determined pursuant to the international private law of the country. In such a case, the explanation below is not necessarily true.

Based on the aforementioned qualifications, the following is the explanation in terms of the international private law of Japan, on the assumption that the disputes are brought into the courts in Japan.

## **2. Where the parties had chosen the governing law**

Firstly, where the parties chose the governing law applicable to the transaction, Article 11, Paragraph 1 of the Act on Application of Laws as well as Article 7, Paragraph 1 of Law Application Principles Act provides that the consumer contract shall be governed by such law. However, there is a great difference in bargaining power between a business entity and a consumer in the determination process of the governing law. Therefore, if the pre-agreement on the governing law is unconditionally approved in transactions with foreign business entities, consumers tend to be forced to accept a governing law which is less protective to

consumers than the law of Japan. As a result, consumers in Japan were exposed to the risk of unexpected damages.

As a solution to the problem of exposure to the risk unexpected damages, Article 11, Paragraph 1 of the Act on the Application of Laws expressly provides that “where the consumer expressly declared to the business entity that certain mandatory clauses set forth in a statute of the jurisdiction that governs his/her permanent residence shall apply, these mandatory clauses shall also apply to the matters stipulated by such clauses in regard to the completion and effectiveness of the consumer contract.” By virtue of this provision, a consumer who has his/her permanent residence in Japan is entitled to claim protection on the basis that certain mandatory clauses stipulated in the consumer protection laws of Japan. These Japanese consumer protection laws apply as Japan is the place of his/her permanent residence, and protection is afforded even if the parties had pre-agreed that a foreign law governs the contract.

### **3. When the governing law is not specified by the parties**

On the other hand, where no governing law was specified by the parties, Article 7, Paragraph 2 (and Article 9) of the Law Application Principles Act provide that the juristic act shall be governed by “the law which governs the place of the act.” Therefore, where the law which governs the place of the act is less protective to consumers compared to that of Japan, consumers in Japan were exposed to the risk of unexpected damages.

By contrast, Article 11, Paragraph 2 of the Application of Laws Act stipulates that where no governing law was specified for a consumer contract by the parties in the consumer contract, the formation and effect of the consumer contract shall be governed by “the law of the consumer's permanent residence.” Therefore, as for the consumer whose permanent residence is in Japan, provisions on consumer protection under the laws of Japan, that is, “the law of permanent residence” shall be fully applied.

### **4. Formalities of consumer contract**

The parties might carelessly enter into the contract, unaware of the mandatory formats required by a foreign law with which they are unfamiliar. In order to prevent parties from suffering unexpected damages in such cases, Article 8 of the Law Application Principles Act and Article 10 of the Act on the Application of Laws provide that, a contract shall be valid if it meets either one of the formats required under the applicable foreign law or those required under the law which governs the place of the act of the law.

However, some consumer contracts, impose certain requirements on format such as a prescribed template or minimum font to serve as protection to consumers, and thus it would not necessarily be appropriate to allow each party to apply whichever law is convenient for it in order to validate the contract to the maximum extent possible in terms of public interest. In these cases, Article 11, Paragraphs 3 and 4 of the Act on the Application of Laws provide that, in regard to the formats of a consumer contract, where the governing law has been specified by the parties, the law which governs the place of the consumer's permanent residence shall govern the contract, so long as the consumer wishes to apply it. Further, Article 5 of the same Act provides that, where no governing law has been specified by the parties, the law which governs the consumer's permanent residence shall exclusively govern the consumer contract. Therefore, in consumer contracts, we should pay special attention to the law applicable to the formats.<sup>24</sup>

## **5. Exceptions where special consumer contract rules do not apply**

Article 11, Paragraph 6 of the Act on the Application of Laws provides an exception to the aforementioned principle, under which no special rules on consumer contracts apply and thus basic rules on contracts apply.

The first case is where (i) a consumer travels to a place outside the territory of Japan where he/she concludes a contract (Article 11, Paragraph 6, Item 1 of the Act on the Application of Laws). If the special rules for consumer contracts were applicable to such "active consumers", even a business entity operating exclusively in Japan would need to take the

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<sup>24</sup> <Act on the Application of Laws>

### Article 11 (Special Rules for Consumer Contracts)

- (3) In regards to the formation of a consumer contract, even where a law other than the law which governs the consumer's permanent residence has been specified under Article 7, where the consumer declared to the business entity his or her intention that a particular mandatory clause stipulated in the law which governs the consumer's permanent residence should be applicable to the formalities of the consumer contract, such mandatory clause shall be, notwithstanding the provisions of Article 10, Paragraphs 1, 2, and 4, applicable exclusively to the matters relating to the formalities of the consumer contract referred to in such mandatory clause.
- (4) Where the law of a consumer's permanent residence has been specified under Article 7 with regards to the formation of a consumer contract, and where the consumer declared to the business entity his or her intention that the law which governs the consumer's permanent residence shall be exclusively applicable to the formalities of a consumer contract, notwithstanding Article 10, paragraphs 2 and 4, the formalities of the consumer contract shall be determined exclusively by the law which governs the consumer's permanent residence.
- (5) Notwithstanding Article 10, paragraphs 1, 2, and 4, where no governing law has been specified under Article 7 with regards to the formation of the contract, the formalities of a consumer contract shall be governed by the law which governs the consumer's permanent residence.

location of the consumer's permanent residence into consideration, which might disturb the business entity's operation of business. Note, however, that this item is applicable only to cases where the consumer physically travels to a place outside the territory of Japan. Therefore, where the consumer does not physically travel abroad, for example if he/she accesses a foreign business entity's website on the internet, this item shall not apply.

The second case is where (ii) the foreign business entity has performed all its obligations under a consumer contract in its home country for the consumer (Article 11, Paragraph 6, Item 2 of the Act on the Application of Laws). Where the product is finally delivered to Japan after the consumer purchased on the internet, the place where the business entity's obligation is performed is in Japan and thus this Item is not applicable to this case. On the other hand, where a consumer in Japan purchased music data by downloading them from a foreign website, it is possible to consider that the business entity's obligation had completely been performed at the moment music data became ready to be downloaded on the server located in a foreign country. In such a case, the issue is whether the place where the business entity's obligation has been performed is, outside the territory of Japan by reference to the location of the server, or alternatively in Japan by reference to the location of the consumers." The purpose of this Item is to exclude "active consumers" who can physically travel to the place where the business entity is located from the consumers under the protection of special rules for consumer contracts. Then, considering that the consumer has little trouble accessing the website, for downloading the music data, operated by a foreign business entity on the internet, the place where the obligation has been performed should be considered to be the place where the consumer is physically located. Therefore, so long as the consumer receives certain data through a terminal placed in Japan, this Item will not be applicable.

The third case is where (iii) the business entity was justifiably unaware of the location of the consumer's permanent residence. The fourth case is where (iv) the business entity was justifiably unaware of the fact that the counterparty to the contract was a consumer (Article 11, Paragraph 6, Items 3 and 4). It seems that transactions on the internet conducted without any face-to-face communication with the counterparty are, compared to other transactions, more likely to fall under the aforementioned categories. In such a case, the business entity may, for various reasons, target consumers whose permanent residence is located in a certain limited area or offer different prices depending on the location of their permanent residence. Some consumers may, taking advantage of the absence of face-to-face communication with the counterparty, seek to purchase a product at a lower price by falsely stating the location of



their permanent residence or by representing themselves as non-consumers. The exception referred to in this Item is unlikely to be applicable to such consumers.<sup>25</sup>

## **6. Legal capacity of the party**

In the case of transactions on the internet, we should also pay attention to the provisions on the legal capacity.

Article 4 of the Act on the Application of Law provides that the legal capacity of a person shall be determined by the law which governs his or her home country except in cases where all the parties involved are located in the same jurisdiction. In such an exceptional case, even if the legal capacity of the person who has performed a juristic act is restricted under the law which governs his or her home country, but not restricted under the law which governs the place of the act, he/she shall be regarded as having full legal capacity.

Therefore, if a business entity in Japan enters into a transaction in the territory of Japan with a consumer in a foreign country, where all the parties are located in the same jurisdiction, then the legal capacity of the parties shall be determined by the laws of Japan. This is because Japan is the place in which the transaction was entered into. By contrast, if a business entity in Japan enters into a transaction with a consumer in a foreign country via the server placed in Japan, where all the parties are not located in the same jurisdiction, then the legal capacity of the consumer shall be, pursuant to the basic principle, determined by the law which governs the his/her home country.

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<sup>25</sup> <Act on the Application of Laws>

Article 11 (Special Rules for Consumer Contracts)

(Paragraph 6)

No provision of the preceding paragraphs shall apply in any of the following cases:

- (i) Where the business entity's place of business in connection with a consumer contract is located in a different jurisdiction from the place of the consumer's permanent residence, and he/she concludes the contract by traveling to a jurisdiction of the business entity's place of business, except in cases where the consumer located in the place of his or her permanent residence was invited by the business entity to conclude the consumer contract in the jurisdiction of the place of business;
- (ii) Where the business entity's place of business in connection with a consumer contract is located in a different jurisdiction from the place of the consumer's permanent residence, and the consumer has or is supposed to have the whole of the obligations under the consumer contract performed by the counterparty in the jurisdiction of the place of business, except in cases where the consumer located in the place of his or her permanent residence, is invited by the business entity to have all such obligations under the consumer contract performed in the jurisdiction of the place of business;
- (iii) Where, at the time of concluding a consumer contract, the business entity was justifiably unaware of the location of consumer's permanent residences; or
- (iv) Where, at the time of concluding a consumer contract, the business entity justifiably misidentified the counterparty to the contract as not being a consumer.

(3) Tort on the Internet and Applicable Law

[Issue]

Where defamatory messages are posted on electronic message boards resulting in damages being incurred in various countries, which jurisdiction shall govern the victim's injunctive relief and claim for compensatory damages?

[Approach]

Article 19 of the Act on General Rules of the Application of Laws (“*hou no tekiyou ni kansuru junsokuhou*” in Japanese, hereinafter, the “Act on the Application of Laws”) applies to the posting of defamatory messages on electronic message boards that are accessible from anywhere in the world. It provides that damages can be incurred across a number of countries in which the posted defamatory messages have been read. These damages may be obtained regardless of whether the victim of the defamation has sought an injunction or compensatory damages. The defamation shall be determined by the law which governs the place of the victim's permanent residence (that is, where the victim is a legal entity (*hojin*) or other corporate association (*shadan*) or financial foundation (*zaidan*), the law which governs its principal business location).<sup>26</sup>

However, it should be noted that, according to Article 22 of the Act on the Application of Laws; where foreign law governs a claim for injunction or compensation of damages, if the act of posting governed by a foreign law does not constitute a tort under the Japanese law, the victim is not entitled to claim for damages or any other remedies in Japan. Further, even where the act of posting constitutes a tort under both of the applicable foreign law and Japanese law, the victim is only entitled to claim for damages or any other remedies within the extent approved under the Japanese law.<sup>27</sup>

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<sup>26</sup> <Act on the Application of Laws>

Article 19 (Special Rules for Defamation)

Notwithstanding the provision of Article 17, the formation and effect of liability claims arising from the tort involving the defamation of another person shall be governed by the law of the victim's permanent residence (i.e., where the victim is a legal entity (*hojin*) or other corporate association (*shadan*) or financial foundation (*zaidan*), the law which governs its principal business location).

<sup>27</sup> Article 22 (Public Policy Limits in Tort)

- (1) Where a foreign law governs an act of tort, if such act does not constitute a tort under the Japanese law, the victim is not entitled to claim for damages or any other remedies in accordance with the foreign law.
- (2) Where a foreign law governs an act of tort, if such act constitutes a tort under both of the Japanese law and such foreign law, the victim is entitled to claim for damages or any other remedies within the extent approved under the Japanese law.

[Explanations]

## **1. Cross-border defamation cases via the electronic message board and international private laws**

The spread of the internet has made available a new mode of business using electronic message boards accessible from anywhere in the world. As a result of this world wide accessibility, a defamatory message that is posted on an electronic message board may be read by a broad range of people in many countries throughout the world. Consequently, the damages caused as a result of a defamatory message being posted may extend across many countries.

Article 11 of the Law Application Principles Act (“*hourei*” in Japanese) provides the law applicable to tort, will be governed by the “place of the occurrence of the cause for the tort”. In regard to these cases, there might be a difference between the place where the offense was committed (the country in which such defamatory message was posted) and the place where the consequence of the posting arose (the country in which the posted message has been read). Therefore, the question in issue is; which country’s law shall be applicable as the law which governs the “place of the occurrence of the cause for the tort.” If the law of the place in which the offense was committed is to be applied then the offender could be discharged from liabilities for tort by posting the defamatory messages in a country of which legislation provides less protection to victims of defamation. This situation does not provide appropriate protection for the needs of victims. On the other hand, if the law of the place where the consequence of the offense arose were to be applicable, it would be difficult to determine the place in which it arose, if the defamation extends across many countries. In this case, whether or not the victim may claim for tort liability damages and other remedies would need to be determined by analysis of the damages accruing in each country, pursuant to the law of each country, which, would be overly complicated from a practical viewpoint<sup>28</sup>

Article 17 of the Act on the Application of Laws provides that, in regard to tort liabilities in general, that the “law which governs the place where the consequence (of the offense) arose”,

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<sup>28</sup> <Law Application Principles Act>

### Article 11

- (1) The formation and effect of claims accruing from the administration without mandate, unjust enrichment and/or acts of tort shall be determined by the law which governs the place of the occurrence of the cause for such act of tort.
- (2) In regard to the liability for tort, where an event occurring in a foreign country is not unlawful under the Japanese law, the preceding paragraph shall not apply.
- (3) Even where an event occurring in a foreign country constitutes a tort under the Japanese law, the victim shall not be entitled to claim for damages or any other remedies that are not approved under the Japanese law.

serves as a solution to the first issue referred to in the preceding paragraph.<sup>29</sup> Further, as for the complicated assessment of cross-jurisdictional damages, Article 19 of the Act on the Application of Laws provides for “Special Rules for Defamation.” Specifically in the case that defamatory messages are posted on the electronic message boards accessible from anywhere in the world and result in damages that extend across many countries. The ability of the victim to claim for injunction or compensation of damages as a result of the defamatory postings shall be exceptionally governed by the law which governs the victim’s permanent residence (i.e., where the victim is a legal entity (*hojin*) or other corporate association (*shadan*) or financial foundation (*zaidan*), the law which governs its principal business location).

Moreover, we should note that at an inter-country level, both Law Application Principles Act and the Act on the Application of Laws set forth that the applicable governing law in Japanese courts. More specifically, where disputes are brought in a court in a foreign country, the applicable law shall be determined pursuant to the international private law of the country. Therefore, the applicable law may be different from the law applicable in Japanese court.

## **2. Cases where the Japanese law is cumulatively applicable**

With respect to the law applicable to liability for tort, pursuant to Article 11 Paragraphs 2 and 3 of the Law Application Principles Act, the Japanese law shall be cumulatively applicable to both of the requirements for and the effects of an act of tort. More specifically, even where an act constitutes a tort under the applicable law, but not under the Japanese law, such act will not constitute a tort. Further, even where an act constitutes a tort under both of the applicable law and the Japanese law, the victim is entitled to claim injunction or other remedies only to the extent approved under the Japanese law.

This rule remains unchanged under Article 22 of the Act on the Application of Laws. Therefore, in order for the victim to seek remedies for defamation on the electronic message board, the requirements and effects provided for under both of the Japanese law and the law which governs the place of the victim’s permanent residence shall be applicable.

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<sup>29</sup> <Act on the Application of Laws>

Article 17 (Tort)

The formation and effect of claims accruing from tort shall be governed by the law of the place where the consequence of the offense arose, provided, however, if the occurrence of such consequence at the place would normally be unforeseeable, the law which governs the place where the offense was committed shall govern.

### 3. Exceptions

In addition to the aforementioned rules, the Act on the Application of Laws further provides that, in regard to liability for tort, an exceptional provision shall be applicable to cases where another place obviously has a closer relation with the offense than the place where the consequence of the offense arose. Therefore, in the case of tort liability for defamation, if there is a place that obviously has closer relation with the defamation in light of all the surrounding circumstances, the applicable law might not be the law(s) determined pursuant to the aforementioned criteria under the Act on the Application of Laws. Note, however, that the Japanese law will also apply cumulatively to such a case, as more fully described in (2).<sup>30</sup>

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<sup>30</sup> Article 20 (Exceptions Where Another Place Is Obviously Closer Relation With the Tort)

With regard to the formation and effect of claims accruing from tort, where another place has, compared to the places governed by the applicable law according to Articles 17, 18, and 19, obviously closer relation with the act of tort, in light of the circumstances such as that both parties had their permanent residence in the same jurisdiction at the time of the tort, or that the tort occurred in breach of contractual obligations under a contract concluded between the parties.

## Part 2: Information Property Trading

### 1. License Agreement

Trading of information property, such as programs and digital content, is often done under ordinary sales agreements and also under license agreements which are concluded between the information property vendor (hereinafter referred to as the “Vendor/Vendors”) and the user for the use of the property in question. Part 2t discusses the legal issues in license agreements.

The license agreement is a contract that is formed when the licensor (Vendor) agrees to allow the licensee (user) to use and benefit from, certain information property within a certain scope and the licensee also agrees thereto. These interpretative guidelines only cover contracts for value which are commonly used in licensing.

Information property that is the object of license agreements refers to sound, images (pictures), and other information that can be recorded in a form available for use on a computer (i.e., in a digital form). Specifically, information property includes programs and other instructions to the computer as well as data that can be the object of information processing by the computer (including digital content such as music, movies, and computer graphics). In the case of custom-made information property, the particular license agreement between the parties will determine its contents, conditions, and other details. Therefore, this part only discusses information property distributed in the market as ready-made products.

(1) Return of the Product by the User After the Conclusion of the Contract

**(A) Cases where information property is provided via media**

[Issue]

When consumers buy media-type package software from a store, they usually read the license agreements only after purchase. Therefore, the question is whether they can return the product and demand a refund if they do not agree to the contents of the license agreements. Normally, license agreements are supposed to be concluded either as (i) a shrink-wrap contract; or (ii) as a click-on contract. Under what circumstances can the consumer return the product and demand a refund?

[Approach]

**<I> Where contracts between stores and users are deemed to be a Primary Agreement**

**(i) Principle**

When contracts between stores and users are deemed to be a agreement for the delivery of tangible materials such as media or manuals (“Primary Agreement”(“*teikyô-keiyaku*”)); and an agreement for setting an option to conclude a license agreement with the user, it is reasonable to consider that a user who does not consent to the contents of the license agreement can return the product and demand a refund. The basis of this consumer right is that there exists a tacit agreement in the contract between the store and the user that if the user does not consent to the contents of the license agreement, he can return the product and demand a refund.

In practice, two types of contracts are usually employed: a shrink-wrap contract and a click-on contract. These two types of contracts will be discussed below.

**(A) Shrink-wrap contract**

If the user is aware of the contents of a license agreement before breaking the seal of the media (such as the film wrap or seal) and he proceeds to break the seal with intent to conclude a license agreement, the license agreement is formed (“shrink-wrap contract”) (Paragraph 2, Article 526 of the Civil Code). In such case, the user cannot return the product on the ground that he did not consent to the agreement.

Therefore, where the film wrap, seal, etc., is broken, the store need not accept the return of the product, so long as the store verifies the adequacy of the information on the film wrap, seal, etc. and confirms that the information is plainly recognizable.

<p>Where a product is considered non-returnable after the seal is broken (i.e. where the license agreement is considered to be concluded)</p> <ul style="list-style-type: none"> <li>• Where the license agreement can be viewed through the film wrap, seal, etc. in a manner plainly recognizable before the user breaks it, that user is requested to check the license agreement form. If he breaks said film wrap, seal, etc. through which the license agreement can be viewed, then the license agreement is formed.</li> <li>•</li> <li>•</li> </ul>
<p>A product is considered returnable even after the user has broken the seal, where he does not consent to the license agreement (the license agreement is not formed)</p> <ul style="list-style-type: none"> <li>• No mention is made of the license agreement on the film wrap, seal, etc. of the media.</li> <li>• No mention is made on the film wrap, seal, etc. of the media about where to find the contents of the license agreement and it is not easy to find that information.</li> <li>•</li> </ul>

**(B) Click-on contract**

If the user is aware of the contents of the license agreement before clicking the button “I Agree (to the license agreement)”, where he clicks the button with intent to conclude a license agreement, the license agreement is formed (“click-on contract”) (Paragraph 2, Article 526 of the Civil Code). Therefore, he cannot return the product on the ground that he did not consent to the agreement.

Although it is usually difficult for the store, etc. to judge whether the button was actually clicked, where the store can determine by some means that the license agreement has been concluded, the store need not accept the return of the product.

<p>Where the product is considered non-returnable after the Agreement Button has been pressed (i.e. where the license agreement is considered concluded)</p> <ul style="list-style-type: none"> <li>• The user pressed the Agreement Button after scrolling through the entire license agreement form.</li> <li>•</li> <li>•</li> </ul>
<p>Where a product is considered returnable even after the user presses the Agreement Button, so long as he did not consent to the license agreement (the license agreement not formed)</p> <ul style="list-style-type: none"> <li>• The screen configuration seeking consent to the license agreement or the Agreement Button is not sufficiently dissimilar from other screen configurations or other buttons. Furthermore, no screen is provided for the user to confirm his consent to the license agreement.</li> <li>•</li> <li>•</li> </ul>
<p>Where a Vendor can confirm the valid formation of a license agreement</p>



- A user registration card bearing the user's signature in the column "I agree to the license agreement" has reached the Vendor.
- A license agreement concluded online or by telephone is registered with the Vendor.
- 

**(ii) Exceptions**

**(A) Where the contents of a license agreement are only clearly shown when the purchase of the product at the store**

Where the user was aware of the contents of a license agreement and paid consideration, he cannot at a later time return the product and demand a refund.

- Where the user cannot return the product and demand a refund on the ground that he has already agreed to the license agreement
- The contents of the agreement are printed on the outside of the product package in a type size large enough for the user to recognize.
  - The store ensured that the user agreed to the license agreement at the time of purchase.
  -

**(B) Where it is clearly stated that the product is non-returnable even if the user does not agree to the license agreement**

Even in cases where it is clearly indicated that the product is non-returnable notwithstanding the user's consent to the agreement, a user who does not agree to the license agreement may be able to return the product to the store, except where he offered the payment (and such payment is accepted) after having specifically agreed to the non-returnable clause

- Where a user cannot return products even if he has not agreed to the license agreement
- When the user purchased the product at the store, the store told the user that he could not return the product even if he did not agree to the license agreement and the user agreed thereto.
  - 
  -

- Where a user can return the product, if he does not agree to the license agreement
- Where there was no indication at the time of payment that the product is non-returnable, which fact could only have become known after opening the package.
  - 
  -

**(II) Where the agreement between the store and the user is considered a sales agreement for a reproduction of information property**

Where an agreement between a store and a user is a sales agreement for a reproduction of information property, no license agreement exists between them. The user can freely use the information property, so long as he does not violate the Copyright Law. Even if a license agreement is presented after the product is purchased, the user is not bound by it. Therefore, no issue exists concerning the return of goods after the conclusion of the license agreement because no license agreement is necessary.

Where information property is considered freely usable regardless of the lack of a license agreement

- The user did not recognize nor intend to conclude a license agreement, no mention was made on the product package of a license agreement, and the store did not tell the user that there should be a license agreement.
- 
- 

[Explanations]

**1. Problem identification**

When information property, such as CD-ROMs or other media, is sold through stores, it is a trade practice that the licensor unilaterally determines the licensing conditions. No explicit agreement has been made about the licensing conditions at the time of the delivery of the media. Rather, the license agreement is reached at a later time, such as at the time when the user breaks the film wrap, seal, etc. or at the time when the user runs the program for the first time and agrees to the license agreement displayed on the screen. In these cases, it is not necessarily clear at which stage the licensing agreement is formed and whether a user who has not agreed to the licensing agreement can return the product and demand a refund.

Therefore, this section discusses the agreement between parties to a medium-based transaction.

## **2. Nature of the agreement between the store and the user**

When the user takes possession of information property by paying consideration to the store, the intention of the parties is reasonably interpreted to conclude either (i) a sales agreement for a reproduction of the information property; or (ii) an agreement by which the store assigns to the user the opportunity to consenting to the license agreement and by which the store delivers tangible objects such as the medium and manuals to the user (“Primary Agreement”). How the parties actually intended to conclude the agreement, either by method (i) or (ii), will be determined according to various factors including general knowledge on transactions in information property (for example, was the buyer aware that the packaged software he purchased could not legally be used absent his consent to the license agreement?). However, the intention of the parties will likely be interpreted as concluding the Primary Agreement (ii), if the necessity to conclude a license agreement is clearly stated on the outside of the medium package in a form easily identifiable to the user or if the store has verbally explained the need to conclude the license agreement.

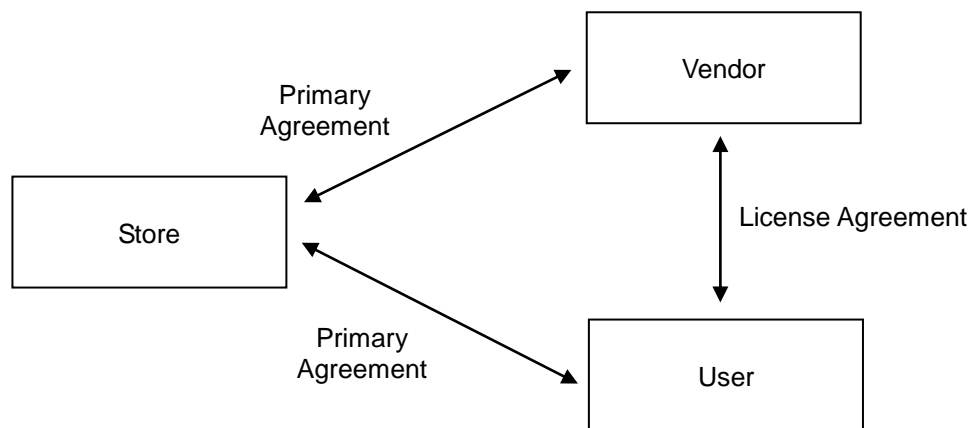
On the other hand, in the case of (i), i.e. when their intent is interpreted as concluding a sales agreement for a reproduction of information property, the user should not be bound by an agreement of which he is not aware. Therefore, the user can use the information property freely, so long as he does not violate the Copyright Law. More specifically, the user can reproduce the information property solely for personal use, except where he must circumvent any technical protective barriers in order to make reproductions (Paragraph 1, Article 30 of the Copyright Law), and he can also reproduce and adapt information property to the extent necessary if it is a program (Paragraph 1, Article 47-2 of the Copyright Law). In addition, since no license agreement has been concluded, difficulties should not occur regarding the return of the product on the ground that the user does not consent to the license agreement.

Where no agreement is reached on any necessity to conclude a license agreement, if a license agreement is clearly presented after the purchase of a product (where the license agreement is enclosed in the outer case of the product package), such license agreement will usually have no legal effect.

Next, under Primary Agreement (ii), the store assigns to the user the right to use the information property after he consents to the license agreement. In other words, the store assigns to the user an option to conclude a license agreement and delivers the tangible objects such as the medium and manuals to the user. The Primary Agreement provides for both the assignment of the right and the delivery of the objects.

In this case, the user has concluded two different agreements. First, the user agrees to the Primary Agreement with the store. Second, the user consents to the license agreement with

the Vendor for the use of the information property. Consenting to the license agreement allows the user to employ the information property (see figure below).



### 3. Requirements and timing of the conclusion of license agreement

As described in 2 (ii), where the agreement between the store and the user is a Primary Agreement, the contents of a license agreement may be clearly presented (A) before the conclusion of the Primary Agreement (e.g. before payment is offered and accepted); or (B) after the conclusion of the Primary Agreement (i.e. after payment is offered and accepted). When exactly is the license agreement formed in each of these cases?

When information property is provided in media form, the license agreement between the Vendor and the user is a contract between remote parties. This means principally that it is necessary for a user to express his intention to accept an offer in order for the license agreement to be formed. However, if the offeror indicates or it is the common trade practice that an acceptance notice is not needed, then the agreement is formed when the conduct of the user explicitly communicates his expresses (“*ishi-jitsugen-kô*”) (Paragraph 2, Article 526 of the Civil Code). This is theoretically because the offeror’s prior expression or common trade practice functions to allow the conduct of the user itself to constitute an intention to execute the contract rather than requiring an actual expression of intention; based on such theoretical principle, license agreements should be considered as well

First, in the case of (A), where a user purchases a product under the Primary Agreement with knowledge of the license agreement’s content , the intention of the user to conclude the contract has been displayed by his conduct. Therefore, the license agreement is formed at the time the Primary Agreement is concluded. An example is where the contents of the agreement are printed on the outside of the product package in a type size large enough for the

user to easily notice and where the store made sure that the user agreed to the license agreement at the time of the product purchase.

Second, in the case of (B), since the contents of the license agreement are not clearly presented at the time the Primary Agreement is concluded, the license agreement is formed at a later time. In the case of the shrink-wrap and click-on contracts, which are now widely used in the industry, the formation of a license agreement depends on whether the conduct of the user constituted an intention to conclude the contract.

In the case of a shrink-wrap contract, the question is whether the act of breaking the film wrap, seal, etc. could be considered as conduct of the user which reflects his intention to conclude the contract. A license agreement is formed where the user breaks the film wrap, seal, etc. with knowledge of the contents of the license agreement and if he intends to conclude the license agreement before breaking it. For example, a statement which requires consent to a license agreement and which asserts that the effect of breaking the film wrap, seal, etc. equates to giving consent to the license agreement, and where the license agreement is printed on the film wrap, seal, etc. in a form that the user can easily identify before breaking the covering, it will often be interpreted that the act of breaking the covering is deemed to be conduct of a user which indicates his intention to conclude the license agreement and that by virtue of his conduct the license agreement has been completed. On the other hand, if the license agreement is not mentioned on the film wrap, seal, etc. of the media or if there is no mention on the film wrap, seal, etc. of the media concerning the location of the license agreement contents and it is also not easy to find them, then the license agreement is not formed, even if the user has broken the film wrap, seal, etc.

Second, in the case of click-on contracts, the question is whether the act of clicking the “I Agree (to the license agreement)” button (hereinafter called the “Agree Button”) displayed on the screen is deemed analogous to conduct displaying the intention of the user to execute the contract. If the user knows the contents of the license agreement before clicking the Agree Button on the screen and clicks the button with intent to conclude a license agreement, the license agreement is formed. For example, if the screen is configured in such a way that the user can easily identify the contents of the license agreement before clicking the Agree Button (in other words the screen configuration is such that the user cannot click the Agree Button unless he has scrolled through the entire contents of the license agreement), then it will often be considered that the license agreement has been formed. However, if the screen configuration seeking consent to the license agreement or the Agree Button are not externally different from other screen configurations or other buttons, and if no screen is provided for the user to confirm his consent to the license agreement, then it is considered that the license agreement could not have been concluded.

#### **4. Termination of the Primary Agreement where there is no consent to the license agreement**

In 3(B) above, where the contents of a license agreement are presented at a time later than the conclusion of the Primary Agreement (e.g., after payment is offered and accepted), the question is whether a user, who does not agree to the licensing agreement, can return the product and demand a refund for the purchase price.

The license agreement and the Primary Agreement are essentially mutually independent contracts. However, since the primary objective of the Primary Agreement is to enable the user to employ information property, the agreement is very closely linked to the license agreement. Furthermore, the value of agreeing to the Primary Agreement is considered to be the right to use the information property. Therefore, a user who does not agree to the license agreement can return the product and demand a refund of the purchase price. Under existing law, a user has the right to return products by way of tacit agreement, where the user does not agree to the license agreement.

Unless otherwise agreed (for example, by clearly indicating on the outside of the product package a reasonable period during which goods may be returned), the right to return goods can either be exercised for a period of 10 years (Paragraph 1, Article 167 of the Civil Code) or for five years (Article 522 of the Commercial Code).

Unless otherwise explicitly agreed upon, parties to the Primary Agreement tacitly agreed on the right of termination. Such agreement by the parties of the right to terminate should still exist, even if it is stated on the outside of the product package that the product is non-returnable after opening.

If a license agreement has been concluded previously, a user cannot return the product on the ground that he does not agree to the license agreement. The question is how the store determines whether a license agreement has been formed.

First, in the case of shrink-wrap contracts, the film wrap, seal, etc. may be (i) broken; or (ii) unbroken. In the latter case, the license agreement is not formed and the store cannot refuse a return on the basis of consent given to the license agreement. In the former case, the question is whether the statements on the film wrap, seal, etc. were sufficient. If the license agreement is present on the film wrap, seal, etc., in a manner the user can easily identify, then that license agreement is duly concluded and the store need not accept the item's return.

Second, in the case of click-on contracts, it is usually difficult for the store to ascertain whether the button was actually clicked. However, in some cases the store can verify the formation of a license agreement by contacting the Vendor (for example, where a user registration card has reached the Vendor or where a license agreement has been concluded online or by telephone which is registered with the Vendor). In these cases, if the store can confirm the formation of a license agreement, it need not accept the return of the product.

Furthermore, there is another problem regarding whether the store can return the product to the wholesaler or the Vendor, when the store has accepted a product returned by a user who had not agreed to the license agreement. Where it is clearly indicated that a prerequisite to use of a product is consent to the license agreement and where there is no indication that the product is non-returnable, the purchaser of the product may terminate the provisional license agreement, if he does not wish to consent to the license agreement, and return the product to the retailer, where such retailer can further terminate its Primary Agreement with the Vendor and return said product to the Vendor(see section 5 below). Therefore, a Vendor and wholesale agent should accept the store's return of products which were returned by users. This conclusion is supported theoretically by explicit or implicit agreement between the parties which assume returns of the products from store to wholesale agent; and from wholesale agent to Vendor.

Vendors and wholesale agents have to accept the return of products when the user does not agree to the license agreement and requests the store to return the product; however, because Vendors and wholesales agent are not in direct contact with the user, they will not be able to discover whether in actuality the store is returning the product as a result of the user not agreeing to the license agreement. In order to resolve common problems promptly and amicably, it may be wise to request the user at the time of formation of the Primary Agreement that if the user should terminate the Primary Agreement, he should submit a document stating the reason therefore (Paragraph 3, Article 30-4 of the Installment Sales Law expressly provides for this.)

## **5. Where there is explicit indication that the product is non-returnable**

The Primary Agreement grants the user a tacit right to terminate it, if he does not agree to the license agreement. Can the user return the product even where it is clearly stated at the time the Primary Agreement is concluded (that is, at the time the product is purchased at the store) that he cannot return the product even if he does not agree to the license agreement?

It is not reasonable that the product cannot be returned simply because the package states that the product is non-returnable. Instead, the user cannot return a product only when he specifically agreed to the non-returnable clause; e.g., he purchased the product after agreeing to the non-returnable clause which the store explained to him verbally and explicitly or indicated such clause which was plainly visible outside of the product package.

A user, who has individually agreed not to return a product, has no other option but to conclude the license agreement whose contents are to be displayed after the purchase of the products. As always, the validity of contractual clauses falling under category “(3) Unreasonable Contractual Clauses” may be negated. In such cases, the user will not be bound by such clauses.



**(B) Where information property is provided online**

[Issue]

A consumer has downloaded chargeable information property from a Vendor's server through an online contract screen. Are there cases where he can demand a refund?

[Approach]

**(I) Where the contents of a license agreement are presented at the time of an online contract**

If the consumer clicked the Purchase (Contract) button after agreeing to the contents of the license agreement, he cannot demand a refund.

Cases where the consumer agreed to the license agreement and cannot demand a refund

- Where the contents of a license agreement are clearly presented on the screen, where the Agreement Button and the Purchase Button are conspicuous and are arranged differently from other buttons used for downloading, and where the consumer clicked the Purchase Button after clicking the Agreement Button.
- Where the screen is configured in such a way that the contractual text is too long to be displayed on a single screen, the Agreement Button cannot be clicked unless the consumer scrolls through the entire text, and the consumer has clicked the Purchase Button after clicking the Agreement Button.
- 

Cases where the consumer did not agree to the license agreement and can demand a refund

- Where the online screen is configured in such a way that consumers move from an online contract screen to a license agreement screen using a link, where the link is hard to find, and where the agreement of the consumer to the license agreement is not required in order to click the Purchase Button.
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In Business-to-Consumer contracts any expression of intention mistakenly made by the consumer shall render the contract invalid, except where business entities have taken measures to confirm the consumer's intention to form a contract and where the consumer has voluntarily waived such confirmation measure (Article 3 of the Electronic Contract Law and Article 95 of the Civil Code).

**(II) Where the necessity to conclude a license agreement is not clearly shown at the time of online contract**

Since no license agreement had been concluded, problems should not occur regarding the return of the product on the ground that the user would not consent to the license agreement. Therefore, the user can use the information property freely, so long as he does not violate the Copyright Law. Even if a license agreement is presented after he has clicked the Purchase Button (and has paid consideration), the consumer is not bound by it.

Cases where the consumer is not bound to the license agreement

- The presence of a license agreement is not indicated on the online contract screen. Instead, a readme.txt file, which extracts when a downloaded file is decompressed, contains the contents of the license agreement.
- 
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There can be cases where the contents of the license agreement can only be seen after downloading and at no time before the Purchase Button is clicked, although the necessity to conclude a license agreement is shown on the online contract screen. As it is quite easy for a business entity to display the contents of a license agreement on the screen, this type of trade system seems unusual. In any event, the user can legitimately demand a refund if he does not agree to the license agreement.

[Explanations]

**1. Problem Identification**

In online delivery of information property, intangible information property is downloaded instead of the media, on which a reproduction of the information property resides, being physically delivered. For example, information property is directly downloaded from a Vendor's server to a user's hard disk, etc. When information property is provided intangibly, the contract between the Vendor and the consumer is also usually concluded online. At present, transactions are often made directly between the user and the Vendor or its agent.

This section discusses the nature of contracts regulating online transactions in information property.

## **2. Where the necessity to conclude a license agreement is not shown in advance**

Where the necessity to conclude a license agreement is not clearly shown on an online contract screen, the user in principle does conclude a contract to acquire ownership of a copy of information property by downloading it. This is exactly the same case as the sale of media information property described in (A) above “Where information property is provided via media”. In this case, the user can use the information property freely so long as he does not violate the Copyright Law. Problems should not occur regarding the return of the product on the ground that the user does not consent to the license agreement. Even if a license agreement is presented after the consumer has clicked the button to purchase the information property (hereinafter called the “Purchase Button”), i.e. after the purchase of the product, the consumer is not bound to it.

## **3. Where the necessity to conclude a license agreement is shown in advance**

Where the necessity to conclude a license agreement is clearly shown on an online contract screen, the user in principle has concluded a contract which enables the user to employ, and benefit from, within a certain scope, the information property provided (transmitted) to the user; in other words, a license agreement combined with a contract for the provision (transmission) of information property.

In this case, the contents of a license agreement (A) may be clearly presented before the product is purchased; or (B) may not be clearly presented before the product is purchased. When is the license agreement formed in each of these cases?

First, in case (A), if the contents of a license agreement are clearly presented on the contract screen before the conclusion of the transaction, and if the consumer clicks the Purchase Button after agreeing to the contents of the license agreement, the whole contract, including the license agreement, is formed at the time at which the information, to which the consumer has given his assent by clicking the Purchase Button, is recorded on the counterparty's server (Article 4 of the Electronic Contract Law). In Business-to-Consumer contracts any expression of intention mistakenly made by the consumer is invalid, except where business entities have taken measures to confirm the consumer's intention to form a contract and where the consumer voluntarily waived such confirmation measure (Article 3 of the Electronic Contract Law and Article 95 of the Civil Code).

For example, where the contents of a license agreement are clearly presented on the online screen, (e.g.) the Agreement Button and the Purchase Button are plainly visible and are arranged distinctively from other buttons used for downloading; the screen is configured in such a way that if the contractual text is too long to be displayed on a single screen, the Agreement Button cannot be clicked unless consumers scroll through the entire text. Under such circumstances, if the consumer clicks the Purchase Button after clicking the Agreement Button, the license agreement is formed, and the consumer can demand no refund.

On the other hand, if the display screen is configured, e.g., in a manner where consumers have to move from the online contract screen to the license agreement screen using a difficult to locate link; the assent of the consumer to the license agreement is not required for clicking the Purchase Button. Under such circumstances, the license agreement is not formed even if the consumer clicks the Purchase Button. Therefore, the consumer may demand a refund in this instance.

Next, in case (B), the whole contract, including the license agreement, is formed at the time at which the user clicks the Agreement Button having knowledge of the contents of the license agreement and with the intention to conclude the contract. For example, where a readme.txt file is extracted following the decompression of a downloaded file and where it contains the contents of a license agreement, then if the user does not agree to the contents of the license agreement, the agreement is not formed and the user may return the product and demand a refund.

However, it should be quite easy for a Vendor to display the contents of a license agreement on the online contract screen. Unlike transactions made through media, there are usually no physical restrictions on clearly presenting the full text of a license agreement. Therefore, in some cases, if the contents of the license agreement were not clearly presented in advance, when the user concludes the contract for acquiring the ownership of the reproduction of information property by downloading it, no license agreement will restrict the use of the information property similarly to the description in 2 above.

## (2) Effects of Not Representing Important Matters

[Issue]

When the user purchases the information property, what information must the Vendor or the store provide? What happens if they do not provide such information?

(Example) At a store, a consumer purchased a program and took possession of it. However, since the store did not provide the consumer with any information about the operating system required to run the program, the consumer was unable to use it. In this case, can the consumer return the product and demand a refund?

[Approach]

### (I) Where important matters are not provided

There are cases where the Vendor or the store is obliged to provide the user with the information necessary for the use of the information property (i.e. important matters). If such important matters are not provided and if, as a result, the user cannot use the information property, the user can return the product and demand a refund (Paragraph 2, Article 1 of the Civil Code).

### (II) Specific contents of important matters

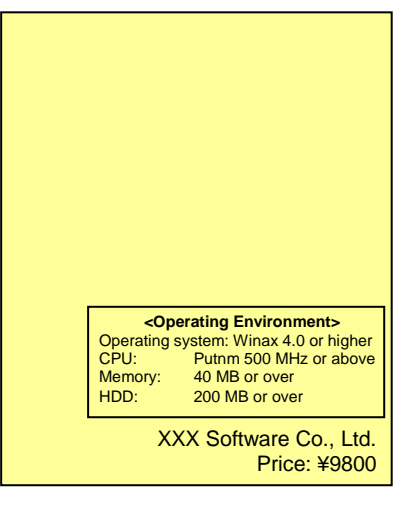
At present, the following could fall under the category of important matters:

Matters that could fall under the category of important matters

- (1) Types and versions of the operating system and platform software. Listing the type and version of either the operating system or the platform software is satisfactory, where such information is sufficient.
- (2) Type of CPU and its operating speed
- (3) Main memory capacity
- (4) Hard disk capacity

### (III) Actual methods of providing information

Since only the Vendor has the applicable information, such as that mentioned above, the important matters will usually be written on the outside of the product package, in the case of a medium-type transaction, and be displayed on the contract screen, in the case of an online transaction.

<p>Where important matters have been sufficiently provided</p> <ul style="list-style-type: none"><li>• Important matters are clearly shown, in an enclosure entitled “Operating Environment” etc., at an easily recognizable position for the user, such as near the price on the outside of the product package (see example at right).</li><li>•</li><li>•</li></ul>	 <p data-bbox="1074 815 1369 920"><b>&lt;Operating Environment&gt;</b> Operating system: Winax 4.0 or higher CPU: Putnm 500 MHz or above Memory: 40 MB or over HDD: 200 MB or over</p> <p data-bbox="1142 936 1369 987">XXX Software Co., Ltd. Price: ¥9800</p>
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[Explanations]

#### 1. Problem identification

Information property is more highly dependent on an operating environment than other types of property. If employed in the wrong environment, information property may not function at all. It is possible that a user may purchase packaged software from a store but cannot actually use it because he was not been provided with information about the required operating environment. The question in this case is whether the user can terminate the Primary Agreement and return the packaged software to the store.

Based on the principle of good faith and mutual trust prescribed in Paragraph 2, Article 1 of the Civil Code, there are cases where one of the parties to a contract is obliged to provide the other party with certain information and where such other party may terminate the contract if the obligation is not performed.

The problem is how this principle actually applies to trading in information property.

## **2. Duty to provide information at the conclusion of a contract**

Where there is a wide gap between the parties to a contract in terms of information or expertise, the superior party is obliged by the principle of good faith and mutual trust (Paragraph 2, Article 1 of the Civil Code) to provide the other party with information on the important matters material to the conclusion of the contract (“*jûyô-jôkô*”)(hereinafter called “Important Matters”) during the process of conclusion.

In the case of information property, the user cannot use the product purchased unless the operating environment requirements, such as those concerning the operating system and the platform software, are met. Therefore, the explanation of the operating environment for the information property, which constitutes a supplementary duty at the time of providing the information property, can sometimes be material information (Important Matters) for determining whether the information property can actually be used. Based on the principle of good faith and mutual trust, the minimum operating environment required to employ the information property must be communicated at the time the Primary Agreement is being concluded.

## **3. Effects of violation of the duty to provide information**

There are judicial precedents that affirm such duty based on the principle of good faith and mutual trust. These judicial precedents have found parties either (i) liable for damages; or (ii) having a right to terminate the contract.

Judicial precedents finding liability for damages mostly concern cases where transactions were made in financial products or a long time has passed between the conclusion of the contract and the plaintiff’s claim for damages.

Judicial precedents in (ii) above are cases which ruled that a party had the right to terminate a contract, all concerning real estate transaction. These judicial precedents holds that a supplementary duty exists associated with the conclusion of a sales contract; which obligates the potential Vendor to inform the potential buyer of Important Matters, such as information about the surrounding environment, and as this is important information in deciding whether to conclude the sales contract, the buyer may terminate the sales contract where the Vendor has failed to perform his duty.

In many cases where a buyer cannot use information property because no information about its operating environment was provided at the time the contract was concluded, the buyer may terminate the contract and demand a refund of the purchase price.

#### **4. Contents of the duty to provide information**

Where the user who purchased the right to employ information property cannot use it because the required operating environment was not clearly indicated, the user might be allowed to terminate the Primary Agreement or even the license agreement.

Summarizing the actual cases, the following would constitute essential matters that need to be clearly shown as regards the operating environment:

- (1) Types and versions of the operating system and the platform software. Type and version of either the operating system or the platform software is satisfactory, where such information is sufficient.
- (2) Type of CPU and its operating speed
- (3) Main memory capacity
- (4) Hard disk capacity

#### **5. Actual methods of providing information**

Since only the Vendor has the relevant information, as mentioned above, it will usually be written on the outside of the product package in the case of medium-type transactions and be displayed on the contract screen in the case of online-delivery transactions. For example, if important matters are clearly shown, in an enclosure entitled “Operation Environment” (“*dōsa-kankyō*”)etc., at a position the user can easily perceive, such as a position near the price on the outside of the product package, then the information has been duly provided. Alternatively, the store can always receive information from the Vendor and provide that information to the user at the time the user offers to purchase the right to use the information property.



### (3) Unreasonable Clauses

[Issue]

What clauses of a license agreement may be interpreted as being unreasonable and therefore invalid?

[Approach]

The contractual clauses shown below could be interpreted as invalid. Users are not bound by invalid clauses.

#### **(I) Contractual clauses contrary to public policy**

Contractual clauses contrary to public policy prescribed in Article 90 of the Civil Code could be interpreted as invalid.

Examples of clauses that could be unreasonable

- Clauses setting extremely advantageous conditions on which the Vendor can terminate the contract.
- Clauses by which the Vendor can only be required to pay a minuscule amount in damages
- 

#### **(II) Contractual clauses violating the Consumer Contract Act**

In consumer contracts, the following clauses could be found invalid under Articles 8 to 10 of the Consumer Contract Act:

- Clauses shielding the Vendor from any liability.
- Clauses protecting the Vendor from liability for intentional acts or acts of gross negligence.
- Clauses making the purchaser liable for damage or penalty amounts at levels unreasonably higher than the amount demanded of the Vendor in similar situations.
- Clauses unfairly restricting the rights or expanding the duties of consumers.

Examples of clauses that could be unreasonable:

- Excluding the Vendor from any liability for bugs
- Charging a customer for any repair of bugs
- Setting an extremely short warranty period
- 

### **(III) Contractual clauses restricting competition**

Contractual clauses that are illegal under the Antimonopoly Act could also be interpreted as invalid under private law since they violate the public policy principle prescribed in Article 90 of the Civil Code.

Examples of clauses that could be unreasonable if they were to impede fair competition in the market:

- Restricting research or experimentation
- Prohibiting the use of specific products or competing products
- Prohibiting reverse engineering
- 

### **(IV) Contractual clauses restricting the user from making such use of information as permitted by the Copyright Law**

Articles 30 to 49 of the Copyright Law partly restrict copyright, that is, permit users to make free use of the information property in a specified way. A view exists that since these clauses are basically discretionary clauses, the rights of users can be contractually restricted. On the other hand, another view exists that clauses of license agreements are invalid which too narrowly restrict how users make use of the information property.

Examples of clauses which could be unreasonable according to the view that contractual clauses are invalid if they more narrowly restrict the user making use of the parts of the information property for which rights are restricted by the Copyright Law:

- Clauses completely forbidding copying for personal use and the making of backup copies
- 
- 

### **[Explanations]**

The following clauses of a license agreement could be invalid:

## **1. Contractual clauses contrary to the public policy prescribed in Article 90 of the Civil Code**

Article 90 of the Civil Code provides that a juristic act, the purpose of which is contrary to public policy, shall be invalid. This is based on the view that a contract should be interpreted as invalid if its effects are deemed to be excessively unreasonable from a social point of view. For example, there exists judicial precedent in which a clause was judged invalid as contrary to public policy because it limited the amount of damages awarded for aviation accidents to 1 million yen (Judgment of Osaka District Court, June 12, 1967, 18-5 to 6 Kaminshû 641). The same principle could apply to the unreasonable contents of license agreements.

For example, clauses could be judged invalid in accordance with the above principle, which set extremely advantageous conditions by which the Vendor can terminate the contract and by which the Vendor can only be required to pay a minuscule amount in damages.

## **2. Contractual clauses that violate the consumer contract act**

In consumer contracts, the following clauses could be interpreted as invalid under Articles 8 to 10 of the Consumer Contract Act:

- Clauses shielding the Vendor from any liability. Clauses protecting the Vendor from liability for intentional acts or acts of gross negligence.
- Clauses making the purchaser liable for damage or penalty amounts at levels unreasonably higher than the amount demanded of the Vendor in similar situations.
- Clauses unfairly restricting the rights or expanding the duties of consumers.

For example, in accordance with the above, clauses excluding the Vendor from all liability for bugs or clauses which set an extremely short warranty period could be interpreted as invalid.

## **3. Contractual clauses restricting competition**

Contractual clauses that are illegal under the Antimonopoly Act could also be interpreted as invalid under private law because they violate the public policy principle prescribed in Article 90 of the Civil Code.

For example, in accordance with the above, clauses which restrict research or experimentation, which prohibit the use of specific products or competing products, and which prohibit reverse engineering, could be interpreted as invalid if they impede fair competition in the market.

In regard to provisions prohibiting reverse-engineering, the Fair Trade Commission issued a document entitled “Views on Software Licensing Agreements, etc. under the Antimonopoly Act – An Interim Report of the Study Group on Software and the Competition Policy.” Specifically, provisions prohibiting reverse-engineering are considered invalid due to their deleterious effect on competition in the market under the following circumstances: (1) where it is necessary to obtain interface information concerning the applicable software in order to develop hardware or software which is compatible with the platform software such as operating systems; (2) the licensor has not provided the interface information; and (3) the performance of reverse-engineering by the licensee is an essential and unavoidable measure in order to develop software and hardware for the applicable software.

(<http://www.jftc.go.jp/pressrelease/02.march/020320.pdf>)

#### **4. Contractual clauses restricting the user from making use of information property whose rights are restricted by the Copyright Law**

When information property is protected by the Copyright Law, the scope of the copyright can be partly restricted by the law (Articles 30 to 49 of the Copyright Law). The Copyright Law allows users to make free use of particular parts of the information property. A view exists that since these clauses are basically discretionary clauses, the user’s right can be contractually restricted. On the other hand, another view exists that clauses of license agreements are invalid which too narrowly restrict how users make use of the information property. According to this view, clauses which completely forbid copying for personal use and the making of backup copies could be interpreted as invalid.

(4) Human Scope of software license

[Issue]

With regard to a software license agreement, where the right to use of software is provided solely to a specified user<sup>16</sup> (hereinafter, “licensee”), the question is, how the human scope of such license should be defined, in other words, the range of persons authorized to use the software and the authorized mode of use by these persons?

More specifically, where the following persons who have a certain connection with the licensee in the course of business make use of the software for the purpose of the company’s business, will these persons fall within the human scope of the software license ?

(Examples)

1. The licensee company’s employees<sup>17</sup> constantly stationed at a third-party company after concluding a ‘software development agreement’ between the licensee and such third-party, pursuant to which such third party is entrusted with the development of such software by the licensee.
2. Temporary workers stationed at and working for the licensee company.
3. A software vendor’s employees constantly stationed at the licensee company that has been entrusted with software development by a third-party and has entrusted such development to the software vendor.
4. Employees of a company with which the licensee company has business relations.

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<sup>16</sup> The following cases shall be excluded from the target of the argument here. i) The scope of license is determined by the computer or the CPU, in which a software license agreement expressly provides that the user is entitled to make only one copy of the software by installing it into a sole computer. ii) The range of persons entitled to use the software is explicitly defined, for example as “Reserved for those who have a membership of [a legal entity name]”. iii) The sale of the software is based on the assumption that it is for personal use.

<sup>17</sup> ‘Employees’ here mean all the persons that have executed a service agreement with the licensee company, which include full-time and part-time workers and contracted employees, but do not include temporary workers.

[Approach]

Where software is actually used by a person other than the licensee, the human scope of such license shall be extended to the person, if the software is considered to be substantially used by the licensee itself, judging comprehensively from the purpose of such use, the human relations between such licensee and the person actually using it, and other factors as well.

### **1. Analysis of Example 1**

The use of such software by the licensee's employees working outside the company will still be considered use by the licensee itself, because such use is with a view to performing the licensee's business, and thus it is a part of the licensee's business activity.

Therefore, the human scope of the software license extends to such employees.

### **2. Analysis of Example 2.**

Temporary workers are virtually no different from other employees of the licensee company in regards to the contents of tasks performed, now that what is called 'human outsourcing' is quite common. Thus, such temporary workers' use of the software will be regarded as use by the licensee itself.

Therefore, the human scope of the software license extends to such temporary workers.

### **3. Analysis of Example 3.**

The entrustee again entrusts the **software vendor** with software development (in this section, the **software vendor** may be referred to as the 'sub-entrustee' / '*sai-jutakusha*'). The employees of the sub-entrustee are constantly stationed at the licensee company (= user) and engaged in such software development.

In this case, whether or not such employees fall within the human scope of the software license shall be judged from the characteristics of the software, the purpose and the specific methods of its use. Then, if the use of software by such employees can be regarded as that by the licensee itself, they may fall within the human scope of such license.

For instance, where a licensee fully capable of developing software enters into a contract regarding the outsourcing of software redevelopment with a software vendor, in order to make up for the shortage of staff, the use of the software by the software vendor's employees may be, depending on the workplace environment where such software is actually being developed, considered as use in the course of the licensee's (= user's) business, which logically leads to the conclusion that the software vendor falls within the human scope of such software license.

However, when the employees of the software vendor, working inside the licensee's company, are expected to work separately from the other employees of the licensee's company in regards to their location and mode of business, it is unlikely that such software vendor will fall within the human scope of such software license.

#### **4. Analysis of Example 4.**

Where the employees of a customer company use the software for the purposes of their own personal business, it is impossible to argue that they fall within the human scope of such software license.

Therefore, the human scope of such software license does not extend to such use.

[Explanation]

#### **1. Identification of Problems**

Until recently, only directors, corporate auditors, and other employees used to engage in business for an enterprise.

For this reason, the 'software license agreement', which authorizes the use of software, was based on the assumption that such software would be used solely by the employees (= users).

In recent years, however, with the increasing diversification of employment in mode and structure, it is not only the employees that work for an enterprise.

This situation has given rise to a problem: whether or not the human scope of a software license extends to people not employed by but working for the licensee company.

The human scope of a license agreement (in other words, those who are authorized to use the software) is subject to the contents of each agreement between the licensor and the licensee, because this is not a matter governed by any mandatory statute.

Thus, where the software license agreement expressly stipulates a contractual clause in regard to the human scope of the software license, that is, the range of persons authorized to use such software, the parties must act in compliance with the contractual clause.

In Japan, many software license agreements have no contractual clause expressly stipulating its human scope, in which case the scope shall be determined by interpreting both parties' reasonably alleged intentions underlying the clauses agreed upon and stipulated in the agreement.

## **2. Basic approach to the human scope of a software license agreement**

The essence of a software license agreement is that the licensor permits the licensee to use the software. Thus, where the licensee is a natural person (=an individual), use of the software by the natural person will quite logically fall within the scope of such license. On the other hand, where the licensee is a legal entity, a new problem arises in connection with the human scope of the software license.

The problem is, since a legal entity is an organization consisting of officers and other employees etc, it is not the legal entity itself that actually uses the software. Instead, the act of use by certain natural persons such as employees must be deemed as that by the licensee (=a legal entity) itself. It is not unclear and in question whose and what mode of use shall be considered as use by the licensee (=user) itself. Where the software is used by the directors or corporate auditors for the purposes of the licensee company's business, such use is of course considered as the use by the user itself.

On the other hand, with regard to the employees and other relevant persons, further consideration will be required, due to their diverse mode of employment.

Use of the software by the employees of the licensee (=user) will, in principle, fall within the scope of the software license, because they engage in such licensee's (=user's) business under its supervision.

However, if such software is used by persons who are not regarded as employees of the licensee (=user), then it is those who have no special connection with the licensee that use the software. Thus, their use cannot be reasonably deemed as the licensee's (=user's).

Based on the aforementioned argument, in principle, the use of software by the employees of the licensee (=user) will fall within the scope of such license, while use by non-employees will not.



However, it may be unreasonable and too inflexible to argue, due to today's diversified mode of employment, that the non-employees of the licensee (=user) engaged in the licensee company's business in the same manner as the other employees are always outside the scope of such software license simply because they have not entered into any service agreement with the licensee.

Another question may arise in connection with the non-employees of the licensee who are engaged in business closely related to but not directly the licensee's (=user's) business. In this case, may such employees' use be, in certain cases, considered to be the licensee's (=user's) use?

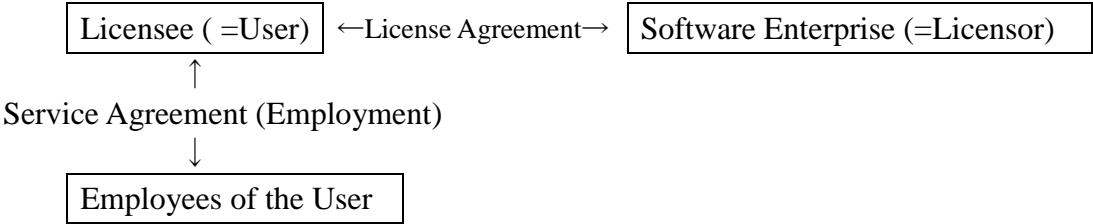
As discussed above, the human scope of a software license should be judged from the perspective of whether the software will be deemed to be used by the licensee (=user) itself, taking into consideration the relationship between the person actually using such software and the licensee (=user), and the purpose of its use, etc.<sup>18</sup>

**3. Further Consideration**

The actual users of software will be classified into 4 categories here, in accordance with the closeness of the actual user's relation to the licensee (=user) and the purpose of the use.

The analysis is based also on consideration of the location where the software is actually being used; inside or outside the licensee company.

**(1) The use of software by a person directly employed by the licensee (=user).**




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<sup>18</sup> The licensee (=user) must establish a system where the user is responsible for managing the licensed software so that it is used only within the scope of its license.

(A) The use of software inside the licensee company

In this case, the software is used by the employees of the licensee inside the licensee company, and thus such use is regarded as use by the licensee (=user) itself. Basically, the employees fall within the human scope of such software license without posing particular problems.

(B) The use of software outside the licensee company

In this case, the software is, even though used outside the licensee company, used by the persons who are directly employed by it, and thus such use is deemed to be a part of its business activities. Therefore, basically, such a mode of use, deemed as use by the licensee (=user) itself, will reasonably fall within the human scope of the software license.

[Examples]

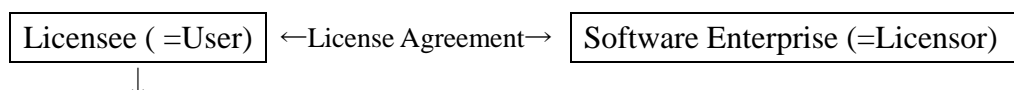
- Cases where the employees use the software at home for the purpose of the licensee company's business.
- Cases where the employees perform a presentation at a customer company's office.

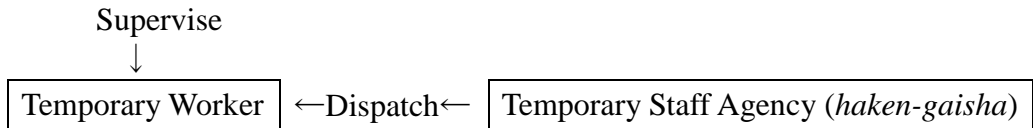
However, where the use of such software outside the company cannot be, due to certain exceptional circumstances, considered as use by the licensee (=user) itself, such a mode of use will not fall within the scope of such software license.

[Example]

- Cases where the employees use the software at home for the purpose of drafting an advertisement of their own private business.

**(2) The use of software by a person not directly employed by the licensee (=user) but using the software under its supervision.**





A typical example of this is the temporary workers working under the supervision of the licensee (=user) at all times inside the licensee company, just as the other employees.

Temporary workers are virtually no different from the other employees of the licensee company in the contents of tasks performed, now that what is called ‘human outsourcing’ is quite common. Thus, such temporary workers’ use of the software shall be regarded as the use by the licensee (=user) itself.

(A) The use of software inside the licensee company

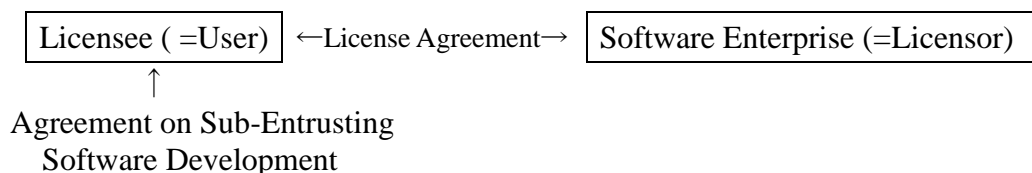
Temporary workers are no different from the other employees, so in principle, the use of such software inside the company will reasonably fall within the scope of such software license.

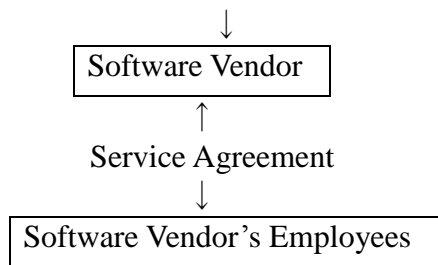
(B) The use of software outside the licensee company

As aforementioned in (1) (B) above, the use of such software by temporary workers in the course of the licensee’s (=user’s) business, even at a location outside the licensee company, will be considered substantially as part of the licensee company’s business.

Therefore, such a mode of use is basically considered as the use by the licensee (=user) itself, and will reasonably fall within the scope of such software license. However, as mentioned above, the software license will not extend to the persons using the software outside the company for any purposes unrelated to the licensee company’s business.

**(3) The use of software by a person not directly employed by the licensee (=user) but engaged in the licensee’s (=user’s) business.**





In this case, it is difficult to regard the use of software by the persons not directly employed by the licensee (=user) as that by the licensee (=user) itself. Rather, it is reasonable and logical to regard such persons as a third-party who has no direct connection with the licensee. Thus, such persons will not reasonably fall within the human scope of the software license.

However, in this case as well, such persons *may* fall within the human scope of the software license, provided that the use of such software can be reasonably deemed as that by the licensee (=user) itself, judging from the characteristics of the software, the purpose of its use, and other specific circumstances.

(A) The use of software inside the licensee company

Where the licensee (=user) is entrusted with software development by a third party and the licensee (=user) subsequently entrusts a software vendor constantly stationed at the licensee company's office with the said business, if the software vendor uses the software for performing the business, the software vendor may, depending on the facts, fall within the human scope of such software license. The assignment of such software development business is closely linked with the licensee's (=user's) business, and thus the software may be deemed as being used by the user itself, because the business performed by such software vendor can be regarded as part of the business of the licensee.

On the other hand, even where the software vendor (sub-entrustee) constantly stationed at the licensee company's office uses the software for the purpose of software development business as entrusted by the licensee (=user), if such software vendor is expected to work separately from other employees of the licensee's company in regard to their workplace and mode of business, it is difficult to consider that the software is used by the licensee (=user) itself, and thus the software vendor will not fall within its human scope.

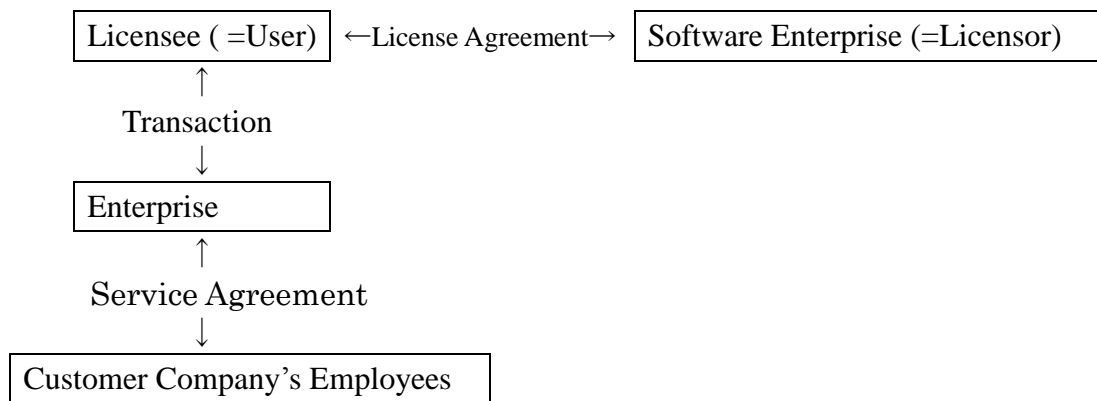
(B) The use of a software outside the licensee company

Generally speaking, as mentioned above, even where the software is used outside the licensee's (=user's) company, such a mode of use may, depending on the facts, reasonably fall within the scope of the software license, if deemed as being used by the licensee (=user) itself, judging from the characteristics of the software, the purpose of its use, and other specific circumstances.

Nevertheless, where those who are neither directly employed by the licensee (=user) nor engaged in the licensee's (=user's) business use the software outside the licensee's company, such use is less likely to fall within the scope of such software license, compared with use inside the licensee's company.

In other words, where the employees of the software vendor (sub-entrustee) are engaged in the entrusted software development business at a location outside of the employee's (=user's) company (for instance at their own office), they are deemed to be performing their own entrusted business. Therefore, in this case, the software vendor will not fall within the human scope of such software license, as the software is deemed to be used by the vendor itself.

(4) Cases where the persons not directly employed by the licensee (=user) use the software for performing the business of the enterprise by which they are employed



In this case, where the employees of a customer company use the software for performing the customer company's business, it is very difficult to deem such a mode of use as that by the licensee (=user) itself, even if it is used inside the licensee company. Therefore, basically, such use of the software will not fall within the scope of such software license.

(5) Duties of the User upon Contract Expiry

[Issue]

When a license agreement is terminated or otherwise ends, what specific duties does the user owe?

(Example) After terminating the license agreement, can the user legally retain the information property?

[Approach]

**(I) Duty of user on termination of the license agreement (restoration; “*genjô-kaifuku*”)**

After the license agreement is terminated, the user has a duty to stop using the information property. To ensure that this duty is performed, the Vendor may demand that the user erase the information property.

**(II) Duty of user where no license agreement was formed (duty to avoid unjust enrichment; “*futô-ritoku-henkan-gimu*”)**

Because the user has a duty to avoid becoming unjustly enriched, where no license agreement is formed, the user may not use the information property. To ensure that this duty is performed, the Vendor may demand that the user erase the information property.

**(III) Duty of User upon the expiry of the term of the license agreement**

When the license agreement expires, the user must fulfill his duty as specified in the license agreement. Therefore, even though the user cannot continue to use the information property after the expiry of the license agreement, he is only obliged to erase it where the license agreement requires.

## [Explanations]

This problem will be confronted in three scenarios: (1) early termination of the license agreement; (2) non-formation of the license agreement; and (3) expiry of the term of the agreement.

### **1. Duty of the user after termination of the license agreement**

#### **(1) Problem identification**

When a contract is terminated, each party has a duty to restore the counterparty to their respective state which existed before the contract was formed (hereinafter called the “Restoration Duty”) under Article 545 of the Civil Code. The Restoration Duty is essentially a duty to avoid any one party becoming unjustly enriched at the expense of the counterparty. However, the scope of the Restoration Duty is larger than that of unjust enrichment. In principle, Restoration Duty specifically means the return of any tangible object already delivered by a Vendor who has terminated the contract. If what has already been delivered cannot be returned in its original form due to its nature, then the objective monetary value of the object must be presented in its place.

Therefore, when a license agreement for information property is terminated, the user not only has to stop using the information property but also has to return any copy of the information property made. However, since information property as an intangible object is impossible to return (to transfer the possession of), a question arises about what the Restoration Duty in Article 545 of the Civil Code means for information property.

#### **(2) Contents of the Restoration Duty**

If a license agreement is terminated, the user has to stop using the information property because he no longer has the right to use it. However, if the user retains the information property after the license agreement is terminated, there exists the possibility that he might continue to use it even though he has no right to do so.

From the perspective of the Vendor, he wishes to take the information property out of the control of the user, so that the user cannot further employ or otherwise benefit from the information property.

Therefore, according to the Restoration Duty prescribed in Article 545 of the Civil Code, a user has to stop using the information property at the time the license agreement is terminated. In order to ensure the performance of this duty, the Vendor may demand that the user completely erase (delete) the information property.

In the Copyright Law, Paragraph 2, Article 47-2 provides: “The owner of a copy of a program shall not retain other copies of the program after ceasing to possess ownership rights to the copy”. The reason that this provision does not allow the owner to retain copies of the program is that if, after transferring any of the copies, the owner is permitted to use the remaining copies, he can easily use the program any number of times, thus unduly harming the interests of the copyright holder. Therefore, requiring the erasure of a copy of information property is consistent with the spirit of the Copyright Law.

## **2. Duty of user where no license agreement formed**

### **(1) Problem identification**

Where certain information property has been provided (transmitted) to a user in conclusion of a contract, if no license agreement is formed or has become invalid, the user has to both stop using the information property and to return any copy of the information property. These acts are necessitated by Article 703 of the Civil Code which places a duty on the user to avoid becoming unjustly enriched and under which the retention of any copies of information property constitutes a benefit.

However, since it is impossible to return (to transfer possession of) information property, by nature an intangible object, a question arises about what the duty to return unjust enrichment as prescribed in Article 703 of the Civil Code actually means.

### **(2) Duty to return unjust enrichment**

When a user makes a copy of information property, the Vendor suffers no loss because the cost of the copy is borne by the user.

However, if the user retains a copy of the information property, he might continue to use it despite possessing no right to do so, even if no contract was formed. Such act is highly likely to cause damage to the Vendor. In addition, it is difficult to quantitatively estimate the extent of the damage.



From the perspective of the Vendor, he wishes to take the information property out of the control of the user, so that the user cannot further employ or otherwise benefit from the information property.

Therefore, according to the duty to return unjust enrichment under Article 703 of the Civil Code (or at least through the analogical application of Article 703 of the Civil Code where its clauses do not directly apply), the user may not employ the information property if a license agreement has not been formed and, in order to ensure that the user will not employ it, the Vendor may demand that the user completely erase (delete) the information property.

### **3. Duty of user at the expiry of the term of the license agreement**

The duty of the user at the expiry of the term of the license agreement can be expressly defined as “contractual obligations”. The duty of the user for contractual obligations is exclusively confined to such stipulated obligations. Therefore, although the user cannot continue to use the information property after the expiry of the license agreement, he is only obliged to erase it where the license agreement requires.

(6) Validity of Security Measures in Preparation for Contract Termination

[Issue]

Will the Vendor have to assume any responsibility where he takes technical protections to forcibly prevent the user from illegally using the information property after the end of the license agreement?

(Example) A program suddenly stops functioning as a result of technical protections taken in advance by its Vendor to prepare for the expiry of the effective term of the license agreement. In this case, will the Vendor have to assume any responsibility?

[Approach]

**(I) Principle**

A technical protections which restricts the use of information property could be interpreted as a means of compulsory execution other than by a court and thus constitute a tort (i.e. a violation of the principle prohibiting self-enforcement).

**(II) Exception**

However, it is likely that if at least the following three requirements are met that such technical protections will not be interpreted as illegal self-enforcement:

**(i) The user has agreed, in advance, that the Vendor may take such technical means.**

Examples which meet the requirement

- The taking of such technical protections is clearly described in the license agreement, and the user has agreed to the agreement.
- 
-

**(ii) Such technical protections are limited to preventing the continued use of the information property.**

Examples which meet the requirement

- Sanctions that stop the operation of the information property after warning.
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Examples which do not meet the requirement

- Sanctions that destroy the files created using the information property.
- Sanctions that interfere with the operation of the computer system.
- 

**(iii) Such technical protections have been taken in advance.**

Examples which do not meeting this requirement

- Methods are installed during a later maintenance operation.
- Methods are installed by transmitting information to the relevant information property via network like internet.
- 

[Explanations]

**1. Problem identification**

After the expiry of a license agreement for information property, a user could continue to use the information property without paying any consideration therefore. To prevent such occurrence, the Vendor may apply a technical means to the information property which functions to forcibly terminate its use, such as making access to the information property impossible or deleting the information property.

Paragraph 1, Article 414 of the Civil Code provides that if a debtor does not voluntarily perform his obligation, the creditor may apply for compulsory enforcement to the court. Conversely, this means that the creditor is not allowed to directly enforce the debtor to perform his obligation (“the prohibition on self-enforcement”; “*jiriki-kyûsai-kinshi-gensoku*”). In principle, the creditor is prohibited from enforcing his right (claim) to any person (by private enforcement). Although it is not expressly stipulated in the Civil Code, most of the academic theories and judicial precedents agree that the enforcement contrary to this principle constitutes a tort.

Therefore, when a Vendor uses a technical means to forcibly obstruct the use of information property at the end of the license agreement, a question arises about whether this act violates the principle prohibiting self-enforcement.

## **2. Standards for judgment**

### **(1) Presence of a prior agreement**

When the Vendor has obtained the prior consent of the user that the information property will be unavailable for use at the expiry of the license agreement, the principle prohibiting self-enforcement will not apply.

However, generally, in a case of title retention (“*shoyûken-ryuho*”), contract clauses usually include such clause as the debtor shall bear a self-enforcement by the creditor, by virtue of recovery clause (“*torimodosi-yakkan*”). However, common theories did not justify such self-enforcement only based on the prior agreement as mentioned above. A judicial precedent (Judgment of Fukushima District Court, February 24, 1972, 278 Hanreitaimusu 201) concerns a case in which an act of repossession was performed by virtue of a recovery clause. The judgment says that, in consideration of the principle prohibiting self-enforcement, the clause could be interpreted as invalid under Article 90 of the Civil Code.

Therefore, the validity of a prior agreement, which allows the presence of a technical means to restrict use to information property, could raise questions in light of the principle prohibiting self-enforcement.

### **(2) Technical sanctions limited to the prevention of continued use (ensuring the termination of contract)**

In a license agreement, it could be agreed in advance that a technical means could employ measures which go beyond merely preventing the future use of information property. However, if the Vendor pressures the user to perform his obligations including payment of the license fee, by way of threatening the use of the software other than the information property which was licensed to the user: such as erasing other information on the hard disks such as files, etc. created and stored using the information property on the hard disk; or interfering with the operations of the computer system. These sanctions would be invalid due to its excessive restriction to the users, considering the difference of the bargaining power of the parties when they entered into such agreement.

### **(3) Technical sanctions taken in advance**

A prior agreement may permit the application of technical protections after the agreement is in force, not in advance, for example, through the modification of the computer system of a user during a maintenance operation which allows the Vendor to prevent the user from employing the information property. This modification could be performed after a certain period or by sending specific signals which prevent the information property from functioning on a network such as the Internet. Such practice may often be arbitrarily used by the Vendor. Therefore, despite the existence of a prior agreement, this practice could be found as an abuse of rights.

### **3. Summary**

In summary, it is highly likely that a technical sanction will be found legal, and not a means of self-enforcement, if (i) the user has agreed in advance that the Vendor may implement the extraordinary technical means; (ii) the technical means is limited to the prevention of the continued use of the information property (ensuring the end of the contract); and (iii) the technical means has been taken in advance.

(7) Liability of Vendors on Programs

[Issue]

If a program malfunctions because of a “bug”, what responsibility does the Vendor have to the user?

(Example) There are cases where a program warranty period (such as within XX days of delivery) is set in the license agreement. If the user has discovered a bug which constitutes a product defect after the expiry of that period, can he question the responsibility of the Vendor?

[Approach]

**(I) For which bugs (which is considered to be defects) is the Vendor responsible?**

(i) Where a program does not have normally expected function nor quality (judged by the reasonable standard based on the trade practice); and (ii) where any malfunction occurs when the program is used under the usually predictable circumstances or along with the usually predictable way of use, then the bug in the program is deemed to be a defect, and the user can hold the Vendor responsible therefor.

**(i) Where a program does not have the normally expected functions or quality judged by the reasonable standard of trade practice**

Examples that do not have the usual functions or quality

- A program does not operate at all.
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Examples that have the usual functions or quality

- Although the user tried to combine ruled lines, shading, rotation, and double sized font using the word-processing software, the intended result was not obtained.
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**(ii) Where a malfunction occurs when a program is used under the normally predictable circumstances or along with the usually predictable way of use**

Examples not falling into this category

- A malfunction occurred when a program was used in an operating environment which did not satisfy the operating environment requirements shown on the outside of the product package.
- A malfunction occurred as a result of a modification the user made to the program code.
- A malfunction occurred only in certain user environments

**(II) When a bug is deemed to be a product defect, what responsibility does the Vendor have to the user?**

A user may demand for damages, for repair or replacement of product against the Vendor, or terminate the contract. However, when considering the nature of software programs, the user may not claim for damages declining the Vendor's offer to repair the software by virtue of principles of good faith, when the Vendor promptly offered to repair or replacement of the software and such repair or replacement is easy to be conducted when the user accept it.

**(III) How long can the Vendor would be responsible for bugs deemed to be product defects?**

Where a license agreement contains a special clause which stipulates a shorter warranty period for bugs deemed to be product defects, a question arises about whether the license is valid.

**(i) Where the user is a consumer**

Article 10 of the Consumer Contract Act declares that any clause extremely disadvantageous to the consumer is invalid. For example, clauses which provide an extremely short warranty period for bugs deemed to be product defects could be considered invalid.

Cases where a clause could be judged invalid due to violating the Consumer Contract Act

- Clauses which set an extremely short warranty period for a program
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The Civil Code and other laws apply where clauses are judged invalid or where there is no special clause. Therefore, the user can demand for damages either of the following period; (A) for one year from the discovery of the defects by virtue of warranty obligation; and (B) for five years by virtue of non-performance of the obligation. With respect to defect warranty liability (“*kashi-tampo-sekinin*”) (Article 570 [Sales Contract; “*baibai*”] and 634 [Work Contract; “*ukeoi*”] of the Civil Code), obligation period is stipulated as (i) one year from the discovery of the defects (Sales Contract, Article 566 of the Civil Code) and (ii) one year from the delivery (Work Contract, Article 637 of the Civil Code). With respect to non-performance of the main obligation (“*saimu-furikō*”) (Article 415 of the Civil Code), ten years from the timing of non-performance (Paragraph 1, Article 167 of the Civil Code); rather, five years from the timing of non-performance because the Commercial Code will apply to Vendors which is usually are business entities (Article 522 of the Commercial Code).

**(ii) Where the user is not a consumer**

The Consumer Contract Act does not apply where the user is not a consumer. If there is a particular clause in the agreement, it applies. If there is no particular clause, under the Civil Code and other laws, the user demand for damages against the Vendor for either of the following obligation period; (A) by virtue of warranty obligation, obligation period shall be six months or one year from the delivery; (B) by virtue of non-performance of main obligation, five years from the timing of non-performance of main obligation. More specifically, with respect to the warranty obligation, basically one year from the discovery of the defects (Sales Contract, Article 566 of the Civil Code) or one year from the delivery (Work Contract, Article 637 of the Civil Code); rather, six months from the delivery because the Commercial Code will apply to Vendors which is usually are business entities (Article 526 of the Commercial Code).

Where a special clause could be judged invalid as being contrary to public policy, etc.

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[Explanations]

**1. Problem identification**

Programs are kind of information property which can have unintentional consequences, for example, where a programming error (hereinafter referred to as a “Bug”) interferes with the



normal operation of the computer. Bugs will prevent the user from using the program thoroughly.

Either of the following clauses could apply to this problem<sup>19</sup>:

- (A) Defect warranty liability: should be filed to the court within one (1) year from the discovery of a defect under Article 570 of the Civil Code (Sales Contract) or within (1) year of delivery under Article 634 of the Civil Code (Work Contract))
- (B) Non-performance of the main obligation: should be demanded for within 10 years from the timing of non-performance under Article 415 of the Civil Code (Damages and Specific Performance); Article 541 of the Civil Code (termination of contract due to the delays in performance of the user's main obligation); Article 543 of the Civil Code (termination due to impossibility of performance) .

In order to apply these clauses, the following questions need to be answered: (i) (a) In what cases can the Vendor be held responsible for program Bugs? (b) How long can the Vendor be held responsible? (ii) Where a license agreement contains particular clause exempting the Vendor from certain responsibilities, is such special clause valid?

## **2. Defects on programs**

### **(1) How to determine whether a program is defective**

Where a program, as object of a contract, does not have the usually expected functions or quality judged by the standard based on trade practice, it will be considered that the program has a defect.

In particular, the following are the examples of cases in which the program may not be considered a defect.

First of all, how a program function depends on the environment in which it is used. It is usually clearly indicated which operating environment a program requires. Where a

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<sup>19</sup> The liability under the Product Liability Law covers that of “products (*“seizô-butsumo”*)”, namely “the movable and tangible properties which have been produced or processed”, and does not cover programs, in principle. However, in case of the purchase of product (movable and tangible property) such as personal computer, if a defect is found in a program recorded in the CD-ROMs and it constitutes a defect of a whole product, the manufacturer of such product (movable and tangible property) may be responsible for the product liability.

program is used outside of the stipulated operating environment and any difficulties arise in the proper functioning of the program, such malfunctioning shall not constitute defects.

Secondly, the user should reasonably be able to understand how a program can be properly be used by referring to its manual, company website, etc. Therefore, a Vendor is not responsible for any problem arising through the unusual way of use of the program, which was not normally predicted by the Vendor (for example, where a problem occurs after the user modified the program code).

Furthermore, a Bug in a program would be necessarily considered as a defect; minor Bugs which do not interfere with the normal use by the user shall not constitute defect. In addition, despite the Bug's presence, if the program can be repaired and used smoothly with the user's "patch", such Bugs might not be deemed to constitute defects. Among the court's precedent (e.g., Judgment of Tokyo District Court, February 18, 1997, 964 Hanreitaimusu 172) states that because every program is likely to have some Bugs, a program should not be considered as having defect because of the Bug if the Vendor repair the Bugs promptly after becoming aware thereof or if they quickly take reasonable, alternative steps after consulting with users.

## **(2) The responsibility of the Vendor**

### **(i) Will Civil Code apply?**

If a defective program is delivered to a user in exchange for payment, the Vendor is responsible for the defect. Under the Civil Code, the Vendor will be either claimed for (A) defect warranty liability (Article 570 [Sales Contract] or Article 634 [Work Contract] of the Civil Code); or (B) non-performance of the main obligation (Article 415 of the Civil Code).

#### **(A) Defect warranty liability**

The user could either (a) terminate the contract, (b) demand for damages or (c) demand for repair of defect.

However, the termination option under (a) above is only available in "cases where the purpose of the transaction cannot be achieved" (Article 566 [Sales Contract] and Article 635 [Work Contract], both of which refer to Article 570 of the Civil Code). Should the Vendor fix the program so that it performs its intended functions, the purpose of the transaction will have been achieved. Therefore, if as demanded by the user, the program is fixed or a functioning

replacement is provided, the user cannot terminate the contract as such scenario constitutes a “case where the purpose of the transaction is achieved”.

As for (b), considering the nature of the program that can easily be repaired, the user should not demand damages after rejecting the offer of the Vendor to promptly repair the program or the provision of a replacement under the principle of good face and trust, as is usually preferable to the Vendor.

(B) Non-performance of the main obligation

A Vendor commits a contractual default where he supplies a defective product which cannot perform its stated functions. In response, the user can either (a) terminate the contract; (b) demand damages; or (c) demand fulfillment of obligation.

(a) Termination of the contract

Article 541 and 543 of the Civil Code stipulate that, where a party to a contract may terminate a contract if the party has already demanded the obligor to perform its obligation within a specified reasonable period of time, and yet the obligor did not perform its obligation, or where it is impossible for the obligor to perform its obligation. Specifically, if a user demands the Vendor fulfill its obligations within a specified (reasonable) time period, which is reasonable, and if the Vendor fixes the program’s defect or provides a functioning replacement within the specified period, then the user may not terminate the contract.

(b) Damages

Under the Article 415 of the Civil Code, if a Vendor cannot perform in accordance with a substance of the obligation, then the user may demand damages. According to the article, the user may also demand damages if the user suffers any damage from a delay in the Vendor fulfilling his obligations. However, considering the nature of the program which may be easily repaired, the user may not demand for damages under and in accordance with the principle of good face, as mentioned above, without accepting the Vendor’s offer to fix or replacement, which is easily realized and is less onerous for the Vendor.

(c) Fulfillment of obligation (“*kanzen-rikô*”)

It is possible for a consumer, who purchased a defective product, to demand its repair or replacement under Article 415 of the Civil Code.

### **3. Period of the Vendor's defect warranty liability and other liability**

Unless there is any particular agreement in the license agreement, the period of the obligation shall be as follows:

The period of the defect warranty liability is limited to the following periods: one (1) year after the user becomes aware of the defect (Articles 570 and 566 of the Civil Code [Sales Contract] ) or one (1) year after delivery (Article 637 of the Civil Code [Work Contract] ); provided that if the user is a business entity, Article 526 of the Commercial Code applies and the period is six (6) months after delivery.

The liability period of the non-performance of main obligation is limited to ten (10) years from the date the program is delivered (Paragraph 1, Article 167 of the Civil Code). However, where the Vendor is a business entity, any liability for default ends following the passage of five (5) years from the date the program is delivered under Article 522 of the Commercial Code. The claim for damages following the termination of contract (due to non-performance of claim for restoration to original state following the termination of contract) ceases following ten (10) years (in principle) or five (5) years (in cases of commercial transaction) from the date of termination.

These periods may be subjected to revision in consideration of the usual short life spans of software programs.

### **4. Disclaimer clause of defect warranty liability or non-performance of the main obligation**

#### **(1) Where the user is a consumer**

Some license agreements have disclaimer clauses concerning defect warranty liability or main obligation of the contract. However, in consumer contracts, the following special clauses are likely to be declared invalid as violations of Subparagraphs 1, 2, or 5, Paragraph 1, Article 8 r Article 10 of the Consumer Contract Act:

- Clauses which shield the Vendor from any and all liability to indemnify the consumer for damages resulting from the Vendor's non-performance of obligation

- Clauses which partially shield the Vendor from liability to indemnify the consumer for damages resulting from the intentional, or grossly negligent, non-performance of main obligation.
- Clauses which shield the Vendor from any and all liability to indemnify the consumer for damages caused by a product defect; provided, however, that these clauses would be valid if it is stipulated in such contract that the Vendor should be responsible, when a latent defect is found in the subject item under such contract, to provide replacement or repair such defect (Subparagraph 1, Paragraph 2, Article 8 of said Act) or if a Vendor's affiliate bearing a certain relation to such Vendor is held responsible (Subparagraph 2, Paragraph 2, Article 8 of said Act).
- Clauses which restrict the rights of consumers or excessively disadvantageous to consumers

For example, clauses which shield the Vendor from any liability related to the Bugs; clauses which stipulate that Bugs will only be repaired on a chargeable basis. These clauses could be ruled invalid under Article 8 of the Consumer Contract Act. In a similar context, where the nature of a program necessitate a certain warranty period, and where a clause sets an unreasonably short, the clause could be judged invalid under Article 10 of the Consumer Contract Act.

## **(2) Where the user is not a consumer**

When the user is not a consumer, the Consumer Contract Act naturally does not apply. For that reason, any special clause will be applicable in principle.

(8) SLA for "Software as a service"/"Application Service Provider"

[Issue]

Where transactions of software involve a "Software as a Service" ("SaaS"), it is widely considered important that parties to the transaction pre-agree on the service level in order to avoid later disputes. Regarding this issue, this memorandum will herein discuss the legal implications of such prior agreements in the above-mentioned transactions. Furthermore, this memorandum will also discuss the kinds of matters that should be pre-agreed upon.

[Approach]

Where a Service Level Agreement ("SLA") is executed with the user of a SaaS<sup>20</sup>, if the parties stipulate to the SLA as a legal obligation, a party who fails to achieve the pre-agreed service level shall bear liability for non-performance of obligations (Article 415 of the Civil Code). By contrast, where the SLA is stipulated, but merely as a nonbinding target, even if the service provider fails to fulfill the service level prescribed therein, he/she/it will not necessarily bear liability for non-performance of obligations; provided, however, that when the provider's service is designed for general consumers, some contractual clauses discharging the service provider from all or part of liabilities may be nullified pursuant to the Consumer Contract Act (Law No.61 of 2000, "*shouhi sha hogo hou*" in Japanese) in certain cases.

[Explanations]

**1. SaaS**

"SaaS" is defined as "software, which part of the functions are, upon delivery thereof by its developer, etc., exclusively selected by customers according to their specific needs"<sup>21</sup>,

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<sup>20</sup> The definition of an "SLA" is sometimes ambiguous. For the purpose of this Guideline, an "SLA" is defined as a "specific commitment in writing by and between the IT service provider and outsourcer on the level of quality of service required in light of its scope and contents and other underlying circumstances, as well as the management rules on adequate implementation of the matters prescribed upon the execution of the IT service agreement". ("Guidelines for Introduction of an SLA to Government Procurement Relating to Information Systems", Information-Technology Promotion Agency, Japan ("*dokuritsu gyousei houjin joho shori suishin kikou*" in Japanese), March 2004)

<sup>21</sup> Dictionary of IT Information Management Terminology ("*IT joho management yougo jiten*" in Japanese) (<http://www.atmarkit.co.jp/im/terminology/>).

meaning that the service provider allows users of the SaaS to gain access, via a network, only to the functions which they wish to utilize and in consideration for which payment is made<sup>22</sup>.

Examples of a SaaS include Customer Relationship Management (CRM), Sales Force Automation (SFA), personal affairs management and payroll calculation service, accounting and corporate service, electronic mail service, collaboration tool related service, security measures service, PC help desk service, ID management and authentication service, etc.

The SaaS is literally a “service”, and therefore the term means the offering of service via the internet, etc. In this regard, its users' major concern will be focused on what service they can receive. On the other hand, unlike a simple purchase and sale of products, the legal implications of a SaaS remain somewhat ambiguous due to the nature of the term "service." Furthermore, considering the nature of a SaaS, which offers its services via a network on a computer system, we cannot reasonably expect that such service will be perfectly rendered by the service provider at all times.

Therefore, to avoid disputes with customers, it is recommended that the service provider offering a SaaS objectively set forth the service level in the SLA, thereby making it clear in advance what service will be offered to the customers.

For details regarding the example SLA with reference to how the service level should be established, see the “SLA Guidelines for SaaS (*SaaS muke SLA guideline* in Japanese)” published by the Ministry of Economy, Trade and Industry<sup>23</sup>.

## **2. Legal Effect of SLA**

The legal implications of an SLA will be entirely different depending on whether its provisions are stipulated as legal obligations or merely as a nonbinding target.

If the SLA is stipulated as a legal obligation and the party owing such obligation fails to achieve the prescribed service level, such party shall bear liability for non-performance of obligations (Article 415 of the Civil Code). By contrast, where the SLA is stipulated merely

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<sup>22</sup> In certain cases, this term is understood as a synonym for the so-called "application service provider" ("ASP").

<sup>23</sup> *SaaS muke SLA guideline* in Japanese (January 21, 2008, Ministry of Economy, Trade and Industry)

[http://www.meti.go.jp/press/20080121004/03\\_guide\\_line\\_set.pdf](http://www.meti.go.jp/press/20080121004/03_guide_line_set.pdf)

as a nonbinding target, even if the service provider fails to fulfill the service level prescribed therein, he/she/it will not necessarily bear liability for non-performance of obligations<sup>24</sup>.

Therefore, a service provider must decide whether each provision within the SLA should be stipulated as a legal obligation or as a nonbinding target on a case-by-case basis, considering the contents of services, infrastructure, working applications, the amount of usage fee collected from users, etc.<sup>25</sup>

Furthermore, service providers will also need to stipulate a disclaimer or limitation of the amount of damages in relation to predictable risk factors<sup>26</sup>.

In this regard, however, it should be noted that, if such service is designed for general consumers, the Consumer Contract Act (Law No. 61 of 2000, "*shouhisya keiyaku hou*" in Japanese) may, without prejudice to the contractual disclaimer or limitation of damages in the SLA, restrict or bar the service provider from receiving legal effects thereof.

On the contrary, those who wish to utilize a SaaS are expected to review and decide whether the service provider is discharging his/her/its expected duties in light of the amount of consideration payable to the provider, whether the provision imposing obligations on the service provider is so constituted as to ensure the fulfillment of services provided to users, and whether the provider bears responsibility for non-fulfillment of such obligations<sup>27</sup>.

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<sup>24</sup> A service provider should nonetheless responsibly make constant efforts to achieve and maintain the expected level of service.

<sup>25</sup> Note that, even where the provision of the SLA is a nonbinding target, if the indication in the SLA misleads general consumers due to significant differences between the services actually offered by the service provider and the services declared to be available to customers, some legal issues may arise, such as failure to complete the service agreement, miscomprehension ("*sakugo*" in Japanese, Article 95 of the Civil Code), and misleading representation as restricted under the Act against Unjustifiable Premiums and Misleading Representations, etc. (Law No.134 of 1962, "*futou keihin oyobi futou hyouji boushi hou*" in Japanese).

<sup>26</sup> In certain cases, parties to the SLA may agree upon the penalty, such as a partial refund of usage fee depending on the seriousness of non-fulfillment of the pre-agreed service level. The service provider will be discharged from liabilities exceeding a certain limit if such agreement on penalty is set forth as a limitation of damages, while such agreement will facilitate customers' claim of penalty against the service provider; therefore, it may be profitable for both parties to set forth a reasonable provision on such penalty in the SLA.

<sup>27</sup> In the case that the SLA provides as a binding clause that the service provider reserves the right to amend the service level at his/her/its own discretion, the binding effect of such provision would significantly be reduced. Such unilateral amendment of the SLA will not pose any serious problems if the SaaS is provided to customers on the occasion of the *beta* test (test to detect a bug) or free of charge by virtue of revenues derived from



### **3. Recommended Items to be Included in SLA**

#### **(1) Conditions Precedent**

It is indispensable to stipulate conditions precedent, such as the communication environment surrounding users as well as hardware specifications.

#### **(2) Availability**

It is particularly important for users to be informed of the availability of the service they receive. In this regard, it is recommended to stipulate the time zone and availability ratio etc. of the service.

For example, if period suspension of service is expected due to maintenance or management, the SLA should expressly mention that fact in advance. Moreover, considering the nature of the SaaS, one can hardly expect the availability ratio of the SaaS to be 100%, and therefore it is recommended to expressly mention the estimated availability ratio.

Although it would be acceptable to provide the time zone and availability ratio, etc. of the service as a nonbinding target, if service is for payment, non-fulfillment of such target may lead to a reduction of the usage fee. Furthermore, when the actual service significantly falls short of the target, it may be a cause for termination of the service agreement.

#### **(3) Reliability**

It is sometimes unavoidable for the service offered in the form of a SaaS to become unavailable due to system error or communication failure. Therefore, it is advisable to provide the estimated time for solution of such problems and measures to be taken in such cases.

However, if the estimated time for solution is set forth as a clause imposing an obligation on the service provider, he/she/it will bear the risk of failure to repair the service within the prescribed time period due to technical reasons, etc. Therefore, the service provider is cautioned to reconsider whether or not to set forth this legal obligation in the SLA.

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advertisements; on the other hand, however, such provision may give rise to disputes between customers and a service provider when the customers pay substantial consideration for the service. To avoid such a situation, it is recommended to set forth a clause granting customers the right to terminate the service agreement in the event of any material amendment etc. to the SLA.

#### **(4) Performance**

In the SLA, it is advisable to indicate response time in order to clarify the quality of service in advance.

However, such response time may vary significantly, depending on the condition of the infrastructure of each user. Therefore, if such response time is set forth as a legal obligation, the service provider should be careful not to mislead users in deciding the wording in the SLA of the condition precedents and other specifications.

#### **(5) Support System**

It is advisable to expressly mention how and when the customer service, if any, is provided to users<sup>28</sup>.

#### **(6) Data Management**

If a service provider receives a considerable bulk of data from customers utilizing the SaaS, it is advisable to provide in the SLA whether or not such data are backed up. However, if such backup of data is mentioned in the SLA as a clause imposing an obligation on the service provider, he/she/it may bear significant risk of loss of such data. Therefore, the service provider is cautioned to reconsider whether or not to set forth such legal obligation in the SLA.

#### **(7) Security**

If the service provider receives confidential and/or personal information from users of the SaaS, it is advisable to expressly mention in advance the method of handling and managing such information. Furthermore, service providers may also wish to expressly mention such matters as the existence of a Secure Sockets Layer (SSL) or Virtual Private Network (VPN), firewall or anti-virus measures in advance, which will caution or, as the case may be, assure customers who utilize such services.

However, even if such information is referred to in the SLA, it needs to be separately considered whether the service provider will be discharged from liabilities for actual leakage of information, etc. Therefore, service providers should in any event be careful in operating the SaaS.

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<sup>28</sup> If customer service is provided by telephone, the waiting time for a response shall be explicitly stated. If customer service is provided by electronic mail or facsimile, the waiting time for the first response, etc. shall be explicitly stated.

(9) Relationship between User and Assignee of Intellectual Property

[Issue]

A user (licensee) is only allowed to employ information property through a contract entered into with the Vendor (licensor). If the intellectual property rights to the information property are assigned to a third party, can the user effectively assert their right to continue to employ the information property against the assignee?

(Examples)

1. If intellectual property rights to certain information property are assigned to a third party, can a user (licensee) of the information property under a license agreement continue to employ the information property?
2. If a Vendor (licensor) goes bankrupt, can the user (licensee) of the information property under a license agreement continue to employ the information property?

[Approach]

**(I) Where intellectual property rights of information property are assigned to a third party.**

(i) Where the position of licensor (Vendor) of information property is transferred  
A present licensor may assign its position as a licensor to a third party by entering into an agreement. In such case, the user (licensee) may continue to employ the information property.

(ii) Where only the intellectual property rights are assigned

(a) Copyright

Simply using information property does not necessarily constitute a infringement of copyrighted work. Therefore, the user (licensee) may continue to employ the information property, so long as he does not violate the copyright of the assignee.

(b) Patent

After a patent right has been assigned, the user may not continue to use the information property because such use constitutes a violation of the patent rights of the assignee; except where the user registered its non-exclusive license of the patent right. However, because the user is a consumer, as the use of information property for private purposes usually does not constitute a violation of patent rights, he may continue to use the information property.

**(II) Where the Vendor (licensor) has gone bankrupt**

The trustee may terminate the license agreement. In that case, the user (licensee) may not continue to use the information property.

However, the trustee does not usually find it beneficial to terminate license agreements for information property in cases of generic packaged software, where the users had already paid total amount of the license fee and do not have to pay license fees continuously.

[Explanations]

**1. Problem identification**

A licensee (user) is only allowed to use information property by virtue of a contract with the licensor (Vendor). Therefore, it is questionable whether a user will be able to effectively assert a right to use the information property against a third party to whom the Vendor (licensor) has assigned the intellectual property rights of the information property. If the Vendor should (licensor) go bankrupt, the trustee in bankruptcy may have the power in certain circumstances to unilaterally terminate the bankrupt's contracts (Paragraph 1, Article 59 of the

Bankruptcy Law; similar clauses can be found in Paragraph 1, Article 103 of the Corporate Rehabilitation Law and Paragraph 1, Article 49 of the Civil Rehabilitation Law). If the trustee terminates a license agreement, there is a risk that the user (licensee) may be immediately unable to use the information property.

## **2. Where intellectual property is assigned to a third party.**

Where the Vendor (licensor) assigns intellectual property rights of information property, the Vendor either (1) assigns the position as licensor of the information property; or (2) assigns only the intellectual property rights.

### **(1) Where the whole position as licensor of information property has been assigned**

Replacing a party to a contract is composed of the assignment of claims and the acceptance of obligations. Therefore, the replacement requires not only an agreement between the assignor and the assignee but also the consent of the counterparty to the contract.

However, where the ownership of land is assigned, and where the new owner assumes the role of lessor of the land under a pre-existing lease agreement, it is held that, except where special circumstances prevail, the new owner may assume the rights and duties of the former owner by way of agreement between the former owner and the new owner, without obtaining the consent of the lessee. This is possible in part due to the assumption of the lessor's duty by the new lessor, since the manner in which the duty is fulfilled would not be substantially different, and partly because it is advantageous for the lessee to allow the new owner of the land to assume the lessor's duties (Judgment of the Supreme Court of Japan, 2<sup>nd</sup> Petty Bench, April 23, 1971; 25-3 Minshû 388).

This judgment could be interpreted to mean that the whole position of the licensor may be assigned under an agreement between the assignor and the assignee of the intellectual property rights. This is partly due to the manner in which the obligation of the Vendor (licensor), which is to allow the user (licensee) to use the information property, would not in some cases differ regardless of who the licensor is. It is also partly because it would be advantageous for the user (licensee) to allow the assignee of the intellectual property to take over the obligations attached thereto. In such a case, the user (licensee) may effectively assert the right to continue to employ the information property.

Where a license fee is payable annually, the new licensor may receive license fees for the next year on if either (i) an assignment agreement is concluded between the three parties; (2) the former licensor notifies the user (licensee) that the right to receive license fees has been assigned to the new licensor; or (iii) the user (licensee) notifies the former licensor or the new licensor that he consents to the assignment of the right to receive license fees (Paragraph 1, Article 467 of the Civil Code).

### **(2) Where only intellectual property rights are assigned**

In this case, the assignee of intellectual property rights to information property could stop the user (licensee) from employing the information property by asserting a violation of the intellectual property rights. This issue will be studied in two different cases: where the intellectual property right is a copyright and where it is a patent right.

#### **(i) Copyright**

The simple use of information property protected by a copyright does not constitute an infringement of a copyrighted work protected by the Copyright Law. Therefore, the user (licensee) may continue to use the information property, so long as he does not otherwise violate the assignee's copyright.

Some acts other than simple use, such as the copying of information property for non-personal use, and the modification of information property (alteration or adaptation), are

highly likely to constitute violations of the copyright.

A licensee cannot assert any perfected right to copyrighted works against a third party because the Copyright Law has no system by which a licensee can perfect a right.

(ii) Patent right

The unauthorized use of information property protected by a patent right constitutes a use of the patent right (Subparagraph 1, Paragraph 3, Article 2 of the Patent Law) and thus constitutes a violation of the assignee's patent rights. In such case, the user (licensee) may not continue to use the information property. However, if the employment is not considered as a use "for business purposes"(for example, for personal or family purposes), such use would not constitute a violation of the patent right. For that reason, the user (licensee) may continue to use the information property (Article 68 of the Patent Law).

When the non-exclusive license of a patent right has been registered, it can be effectively asserted against a third party (Paragraph 1, Article 99 of the Patent Law). Therefore, even if the user (licensee) employs the information property for business purposes, the user (licensee) may continue to employ the information property, so long as he registers any non-exclusive licenses of patent rights to the information property.

In both cases of (i) and (ii), the user (licensee) may demand damages from the Vendor (licensor), where the user is unable to continue to use the information property as a result of the assignment of the intellectual property right to a third party.

### **3. Where the Vendor (licensor) has gone bankrupt**

Where both parties to a bilateral contract have not yet fulfilled their obligations, bankruptcy laws allow the trustee to choose between terminating the contract and demanding its specific performance (Paragraph 1, Article 59 of the Bankruptcy Law, Paragraph 1, Article 103 of the Corporate Rehabilitation Law, and Paragraph 1, Article 49 of the Civil Rehabilitation Law).

Therefore, if the Vendor (licensor) goes bankrupt, the trustee could terminate the license agreement. If the trustee chooses to terminate the contract, the user (licensee) may not continue to use the information property, unless the user (licensee) concludes a new license agreement with the trustee or with the third party (assignee) to whom the trustee has assigned the right.

The trustee only can terminate those bilateral contracts under which both parties have yet to fulfill their respective obligations. Therefore, license agreements for information property (for example, generic packaged software), which require no further payment aside from the initial purchase, do not fall under this category.

## 2. Intellectual Property

### (1) Rules Concerning Intellectual Property Rights on Software

[Issue]

Is Article 1, Paragraph 3 (Abuse of Rights) of the Civil Code applicable to the exercise of patent rights<sup>31</sup> (injunction claims, claim of compensation for damages, etc.) on software?

[Approach]

An exercise of patent rights on software may be considered to be an abuse of such rights if one or more of  $\alpha$  through  $\gamma$  apply.<sup>32</sup> The infringer of a patent right may claim an abuse of rights as a defense against a suit by a patent holder, or grounds for a claim in legal proceedings requesting a declaratory judgment for the non-applicability of a patent right, such as an injunction claim.

- $\alpha$  Where the person exercising the right subjectively has malicious intent, such as to cause damage to others.
- $\beta$  Where such person has malicious intent to cause unreasonable damage to another party by exercising such right.<sup>33</sup>
- $\gamma$  The exercise of such right causes far more significant damage to the other party or to society compared with the benefits gained by the party exercising such right.

[Explanations]

Under the Patent Law, a patent holder (including any exclusive licensee (if any), hereinafter the same) has the right to use its proprietary invention as a part of its business. Exclusive licensees, only have such rights to the extent that they are prescribed by their license. Such rights may be exercised to obtain civil relief such as an injunction against any acts that infringe upon such rights, e.g., the use of a proprietary invention which is not authorized by

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<sup>31</sup> This means a patent which is granted to an invention which requires software for its implementation.

<sup>32</sup> In the past, there are some judicial precedents which affirmed the applicability of the “abuse of right” principle based on either one of  $\alpha$  through  $\gamma$ . Recently, however, as described in 2. below, a Supreme Court judgment overturned the decision of the lower courts which had affirmed the application of “abuse of right” principle solely on the basis of  $\gamma$ .

<sup>33</sup> To deviate from a justifiable exercise of right

the patent holder. The basis for the exercise of patent rights on software, such as an injunction claim, derives, in principle, from this purpose of the Patent Law.

However, software has a multilayer structure<sup>34</sup> as well as a communication structure<sup>35</sup> and its users thus tend to become committed to a particular software program.<sup>36</sup> Therefore, the exercise of software patent rights such as an injunction claim may deviate from the purpose of the Patent Law because the exercise of such rights may result in discouraging innovation. In such cases, Article 1, Paragraph 3 of the Civil Code, which provides for “abuse of rights” may be applicable to such exercise of rights.<sup>37</sup>

To clarify our approach to the applicability of the provision regarding the abuse of rights to the exercise of software patent rights such as by an injunction claim, we would like to explain the method and factors on the basis of which the applicability of the “abuse of right” principle should generally be determined (1. below), and which factors need to be considered when such principle is applied to the exercise of software patent rights (2. below).

### **1. Method and factors on the basis of which the applicability of the “abuse of right” principle is to be considered**

To determine the applicability of the “abuse of right” principle, we need to comprehensively consider on a case-by-case basis the following factors, reflecting the circumstances surrounding the plaintiff and the defendant as well as the social environment.<sup>38</sup>

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<sup>34</sup> Software products such as operating systems, interface software and application software have a multilayer structure in terms of their features, where software on the upper level is dependent on software on the lower level and functions only with the lower level software (Study Group concerning legal protection and promotion of innovation in software “Interim Summary of Issues (“*chukan ronten seiri*”)”)

<sup>35</sup> Software components function only when they communicate with other relevant components (“Interim Summary of Issues (“*chukan ronten seiri*”)”)

<sup>36</sup> With respect to IT systems, where the required data is accumulated, the utilized applications come to be organized, and numerous systems are linked with one another through the network, a certain principle of behavior going beyond products features or price competition begins to control the market when the vendors providing software for such systems come to be more and more monopolized. In other words, where a software provider holding a high market share has exclusive rights in connection with the technology related to interoperability/interface (even more significantly if such technology has been standardized), this tends to maintain the monopolized market conditions and undermines the incentive for innovation due to its adverse competitive effect, because the principle of economy of scale comes into effect and a higher cost will be incurred by users for transferring to another platform. (“Interim Summary of Issues (“*chukan ronten seiri*”)”)

<sup>37</sup> In the actual litigation, the existence of defects in the patent right may be argued prior to the applicability of the “abuse of right” principle set forth in Article 1, Paragraph 3 of the Civil Code. In other words, the infringer may attempt to argue that “the patent right shall be held invalid by a trial for invalidation of patent” under Article 104-3, Paragraph 1 of the Patent Law.

<sup>38</sup> The “abuse of right” principle developed in the judicial precedents had, under the influence of German

**(1) Assessment and analysis of the legitimacy and maliciousness of the claimed rights ( $\alpha$  and  $\beta$  above); and**

**(2) Weighing (objectively) the advantages and disadvantages in permitting or preventing the exercise of rights ( $\gamma$  above).**

**(1) Assessment and analysis of the legitimacy and maliciousness of the claimed rights**

The claim made by the rights holder will be assessed and analyzed in consideration of the following circumstances:

(i) Whether the subjective intent of the person exercising such patent rights is malicious (for instance, whether the sole purpose of the exercise is to cause harm to the other party);<sup>39</sup>

(ii) Whether objectively the exercise of such patent rights is malicious

The subjective and objective aspects of the infringement of the patent rights should also be considered in order to comprehensively determine whether the “abuse of right” principle should apply.

**(2) Weighing the advantages and disadvantages in permitting or preventing the exercise of rights**

The advantages and disadvantages to the rights holder, the rights infringer, and society as a whole that would result from permitting or preventing such exercise of rights shall be weighed.

If permitting the exercise of rights would lead to disadvantages to the rights-infringer and society as a whole that are significantly greater than advantages conferred on the right holder and the whole of the society, and preventing such exercise of right would result in

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law, barred solely exercises of rights with the intent to or for the purpose of causing damage to the other party as an “abuse of right”. However, the principle eventually expanded to include the adjustment of rights between private individuals or entities, and the applicability of such principle came to be determined in terms of objective factors (comparison of the interests of both parties) as well as of subjective factors (intention to cause damages). (p.17 of “*Minpo Sousoku Vers. 7*” by Kazuo Shinomiya, Yoshihisa Noumi)

<sup>39</sup> “Exercise of Rights for the Sole Purpose of Causing Damages to the Other Party” (Masaaki Yasunaga, p.127 of “*Shinban Chushaku Minpo* (1) (compiled by Tomohei Taniguchi, Kikuo Ishida) Volume 1, Preface Ⅰ 1 (Basic Principle) III Prohibition of abuse of right”)

“Exercise of Right for the Sole Purpose of Causing Damage to the Other Party” (p.17 of “*Minpo Sosoku Vers. 7*” by Kazuo Shinomiya, Yoshihisa Nomi)



significantly greater social or economic benefits than permitting it, the “abuse of rights” principle may be applicable.<sup>40</sup>

Some judicial precedents in the past have applied the “abuse of right” principle based on either (1) or (2). However, a judgment was rendered by the Supreme Court recently which revoked the original decision that affirmed the applicability of the “abuse of right” principle based solely on (2)<sup>41</sup>, and the theories advocated by many scholars<sup>42</sup> argue that (1) and (2)

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<sup>40</sup> November 26, 1968 Superior Court Judgment (p.32 of *Hanrei Jiho* No. 544, p.150 of *Hanrei Times* No. 229)

“The original judgment ruled that plaintiff X’s claim in the principal action shall not be approved because it is an abuse of rights, although the water pipes, etc., owned by defendant Y are on forest lands A & B, which are both owned by X. .... In other words, whereas the benefits which X would gain from the removal of the water pipes, etc. would be minimal, such water pipes and other facilities were constructed by digging, spending a huge amount of time and financial resources for the use of the 70,000 habitants of the southern district of Y city. Moreover, they form an essential part of the general waterworks on a broad scale linked to such pipes, and so their removal and the restoration of the status quo would be necessary, followed by the construction of the same type of facility at a new location. Therefore, their removal would not only require a considerably huge amount of time and financial resources but also suspend the supply of water, which could not be recovered over a short amount of time, and consequently this will cause unexpected and material damage to the daily life of the habitants. Therefore, the claim made by X in the principal action shall be ruled as an abuse of right. The accreditation and judgment of the original judgment shall be acceptable in light of the pieces of evidence listed in the original judgment.”

<sup>41</sup> Supreme Court Judgment, October 19, 1982 (p.22 of *Hanrei Jiho* No. 1086, p.94 of *Hanrei Times* No.504)

“The original judgment which does not specify any other reason for rejecting the claims of compensation for damages made by X in the principal action solely by comparing the disadvantages suffered by X and Y as mentioned above (omitted) mistakenly interpreted and applied Article 1, Paragraph 3 of the Civil Code.”

<sup>42</sup> The following theories argue that both (1) and (2) should be comprehensively taken into consideration in order to determine the applicability of the “abuse of right” principle.

“There is a critical view that excessive emphasis on the balancing from an objective perspective of the interests of the parties involved would not be appropriate, because the benefits of the majority (public) or the party in a stronger position will always prevail. (omitted) Considering the subjective factors such as the non-existence of the purpose of causing damages on the part of the party exercising rights should be taken into consideration in determination of the applicability of the “abuse of right” principle. (p.17 of “*Minpo Sosoku Vers. 7*” by Kazuo Shinomiya, Yoshihisa Nomi)

“If emphasis is exclusively placed on objective factors, the interests of a party in a stronger position such as leading companies or the government which have procured a *fait accompli* would unilaterally take precedence regardless of the reasonableness of the claim made by the right holder, and such an approach would be inevitably criticized as unfair. In recent years, many leading theories argue that the applicability of the “abuse of right” principle should be determined in comprehensive consideration of subjective as well as objective factors.....” (p.88 of “Abuse of right doctrine – Study of Civil Law (“*minpo no kenkyu*”) V” by Koki Sugano)

“In order for the “abuse of right” principle to be applicable to this type of case (unauthorized occupancy of land owned by others), as a rule, the existence of the intention to cause damages, or to advance personal interests unfairly or any other subjective maliciousness is required. In the absence of such subjective factors, the applicability of the “abuse of right” principle should be, if any, very exceptional and limited to the cases where the following circumstances exist, but the approach should not be based on the comparison of interests from an objective perspective. Such circumstances would be that the infringing party is qualified to claim for protection from an ethical perspective (by applying the “abuse of rights” principle to his case), and that there are special circumstances under which the right holder should tolerate such infringement” (p.131 of “*Shinban Chushaku Minpo* (1) (compiled by Tomohei Taniguchi, Kikuo Ishida,.) Vol. 1, Preface [1 (Basic Principal) “III Prohibition of Abuse of Right” by

should be comprehensively considered in order to determine the applicability of the “abuse of right” principle.

## **2. Factors to be considered in determining the applicability of the provision on the abuse of rights to the exercise of patent rights on software**

In the exercise of software patent rights, the factors which may affect the applicability of the provision on the abuse of rights will be explained separately in “Assessment and analysis of legitimacy and maliciousness of the claimed rights” and “Weighing the advantages and disadvantages in permitting or preventing the exercise of rights by the Patent Holder”.

Note, however, that even if one of the factors listed below applies, a claim of abuse of rights may still not be admitted. As explained below, the applicability of such provision shall be determined by a comprehensive assessment and analysis of the legitimacy and maliciousness of the claimed rights as well as by balancing the advantages and disadvantages resulting from permitting or preventing such exercise of rights.

### **(1) Assessment and analysis of legitimacy and maliciousness of the claimed rights**

As explained in 1. (1) above, in order to conduct an assessment and analysis of the legitimacy and maliciousness of claims by patent holders such as an injunction claim, both (i) subjective; and (ii) objective aspects of the patent holder’s claim should be considered, as well as whether and to what extent such claim is legitimate or malicious.

At the same time, the subjective and objective aspects of the rights infringement should also be considered to comprehensively determine whether the “abuse of right” principle should be applied. For example, if the infringement was committed intentionally, the maliciousness of infringement will be counted as a negative factor in the determination of the applicability of the “abuse of right” principle.

#### **(i) Subjective Aspect**

(A) If the patent holder exercises his rights (such as an injunction claim) solely for the purpose of causing damage to the other party, as a rule, such exercise of right will not be considered as legitimate.<sup>43</sup>

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Masaaki Yasunaga)

<sup>43</sup> Major examples of “exercises his rights ... solely for the purpose of causing damages to the other party (which is considered as an abuse of right” are as follows:

Anotstu District Court, August 10, 1926 (p.11 of *Houritsu Shimbun*, No. 2648)

“If a right holder willfully or negligently exercises his rights beyond the appropriate scope and in an

(B) If the patent holder exercises his rights solely for the purpose of gaining unfair profits, it is likely that such exercise of rights will be considered illegitimate.<sup>44</sup>

(ii) Objective Aspect

(A) If the patent holder commits one or more of the actions listed below in the course of exercising his patent rights, such action may be a negative factor in the determination of the legitimacy of such exercise of rights.

- a) The patent holder commits an act which is not compliant with the principle of faith and trust such as making inconsistent allegations without any reasonable cause.<sup>45/46</sup>
- b) The patent holder unilaterally forces the other party to suffer disadvantages, deviating from the purpose of the Patent Law, which is “encouragement of

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inappropriate manner, and infringes the rights of another person, such exercise of rights shall be considered as an abuse of right, and such right holder will be liable in tort, . . . even though the defendant built the premises on his own land . . . the exercise of rights comes from the intention to hinder the defendant’s exercise of ownership rights and operation of the hospital (Building No.5), and so it is evidently an abuse of ownership rights.”

<sup>44</sup> The following is a judicial precedent which affirmed the applicability of the “abuse of right” principle in comprehensive consideration of the exercise of right for the sole purpose of gaining unfair profits as well as of other factors:

October 5, 1935, Former Supreme Court Judgment (Unazuki Hot Spring Case) (Vol.14, p.1965 of Civil Case Law Reports (*minji hanrei shu*) of the Superior Court)

“The exercise of ownership for the sole purpose of earning unjustifiable profit does not comply with the purpose of ownership rights under the commonly accepted norms of the society, and thus such an exercise of rights deviates from the permitted scope of its function. Therefore, this is an abuse of rights ...”

<sup>45</sup> Supreme Court Case, June 15, 1972 (Vol. 5, p.1015 of Civil Case Law Reports (*minji hanrei shu*) of the Supreme Court, p.69 of *Hanrei Jiho*, No. 674, p.194 of *Hanrei Times*, No. 279)

“Unless other special circumstances exist, X’s claim against Y that the agreement on the lease of the premises has been terminated on the basis of the unauthorized sublease and thus the occupied premises shall be vacated on the basis of X’s ownership of the premises shall not be accepted, as such claim is not compliant with the principle of faith and trust or else it is an abuse of rights.”

<sup>46</sup> “An act which does not comply with the principle of faith and trust” includes a case where a participant in a standardization activity of a standardization organization with a patent policy under the obligation to submit a patent statement fails to raise any assertion of patent rights in the course of developing standards, although some patents are mandatory for such participant, and reveals only after the completion of such standard that he is the holder of such patent and further demands a huge amount of royalties from the other participants in the standardization activity, or otherwise intentionally harm the obligations or commitments formed between business operators through agreements or business activities. Where the person holding the mandatory patent (patent holder) in the course of developing standards represents that he will license the patent on a “Reasonable And Non-Discriminatory” (hereinafter “RAND”) basis, if the licensee fights for the specific conditions of RAND against the patent holder after the completion of the standards by arguing ,for example, that the amount of royalties alleged by the patent holder to be RAND is so large that it is not a RAND, it would be discussed and determined whether the licensor’s allegation is compliant with the principle of faith and trust on the basis of a comprehensive analysis of subjective aspect of the licensor as well as the existence and extent (if any) etc. of the fiduciary relation on the part of the licensee.

inventions and development of industry”, by making an injunction claim against the other party after the patent holder tried to force such other party to accept a license agreement unacceptable to normal business operators<sup>47</sup> and it was eventually refused by such other party<sup>48</sup>

- c) Despite the efforts of the rights infringer to restore any damage suffered by the patent holder as a result of his infringement by compensating the patent holder or paying an appropriate amount of royalties, the patent holder refuses to negotiate with the other party without any reasonable cause and proceeds to exercise its rights.<sup>49</sup>

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<sup>47</sup> “A license agreement unacceptable for normal business operators” assumes the following two cases listed in (1) and (2) below. However, note that not all agreements which fall under the following two cases are necessarily regarded as “a license agreement unacceptable for normal business operators.” Rather, it will be determined in consideration of specific conditions such as the contractual conditions which supplement the agreement, the status of transaction between the parties, the market conditions.

- (1) An agreement which requires payment of royalties in an amount apparently exceeding the objective value of such technology
- (2) An agreement which requires the following conditions, instead of direct payment of a huge amount of royalties:
- an agreement which requires the other party to be licensed on the implementation of another patent or to purchase products or services which are not subject to the patent (contractual tying (“*dakiawase*” in Japanese))
  - an agreement which requires an exclusive license or a transfer of relevant patent rights acquired after the grant of implementation thereof (assign-back or exclusive grant-back clause)
  - an agreement which prohibits the licensee from filing a legal proceeding against any infringement of the relevant patent against the licensor or other licensees (non-assertion obligation)
  - an agreement which prohibits the licensee from filing a trial for invalidation etc. of the patent or arguing the validity of the patent right (non-claim obligation)

In relation to (2) above, practically speaking, most licensees would enter into such agreement in the recognition of the unfairness of such provision. In such a case, if there is a special provision that stipulates that the agreement may be terminated based on non-compliance with such provision, with respect to such special provision and the exercise of termination right based thereon, the applicability of the “abuse of right” principle may be argued in light of the power relationship between the licensor and the licensee and the maliciousness of the provision.

In Japan, apart from the “abuse of right” issue, if such clause is proved to be disturbing fair competition in the context of antimonopoly law, such clause would be illegitimate on the grounds that it falls under the definition of “unfair business practice (“*fukousei na torihiki houhou*”)), which is subject to relief in the form of an abatement by order of Japan FTC’s or by private action.

In addition, although not equal to the “abuse of rights” due to the differences in the legal system of Japan, such clause will be held as “patent misuse” in the USA, and the subject patent right may not be exercised in litigation until such situation is resolved.

<sup>48</sup> This does not mean that the failure to enter into a license agreement by refusing the grant of license, etc. is generally a test of the applicability of the principle of “abuse of right”.

<sup>49</sup> This does not mean that a refusal to negotiate the license always renders the claim of rights illegitimate. The following is a judicial precedent which mentions that it is one of the factors in the determination of the applicability of the “abuse of right” principle that the patent holder persistently refused to negotiate the recovery of the right holder’s damages incurred by the right holder caused by the infringement despite the efforts of the party subject to such exercise of right to do so.

- d) The patent holder proceeds to exercise his rights after he acquires and holds them through a dishonest manner and process<sup>50</sup>.
- B) If the rights are claimed in a manner listed as examples below, such manner may be a negative factor in determining whether such rights claim is legitimate.
- a) The rights claim deviates from the reason for and purpose of the patent right granted on the software, aiming at obtaining unfair profits or is significantly detrimental to the interests of the users of the products where the patent technology in question is employed.
- b) The rights claim leads, from an objective perspective, only to the damages of the other party, but does not confer any benefit on the software patent holder.

**(2) Weighing the Advantages and Disadvantages of Permitting or Preventing the Exercise of Rights by the Patent Holder**

In the case of an actual infringement of software patent rights, assuming the exercise of rights is approved, there would be a large range of difference in the level of advantages conferred on the patent holder and on the whole of society and the disadvantages incurred by the rights infringer and by the whole of society. This difference would depend on such factors as:

- X) the method of exercising rights (injunction claims, compensatory damages claims, restitution of unjust enrichment claims, claims for the recovery of confidence, etc.)
- Y) the target object of the exercise of rights (usage, status of use, nature of the software where the proprietary technology subject to such exercise of right is employed)

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Tokyo District Court Judgment, May 26, 1977 (p.51 of *Hanrei Jiho* No. 832)

“Judging from the fact that the use of the land constitutes an indispensable basis of the daily life of Y and his family . . . the bid is reasonably sufficient, even considering that the land has Y’s leasehold rights. In this context, X demanded Y to vacate the land immediately after X won the bid without negotiating with Y at all . . . it is assumed that, in this auction case, despite the fact that X had announced that the land is accompanied by the leasehold in accordance with which the lessee is supposed to own a building thereon, which could be perfected against the winning bidder, X was trying to obtain a huge amount of profits by winning the bid at an extremely low price, taking advantage of the lack of registry required for perfection of such leasehold. Considering the circumstances with respect to Y as recognized in the foregoing, X’s demand of the removal of and vacation of the building on the land shall not be accepted on the ground that it is an abuse of right.”

<sup>50</sup> Supreme Court Judgment, March 31, 1977 (p.355 of Civil Case Law Reports of the Supreme Court (“*saikou saiban sho saiban shu minji*”), Vol. 120)

“If the buyer of land purchased the land with leasehold rights with intent to gain his own profits by, for example, demanding the lessee to vacate the land, taking advantage of the lack of perfection of such leaseholds, such buyer’s demand of vacation of the land against the lessee shall not be accepted on the basis of the “abuse of right” principle.

- Z) the status of use and feasibility of the patent (the existence or extent of the patent holder's profit)

The advantages and disadvantages resulting from permitting or preventing such exercise of rights will be weighed upon consideration of these factors.

As explained in 1.(2), if the disadvantages suffered by the rights infringer and by the whole of society resulting from permitting the patent holder's exercise of rights are significantly greater than the advantages gained by the rights holder and by the whole of society, and therefore the prevention of such exercise of rights leads to higher levels of social and economic welfare than in a case where such exercise of rights is approved, the exercise of rights may be regarded as an abuse of rights.

(i) Method of Exercising Rights

- (A) The rights that a right holder may claim against a rights infringer include injunction claims, compensatory damages claims, restitution of unjust enrichment claims, confidence recovery claims among others. Injunction claims will, depending on the usage or status of use of the software which constitutes the infringement, not only prevent the infringing party from using the software but also have enormous impact on the services being provided to society through the software, which may cause disadvantages to the whole of the society.
- (B) With respect to injunction claims, the identity of the counterparty to the claim the extent of the disadvantages caused to the rights infringer and society will differ depending on which act of "implementation", ("production", "use" and "transfer") prescribed in each item of Article 2, Paragraph 3 of the Patent Law is to be suspended.

In addition, the contents and the level of disadvantages caused to the other party subject to such exercise of right and society will further depend on whether or not a "claim for disposal of products which constitute an infringement (*"shingai soseibutsu haiki seikyu"*)" or a "claim for removal of facilities used for the infringement (*"shingai kyoyou setsubi jokyaku seikyu"*)" is made in addition to the injunction claims.

ii) Target Object of Exercise of Right

Depending on the usage and status of use of the software<sup>51</sup>, the rights infringer and society may suffer from significant disadvantages.

Even if the patent holder exercises his rights in connection with the features protected by such patent, the influence of such exercise of rights may ripple out in the following cases, depending on the characteristics of the software.

(A) If the features<sup>52</sup> protected by the relevant patent is a feature required for securing interoperability<sup>53</sup>, if two programs fail to work on each side, being unable to communicate with each other by transmitting data mutually, some of the features that require such information may not work, in which case the party subject to the exercise of rights may consequently suffer significant damages.

(B) If the feature protected by the patent is a feature of OS software, middleware, etc., the absence of such feature interrupts the operability not only of such software but also of other software as well as hardware which uses the features of such software, which may cause material damages to the party subject to such exercise of rights.

### iii) Status of Use and Availability of Patent

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<sup>51</sup> Examples of “Usage and status of use” and the possible effects

(1) Software used for information systems that supports critical infrastructure (finance, electricity, railway and others) which lead directly to the safety and comfort of our society.

→ if the system itself is disabled, it will cause significant damages not only to the developer of the information system which infringed the patent on the software and the enterprises which are operating such critical infrastructure by using the software, but also to the life of the people.

(2) Universal software that is widely used in our society (OS software for PCs, OS software for servers and office software)

→ if the system itself is disabled, it will cause damage not only to the developer of the information system software which infringed the patent on the software but also to its users (corporations and individuals).

(3) Information systems supporting services in which particular individuals participate (ASP, net auctions, etc.)

→ if the system itself is disabled, it will cause significant damage not only to the developer of the information system that infringed the patent on the software as well as the business operators providing such service, but also to those who receive such services.

(4) Software used for an operating system in an enterprise

→ if the software is disabled, the developer of the information system that infringed the patent on the software as well as the enterprise which utilizes such software will incur damages.

(5) Software embedded in devices such as home appliance.

→ if the software is disabled, the product will be unable to function, and the recall of the products may be necessary, and thus significant damages may be incurred depending on the level of its diffusion in the market.

<sup>52</sup> This applies especially when the interface of the software product has already become standard.

<sup>53</sup> The capacity of all of the features which require certain information exchanged by mutual transmission between and utilized by programs.

The existence or extent of the direct profits which the right holder will gain by utilizing the patent on the software, or of the profit restituted by such exercise of rights will depend on the following factors; whether or not the right holder, taking advantage of the technology subject to the software patent, sells (or is planning to sell) the software in his company; whether or not he conducts (or is planning to conduct) business by granting a license to others; whether he utilizes (or is planning to use) such patent for his company's service or its own use, whether he has some history of usage in the past (or plans) of use; and to what extent he gains (or will gain) profits, if any, from his business.



## (2) Liability of Provider of P-to-P (P-to-P) File Sharing Software

[Issue]

Does the act of unauthorized uploading of music files on the internet or downloading such music files from the internet by using Peer-to-Peer file sharing software constitute an infringement of the Copyright Law? Does the act of providing Peer-to-Peer file sharing software constitute an infringement of the Copyright Law?

[Approach]

### (I) Act of Users of P-to-P File Sharing Software

P-to-P file sharing software involves two functions; one is to upload files on the internet to make them transmittable, and the other is to download files to duplicate the files on the internet to the medium on the user's personal computers.

The act of uploading music files and the like on the internet without permission of the person who holds rights to such files constitutes an infringement of public transmission rights ("*koshu soushin ken*" in Japanese) and right of making transmittable ("*soushin kanouka ken*" in Japanese) under the Copyright Law. In other words, this is an infringement of copyrights or rights related thereto.

On the other hand, the act of users downloading music files and the like from the internet would constitute an infringement of copyrights or related rights except in the case of reproduction for the purpose of personal use.

### (II) Act of Provider of P-to-P File Sharing Software

With regard to the use of P-to-P file sharing software, if a majority of the exchanged files infringes copyrights, if the provider of P-to-P file sharing software is deeply involved in the users' act of infringement, such provider may also be regarded as infringing copyrights or related rights.

[Explanations]

## **1. Problem identification**

In recent years, the existence of P-to-P file sharing software such as Napster,<sup>54</sup> Gnutella,<sup>55</sup> Winny<sup>56</sup> and Share,<sup>57</sup> which enable users to exchange music files and the like on the internet has had an adverse impact on the interests of copyright and related right holders.

The following structures are the two major types of P-to-P file sharing:

- i) the software uses a central server and acts as an intermediary in the exchange of file information between users (this is the “hybrid type P-to-P file sharing”) and;
- ii) the software does not use such central server (“genuine P-to-P file sharing”).

In the hybrid type P-to-P file sharing, users wishing to exchange files first download and install P-to-P file sharing software designed for such services and then access the central server in order to obtain information on the shared files, which eventually enable them to exchange files with other users.

In a genuine P-to-P file exchange, by contrast, users obtain and install P-to-P file sharing software on their computers, and then access other users directly, which enables them to exchange their files with other users.

### **(1) Acts by Users of P-to-P File Sharing Software**

P-to-P file sharing software has two functions; one is to upload files to the internet and make them accessible via the internet, and the second is to download and duplicate files from the internet (including the act of recording sound and images) to a user’s personal computer.

The issue here is whether or not the user of such P-to-P file sharing software will be regarded as infringing copyrights.

### **(2) Act of Providers of P-to-P File Sharing Software**

The issue is whether or not it constitutes an infringement of copyright to provide P-to-P file sharing software by using a central server for facilitating the exchange of music files and the like between users on the internet.

## **2. Acts of Users**

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<sup>54</sup> Hybrid file sharing software using P-to-P technology, which was released in January 1999.

<sup>55</sup> Genuine file sharing software using P-to-P technology, which was released in March 2000.

<sup>56</sup> Genuine file sharing software using P-to-P technology, which was released in May 2002.

<sup>57</sup> Genuine file sharing software using P-to-P technology, which was released in January 2004.

## **(1) The Act of Uploading**

The right to reproduce copyrighted works is reserved exclusively for copyright and related right holders (Article 21, Article 91, Paragraph 1, Article 96, Article 98, Article 100-2 of the Copyright Law). However, the copyright holders' reproduction rights will be less exclusive if the copyrighted works are reproduced for the purpose of personal use (Article 30, Paragraph 1 of the Copyright Law).

In P-to-P file sharing, in order to prepare music files for uploading, for example, such files are reproduced into an MP3 file format etc. from certain copyrighted works such as music CDs and the like, and if the initial purpose of such reproduction is to transmit the copyrighted works to the public, it is not regarded as a reproduction of copyrighted works for the purpose of personal use as defined in Article 30, Paragraph 1 of the Copyright Law. Additionally, even if the file is initially duplicated for the purpose of personal use, if such file is uploaded later, the purpose of such reproduction will not be regarded as private use (Article 49 Paragraph 1, Item 1 and Article 102, Paragraph 4, Item 1 of the Copyright Law).

In addition, the act of making music files and the like accessible on the internet (act of uploading) falls under the definition of the "act of making accessible" (*soushin kanouka* in Japanese) under Article 2, Paragraph 1, Item 9-5 of the Copyright Law. Also, the right to make files accessible is reserved exclusively for copyright and related right holders (Article 23, Article 92-2, Article 96-2, Article 99-2, Article 100-4 of the Copyright Law).

Therefore, those who intentionally or negligently provide music files and the like on the internet by using P-to-P file sharing software without the right holders' permission are infringing the right to reproduce (Article 21, Article 91, Paragraph 1, Article 96, Article 98, Article 100-2 of the Copyright Law), the right to transmit, or the right to make accessible (Article 23, Article 92-2, Article 96-2, Article 99-2, Article 100-4 of the Copyright Law), and so would be liable for damages (Article 709 of the Civil Code). In addition, if there is an actual or threatened infringement of rights, irrespective of whether such infringement is intentional or negligent or otherwise, the right holder may file an injunction claim against the infringing party (Article 112 of the Copyright Law).

Further, if the infringer's act is intentional and he/she is accused by the wronged party, the infringer may be sentenced to up to 5 years of imprisonment with forced labor or a fine in an amount not exceeding five million yen (Article 119 of the Copyright Law).

## **(2) The Act of Downloading**

The act of duplicating music files and the like after receiving them from other users without the right holder's permission on the internet by using P-to-P file sharing software

(downloading) would be regarded as an infringement of the copyright or related rights unless the purpose of such downloading is to use them personally, within the family or otherwise within a similar limited group of people, and is not intended to unreasonably slip through the technical protections (Article 30, Paragraph 1, Article 102, Paragraph 1, Article 21, Article 91, Paragraph 1, Article 96, Article 98, Article 100-2 of the Copyright Law).

In addition, even if the act of downloading does not in itself constitute an infringement of a copyright or any related rights, if the downloaded reproduction is used for purposes other than personal use, this will also constitute an infringement (Article 21, Article 91, Paragraph 1, Article 96, Article 98, Article 100-2 of the Copyright Law) of the reproduction right (Article 49, Paragraph 1, Item 1 and Article 102, Paragraph 4, Item 1 of the Copyright Law), and the user may be held liable for damages (Article 709 of the Civil Code), subject to injunction claims from the right holders (Article 112 of the Copyright Law), and subject to criminal prosecution (Article 119 of the Copyright Law).

For example, if a user downloading a file immediately records it in a public transmission area so that the file can be transmitted on the internet (the acts of downloading and uploading simultaneously take place), such act of downloading will be regarded as an infringement of reproduction rights, because the purpose of such reproduction is not for personal use.

### **(3) Act of a service provider using P-to-P file sharing software**

With respect to the acts of the provider of a hybrid P-to-P file sharing service equipped with a central server, there is a precedent case where a certain business entity in charge of the management of a copyright and the holder of the related rights filed an action demanding the suspension of such service. The Tokyo High Court judgment of March 31, 2005 upheld the original decision ruling that the service provider had infringed the right to make the copyrighted work transmittable and that there is a concrete and realistic risk that that automatic public transmission services will, by nature, trigger certain types of copyright infringements by its users, which would be foreseeable for the service provider operating such service, who consequently induces such infringements. Moreover, where the service provider may procure certain economic benefits from operating such service, the service provider will be held responsible for the infringement, because such provider has caused damages from actions which are under his/her own control. In this case, it is natural that such service provider should be held liable for such infringement, in other words he/she would himself/herself be regarded as the infringer.<sup>58</sup>

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<sup>58</sup> In Japan, there has been no decisive judicial precedent concerning the act of providing genuine P-to-P file sharing software. In genuine P-to-P file sharing software, which has no central server, the nature and level of control the service provider may exercise over the users' infringements of copyright after such software is provided to the users should be considered differently from the case of providers of hybrid P-to-P file sharing

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software. However, in light of precedent cases in foreign countries, that providers of genuine P-to-P file sharing software are not necessarily excluded from any liability for such infringement. There are cases where P-to-P file sharing software service providers are held liable to a certain extent on the grounds that the service provider, while intentionally inducing and prompting the users' act of infringement, is procuring certain economic benefits such as advertising revenue without taking any measures against such infringement by filtering technology. (US Superior Court Judgment, June 27, 2005 (Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd., 545 U. S. 913 (2005)), Federal Court Judgment (Australia), September 5, 2005 (Universal Music Australia Pty Ltd. v. Sharman License Holdings Ltd., (2005) FCA 1242).

### (3) Illegal Acquisition of Domain Names

[Issue]

The illegal acquisition of a domain name is defined as “unfair competition” in Subparagraph 12, Paragraph 1, Article 2 of the Unfair Competition Prevention Law. What are the specific acts that fall under the term “unfair competition”?

[Approach]

#### **(I) Definition and objects of unfair competition under the Unfair Competition Prevention Law**

Subparagraph 12, Paragraph 1, Article 2 of the Unfair Competition Prevention Law defines “unfair competition (*“fusei-kyôso”*)” as an act of (i) acquiring or holding the right to use a domain name or using a domain name; (ii) that is the identical with or similar to another party's specific trademark, service mark or the like; (iii) for the purpose of obtaining an illegal profit (profit-making purpose)(*“tori-mokuteki”*) or causing damage to a party (damage-causing purpose)(*“kagai-mokuteki”*).

The Unfair Competition Prevention Law covers not only JP Domain Names, those that end with the suffix “.jp“, but also generic domain names that do not end with a country code (such as those ending with “.com“ and “.org“).

#### **(II) Cases falling under the category of unfair competition**

Shown below in (i) are some of the cases which ruled that the acquisition or use of a domain name was made in bad faith and in (ii) are cases decided by courts and by alternative dispute resolution panels which held that the domain names at issue were identical with, or similar to, other parties' trademarks, service marks, etc.. All of these cases are highly likely to violate the Unfair Competition Prevention Law.

**(i) Cases where it was ruled that the acquisition or use of a domain name was made for illegal purposes, etc.**

- Where the domain name acquired was identical or similar to a trademark, for example, of a well-known business entity, and where products were sold taking advantage of the reputation and the brand recognition of the well-known business entity.
- Where the domain name acquired was identical or similar to a trademark, for example, of a well-known business entity, and using the domain to harm the reputation of the business entity by displaying a message defaming or disparaging the business entity on the website.
- Where a domain name was used which was identical or similar to a trademark, for example, of a well-known business entity, and opening a pornographic website.
- Where a domain name was used which was identical or similar to a trademark, for example, of a well-known business entity for the purpose of assigning the user to another website.
- Where a domain name was used which was identical or similar to a trademark, for example, of a well-known business entity, in order to make it difficult for such business entity to set up a website.
- Where the domain name registered is identical or similar to a trademark, for example, of a well-known business entity, and demanding the payment of unreasonable price for the domain name (ruled that the domain name was purchased for the purpose of reselling).
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**(ii) Where domain names were ruled identical or similar to another party's trademarks, service marks, etc.**

- “jaccs.co.jp” and JACCS
- “j-phone.co.jp” and J-PHONE
- “sunkist.co.jp” and SUNKIST or Sunkist
- “sonybank.co.jp” and SONY
- “itoyokado.co.jp” and Ito Yokado
- “goo.co.jp” and goo
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**(III) Effects of the Unfair Competition Prevention Law**

Those who experience lost profits or reputation damage due to unfair competition may demand (i) injunction of the use of the domain name (Article 3 of the Unfair Competition Prevention Law); (ii) damages (Articles 4 and 5 of the law); and (iii) an action to restore the business entity's reputation (Article 7 of the law).

#### **(IV) Dispute settlement guidelines**

The settlement of disputes can be sought not only by the Unfair Competition Prevention Law but also in accordance with dispute resolution policies formulated by private organizations.

##### **(i) JP Domain Names**

When a dispute concerns a JP Domain Name, it is possible to seek a settlement through a dispute settlement institution authorized by the Japan Network Information Center (JPNIC) in accordance with the JP Domain Name Disputes Resolution Policy established by JPNIC. The applicant can demand the deletion of the registered domain name or its assignment to the applicant. The award given by the agency is not final, since the party dissatisfied with the award can file a subsequent suit through an appropriate court.

##### **(ii) Other domain names**

When a dispute concerns other domain names, it is possible to seek a settlement from a dispute settlement agency certified by the Internet Corporation for Assigned Names and Numbers (ICANN) in accordance with the Uniform Domain Name Dispute Resolution Policy established by ICANN. The applicant can demand the cancellation of the registered domain name or its assignment to the applicant. The decision given by the agency is not final, since the party dissatisfied with the award can file a subsequent suit through the appropriate court.

[Explanations]

#### **1. Regulation of illegal acquisitions of domain names under the unfair Competition Prevention Law**

The rapidly growing use of the internet in recent years has been making it increasingly important for business entities to conduct sales, advertising, and other business activities via the internet. The value of domain names has been rising as a result. Anyone can have domain names registered on a first-come, first-served basis. As a result, there have been many cases worldwide in which a person has registered domain names composed of a string of characters, numerals, etc. that were identical or similar to the name of a well-known company, trademark, or service mark and the like. The registered holder then offered to sell the domain name to



the company at an exorbitantly high price or instead attempted to disparage the reputation of the company through the website.

Paragraph 7, Article 2 of the Unfair Competition Prevention Law defines a domain name as “the characters, numerals, signs, or the combination of any of them corresponding to the characters, numerals, signs, or the combination of any of them assigned to each electronic computer on the Internet.” Subparagraph 12, Paragraph 1, Article 2 of the law defines “unfair competition” as an act of (i) acquiring or holding the right to use a domain name or using a domain name; (ii) that is the identical with or similar to another party's specific trademark, service mark or the like; (iii) for the purpose of obtaining an illegal profit (profit-making purpose) or causing damage to a party (damage-causing purpose).

As is clear from the above definition of a domain name, the Unfair Competition Prevention Law covers not only domain names with the country code of Japan, which end with “.jp” (hereinafter referred to as “JP Domain Names”) but also to domain names that end with the country codes of other countries such as those ending with “.uk”, “.ca”, “.de” or do not end with a country code at all (such as those ending with “.com”, “.net”, “.org”, or “.info”) (hereinafter referred to as “Generic Domain Names”).

## **2. What Acts constitute “Unfair Competition”?**

### **(1) For the purpose of obtaining an illegal profit or causing damage to a party (profit-making or damage-causing)**

As subjective requirements, the Unfair Competition Prevention Law defines two types of purpose: profit-making and damage-causing. The former means in order to make a profit for oneself or for a third party in a manner contrary to public policy or to the principle of good face and trust. The latter means in order to cause tangible or intangible damage to a third party such as financial loss or reputation damage.

Shown below are some of the cases where it was ruled that the registration or use of a domain name was in bad faith. These examples are drawn from judicial precedents and actual civil disputes adjudicated by the Japan Intellectual Property Arbitration Center (hereinafter referred to as “JIPAC”). These cases are helpful when interpreting the profit-making and damage-causing purposes defined in the law.

- Where the domain name acquired was identical or similar to a trademark, for example, of a well-known business entity, and where products were sold taking advantage of the reputation and the brand recognition of the well-known business entity.

- Where the domain name acquired was identical or similar to a trademark, for example, of a well-known business entity, and using the domain to harm the reputation of the business entity by displaying a message defaming or disparaging the business entity on the website.
- Where a domain name was used which was identical or similar to a trademark, for example, of a well-known business entity, and opening a pornographic website.
- Where a domain name was used which was identical or similar to a trademark, for example, of a well-known business entity for the purpose of assigning the user to another website.
- Where a domain name was used which was identical or similar to a trademark, for example, of a well-known business entity, in order to make it difficult for the business entity to set up a website.
- Where the domain name registered is identical or similar to a trademark, for example, of a well-known business entity, and demanding the payment of unreasonable price for the domain name (ruled that the domain name was purchased for the purpose of reselling).

**(2) Domain names identical or similar to another party's trademarks, service marks and the like**

“Trademarks, Service marks and the like” means the name of a party, trademark, service mark or symbol related to a party's business or a mark indicating a specific product or service. In order to come within this category, a mark has to perform both a distinguishing function vis-a-vis other marks as well as an identification function. Therefore, for example, when an ordinary name, which does not have either or both of these functions, is used as a domain name, it does not come within this category.

With respect to “similarity”, the criteria presented by judicial precedents, etc. under Subparagraph 1, Paragraph 1, Article 2 and other clauses of the law will apply. For example, a Toyama District Court Judgment dated December 6, 2000 ruled that “When compared, apart for the capitalization, ‘JACCS’ and ‘jaccs’ are identical. In addition, taking into account the fact that most domain names consist of lowercase letters, the capitalization of the letters is immaterial.” (This judgment was upheld by the High Court and was later affirmed [Nagoya High Court, Kanazawa Branch judgment, Sept. 10, 2001. An appeal to this judgment was rejected by the Second Petty Bench, Supreme Court, February 8, 2002].) A Tokyo District Court judgment dated April 24, 2001 concluded that “The defendant’s website contains the names “J-PHONE” in English, “JPHONE” in Japanese, “J-PHONE“ in combination of English (“J”) and “PHONE“ in Japanese, all written horizontally. These are substantively

identical or similar to the aforesaid English name “J-PHONE” on the website.” This judgment was upheld by the High Court (Tokyo High Court judgment, Oct. 25, 2001).

Shown below are some of the rulings delivered by the Japan Intellectual Property Arbitration Center (formerly, the Industrial Property Arbitration Center) in court and alternative dispute resolution panel where “similarity” was found to exist.

- “jaccs.co.jp” and JACCS (Judgment of Kanazawa Branch of Nagoya High Court, September 10, 2001).
- “j-phone.co.jp” and J-PHONE (Judgment of Tokyo High Court, October 25, 2001).
- “sunkist.co.jp” and SUNKIST or Sunkist (Award of JIPAC, June 1, 2001).
- “sonybank.co.jp” and SONY (Award of Industrial Property Arbitration Center [presently JIPAC], March 16, 2001).
- “itoyokado.co.jp” and Ito Yokado (Award of Industrial Property Arbitration Center [currently JIPAC], March 14, 2001).
- “goo.co.jp” and goo (Judgment of Tokyo High Court, October 17, 2002)

### **(3) Acquiring/Keeping of the right to use a domain name or act of using a domain name**

Acquiring the right to use a domain name includes cases where (i) an applicant acquires the right to use a domain name by applying to a domain name registration agency for its registration; (ii) an entity acquires the right to use a domain name through its assignment from a third party in whose name the domain name was originally registered with a registration agency; and (iii) an entity receives a license for the domain name from the third party in whose name the domain name is registered with a registration agency.

Keeping the rights to use a domain name is equivalent to having the right to use a domain name continuously. Using a domain name means using a domain name for purposes such as setting up a website.

### **3. Effects of falling into the category of “Unfair Competition”**

Business entity who suffer loss of revenue or reputation damage through acts of unfair competition may demand that the use of a domain name be stopped (Article 3 of the Unfair Competition Prevention Law), damages (Articles 4 and 5 of the law), and measures be taken to restore reputation (Article 7 of the Unfair Competition Prevention Law). Business entity who suffer loss of revenue because a party has illegally acquired a domain name identical or similar to their trademarks, service marks or the like, may demand damages equivalent to the price of a license fee which they could have received had they granted a license for the use of the domain name in advance (Subparagraph 4, Paragraph 2, Article 5 of the Unfair Competition Prevention Law).

### **4. Domain name dispute resolution policies**

The Unfair Competition Prevention Law does not contain any explicit provisions with respect to the assignment of domain names. Even if a claim for the assignment of a domain name is made based on the right to order an injunction against the use of the domain name in a litigation proceeding, it would be difficult to obtain a judgment for the assignment of such domain name. However, private organizations, such as JPNIC and ICANN, have formulated dispute resolution policies for both JP and generic domain names. In accordance with these policies, disputes are settled as described below.

#### **(1) JP Domain Names**

With respect to JP Domain Names, JPNIC's Regulations Concerning the Registration, etc. of Attribute Type (Organization Class Type) and Regional Type Domain Names (Article 40) and Regulations Concerning the Registration, etc. of General Purpose JP Domain Names (Article 37) (hereinafter collectively referred to as the “Registration Regulations”) provide that whenever there is a dispute between a registrant and a third party over a JP Domain Name registered in the name of the registrant, the registrant shall consent to the dispute settlement agency's authority to resolve the dispute in accordance with the JP Domain Name Dispute Resolution Policy (hereinafter referred to as the “JP-DRP). The JP-DRP provides that a third party applicant may seek, as a remedy, the cancellation of the registrant's domain name registration or the assignment of the domain name registration to the applicant (Part i, Article 4 of the JP-DRP). The regulations provide that when an award is issued by a dispute settlement agency (presently, JIPAC is the only one) certified by JPNIC, the Japan Registry Service Corporation (hereinafter referred to as the “JPRS”) shall take steps for the assignor cancellation of the domain name registration (Article 3 and Part k, Article 4 of the JP-DRP).

However, any party dissatisfied with an award issued by the dispute settlement agency may file a suit with the appropriate court. It is provided that jurisdiction by agreement shall belong to the Tokyo District Court or the court having jurisdiction over the residency area of the registrant. If a suit is filed within 10 days of the notification of an award, the JPRS can withhold the assignor cancellation of the registration, which it may have ordered in the award. Where a court becomes involved, the JPRS will ultimately carry out the instructions of the court as regards the domain name (Part k, Article 4 of the JP-DRP).

As the details of any rights to a domain name are prescribed in the contract between the registrant and JPRS, a cancellation or assignment executed by JPRS, in accordance with the Registration Regulations, does not constitute a tort. A judicial precedent also states, “The registration of a domain name is granted by private contract (the contents of which are the Registration Regulations) between an internet user and JPNIC (which handled the registration of domain names in the past), a domain name registration agency. The registrant of a domain name uses the domain name by virtue of the contract with JPNIC, and any right the registrant has to the domain name is a contractual one to be asserted against the JPNIC”(Judgment of Tokyo District Court, November. 29, 2001).

## **(2) Generic Domain Names**

With respect to Generic Domain Names, arbitration is performed by certified dispute settlement agencies (such as the Arbitration Center of the World Intellectual Property Organization) in accordance with the Uniform Domain Name Dispute Resolution Policy (hereinafter called the “UDRP”) adopted by ICANN.

Therefore, if a dispute occurs about a Generic Domain Name, a party may seek to cancel or assign its registration by filing an application with a dispute settlement agency certified by ICANN. However, any party dissatisfied with an award, issued in accordance with the UDRP, may file a suit with the appropriate court. It is provided that jurisdiction by agreement shall belong to either the court having jurisdiction over the address of the head office of a registrar certified by ICANN or the address of the registrant. If a suit is filed within 10 days of the notification of an award, the enforcement of the judgment, such as an assignor cancellation, will be withheld (Part k, Article 4 of the UDRP).

(4) Presentation of Product Information on the Internet and Trademark Infringement

[Issue]

Does the presentation of brand-name goods in internet auctions or offers to sell brand-name goods on internet message boards infringe upon trademark rights?

[Approach]

(i) Where these acts are conducted “as a business” (“*gyô-to-shite*”); and (ii) the goods sold “are not genuine products“, liability for trademark infringement potentially exists.

**(i) Whether these acts are conducted “as a business”**

Where these acts are not conducted “as a business” as defined by the Trademark Law, there is no infringement of trademarks. If an individual or entity, for example, conducts transactions on a repeated and ongoing basis, or when the same goods are sold at one time in large quantities, such individual or entity will be operating “as a business.”

**(ii) Whether these are “genuine products”**

Trademark rights are deemed legally exhausted after the initial sale. Therefore, if the goods being resold are the genuine products, the resale of such goods does not infringe any trademark right.

[Explanations]

**1. Problem identification**

The growth of the internet has led to the sale of brand-name goods (meaning, in this section, goods that are subject to registered trademark rights) in internet auctions and on internet message boards. In addition to the sale of goods owned by persons, businesses are selling products which they acquired in large quantities. Replica goods are also being sold in combination with genuine products.

Are people infringing the rights of trademark owners, who exhibit brand-name goods in internet auctions or who offer to sell brand-name goods on internet message boards (hereinafter referred to as “Exhibitors”)?

## 2. Liability of Exhibitors

“Trademarks” as used herein refers to “characters, figures, symbols or three-dimensional forms, or combinations thereof, or combinations of the foregoing with colors, which are used by parties who attach such marks to products that such parties produce, demonstrate, or assignment as a business” (Subparagraph 1, Paragraph 1, Article 2 of Trademark Law). The owner of a trademark right has the exclusive right to use the trademark for the purpose of attaching to products or product packaging (Article 25 of the Trademark Law).

Furthermore, advertisements on the internet constitute the use of trademarks (Subparagraph 8, Paragraph 3, Article 2 of the Trademark Law), and acts including the exhibition of goods in internet auctions and offers to sell on the internet are deemed subject to the same provision.

### (1) “As a business”

As specified above, the definition of trademark use requires that the trademarks be used in the course of acting “as a business.” Thus, the exhibition of brand-name goods in internet auctions and offers to sell brand-name goods on internet message boards, when there is no assignment of such goods “as a business,” do not constitute use of trademarks and are deemed not to infringe trademark rights.

By way of example, a person would be regarded as acting “as a business” in the following two cases (a) and (b). Moreover, this would apply to acts whether conducted by a person or an entity<sup>29</sup>.

#### (a) Cases involving repeated and ongoing transactions

In practice, when transactions are conducted on a repeated and ongoing basis, such conduct is deemed acting “as a business.” Moreover, when an Exhibitor intends to conduct transactions on a repeated and ongoing basis, that is also deemed to acting “as a business.”

A person does not act “as a business” where he uses a single internet auction website to exhibit the same brand-name goods multiple times using the same ID.

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<sup>29</sup> Please keep in mind that the definition of “business” differs from law to law.

For example, the meaning of “business” in Paragraph 2, Article 2 of the Electronic Contract Law covers instances where the same action is conducted on a repeated and ongoing basis without the need for a profit objective, whereas a “business” under the Specified Commercial Transactions Law applies to sales conducted on a repeated and ongoing basis with a view to profit.

Rather, a person is deemed to be acting “as a business“, if on multiple websites he exhibits the same brand-name goods and offers to sell such goods overall on a repeated and ongoing basis.

Where no bids are made for the exhibited items, even where the same goods may be exhibited several times on internet auction websites or internet message boards, such instances will not constitute repeated and ongoing transactions.

(b) Conducting single transactions involving large quantities of the same goods

It is now possible and common to exhibit and offer for sale the same goods at the same time on internet auction websites and internet message boards. A person will be deemed to be acting “as a business” where he conducts single transactions involving large quantities of the same goods.

(2) Genuine Products

The term “Genuine products” as used herein refers to goods put into distribution by the owner of the trademark. With respect to goods that are in lawful distribution, such as those procured through normal channels, the trademark rights are deemed exhausted at the time the goods are initially sold to a consumer. Any subsequent resale of such goods does not constitute an infringement of trademark rights. Furthermore, when acquired from a foreign country (such as in the case of parallel imports), the trademark rights are also deemed exhausted when the owner puts the goods into distribution in a foreign country. If the same person owns the trademark rights in both Japan and the relevant foreign country, or if the goods are manufactured in a foreign country by the respective owner of the rights, where the trademarked goods are assigned by proper means, the trademark rights are exhausted upon the initial sale of the goods in Japan, meaning following sales in Japan will generally not be deemed an infringement of trademark rights (Judgment of Osaka District Court, February 27, 1970, 625 Hanrei Jihô 75)

Accordingly, the resale of goods, which were acquired by proper means, does not raise any issue under the Trademark Law. Specifically, such goods are similar to the ones which a retailer acquires from a wholesaler, where the retailer independently determines the retail price without ever requiring a license from the trademark owner. Offering goods for sale on an internet auction website or an internet message board is regarded as the equivalent of an advertisement flyer of a retailer under the Trademark Law.



Nevertheless, when goods are produced at a legal factory but are not put into distribution by decision of the trademark owner, if, for example, the goods are stolen, such goods will not be treated as genuine products.

In light of the above, when a person is acting “as a business“ and the goods “are not genuine products,“ the act of exhibiting such goods on an internet auction site or offering the goods for sale on an internet message board constitutes an infringement of trademark rights; any person engaging in such action is deemed liable to indemnify the damaged parties (Article 709 of Civil Code). Moreover, there are cases in which such person may be subject to a claim for an injunction from the owner of the rights (Article 36 of Trademark Law) or to criminal sanction (Article 78 of Trademark law).

In addition, where a person who exhibits, or offers for sale, replica goods, which are not genuine products, and even where the person has clearly specified the replica goods as replications, such act will constitute an infringement of trademark rights because the person is selling goods to which a trademark is attached without having received a license from the owner of the trademark right (Article 25 of Trademark law).

Where a Vendor sells replica goods in a manner which presents the replications as genuine products, and where the Vendor is aware that they are replications, such Vendor may be subject to a criminal sanction under the Criminal Law for the commission of fraud (Article 246 of Criminal Law).

(5) Providing IDs and Passwords on the Internet

[Issue]

Which regulations would apply with respect to exhibiting IDs and passwords in internet auctions, and the disclosure of this information on internet message boards, for the purpose of gaining access to and copying (installing) digital content and programs?

[Approach]

**(I) Contractual regulations**

Where a contract has been concluded between a provider and a user that prohibits communication of IDs and passwords to third parties, users who sell or disclose IDs or passwords on the internet bear contractual liability (liability for the non-performance of contractual obligations).

**(II) Regulations based on the Unauthorized Computer Access Law**

Where IDs and passwords are provided for the purpose of using computers via the internet, it is prohibited by the Unauthorized Computer Access Law (Law No. 128 of 1999, "*fusei access koui no kinshi nado ni kansuru houritsu*" in Japanese) to leak IDs or passwords with the information that which computer could be used by such IDs and passwords without the permission of the authorized user<sup>30</sup> of such IDs and passwords nor the permission of the issuer of such IDs and passwords.

**(III) Regulations based on the intellectual property laws**

The sale or disclosure of IDs and passwords on the internet is deemed not to constitute unfair competition with respect to technical sanctions, but may be regarded as an act to facilitate the infringement of reproduction right, on the ground that such act foments the infringement of such rights.

**(IV) General Tortious Acts**

A person or company who has disclosed or provided IDs, passwords, serial numbers etc. on the internet may be liable for compensation of damages pursuant to the provision on tortious acts (Article 709 of the Civil Code).

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<sup>30</sup> "Authorized user" as used herein refers to a user who has obtained permission to use other computers from the person who is authorized to grant applicable IDs and passwords for use of said computers.

[Explanations]

## **1. Problem identification**

Businesses impose technical sanctions (known as “access controls”) on the viewing, listening, and usage of digital contents and programs (hereinafter referred to as “Content”), as well as technical sanctions on copying (e.g., installation; known as “copy controls”), and by providing content only to users who pay a fee and who are given access based on user IDs, passwords, product IDs, serial numbers, and the like (hereinafter referred to as “IDs/Passwords”) by which technical sanctions can be removed (in some cases, the users establish specific IDs/Passwords). Users can then use their IDs/Passwords to view, listen, use, or copy (hereinafter referred to as “Accessing and Copying”) the Content.

With the growth of the internet, IDs/Passwords are being sold and disclosed by means of internet auctions and internet message boards which allow access to and the copying of Content. Moreover, methods to avoid technical sanctions for the purpose of Accessing and Copying Content (know-how), in the form of documented information such as manuals (hereinafter referred to as “Circumvention Manuals”) are also being sold and disclosed. As a result, businesses, which provide access to and the copying of Content for the payment of a fee, are experiencing revenue losses.

What types of legal regulations exist with respect to the sale and disclosure on the internet of IDs/Passwords and Circumvention Manuals?

This section discusses IDs/Passwords for Accessing and Copying Content, which is being provided in the market for commercial purposes, but does not concern security numbers for banking cash cards, passwords for the control of corporate trade secrets, or the like.

## **2. Contractual regulations**

In some cases, contracts may be concluded between providers and users specifying that IDs/Passwords may not be provided to third parties upon provision of the IDs/Passwords. In such cases, users who sell or disclose such IDs/Passwords on the internet bear contractual liability (liability for the non-performance of the main obligations; Article 415 of Civil Code).

### **3. Regulations under the Unauthorized Computer Access Law**

Where a person can connect via a network such as the internet to a computer that can be used by entering distinct codes such as IDs/Passwords, and where such use is made possible by entering the distinct codes of another person without authorization, such acts are prohibited as acts of unauthorized access and punishable by law (Articles 3 and 8 of the Unauthorized Computer Access Law). Specifically, the act of entering the distinct code of another person without authorization and any action which can be classified as an “attack on a security loophole” constitute such an action. As used herein, in order to be a distinct codes two requirements must be satisfied. A distinct code must allow access to: (1) information which allows specified usage that differs for each individual user; and (2) information that cannot be used by anyone other than such other person. As used herein, “specified usage“ means use via an electronic telecommunications line such as the internet, whereby no limits exists on usage and where Accessing and Copying Content can be performed.

The acts of providing the distinct codes of another person without authorization and disclosing which computers can be used with such IDs/Passwords to a third party are prohibited as acts that promote unauthorized access (Articles 4 and 9 of the Unauthorized Computer Access Law). Moreover, the provisions of this information is prohibited by any and every means both online and offline. It does not matter whether such acts result in financial gain.

Accordingly, for IDs/Passwords whose purpose is to provide access to other computers by means such as the internet, the Unauthorized Computer Access Law bars the sale or disclosure of such IDs/Passwords via the internet as well as the disclosure of computers accessible with such IDs/Passwords, if the provision occurs without either the permission of the authorized user of such IDs/Passwords or the individual granting such authorization.

### **4. Regulations under the intellectual property laws**

#### **(1) Unfair Competition Prevention Act**

##### **(i) Unfair competition against technical protections**

Under the Unfair Competition Prevention Act (Law No. 47 of 1994, "*fusei kyousou boushi hou*" in Japanese), where measures are taken for business reasons to restrict access to and the copying of Content by electronic means (technical protections (Article 2, Paragraph 7 of the Unfair Competition Prevention Act)), the act of assigning devices or programs (including, in the case of programs, providing them via electronic

telecommunications lines), whose sole function is to enable unauthorized access or copying by means of circumventing the effects of such technical protections, constitutes unfair competition (Article 2, Paragraph 1, Items 10 and 11 of the Unfair Competition Prevention Act). Moreover, where any business, which makes Content available and which is protected by technical protections, is being harmed by assigning programs or devices which invalidate their technical protections, so that the business loses revenue or is at risk of losing revenue, such business can apply for an injunction or for indemnification from the persons distributing the assigning programs or circumvention devices (Articles 3 and 4 of the Unfair Competition Prevention Act).

Nevertheless, properly inputting such IDs/passwords into a computer in order to obtain a certain result conceived in advance does not constitute improper use of the computer. Therefore, as a rule, proper use of IDs/Passwords does not constitute an act circumventing the effects of technical protections.

Items that are the focus of unfair competition include “devices” and “programs” designed for a special purpose. As used herein, “programs” mean combination of structured orders, by which one can obtain certain results (Article 2, Paragraph 8 of the Unfair Competition Prevention Act). IDs/Passwords are simply strings of letters, numbers, or symbols, and constitute neither programs nor devices.

Similarly, Circumvention Manuals constitute neither programs nor devices.

Therefore, the act of assigning IDs/Passwords or Circumvention Manuals is not deemed to constitute unfair competition with respect to technical protections.

(ii) Unfair competition related to trade secrets

Under the Unfair Competition Prevention Act, trade secrets: (1) are managed as secrets (confidentiality); (2) constitute valuable technical or business information for business activities (value); and (3) are not in the public domain (non-public) (Article 2, Paragraph 6 of the Unfair Competition Prevention Act).

If the information is regarded as a trade secret, whether the acquiring of the secrets will be held as an act of unfair competition will depend on how the trade secrets were acquired. If the information was acquired by means of theft, fraud, coercion, or other improper means (hereinafter referred to as an “act of unfair acquisition”), or if a person acquired certain information from third parties and was aware of or very negligently unaware of the fact that such third parties had acquired the information by an act of unfair competition, his/her act of acquisition, use or disclosure of such information constitutes an act of unfair competition (Article 2, Paragraph 1, Items 4 and 5 of the Unfair

Competition Prevention Act). If a person acquired certain information from third parties and it was only after acquiring this information that he/she became aware of the fact that the third parties had acquired it by an act of unfair acquisition (or if he/she remained unaware of such fact due to gross negligence), the act of using or disclosing the information would constitute an unfair competition (Article 2, Paragraph 1, Item 6 of the Unfair Competition Prevention Act). However, the acquiring of information by reverse engineering is not regarded as an act involving improper means.

If any actual or threatened financial loss is incurred as a result of unfair acts relating to trade secrets, the victim of the loss may claim an injunction or compensation of damages against the party committing such unfair acts (Articles 3 and 4 of the Unfair Competition Prevention Act).

(A) IDs/Passwords

Trade secrets are determined by whether the item of information satisfies the relevant legal requirements. For example, where a business, who employs IDs/Passwords as a technical protection to the access of Content, grants the same IDs/Passwords to multiple users without imposing any condition that such IDs/Passwords shall not be provided to third parties, users are unlikely to be aware of (1) any confidentiality requirement and (2) the non-public nature of the information, rendering it difficult to regard such IDs/Passwords as trade secrets.

If such persons grant different IDs/Passwords to each person on the condition that such IDs/Passwords shall not be provided to third parties, the requirements of (1) confidentiality and (3) non-public nature may be satisfied. In addition, as the IDs/Passwords have value as regards their role in the business, the IDs/Passwords would consequently be regarded as trade secrets.

(B) Circumvention Manuals

Methods of circumventing technical protections, in order to access or copy Content that satisfies the criteria of (1) confidentiality, (2) value, and (3) non-public nature, may be regarded as trade secrets.

**(2) Copyright Law**

(i) Circumvention of Technical Protections

Under the Copyright Law, the public assignment of devices, including programs for public transmissions, or programs whose primary function is to circumvent technical protections, including programs or which enable transmissions, is prohibited, and criminal penalties may be imposed on persons engaging in such acts (up to three years' imprisonment with forced labor or fines of up to three million yen) (Article 120-2 of the Copyright Law).

As used herein, "technical protections" refers to measures based on electronic methods for blocking or obstructing acts which violate copyright (Article 2, Paragraph 1, Item 20 of the Copyright Law), and which in any case are a means of blocking or obstructing acts for the unauthorized use of copyrighted works (reproduction, public transmission, or enabling transmission). Access controls such as restrictions on the use of programs or control of the viewing of and listening to digital Content, fall beyond the scope of this definition. Moreover, the "circumvention of technical protections" means, based on the removal or alteration of codes used for technical protections, facilitating acts and/or removing any obstacles to acts which the technical protections were designed to prevent (Article 30, Paragraph 1, Item 2 of the Copyright Law).

Nevertheless, properly inputting such IDs/Passwords into a computer in order to obtain a certain result conceived in advance does not constitute improper use of the computer. Therefore, as a rule, the deletion of IDs/Passwords does not constitute an act of eliminating or altering the code used for circumvent the effects of technical protections.

The focus herein is devices and programs, specifically special purpose items. "Programs" refer to "expression of combinations of instructions, by which one can operate a computer to obtain certain results" (Article 2, Paragraph 1, Item 10-2 of the Copyright Law). IDs/Passwords are simply strings of letters, numbers, or symbols, and constitute neither programs nor devices.

Moreover, Circumvention Manuals constitute neither programs nor devices.

Therefore, the act of assigning IDs/Passwords or Circumvention Manuals to the public is not deemed to violate Article 120-2 of the Copyright Law.

(ii) Facilitating the Infringement of Reproduction Rights

If the software is downloaded or installed, a copy of the software will be newly created.

An act of fomenting the infringement of copyright may lead to liability for joint tortious liability pursuant to Article 719 of the Civil Code as an act of facilitating the infringement of copyright<sup>15</sup>.

Will the act of providing IDs/Passwords on the internet which are required for downloading or installing certain software, constitute an act of facilitating the infringement of reproduction right?

In order to discuss this issue, we will consider the following:

- whether the act of downloading or installing a certain software by entering IDs/Passwords that were acquired by improper means constitute an infringement of reproduction right under the Copyright Law;

and

- assuming that the answer to the preceding question is affirmative, whether the act of providing IDs/Passwords on the internet to the person who downloads or installs it constitute a facilitation of reproduction right.

(A) Downloading and installing a software by entering IDs/Passwords that were acquired by improper means

Firstly, we will consider the following based on cases where the entry of IDs/Passwords is required for downloading and installing certain software.

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<sup>15</sup> Osaka High Court Judgment, February 27, 1997, p.131 of *Hanrei Jiho* vol. 1624

“The Respondent Company does not operate the Device by itself, but repeatedly conducts a certain lease business which provides commercially used karaoke devices to users which are highly likely to infringe the representation and performance rights of musical works managed by the Appellant [omitted]. If the user uses this Device for providing karaoke music to their customers without being licensed by the Appellant, the user was aware that it violates the representation and performance rights of musical works managed by the Appellant. Alternatively, if he/she was not aware of it, they should have been, as it would be easy for such user to become aware of it.

In this particular case, the Respondent Company was aware of the fact that it continued to provide customers with karaoke services by using the Device without holding any license to do so. The Respondent Company continued and renewed the Lease Agreement and provided the Device, silently accepting the results of such infringement of copyrights. Therefore, the Respondent acted jointly with Appellants Noriko and Takashi in the aforementioned infringement of copyrights.”

“The Respondent Company failed this duty of care and continued to infringe the copyrights without taking any appropriate measures to prevent such infringement (omitted) and continued and renewed the Lease Agreement with [omitted] and provided the Device. This was negligence on the part of the Respondent Company, and therefore Respondent Company shall be liable for joint tort pursuant to Article 719, Paragraph 2 of the Civil Law on the ground that the Respondent Company facilitated such infringement of copyrights.”



- (p) The target software on the server is provided so that it can be installed directly onto the computer on the internet, however, the entry of IDs/Passwords is required in order to directly install the software.
- (q) The target software on the server is not provided so that it can be installed directly to the computer, but an installer<sup>16</sup> on the server is in a downloadable format for anybody<sup>17</sup>, and the user is expected to install the software by activating the installer after downloading such installer to the hard disk or any other media in the computer.
- (q1) The entry of IDs/Passwords is indispensable for downloading the installer.
- (q2) The entry of IDs/Passwords is indispensable for installing the target software by activating the installer which has been downloaded to the hard disk.
- (r) The entry of IDs/Passwords is indispensable for installing the target software onto the computer from a CD-ROM or any other media in which the target software is stored.

In each of the cases listed above, the act of downloading or installing the target software constitutes an act of reproduction.

In the acts of installment described in (p),(q2),(r), the target software is reproduced in the hard disk drive of the computer, while in the case of (q1), downloading the installer results in a reproduction of the installer. Therefore, all of these acts constitute an act of reproduction.

Secondly, we will consider whether or not it constitutes an infringement of the reproduction right under the Copyright Law to download or install certain software by entering IDs/Passwords that were acquired by improper means.

X) In the cases of (p) and (q1)

As a rule, the act of installing the software by using IDs/Passwords which were acquired by improper means is considered to be an infringement of the reproduction right under the Copyright Law.

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<sup>16</sup> In this document, “installer” means a program which includes all the programs necessary to enable the computer to work with the target application program.

<sup>17</sup> Typically, a software producer operating a publicly accessible website sets up a link to a free access installer.

This is because, where the entry of IDs/Passwords are indispensable for installing a certain software, the copyright holder of such software is generally considered to have allowed those who enter the IDs/Passwords after properly acquiring them to install it. Therefore, the act of installing a software by using IDs/Passwords which were acquired by improper means is considered to constitute an infringement of the reproduction right, unless it is exceptionally permitted as in the case of reproduction for the purpose of personal use under the Copyright Law).

Y) In the cases of (q2) and (r)

Firstly, the copyright holder should be regarded as permitting the downloading of the installer as it may be installed freely without any restrictions. Therefore, it is difficult to argue that such act of downloading the installer constitutes an infringement of reproduction right under the Copyright Law.

On the other hand, in the case of an act of installment of software, the owner of the installer, which is a reproduction of the copyrighted program, fabricates the target software by the act of installment. Therefore, whether Article 47-2, Paragraph 1 of the Copyright Law is applicable becomes an issue.

However, as the installer contains the whole of the program to be installed, and works as a medium for reproducing the program to be installed, it would be difficult to argue that the owner of the installer is not the “owner of the reproduced program” to be installed.<sup>18</sup>

For the reason explained above, in the case of (q2), the act of installing a software by using IDs/Passwords which were acquired by improper means is not considered to constitute an infringement of the reproduction right. The same logic will be applicable to (r).

In addition, such act of installing is not considered to constitute an infringement of the rights of adaptation because the fundamental function of the program itself is not modified at all.

Z) Conclusion

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<sup>18</sup> p.494 of “Copyright Law Commentary (First Volume)” (“*chosakuken hou konmenta-ru (joukan)*” in Japanese) by Koji Fujita; p.377 of “Detailed Explanation of the Copyright Law, (Third Edition)” (“*shoukai chosakuken hou dai 3 han*” in Japanese) by Fumio Sakka

Where the entry of IDs/Passwords is required for installing a software directly through the internet or downloading an installer through the internet, the act of installing or downloading such software by using IDs/Passwords which are acquired by improper means constitute an infringement of the reproduction right. These acts will only be permitted as in the case of reproduction for the purpose of personal use under the Copyright Law (Article 30, Paragraph 1 of the Copyright Law)).

In addition, where a person installs software which he/she obtained by way of downloading an installer or in the form of a CD-ROM after entering an ID or password he/she accessed by an unfair method, he/she may be liable for tort in general, even if such installing in itself does not constitute an infringement of copyrights.

(B) Providing IDs/Passwords through the Internet

Some may argue that in cases of infringement of the reproduction rights such as (p) and (q1), that the act of providing IDs/Passwords which are indispensable for reproduction to the general public through the internet may be considered as equivalent to causing such website audience to reproduce such software, in other words to use them as a tool for committing an unauthorized reproduction of the software, and thus such act in itself constitutes an infringement of reproduction rights.

However, whether or not such software is illegally reproduced by using the IDs/Passwords provided on the internet entirely depends on the voluntary will of that internet audience, and the party providing such IDs/Passwords may not be considered as controlling or managing the internet audience, and therefore the party providing such IDs/Passwords would not be regarded as infringing the reproduction rights<sup>19</sup>.

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<sup>19</sup> Tokyo District Court Judgment dated May 16, 2000, p.128 of *Hanrei Jiho* vol. 1751  
“As a general matter, even where a person does not commit a certain act by himself/herself, if such person has so strong control over such act that he/she can be regarded as “causing another person to act as his/her tools”, the person, who does not commit the act by himself/herself, can be legally regarded as substantially committing the act by himself and further as liable for such action. The Plaintiff’s allegation in the former paragraph in (1) above can be approved on the ground that the aforementioned general theory should be applied to the act of “reproduction” under the Copyright Law.

As with the relationship between the Defendant, sending the sound source in the Program and the receiver of such sound source who records it on MD, the only agreement that exists by and between these parties is that the Defendant shall license the receiver to receive such Program and the receiver shall pay certain amount of consideration for receipt of such Program. There is no agreement on the receiver’s recording of the sound

On the other hand, as IDs/Passwords are indispensable for such reproduction, the act of providing such IDs/Passwords should be regarded as illegal on the ground that the act facilitates the infringement of reproduction rights, unless personal use would normally be the sole purpose for the reproduction such as in the case of a simply structured game for individual amusement.

Therefore, in the case of (p) and (q1), we cannot deny the possibility that the assignment of IDs/Passwords and Circumvention Manual to the general public may be regarded as an act of facilitating the infringement of reproduction rights because that assignment tends to foment the infringement, except in cases personal use would normally be the sole purpose for such reproduction.

## **5. General Tortious Acts**

### **(1) General Tortious Acts**

A person who, by intention or by negligence, has infringed the rights or legally protected benefits of others shall be liable for compensating the damages incurred by such infringement (Article 709 of the Civil Code).

It may be argued that if a person commits an act which is not in breach of any specific statutes such as the Copyright Law or the Unfair Competition Prevention Act each of which specifically set forth various rights, such act is, as a rule, not regulated by law, and thus it does not generally constitute a tort, unless the purpose of such act is his/her own unjust enrichment or to cause damages to others<sup>20</sup>.

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source. Whether or not to record the sound source depends on the receiver's voluntary will, and the receiver will record it at its discretion by preparing the equipments for recording. Considering that the Defendant has no way to exercise any control over the receiver's decision making, therefore, it is evident that the relationship between the Defendant and the receiver shall not be so constituted that the Defendant has control over the receiver's act of recording to the extent that the Defendant is regarded as causing the receiver to record the sound source on MD as if the receiver were the Defendant's tool.

<sup>20</sup> Separately from the examples referred to in this document, the Tokyo District Court judgment dated March 24, 2005, where the information released on the internet by the Plaintiff (index) were ruled as not being a copyrighted work, refers to the liability for tort as follows:

“The “YOL index” is the information which the Plaintiff released on the internet free of charge. Considering the fact that, as explained in the foregoing, the Copyright Law etc. does not grant any exclusive right to the Plaintiff, such information can be used freely by third parties. The use of information released on the internet will not be held illegal, except in special cases such as that the purpose of such use is to obtain unjust profits, or to cause damage to the Plaintiff.”

However, the scope of tortious liability for should not be limited to cases where certain statutorily prescribed rights, which, in a narrow sense have been infringed, but shall be extended to cases where any interests worthy of legal protection have been infringed.<sup>21</sup>

## **(2) Analysis of the Example**

Question: Where a person sells or discloses an ID and/or password etc. necessary for the installation and running of the software, will he/or she be liable in tort?

The vendor (i.e. license holder/copyright holder) of software often requires its users to enter an ID and/or password for the installation and running of the software. Such measure is in place so that only the authorised users who have duly paid for the use of the software can access it.

If the ID and/or password are disclosed or provided on an internet message board against the vendor's consent, anybody who has viewed the message board and thus possess the ID and/or password will be able to utilize the without paying any compensation to the vendor.

This will cause the vendor to lose revenues from the sales of the software. Consequently, the vendor will not be able to recover the financial and capital investments he/she has made for the development and the sale of the software and a considerable financial loss will result. The vendor's entitlement to the profit derived from the value of the software should be legally protected.

The distribution of an ID and/or password to the public will cause significant damages to the vendor. Therefore, such distribution of the ID and/or password is a socially-unacceptable and illegal conduct, even after taken into account the rights to freedom of speech and free competitions of the person who engages in the distribution.

Therefore, the distribution of the ID and/or password may be held illegal and constitute a tort under Japanese laws, because it causes financial damage to the vendor in his business activities. On this basis, such an act may be held illegal and may constitute a tort. This is,

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<sup>21</sup> The High Court (Division of Intellectual Property) judgment dated October 6, 2005 (appeal trial judgment of the Tokyo District Court judgment dated March 24, 2005, referred to above ruled that "The scope of the Act of tort (Article 709) shall not be limited to the infringement of rights specifically prescribed in the statute such as the Copyright Law, but shall include any illegal infringement of interests which are worthy of legal protection."

There are also other judicial precedents which affirmed the liability for tort while denying that the target work was copyrighted (Tokyo High Court judgment dated December 17, 1991).

however, subject to exceptions in special circumstances such as where the disclosure of ID and/or password will not be sufficient to access the software.

Therefore, where a person sells or discloses an ID and/or password etc. necessary for installation and running of software, he/she may be held liable for torts on the ground that he/she has the intent to cause financial damage to the vendor.

- (6) Liability for providing a method for destroying access control of software with limited functions, usable period, etc. (i.e. "try-and-buy software")

[Issue]

What restrictions are imposed on the act of providing, on a website, devices for destroying the access control on a try-and-buy version of application software or shareware?

(Examples of restricted acts)

1. Providing serial data necessary for destroying the access control.
2. Providing a key generator (so-called *key-gene*) capable of calculating serial data necessary for destroying the access control
3. Providing a pseudo-information generation program transmitting false information regarding time and date to try-and-buy software
4. Providing information for modifying data in the registry, etc., that are recorded in a limited version
5. Providing pseudo-software that is free from access control by modifying the try-and-buy software's processing routine to provide the access control
6. Providing a crack patch to modify the try-and-buy software's processing routine to provide the access control
7. Providing binary changing information necessary for modifying the try-and-buy software's processing routine to provide the access control

[Approach]

We will herein discuss legal liabilities arising from the above-listed examples. (For other legal restrictions applicable to the above-listed examples, see Part 2, 2 (5) "Providing IDs and Passwords on the Internet.")

- (1) Where a person receiving trial software, on the condition that no serial data therein shall be provided to any third party, offers the same on a website, he/she will be held liable for non-performance of obligations.
- (2) Where a person receiving trial software, on the condition that no key generator therein shall be provided to any third party, offers the same on a website, he/she will be held liable for non-performance of obligations.
- (3) Where a person receiving trial software, on the condition that no program generating pseudo information shall be provided to any third party, offers the same on a website, he/she will be held liable for non-performance of obligations.
- (4) Where a person receiving trial software, on the condition that no modified data such as registry shall be provided to any third party, offers the same on a website, he/she will be held liable for non-performance of obligations.

- (5) The act of offering pirated copies of regular software on the website will constitute an infringement of reproduction rights and public transmission rights, etc. under the Copyright Law and thus lead to penal and civil liabilities. In addition, separately from this, the modification of trial software to pirated copies of regular software will also constitute an infringement of the author's moral rights, and thus lead to penal and civil liability. Furthermore, where a person receiving trial software, on the condition that no pirated copies of regular software shall be provided to any third party, offers the same on a website, he/she will be held liable for non- performance of obligations.
- (6) The act of offering a crack patch on a website will constitute an infringement of reproduction rights, and thus may lead to penal and civil liabilities.

Furthermore, where a person receiving trial software, on the condition that no crack patch shall be provided to any third party, offers the same on a website, he/she will be held liable for non- performance of obligations.

- (7) The act of providing binary changing information on a website will constitute an infringement of reproduction rights, and thus may lead to penal and civil liabilities.

Furthermore, where a person receiving trial software, on the condition that no binary changing information shall be provided to any third party, offers the same on a website, he/she will be held liable for non- performance of obligations.

In addition, all the acts referred to in (1) through (7) above may be held as torts, and therefore each will lead to liability for compensation of damages.

[Explanations]

## **1. Problem Identification**

In a business handling application software or shareware, generally, its operator initially distributes software to which access is more restricted than its regular version, such as software for which functions are in part made unavailable, or a try-and-buy version usable free of charge for a limited period of time. Then, the operator provides customers wishing to utilize its regular version with a priced device for destroying such restricted access to the software by, for example, offering a serial number necessary for that purpose, or a patch for unlocking the access control so that the software fully functions.

In connection with the aforementioned business, there are a number of websites offering, without permission of the right holder, devices for removing the access control. For this



reason, it is held that offering of such devices unjustifiably injures the right holder's interests in collecting consideration for the software.

Therefore, we need to discuss herein whether the act of offering, without permission of the right holder, a device for removing access control is subject to legal restrictions.

Since there are a wide variety of devices for removing access control, we will first list some typical models for removing access control and then discuss legal the implications applicable to each.

## **2. Methods of Removing Access Control**

The following are currently known devices for removing access control:

### **(1) Model Providing Serial Data**

This model consists of an act of offering serial data on a website, where the entry of such serial data is required for unlocking the access control over the software. Consequently, the user of trial software receiving the serial data will, by entering such serial data upon setting up his/her own trial version, gain access to all functions of the software.

The serial data will become available to users if, for example, they pay the right holder for disclosure of such information, if they discover such data through analysis of its try-and-buy version, or if they obtain the serial data from another person's website offering such data to users.

### **(2) Model Providing Key Generator**

This model consists of an act of offering a program generating serial data (a so-called "key generator") on a website, where such serial data are in sequence generated from such information as the user name,. Consequently, the user of trial software receiving the serial data generated by running the key generator will, by entering such serial data upon setting up his/her own trial version, gain full access to all functions of the software.

The serial data will become available to users if, for example, they fabricate them through analysis of its try-and-buy version or if they obtain the serial data from another person's website offering such key generator to users.

### **(3) Model Providing Pseudo-Information Generation Program**

This model consists of an act of offering on a website a pseudo-information generation program which is capable of transmitting false data on time and date as if they were accurate. Consequently, a user of software with limited usable time will, by executing such program, be able to lift such limitation on usable time and then access it even after the period of time.

The pseudo-information generation program will become available to users if, for example, they fabricate them or if they obtain such program from another person's website offering such program to users.

The pseudo-information generation program is, unlike other models, commonly provided in a highly versatile program universally workable with any software. For this reason, in this model, generally, those wishing to obtain such information need not analyze specific software.

### **(4) Model Changing Setting Data**

This model consists of an act of offering on a website registry changing information, etc. on the website to transform trial software into the regular version thereof. Such information becomes available through analysis of information in the registry containing the setting data for application software. Consequently, a user of trial software will, by way of modification of the registry information etc. in the trial software installed in his/her own personal computer, be able to utilize it as if it were a regular version.

The registry changing information will become available to users if, for example, they discover such information, etc. through analysis of its try-and-buy version or if they obtain it from another person's website offering such registry information to users.

In this model, it is only the setting information, not the software in itself that will be modified. Therefore, this model is reserved for users with certain expertise since they need to manually modify the registry changing information, etc. within the program provided to them.

### **(5) Model Providing Pseudo Regular Software**

This model consists of an act of offering on a website pirated regular software on the website fabricated by way of modification of the trial version thereof into pseudo-software functioning as well as its regular version. Such fabrication is accomplished by destroying the processing routine that provides access control. Software functioning as well as its regular version will thereby become available to users merely by installing such pirated regular software.

The pirated regular software will become available to users if, for example, they pirate such software through analysis of its try-and-buy version or if they obtain it from another person's website offering such pirated software to users.

This model tends to target users without special expertise, since they will gain full access to the software once they obtain pirated regular software.

#### **(6) Model Providing a Crack Patch**

This model consists of an act of offering on a website a program called crack patch, which automatically transforms trial software into a regular version based on the information derived from the processing routine that provides access control. Consequently, a user of trial software, by inserting a crack patch into a program (that is, executing the program), will convert the trial software into pseudo regular software and utilize the latter as if it were a regular version.

The crack patch will become available to users if, for example, they fabricate it through analysis of its try-and-buy version or if they obtain it from another person's website offering such crack patch to users.

In this model, unlike the "model providing pseudo regular software" referred to in (5), it will be the users themselves that will fabricate the pseudo regular software. Nevertheless, this model also targets users without special expertise, since all they need to do is to run the crack patch.

#### **(7) Information for Changing Binary Providing Model**

This model consists of an act of offering on a website certain binary<sup>22</sup> information (including information necessary for conversion of trial software into pseudo-regular software) that controls the processing routine that provides access control. Consequently, a user of trial software, by converting, with reference to the binary information, the trial software into pseudo-software (which functions as well as the regular version), will utilize the latter as if it were a regular version.

The binary changing information will become available to users if, for example, they discover it through analysis of its try-and-buy version or if they obtain it from another person's website offering such information to users.

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<sup>22</sup> This term describes the data format in general except for the text format; however, for the purpose of this document, it describes an executable format of computer program.

In this model, only the analysis information will be provided to users, meaning that, unlike the "model providing a crack patch" referred to in (6) above, no conversion of software will occur automatically. For this reason, this model will be reserved for users with certain expertise since they need to manually modify the program.

### **3. Consideration of Legal Issues**

The distribution of the aforementioned devices for removing access control constitutes an unauthorized use of the regular software, which is one of the right holder's copyrighted works.

Thus, this memorandum will first discuss whether the act of offering the aforementioned devices for removing access control constitutes an infringement of another person's legal interests, and then further discuss whether any restrictions under other laws or ordinances will be apply. (For details regarding issues other than the infringement of rights under the Copyright Law, see II-2-5 "Providing IDs and Passwords on the Internet.")

#### **(1) Whether the aforementioned devices fall under the infringement of rights under the Copyright Law**

The devices designed for removing access control can be classified into two main categories: models where the trial software will ultimately be transformed into different software ((5) through (7) above) and models where no transformation of software occurs ((1) through (4) above).

The former model, where the trial software will be somewhat transformed, is highly likely to fall under an infringement of rights under the Copyright Law.

Therefore, this memorandum will herein discuss each of the above two categories herein separately from the perspective of the Copyright Law.

Note, however, in the following cases, that the processing routine that provides access control will not fall under the "work" protected by the Copyright Law: when: (1) such processing routine is completely segregated from the program, which is the main portion of the software (for example, if the processing routine is structured as a completely separate file); or (2) when such processing routine in itself lacks creativity (for example, if a well-known program referred to in publications, etc. is copied and utilized for this purpose).

Therefore, we will herein limit the scope of discussion to cases where the processing routine that provides access control is not segregated from the program(i.e., the main portion of the

software) or where, assuming that such processing routine is segregated, such processing routine in itself takes on creativity.

**(i) Models designed to modify software ultimately**

**(a) Infringement of the moral rights of authors**

Firstly, in the "model providing pseudo regular software", where the person providing such model converts a trial version into a regular version by his or herself, such conversion is clearly against the will of the author. Therefore, in such cases, one needs to consider an infringement of the right of the author to preserve the integrity ("*douitsu-sei hoji ken*" in Japanese) of his or her work, which is one of the moral rights of authors (Article 20, Paragraph 1 of the Copyright Law).

In this regard, pursuant to Article 20, Paragraph 2, Item 3 of the Copyright Law, Article 20, Paragraph 1 of the Copyright Law will not apply to "modification which is necessary to make more effective the use of a program work on a computer". In light of the above-mentioned provision, we need to consider whether such modification nonetheless constitutes an infringement of the author's right to preserve the integrity of his or her work.

The purpose of converting a trial version into a pseudo regular version will undoubtedly be to utilize the software more effectively, especially for users for whom only the trial version is available.

However, some theories argue that Article 20, Paragraph 2 of the Copyright Law should be construed and enforced under extremely limited circumstances<sup>23</sup>. Such theories argue that Item 3 of the same paragraph is applicable to a modification for adding value to the program by, for example, eliminating a bug causing malfunctions of the computer program, or by upgrading its version equipped with some more useful functions)<sup>24</sup>. On that basis, considering the fact that a person converting a trial version into a pseudo-regular version simply destroys the limits on access to certain functions as created by the author, but neither eliminates bugs nor upgrades the version, Article 20, Paragraph 2, Item 3 of the Copyright Law will not apply, and therefore such act will constitute an infringement of the right to preserve integrity.

Therefore, the act referred to in the above-mentioned case may be construed as an infringement of the author's right to preserve integrity.

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<sup>23</sup> See p. 173 of "Commentary of Copyright Law, 5<sup>th</sup> New Edition" ("*chosaku ken hou chikujyo kougi gotei shinban*" in Japanese) written by Moriyuki Kato.

<sup>24</sup> See p.175 of the above.

Secondly, this memorandum will discuss an infringement of the moral rights of the author in the "model providing a crack patch" and the "model for providing binary changing information."

In these cases, a person who offers such crack patch or information will not modify the trial version by himself.

Nevertheless, considering that, as mentioned above, the act of users exploiting the crackpatch or converting a trial version into pseudo regular software based on the binary changing information constitutes an infringement of the author's right to preserve integrity, it is evident that the crack patch and binary changing information facilitate acts that infringe the author's right to preserve integrity.

Therefore, offering a crack patch or binary changing information will be viewed as an act of inducing or facilitating the users' modification of software, and it therefore may be considered an infringement of the author's right to preserve integrity<sup>25</sup>.

On that basis, a person who fabricated pseudo-regular software by his or herself will be charged with an infringement of the right to preserve integrity and will be subject to: (1) a penal servitude of up to five (5) years and/or a fine not exceeding five (5) million yen (Article 119, Paragraph 2, Item 1 of the Copyright Law), (2) the right holder's claim for suspension of such act (Article 112 of the same), and (3) compensation for damages in civil procedures (Article 709 of the Civil Code). Further, a person who offers a crack patch or binary changing information may bear penal and civil liabilities for an infringement of the right to preserve integrity.

#### **(b) Infringement of Copyrights**

One consideration regarding the "model providing pseudo regular software" is, where a person offering such program modifies a trial version into a pseudo regular version by oneself, whether this act will constitute an infringement of the rights of adaptation ("*hon-an ken*" in Japanese) (Article 27 of the Copyright Law).

On this issue, it may appear reasonable to argue that such act is not an infringement of the rights of adaptation because the fundamental function of the software is, aside from the processing routine discriminating the trial version, not modified at all, and therefore the modification to software takes on no creativity. On the other hand, however, one can also reasonably argue that such model infringes the rights of

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<sup>25</sup> Judgment of Tokyo High Court as of March 31, 2004 (the Case of "Dead or Alive 2", p.158 of *Hanrei Jiho* vol.1864).

adaptation, considering the changes made to the creative portion of the work when the trial version is compared with the regular version<sup>26</sup>.

In addition, the act of newly reproducing a pseudo regular version will constitute an infringement of copyrights, aside from the aforementioned issue of whether the modification of software thereto constitutes an infringement of rights of adaptation<sup>27</sup>.

Aside from the aforementioned issue of whether the modification of software constitutes an infringement of the rights of adaptation, the act of uploading a pseudo regular version onto a server will constitute an infringement of the right of reproduction ("*fukusei ken*" in Japanese) (Article 21 of the Copyright Law) and/or the right of original author ("*gen chosaku sha no kenri*" in Japanese) (Article 28 of the same). In addition, the act of causing a third party to download the pseudo regular version on a server will further constitute an infringement of the rights of public transmission ("*koushu soushin ken*" in Japanese) (Article 23, Paragraph 1 of the same) and/or the right of original author (Article 28 of the same).

Therefore, when a person commits the aforementioned acts, if any of the acts are held to be an infringement of the right of reproduction etc., the person will be subject to: (1) a penal servitude of up to ten years and/or a fine not exceeding ten million yen (Article 119, Paragraph 1 of the Copyright Law), (2) the right holder's claim for suspension of such act (Article 112 of the same), and (3) compensation for damages in civil procedures (Article 709 of the Civil Code).

Secondly, this memorandum will discuss whether the "model providing a crack patch" or the "model providing binary changing information" constitutes an infringement of the right of reproduction, etc.

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<sup>26</sup> The judgment rendered by Tokyo District Court as of March 16, 2007 affirms the applicability of infringement of the "right of adaptation" to a similar case (p.93 of *Lexis Hanrei Sokuhou* vol. 19).

<sup>27</sup> Assuming that the act of pirating pseudo-regular software does not take on creativity, and therefore does not constitute an infringement of the right of adaptation, the act of reproducing a pseudo regular version without approval of the copyright holder is substantially equivalent to the act of reproducing the trial version, and it therefore infringes the right of reproduction of such trial version. Assuming, on the contrary, that the act of pirating pseudo-regular software does take on creativity and therefore constitutes an infringement of the right of adaptation, the trial version is the original work ("*gen chosaku butsu*" in Japanese) of the pseudo regular software, and therefore an act of modifying it to a pseudo regular version without approval of the copyright holder infringes the rights of the original author (Article 28 of the Copyright Law).

In this regard, because the offering of a crack patch or binary changing information may induce or facilitate website users to infringe another person's rights of reproduction or adaptation, such offering may be considered an infringement of the right of reproduction and the right of adaptation, except in cases where the reproduction or adaptation for personal use is almost impossible.

**(ii) Models designed not to modify software ultimately**

In each of these models, the software in itself is neither modified nor reproduced, and therefore no problem arises in connection with the Copyright Law.

In this regard, the pseudo-information generation program will not be considered a “reproduction of a program having a principal function for the circumvention of technological protection measures” (Article 120-2, Item 1 of the Copyright Law), because such program simply transmits false time and date information to the software, but contains no signal specifically reacting to the software.

Further, the modification of certain setting information such as registry information will not give rise to problems under the Copyright Law, because the registry information is nothing more than data, and therefore does not fall under "work," as that term is used in the Act.

Therefore, in each of these models, the infringement of rights under the Copyright Law will be unlikely.

**(2) Restrictions under the Unauthorized Access Prohibition Act**

In any model discussed herein, the act of utilizing the software by exploiting the illegally acquired serial data, etc. will not constitute an “act of unauthorized access” under Article 3, Paragraph 2 of the Unauthorized Access Prohibition Act (Law. No. 128 of 1999, "*fusei access koui no kinshi nado ni kansuru houritsu*" in Japanese), because such act is not conducted “through an electric telecommunication line”.

**(3) Restrictions under the Unfair Competition Prevention Act**

**(i) Unfair Competition against Technological Protection Measures**

Under the Unfair Competition Prevention Act, "unfair competition" is defined as an act of assigning, etc. devices or programs having the sole function of enabling the running of program by obstructing the effect of a method for restricting the running of the program (i.e., technological protection measures) (Article 2, Paragraph 7 of the same), if such technological protection measures are designed for business purposes by recording



signals which react in a specific manner to the programs on a data storage media or otherwise recording such signals to require specific conversion through electromagnetic means (Article 2, Paragraph 1 (i), Items 10 and 11 of the same).

However, the method of access control employed in the trial version will not constitute a technological protection measure,

because, generally, no signal reacting in a specific manner to the programs is recorded, and the program itself does not necessitate such specific conversion.

Therefore, none of the models discussed herein will constitute unfair competition against technological protection measures.

#### **(ii) Unfair competition relating to trade secrets**

In the "model providing serial data" and the "model providing key generator", it appears that certain trade secrets are illegally offered.

However, the offering of serial data is not in itself viewed as illegally leaking the trade secrets, because such serial data are offered to a large number of users.

In addition, where the key generator is offered, no leakage of trade secrets arises, because no serial data are offered.

Therefore, serial data are unlikely held as trade secrets unless they are given to a person on condition that he/she shall not disclose them to any third parties.

#### **(4) Contractual restrictions**

If the contractual provisions executed between the right holder and the person offering the programs, etc. referred to in the models discussed herein expressly prohibit the acts of offering programs, etc. specifically referred to in each model, such person offering them shall bear liability for non-performance of contractual obligations and be subject to paying compensation for damages (Article 415 of the Civil Code).

Further, in each model, in order to discover the serial data, the analysis of a trial version by way of reverse engineering unavoidably becomes necessary. In some cases, additionally, it is a prerequisite to execute an agreement containing provisions on the prohibition of reverse engineering upon receipt of the trial version from the right holder, on the assumption that such prohibition of reverse engineering is legally valid. (For details regarding the interpretation of reverse engineering in the context of the Antimonopoly Act see Part 2, 1 (3) "Unreasonable

Clauses”, III. “Contractual clause restricting competition.”) If a party to such agreement discovers the serial data by reverse engineering, such party will bear contractual liabilities.

**(5) General Torts**

In all the models discussed herein, the acts referred to in each model may be held illegal and constitute a tort, because such acts cause damages to the right holder's business activities.

[Issue]

Do legal restrictions apply to the extraction of information and data from databases provided online via the internet or from packaged CD-ROMs, and to the provision of such information and data to third parties?

[Approach]

**(I) Where each element of data extracted from a database is a copyrighted work**

Copyrights extend to such data. The use of such data without permission from the owner of the right violates copyright.

**(II) Where each element of data extracted from a database is not a copyrighted work**

Generally, this data can be freely used. However, in cases i) and ii) below, where large amounts of relatively organized data are extracted, legal restrictions may apply.

**(i) Where the creativity of an original database is reproduced through the use of a body of data, which had been extracted from the original database with creativity.**

The use of the data without permission of the owner of the right violates copyright.

**(ii) Where data extracted from a database interfere with business related to the original database, although the database is not deemed to have creativity.**

Acts such as the sale of such body of data, interfering with business related to the original database, constitute illegal acts giving rise to liability for indemnification.

[Explanations]

**1. Problem identification**

Databases refer to collections of data in which (1) data is or can be saved as part of a systematic scheme embodying a structure involving hierarchies or links; (2) it is possible to identify and extract only specifically required items from the whole of the database; (3) enables searches for such required items from an information terminal device possessing the appropriate functions. Such databases are provided online via the internet, packaged on CD-ROMs and the like, and are characterized by a system of information and data that enables the information and data to be easily searched from the appropriate terminal.

Along with the development of digital means of data capture, storage, and transmission, there has also been a dramatic increase in the flow of information, making it increasingly important to efficiently and accurately extract the requisite information from vast amounts of information. As a result, there is an increased need for databases which enable searches by computer.

Moreover, the spread of the internet and personal computers has been accompanied by an increase in the transmission of information from individual users. In certain cases, information and data extracted from databases is provided as is or with further processing to third parties (such as the distribution of printed materials uploaded to the internet). Do legal restrictions apply to the use of information and data extracted from databases such as the provision of such information and data to third parties?

## **2. Where each item of data extracted from a database is a copyrighted work**

Where information and data extracted from a database are deemed subject to copyright, each item of information or data is protected as a copyrighted work. For example, where information or data extracted from a database is a newspaper or magazine article, a map, an image, or the like, such items often constitute copyrighted works.

In this case, the act of using (reproduction (Article 21 of Copyright Law), assigning (Article 26-2), publicly transmitting, or enabling transmission (such as by uploading to the internet) (Articles 23, 92-2, 96-2, 99-2, 100-4 of Copyright Law) of each item of data without permission of the owner of the rights infringes upon such copyrights and may give rise to liability for indemnification (Article 709 of Civil Code), a claim for injunction (Article 112 of Copyright Law), or criminal liability (Article 119 of the Copyright Law).

However, where the purpose of reproduction is personal use, these acts do not infringe upon copyrights (Paragraph 1, Article 30 of Copyright Law).

## **3. Where each item of data extracted from a database is not a copyrighted work**

Where each item of information and data extracted from a database is simply a fact, such as a train schedule, the names and elevations of mountains, or stock information, such items are generally deemed not to constitute copyrighted works. Therefore, such information is generally in the public domain.

However, where large amounts of relatively organized data are extracted, legal restrictions may apply where (1) a body of data extracted from a database with creativity reproduces the creativity of the original database, and (2) a body of data extracted from a database infringes

upon business activities related to the original database, despite the fact that the original database is not deemed to have creativity.

- (1) Where the creativity of an original database is reproduced through the use of a body of data, which had been extracted from the original database with creativity.

Under Copyright Law, where databases are comprised of bodies of information such as text, figures, or diagrams which are systematically organized to enable searches by an electronic computer and which constitute original works because of the selected data and systematic structure, such databases shall be protected as copyrighted works (Subparagraph 10-3, Paragraph 1, Article 2 and Article 12-2).

Specifically, databases deemed to be protected as copyrighted works are those that exhibit creativity such as a unique method of data selection or a specialized format for each item of information, search systems, setting of keywords, and hierarchy of the database which enables information to be found efficiently because of its systematic structure. By way of example, in one judicial precedent where a database was protected as a copyrighted work, the court acknowledged the creativity of the NTT Town-Page database with respect to the classification of telephone numbers by the employment field of the respective owners (Judgment of Tokyo District Court, March 17, 2000, 1714 Hanrei Jihô 128).

When a body of relatively organized information and data (hereinafter referred to as a “Body of Data”) is extracted from a database having creativity, and the selection or systematic structure of such information is deemed to have creativity that did not arise as a result of additional processing by the person who extracted the information (when information and data extracted from a database with creativity are reproduced in a form which is relatively organized and does not detract from their value as a copyrighted work), the copyrights to the original database are deemed to extend to that Body of Data. Therefore, the act of using (such as reproduction (Article 21 of the Copyright Law), assigning (Article 26-2 of the Copyright Law), publicly transmitting or enabling the public transmission of (such by uploading to the internet) [Article 23 of the Copyright Law]), the Body of Data without the permission of the owner of the rights infringes upon copyrights and may give rise to liability for indemnification (Article 709 of Civil Code), a claim for injunction (Article 112 of Copyright Law), or criminal liability (Article 119 of the Copyright Law).

However, when reproductions are for personal use, such acts do not infringe upon copyrights (Paragraph 1, Article 30 of Copyright Law).

- (2) Where extracting a Body of Data from a database infringes upon business activities related to the original database despite the fact that the original database is not deemed to be an original work

Databases not deemed to be original works are not protected by copyright. In a judicial precedent concerning a database comprised of certain information on existing four-wheel automobiles in Japan for purposes of automobile servicing, the selection criteria were common, and this feature was not regarded as having creativity. Moreover, information was simply placed in order from the oldest to the newest, and was not further classified. Since other businesses independently adopted the same structure, the systematical structure of the database was also not regarded as original (Interim Decision of Tokyo District Court, May 25, 2001; 1744 Hanrei Jihô 132).

This decision held that (1) the database was created by a person who expended labor and money to collect and organize the information; and (2) such person engaged in business activities to compile and sell the database; and (3) the acts of reproducing the data of the database and compiling a new database to sell in a geographic area that competes with the sales geography of such person were deemed to constitute illegal acts using conspicuously unfair means that infringed upon the business interests of another person in the trading society subject to legal protection under the principle of fairness and free competition.

Accordingly, regarding the creation of a Body of Data from a database that is not original, where (i) the original database has economic value such as being created through a considerable investment of capital; and (ii) it is used for business activities; and (iii) an act such as the sale of such Body of Data infringes upon the business activities related to the original database, such act may be deemed to be illegal, giving rise to liability for indemnification (Article 709 of Civil Code).

However, this case held that an injunction was not approved which would have barred acts such as the reproduction of a Body of Data (Judgment of Tokyo District Court, March 28, 2002, 1104 Hanreitaimus).

#### **4. Where, with respect to the provision of a database, a contract is concluded between the provider and the users regarding the conditions for information and data use**

With respect to the provision of a database, a contract may be concluded between the provider and the users regarding the conditions for use of information and data in the database.

When a contract is concluded, users must generally use the database itself and the information and data included in such database in accordance with the applicable conditions of use, and the provider of the database is deemed able to assert contractual liability (liability for

non-performance of the main obligation, Article 415 of Civil Code) with respect to acts of use by the user outside the contract.

However, some opinions have highlighted the need to further scrutinize the validity of such contracts especially the contractual provisions which restrict the acts of users.

(8) Disclosure of Photo or Image in which General Public Appears

[Issue]

Is the act of disclosing a photograph or image in which general public appears lawful? What if the photograph or image includes the images of celebrities?

(Example)

1. A photograph or image of a concert hall in which spectators appear is disclosed on a website for the purpose of announcing a concert.
2. A privately videotaped image in which unintended persons appear is uploaded onto a website.

[Approach]

**I. In the case of general public**

Even where images of the general public appear, if the graphic mode is reduced to the extent that the identity of the persons in the image cannot be identified, the portrait right will not become an issue. However, if each person is identifiable, as a rule, this would constitute an infringement of portrait rights, unless the infringement is within the extent which should be reasonably tolerated by the holder of portrait rights.

In Example 1, it would be necessary to utilize the image of spectators for advertisement purposes in order to convey the atmosphere of the concert; and in cases such as this it is not necessary to have agreement from all the spectators to appear in the photograph or image. Moreover, as the image is not utilized for the purpose of media report, it would be difficult to argue that the infringement of the audience's portrait rights is outside the scope in which they should reasonably tolerate.

In Example 2, where, having regard to the purpose of the videotaped image and other relevant images, the person included in an insignificant portion of images, generally, the persons unintentionally included in the image would reasonably tolerate the infringement of portrait rights.

Further, if the utilization of another person's image unavoidably leads to the disclosure of his/her daily life and activities, he/she may be entitled to claim for injunction or compensation of damages on the ground of invasion of his/her privacy rights.



## **II. In the case of celebrities**

Where the name or image of celebrities is utilized for the sole purpose of attracting customers and amounts to taking advantage of their name recognition, this would constitute an infringement of their publicity rights.

Therefore, it is highly likely that the act of utilizing the image of a celebrity for an advertisement on the website without his/her consent would be held as an infringement of their publicity rights.

[Explanations]

### **1. Portrait Rights**

#### **(1) Problem identification**

##### **(i) Protection of Portrait Rights**

The Portrait right is not a right expressly defined by a statute. However, the Superior Court Judgment of December 24, 1969 ruled that “every person has, as part of his/her freedom in his/her personal life, the right not to have his/her face or other part of exterior (the “appearances”) photographed without his/her consent. Aside from whether such right should be named “portrait right”, the policemen are not permitted, in light of the purport of Article 13 of the Constitution, to photograph the appearances of individuals without due cause.” This judgment substantially approved the portrait right as a human right protected under the Constitution.

The aforementioned judgment was followed by similar court precedents which substantially approved the protection of portrait rights. In this sense, judicial precedents generally tend to approve the portrait right as a right (p.265 of “[revised and enlarged version] Violation of Privacy and Civil Liability (“*privacy shingai to minji sekinin*”) by Minoru Takeda, etc.).

##### **(ii) Scope of Protection of Portrait Rights**

While approving the need for protection of the portrait right, the aforementioned Superior Court judgment states that “the right of individuals should not, however, be limitlessly protected against the exercise of state power. It is evident from Article 13 of the Constitution that such right should be limited in light of balancing with the need for maintenance of public welfare. Crime investigation is one of the state powers

delegated to the police for the purpose of maintenance of public welfare, and the police bears the responsibility to exercise such power (see Article 2, Paragraph 1 of the Police Law (*keisatsu ho*)). Therefore, even if the photographs taken by the policemen for the necessity of crime investigation happen to include the appearances of individuals in addition to the image of the suspects, it might be permissible depending on the case.” This judgment held that the protection of portrait rights may be limited to a certain extent. The aforementioned judgment was rendered in a criminal case where; whether the police may lawfully photograph the participants of a demonstration march was in question.

There have also been some civil cases which held that portrait rights should be protected within a certain limit. For example, Tokyo District Court Judgment dated May 22, 1990 (p.93 of *Hanrei Jiho* Vol.1357) states that “The dissemination of photographs explicitly depicts the image of the person appearing it, giving a very vivid impression to the readers. Therefore, compared to written article which refers to the person, the photographs will inflict more mental damages on the targeted person if he/she does not wish it. However, photographs are often necessary for accurate media report. Therefore, whether or not the dissemination of such photograph is unlawful should be determined by comprehensive consideration of circumstances such as the extent his/her portrait rights or privacy are infringed. Circumstances which may be considered include; the relevancy between the object matter appearing therein, his/her activities in society, the place and method of photographing, and whether or not such photograph is an indispensable means for the photographer to express his/her intention. In other words the court, in considering whether the photograph is lawful will consider, whether or not the level of infringement is within the scope reasonably tolerated in our lives, in light of the balancing the need for protection of portrait and privacy rights with the need for protection of freedom of expression.”

The aforementioned cases provide a trend in judicial precedents, they suggest that it is an infringement of portrait rights to photograph (or videotape) another person’s image or figure without his/her consent or to utilize the photograph or image (regardless of whether or not it is a static or moving image, hereinafter the same). However, they also provide that such acts may be permitted if the infringement of the portrait rights of the person appearing therein is within the scope he/she should reasonably tolerate. Whether these acts are permitted shall be determined after comprehensive consideration of the circumstances such as the necessity of such photographing, the extent of such infringement in light of the purpose and method for which the photograph is utilized, the relationship between the object matter and the user of the photograph or image in question.

## (2) Detailed Analysis

- (i) Where the general public appears in a photograph or image, but each person cannot be identified

This is specifically, the case where the photograph or image has been reduced in graphic mode or processed by means of softening or mosaic. In this case, there would not be a problem regarding the infringement of portrait rights because the infringed party in itself cannot be identified.

Even if we were to assume that there is an infringement, the infringement of the rights of persons appearing therein is so trivial that it would not legally constitute an infringement of portrait rights except under special circumstances, irrespective of the necessity or method of utilizing such photograph or image.

- (ii) Where general public appears in a photograph or image, and each person can be identified

Unlike the case of (i) above, a photograph or image in which each member of the general public can be identified infringes the portrait rights of the general public unless there are circumstances that may justify such infringement as being within the extent they should reasonably tolerate.

It is true that it would be necessary to utilize the facial expressions of the spectators for the purpose of advertisement in order to communicate the atmosphere of the concert hall and their satisfaction etc. to customers.

However, it would still be arguable whether it is necessary to utilize the images of the spectators in an identifiable manner.

It may be argued that the spectators who come to a concert hall can fully expect that they may be photographed or videotaped, and thus the infringement of their portrait rights incurred as a result of the utilization of photographs or videotape should be considered so trivial that they should reasonably tolerate it. However, the spectators need not necessarily give consent to the photographing or videotaping, and some individuals would not give such consent. Moreover, the purpose of such photographing or videotaping is not media report. Therefore, for the time being, if a photograph or image is utilized in a manner in which individuals can be identified, it might be held as an infringement of portrait rights.

However, the infringement of portrait rights may not be infringed in the case where the images have been personally videotaped at places such as tourist locations and happen to include unintended persons such as other tourists. Portrait rights would not be infringed if the images taken, in light of the purpose of the videotaping (and other relevant images) do not include a significant portion of the image.

## **2. Privacy Rights**

### **(1) Problem identification**

In the case of the examples, if the utilization of another person's image unavoidably leads to the disclosure of his/her daily life and activities, the infringement of his/her privacy rights will also be an issue.

In this regard, it is widely held that privacy rights should be analyzed separately from portrait rights (p.163 of the aforementioned publication written by Takeda). Privacy rights can be analyzed that way, however, the elements discussed in the aforementioned limitations of the portrait rights should be analogically considered for determining under what circumstances the infringement of privacy rights would be tolerated. We will not further refer to the infringement of privacy rights in this chapter.<sup>65</sup>

## **3. Publicity Rights**

### **(1) Problem identification**

#### **(i) What is "Publicity Right"?**

A "publicity right" is construed as the right of a celebrity etc. to exercise exclusive control of the economic interests and value (so-called publicity value) involved in the his/her personal identifying information, where such information such as his/her image or name attracts customers and thus promotes purchase of the products that are associated with him/her. This concept of publicity rights derives from the United States, however, they were substantially approved in Japan in the Tokyo District Court Judgment dated June 29, 1976 (Mark Lester case).

The judgment for the Mark Lester case states that "A person who selected to engage in an occupation such as an actor may be considered as having given comprehensive consent to the disclosure of his/her name and image to public. Therefore, so far as

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<sup>65</sup> Where an unidentifiable image of a person is disclosed together with his/her name or where the person appearing in such image is identifiable from the surrounding scenery, not his/her portrait rights, but privacy rights are infringed.

such person is concerned, there would be much less need for protection of the aforementioned personal moral rights. Further, considering that gaining popularity is the essence of such an occupation, a person like an actor normally wishes to have his/her name and images widely disclosed to public and thus he/she will not, unlike ordinary people, generally suffer mental damages due to the disclosure of his/her name and images. Therefore, the actor etc. is entitled to claim for compensation of damages on the ground of his/her mental suffering due to the unauthorized utilization of his/her name or images only where the method, manner or purpose of utilization is detrimental to his/her occupational reputation, fame, and public image or where any other special circumstances exist (for example, where the actor sticks to the belief that his name or images should never be utilized for product advertisements).” This case held that the portrait rights and privacy rights of celebrities are limited to a considerable extent.

The judgment further states, however, that “although there is less need for protection of certain moral rights of an actor etc, he/she has certain interests that deserve protection in connection with his/her name and image, which are alien to ordinary citizen. More specifically, the name and image of an actor may, if they are utilized for the purpose of product advertisements, serve in favor of the advertisement and promotion of sales of products by virtue of his/her reputation in the society, fame, public image etc. From the viewpoint of the actor etc, he/she should reasonably hold the interest, by virtue of the reputation he/she gained by himself/herself, to grant a third party on an exclusively basis the right to utilize his/her name or images in exchange for certain amount of consideration. Therefore, his/her name and image takes on, separately from the moral rights referred to in (1) above, a sort of economic interests (which should of course be protected by the tort law). Consequently, even where the actor etc. does not suffer mental damages due to the unauthorized utilization of his/her name or image, he/she is likely to be entitled to certain legal remedies on the ground of infringement of aforementioned economic interests.” In conclusion, the judgment further held that the celebrities should have exclusive economic interests to grant the right to utilize his/her name and image to third parties.

Judgments that have been delivered subsequent to the Mark Lester Case have consistently approved the basic approach taken in the Mark Lester Case in connection with the publicity rights of celebrities, although no statutory provision expressly mentions such rights. (Such court precedents include “Onyanko case”, “King Crimson case”, “Hidetoshi Nakata case”, and “Bubka Idol case”). In this regard, the publicity rights (at the level of legally protected rights) have been, as a matter of practice, substantially recognized as a “right”.

(ii) Relations with Freedom of Expression

In case of an expression using the name or image of a celebrity, in light of the significance of freedom of expression (Article 21 of the Constitution), there have been many court precedents that approve the publicity right of celebrities in connection with his/her name and image within a limited extent. The Tokyo High Court judgment dated February 24, 1999, a major judicial precedent (“King Crimson Case”) states that, where a name or image of a celebrity is utilized in speech or publication, “the introduction etc. of a celebrity unavoidably brings with it his/her power to attract customers. Since it is impossible to introduce him/her free of influence of his/her power to attract customers’ attention. Therefore, a person is regarded as utilizing a celebrity’s power to attract customer only if the sole purpose and effect of such utilization is solely focused on the procurement of the economic benefit or value derived from his/her power to attract customers. If such person simply introduces a celebrity or does something similar thereto, aware of his/her power to attract customers, such person shall not be considered as having utilized such power.” This judgment held that such person shall not be regarded as having infringed the publicity rights except in cases such person “solely” utilized the celebrity’s power to attract customers. The judgments subsequent to the King Crimson Case have generally maintained this stance (for example, Tokyo District Court judgment dated February 19, 2000, Tokyo District Court Judgment dated June 14, 2005).<sup>66</sup>

In its judgment dated April 26, 2006, the Tokyo High Court (appeal trial judgment for the Bubka Idol case) stated that “it is not appropriate to argue that publicity rights and matters pertaining to infringement thereof shall be and superseded by the protection of freedom of expression simply because it is a publication. Instead, the infringement of publicity rights should be analyzed, in consideration of the protection of freedom of expression in the sale of the publication, based on the circumstances such as the reputation, evaluation in the society, name recognition etc, whether the publication contributed to the promotion of its sale, and whether the utilization of such publication

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<sup>66</sup> Tokyo District Court judgment dated June 14, 2005 (p.135 of *Hanrei Jiho* No. 1917) states that, “However, the actual method of use of self-identifying information is diverse varies, for analysis of whether or not it should constitute an infringement of rights and remedies thereto, the interests of both parties must be specifically balanced in view of the conflicting interests such as the freedom of expression and commercial activities, and so emphasis should not be placed too much on the predominance of moral rights. More specifically, the contents and nature, the purpose and method of use of self-identifying information, and the significance of damages incurred by the individuals therefrom should be comprehensively examined.” This case argues that, for determining whether or not the publicity rights have been infringed, such publicity rights should be specifically balanced with a broader range of rights, not limited to the freedom of expression, while the King Crimson Case focused solely on the “freedom of expression” as the only conflicting interest.

should be considered as an unauthorized utilization for commercial purposes.” The approach taken by this judgment was slightly different from that consistently held since the King Crimson Case, which focused on whether the infringer “solely” utilized the celebrity’s power to attract the customers’ attention.<sup>67</sup>

## (2) Detailed Analysis

In the case of the (Example), where the image of a celebrity is utilized for advertisements on the website, assuming that we take the position that the freedom of expression should also be respected, can we reasonably argue that the image of a celebrity appearing in such advertisement is justifiable in light of the criteria referred to in the King Crimson Case?

In advertisements, it is easy to exclude a photograph or image in which the image of a celebrity appears, and moreover, there is little need for utilizing the photograph and image. even if the advertisement should be protected as an “expression” defined under Article 21 of the Constitution under Even and we were to protect the advertisement as “expression” protected under Article 21 of the Constitution, where the celebrity has significant power (normally so) to attract customers’ attention, the photograph or image in which his/her image appears is likely considered as solely utilizing his/her power to attract the customers’ attention.

Therefore, it is highly likely that the act of utilizing the image of a celebrity without his/her consent will be held to be an infringement of his/her publicity rights<sup>68</sup>.

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<sup>67</sup> According to this High Court judgment, although due criticism of, comments on, and introduction of activities for public entertainment performed by a personality should be respected in light of the freedom of expression, the act of selling, under the pretext of the freedom of expression, a publication for commercial purposes that includes a photograph (an image etc.) of or comments on such personality without his/her consent thereto should be beyond the scope of his/her due activities involving the matters pertaining to the freedom of expression. The judgment further argues that the object matter of the expression (a magazine with photos) should be much less valued than that (a published book) in the King Crimson Case and concluded that such magazine is not worthy of being protected on the ground of the freedom of expression. It would appear that this judgment has led to a slightly different approach that does not necessarily place emphasis on the protection of the freedom of expression.

<sup>68</sup> The High Court judgment of the King Crimson Case emphasizes the freedom of expression as a legally protected interest conflicting with the value of publicity rights, and argues that a person should be considered as having infringed the publicity rights only if he/she “solely utilized” the celebrity’s power to attract customers. On the other hand, the appeals trial judgment for the Bubka Idol case ruled that the publicity rights had been infringed by employing the criteria considering broader range of circumstances (not limited to cases where (the celebrity’s power to attract customers) had been “solely utilized” by arguing that the photo magazine deviates from the scope of being protected on the ground of the freedom of expression. The future development of theories and judicial precedents based on the aforementioned judicial precedents are notable in connection with how to resolve the conflict of interests between the publicity rights and the freedom of expression.

(9) Disclosure of Photo or Image in which Copyrighted Work Appears

[Issue]

Where a copyrighted work appears in a photograph or movie, will it pose any legal problems?

(Examples)

1. Where a copyrighted poster appears in its background of another photograph or movie.
2. The photograph referred to in example 1 above is uploaded onto a personal website and disclosed to the public.

[Approach]

**(I) In the case of Example 1**

Under the Copyright Law, “reproduction” means to “reproduce in a tangible form by means such as printing, photographing, copying, sound recording or videotaping” (Article 2, Paragraph 1, Item 15 of the Copyright Law). Where a copyrighted work appears in a photograph or movie, it may constitute an infringement of copyrights unless the copyright holder has given consent.

**(II) In the case of Example 2**

The act of uploading a photograph or movie where a copyrighted work happens to appear onto a personal website may constitute an infringement of public transmission rights (Article 23 of the Copyright Law).

[Explanations]

**1. Template.**

**1. Example 1**

**(1) Problem identification**

Where the whole of a poster displayed on a street is photographed as the only photographic subject, the act of such photographing would constitute an infringement of copyright, unless it falls under the definition of reproduction, etc. for personal use.

On the other hand, it would be outside the realm of common sense in the eyes of the public seeking justice to conclude that any photograph which happens to contain a copyrighted work appearing in its background constitutes an infringement of copyrights.



## (2) Detailed Analysis

### (i) The “manner in which the copyrighted work appears”

For example, where the copyrighted work appearing in a photograph or movie is too indistinct to identify or distinguish what it is, especially if the copyrighted work appearing in the photograph or video is intentionally processed to lower its graphic mode of or modified by means of mosaic or softening, it would be clear that such photograph or movie does not constitute an infringement of copyrights and thus no issue would arise in connection thereto.

On the other hand, if the copyrighted work appearing in the background of a photograph or movie is identifiable to a certain extent, it may constitute an infringement of copyrights.

In the *Setsugetsuka* Case (Tokyo High Court judgment, February 18, 2002, p.136 of *Hanrei Jiho* Vol. 1786), the Tokyo High Court ruled that, a copyrighted work appearing in the background of a photograph only constituted a “reproduction” if the copyrighted work has been recurred to the extent that the creative essence of the reproduced work can be, in light of the normal attention of general public, directly perceived. The Tokyo High Court further held that this criterion is irrelevant to whether a certain work is identifiable as a specific copyrighted work.<sup>69</sup>

According to this approach, the identifiability of a copyrighted work that merely appears in a photograph or movie would not constitute an infringement of copyright. Rather, only where the creative essence of the work can directly be perceived, will there be an infringement of copyright.<sup>70</sup>

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<sup>69</sup> According to p.288-289 of Moriyuki Kado’s “Annotations to the Copyright Law (*chosakuken hou chikujo kaisetsu*)” (5<sup>th</sup> edition) it is stated that “where a painting or similar artwork appears in the background of the main subject matter (of a photograph), it does not substantially constitute the use of a copyrighted work and thus such a situation does not involve any matters pertaining to copyrights (omitted). However, this principle will not apply if the focus is intentionally placed on the background painting.” According to the US judicial precedent of *Sandoval v. New Line Cinema corp.* 147 F. 3d 215 (2d Cir, 1998) Article 107 of the US Copyright Law, the criteria for determining whether the use of a copyrighted work falls under the “fair use” is the following; (1) the purpose or nature of use, (2) the nature of the utilized copyrighted work, (3) the amount and substantial value of the utilized copyrighted work in proportion to the whole of such copyrighted work, and (4) the effect on the potential market value caused by the use of the copyrighted work. Article 57 of the German Copyright Law approves the use of copyrighted works in case such copyrighted work is sporadically used in an insignificant portion of another work.

<sup>70</sup> Tokyo High Court judgment dated February 18, 2002 (p.136 of *Hanrei Jiho* Vol. 1786) states as follows: “In calligraphy, as a rule, (omitted) it is difficult to regard the character type or font in itself as a copyrighted work. Therefore, the characteristic nature of calligraphy, in other words, the creative essence of the chirographer’s thoughts and emotions expressed in his/her work should consist in the aforementioned aesthetic elements appended to the character type or font in the calligraphy work. (omitted) In order for an act to be regarded as “reproduction” of a calligraphy, which is a kind of copyrighted artistic work, the photograph of such

(ii) Reproduction for personal use

Where a copyrighted work appears in the background of a photograph or movie taken or shot by an individual, it is likely that the photograph or movie would be considered to be a reproduction for personal use (Article 30, Paragraph 1 of the Copyright Law), and, therefore, would not constitute an infringement of reproduction rights.

It should, however, be noted that Article 30, Paragraph 1 of the Copyright Law is not applicable to public transmission rights. Therefore, if, for example a person discloses on his/her personal website a photograph in which a copyrighted work appears, this may be considered as an infringement of public transmission rights, as more fully discussed below in this document.

(iii) Copyrighted artistic works disclosed to public

Where the original copyrighted artistic works (such as sculptures and monuments) are permanently installed outdoors, a photograph or movie including the images of such artistic work will not constitute an infringement of reproduction rights (main sentence of Article 46 of Copyright Law).<sup>71</sup>

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calligraphy should be, in light of the normal attention of general viewers thereof, well reproducing the original to the extent the characteristic essence of the work comprising not only of its character type and font, but also of the originality of the shapes of the letters, the beauty and the delicacy of the lines, the architectural beauty of space and the sequence of letters, speed and inflection of the brush stroke, clearness and diversities of the ink color, and momentum of the brush etc. can be directly perceived from the photograph. (omitted) Whether or not the work and its chirographer can be identified at a glance of the photograph is irrelevant to whether the characteristic essence of copyrighted work as a copyrighted artistic work can be directly perceived from the photograph. Therefore, the aforementioned judgment shall remain unchanged.

However, this decision is a judicial precedent on “calligraphy” which is a special type of copyrighted work, and thus different decisions would be rendered for other types of copyrighted artistic works such as movies, photographs in accordance with the characteristic of each genre of art.

<sup>71</sup> In regard to a case where a photograph of a city bus with a painting was utilized for cover page of a book designated for children titled “*Hataraku jidosha*”, Tokyo District Court judgment dated July 25, 2001 (p.137 of *Hanrei Jiho* Vol. 1758) (the “City Bus Case”) provides a definition of the definition of “open place” and “permanently installed” referred to in the main sentence of Article 46 of the Copyright Law. According to the judgment, “open place should be construed as a open place to which the general public is freely accessible if they wish”, while the term “permanently installed” should be construed as “being placed in a manner in which the general public may, in light of common sense, freely view at any time during a certain period of time.” Based on the aforementioned criteria, “the bus with the plaintiff’s work on its body is operated not for a very limited period of time for a specific event, but on a regular basis just as other city buses are, the act of drawing the plaintiff’s work on the body of such city bus scheduled to be regularly operated on public roads falls under the definition of ‘permanently installing’ the copyrighted artistic work.” Therefore, according to the aforementioned judgment, although temporarily displayed advertising materials do not fall under the definition, the copyrighted works used for a certain period of time and will be protected under the Copyright Law. In these cases, some theories argue that Article 32, Paragraph 1 of the Copyright Law should be applicable (“Possibility of Limitations on Copyright in accordance with Changes in Technical Environment” by Yoshiyuki Tamura, p.124 of *Jurist* Vol. 1255). However, considering the normal usage of the term of “quotation”, it would be difficult to (analogically) apply the Article to copyrighted works that happen to appear in a photograph etc.

However, where a photograph or movie is taken or shot for the purpose of marketing or where such photograph or movie is actually sold to third parties, it would be an infringement of copyrights (Article 46, Item 4 of the Copyright Law)<sup>72</sup>.

In addition, the main sentence of Article 46 will not be applicable to the reproductions of the original artistic work<sup>73</sup>. For example, where a poster of a famous sculpture appears in a photograph or movie, the Article will not be applicable and therefore any photograph or movie would constitute an infringement of reproduction rights.

(iv) Implicit consent of the copyright holder

Where a copyrighted work appears clearly in the background of a photograph or movie, it is difficult to argue that it does not constitute a reproduction. However, the copyright holder may be, depending on the manner in which such copyrighted work is displayed, regarded as having given their implicit consent.

For example, if the copyrighted works (such as characters) are displayed at locations where many people are expected to come and take pictures such as theme parks and tourist spots, the copyright holder may be considered as having given implicit consent to displaying them. The act of photographing the original of copyrighted artistic

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<sup>72</sup> In the *City Bus* case the Tokyo District Court July 25, 2001 ruled that “whether or not Article 46, Item 4 is applicable should depend on whether the copyrighted artistic work is reproduced “exclusively” for marketing or the reproduced work is actually sold to third parties. In order to determine this, circumstances such as the formalities, the contents, the manner and method of use of the publication should be objectively examined.” In light of these criteria, the judgment further held that “the Defendant’s book is a publication edited for the purpose of explaining to children various types of vehicles running on the street by using their photographs. It provides an explanation on the exterior and role of each of the 24 types of vehicles in total. This book is edited from the viewpoint of pre-school education in that children are expected to develop their observation skills as well as curiosity, which will in the future become a basis for learning. The method of inserting the picture in the cover page and page 14 is not unnatural in light of the purpose of this publication. Considering that the viewers of this book will have the impression that the photograph of the bus is placed on various pages as an the example of the diverse vehicles referred to in the body text of the book, the act of selling a book which includes a photograph of the bus with the plaintiff’s work shall not fall under the relevant criteria as previously described; the copyrighted artistic work is reproduced “exclusively” for marketing or such reproduced work is actually sold to third parties. Therefore, such act does not fulfill the conditions required under Article 46, Item 4 of the Copyright Law.

<sup>73</sup> Article 46 (Utilization of an artistic work, etc. located in open places)

With the exception of the following instances, it shall be permissible to utilize, by any means whatsoever, an artistic work permanently installed in an open place as provided for in paragraph (2) of the preceding Article and an architectural work:

- (i) reproduction of a sculpture and offering such reproduction to the public by transferring ownership of it;
- (ii) reproduction of an architectural work and offering such reproduction to the public by transferring ownership of it;
- (iii) reproduction of a work for the purpose of permanent installation in an open place as provided for in paragraph (2) of the preceding Article;
- (iv) reproduction of an artistic work exclusively for the purpose of selling its reproductions and the sale of such reproductions.

works and constructions permanently installed outdoors would not constitute an infringement of copyrights (Article 46 of Copyright Law).

(v) Abuse of rights

Even where the copyright holder is not considered as having given express consent to the display of such artistic work, it would be held as an abuse of rights (Article 1, Paragraph 3 of the Civil Law) for the copyright holder to file an injunction claim on the ground that his/her copyrighted work appearing in the photograph or movie constitutes an infringement of copyrights.<sup>74</sup>

## 2. Example 2

### (1) Specific Analysis

(i) Where no problem arises in connection with the public transmission

So long as a copyrighted work appearing in a photograph or movie personally taken or shot is not clearly reproduced to the extent that the creative essence of such work can be, in light of the normal attention of general public, directly perceived, the act of uploading such photograph onto a website does not pose any problems involving public transmission.

(ii) Reproduction for Personal Use

As explained above, the provision on the limitation of copyright in the case of reproductions for personal use is not applicable to the public transmission rights. Therefore, the act of an individual uploading a photograph or movie on his/her personal website does not pose any problems involving the reproduction for personal use.

(iii) Copyrighted artistic works disclosed to public

The explanation provided in 1. (2) (iii) above also applies. More specifically, the act of photographing the original copyrighted artistic works permanently installed outdoor does not constitute an infringement of reproduction rights, except where the sole purpose for such photographing is marketing (Article 46 of the Copyright Law).

(iv) Implicit consent of the copyright holder

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<sup>74</sup> Tokyo District Court judgment dated February 23, 1996 (*Han ta* 905-222) ruled that the exercise of the author's moral rights constitutes an abuse of right.

Where a photograph or movie is uploaded onto a website, the copyright holder may be, as with the case of reproductions, considered as having given an implicit consent.

However, it would be under limited circumstances where the copyright holder should be considered as having given consent not only to the shooting as part of a photograph or movie but also to the public transmission of the copyrighted work.

(v) Abuse of rights

As with the case of 1. (2) (v) above the doctrine of abuse of rights will be applicable.

Those who intend to transmit a photograph or movie to the public have the opportunity to delete or make unidentifiable the copyrighted work appearing therein by processing the photograph or image when they upload such photograph or movie onto a website. Therefore, compared to the case referred to in 1. (2) (v) above, the injunction claim referred to therein is less likely to be held as an abuse of rights.

**(2) Right to determine the indication of author's name**

The act of uploading the image of a photograph or movie in which a copyrighted work appears onto a website may be an infringement of right to determine the indication of author's name (for the purpose of this paragraph, the "name indication rights", Article 19 of the Copyright Law). It is permissible to omit the name of the author where there is no risk of damage to the interests of the author in his claim to authorship in light of the purpose and the manner of the utilization of the work in so far as such omission is compatible with fair practice (Article 19, Paragraph 3 of the Copyright Law). In regard to the cases referred to in 2. (1) (i) through (iii) above, where the purpose and method of use of copyrighted works would comply with fair practice, the interests of the author would generally not be impaired. Therefore, the infringement of the author's name indication rights would unlikely become an issue.<sup>75</sup>

In regard to 2. (1) (iv), the purpose and method of use could be considered within the scope to which the author has given approval (in other words, permission to use the copyrighted material without indicating the author's name).

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<sup>75</sup> The Tokyo District Court judgment dated July 25, 2001 also disapproved the plaintiff's claim based on its right to determine the indication of author's name.

(10) The use of information on the internet

[Issue]

Is it permitted to print, transmit by e-mail, or make secondhand use of the information on the internet?

(Examples)

1. Is it permitted to print the information on the internet provided by another person, or distribute the printed materials by duplicating them for members inside a company? What if they are distributed as data by internal e-mail instead of printed materials?
2. Is the operator of an internet bulletin board authorized to make secondhand use of the information included on the bulletin board?

[Approach]

**1. Cases where the information on the internet is printed or transmitted to another by e-mail.**

Most of the information on the internet, such as news articles, theses, company advertisements, photographs and images, and other types of information as well as the messages written on an internet bulletin board are copyrighted works. Thus, for using such information by means of duplication etc, the copyright holder's permission is necessary in principle, except where such duplication is for personal use by an individual (Article 30 of the Copyright Law), etc. Although many copyright holders implicitly permit the use of the copyrighted works in a manner normally acceptable for them, the users of such information should be careful not to infringe their copyrights, with discrete consideration of the type and nature of copyrighted works and the purpose and mode of use.

## **2. Cases where the operator of the internet bulletin board makes secondhand use of the information included on the board**

It is difficult to consider that the writer of a message on an internet bulletin board will be deemed to have agreed, whether explicitly or implicitly, to all types of secondhand use by others simply because he/she wrote the message on the internet.

On the other hand, it is generally highly probable that the writer of a message will be deemed to have agreed to the secondhand use of information written on a board where ‘Terms of Use’ concerning the secondhand use is stipulated by the business entity providing the internet bulletin service in a manner easily recognizable for message writers (especially where some measure is taken to confirm that the message writers are aware of the ‘Terms of Use’)<sup>31</sup>.

[Explanation]

### **1. Printing the information on the internet**

#### **(1) Is the information on the internet a copyrighted work, in other words, within the scope of legal protection by the Copyright Law?**

In principle, where a work “expresses certain thoughts or human emotion in a creative manner”, as defined in Article 2, Paragraph 1, Item 1 of the Copyright Law), even news articles, theses, advertisements, photographs and images fall within the definition of copyrighted works. ‘Creative’ here simply requires the revelation of personal character. Even if such information is not new, it can be deemed as creative. Therefore, as most of the information on the internet satisfies this requirement and will be regarded as copyrighted works, the use of such information by means of duplication or transmission to the public requires, in principle, the permission of the Copyright holder to use the information in such a way.

Printing information from the internet, regardless of the number of copies, even if a single copy is made for a circulating notice, shall fall into the definition of ‘duplication’, because the act of printing is deemed as “reproduction in a tangible manner” (Article 2, Paragraph 1, Item 15 of the Copyright Law).

The act of transmitting the information by e-mail to the members of a company by connecting the offices in Tokyo and those in Osaka with a special line or by establishing a VPN through

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<sup>31</sup> The copyright holder’s moral rights and the tort liability under the Civil Code should also be taken into consideration ultimately.

the internet, or of displaying it on the INTRANET subject to common use both at the principal and branch offices, may fall within the definition of ‘public transmission’ (the Copyright Law Article 2, Paragraph 1, Item 7-2), as it may normally be received and perceived by a large number of people. We should pay special attention to these modes of use, because they can be regarded as acts of duplication or public transmission under the Copyright Law.

Note that the use of very short articles and messages (commonly called ‘*tanshin*’) in a news report simply stating facts such as personnel changes and obituaries, that would be expressed in the same way whoever writes them, does not infringe any copyright, since they are not regarded as copyrighted works (Article 10, Paragraph 2 of the Copyright Law). Further, the use of administrative agencies’ notifications, instructions and circular notes, and courts’ judgments, although they are copyrighted works, does not infringe any copyright either, as they are excluded from the protected categories under the Copyright Law (Article 13 of the Copyright Law).

**(2) The mode of use, and permission (including implicit permission) to use, the information**

The act of using copyrighted works will not infringe copyright, as long as such use is permitted by the copyright holder. The copyright holder may be, depending on the contents and the mode of use of their copyrighted works, deemed as implicitly permitting such use of copyrighted works.

It should be determined on a case-by-case basis under what circumstances the copyright holder is deemed as implicitly permitting such use, taking comprehensively into consideration the type and nature of the work, the purpose and manner of the provision of the information on the internet on the copyright holder’s side, and of the act of transmission and duplication on the user’s side, and what mode of use would be expected by the copyright holder, and the like.

Where the copyright holder displays information on a website accessed by anyone free of charge, he/she logically permits all that have access to the site to view the information. So, the copyright holder will be normally deemed as having implicitly permitted the act of duplication by printing such information on the website in order to read it on paper, not on the screen, unless this is exceptionally prohibited by the copyright holder.

In addition, the act of using a printed advertisement on the internet etc, for a circulating notice, or of making several copies of the advertisement for distribution to members of relevant



company sections for consideration of the purchase of certain equipment used in the company, will also be deemed as falling within the scope of the copyright holder's implicit permission, as such mode of use is normally expected and predictable. For the same reason, the act of transmitting the contents of such advertisement on the internet by e-mail to relevant company sections for the same purpose will be generally permitted as well.

The copyright holder of news articles and theses, displayed on websites accessed by anyone free of charge, will be normally deemed as having permitted any users to print them in order to read them on paper, so the act of duplication by printing them for reading on paper, instead of on the screen, will be normally considered implicitly permitted by the copyright holder, unless exceptionally prohibited by them.

On the other hand, it will be outside the scope of the copyright holder's expectation and thus not implicitly permitted to sell the printed news articles or thesis after duplication to a third party, or to distribute them outside the company as materials for reference for business purposes, even where they are accessed free of charge on the internet.

The distribution of multiple printed copies of information on a website that charges users to view it, or is accessible only for membership holders, to colleagues on paper or by e-mail after duplicating such information, is, generally speaking, contractually prohibited by the 'Terms of Use'. Such provision of such information free of charge is normally outside the scope of the copyright holder's expectations, and thus not considered as implicitly permitted, even where such duplication is not expressly prohibited by contractual clauses.

### **(3) Other Problems**

As mentioned in (2), where technical measures are taken to limit or prohibit printing of a certain website, the copyright holder is deemed as expressly presenting his/her will to prohibit any duplication of the information on the website by a third party, even if the copyright holder seems to permit such a way of duplication implicitly judging from the manner the information is provided and the manner that the user makes use of it. Thus, in these cases, printing such information is basically not permitted.

Printing is not permitted also in cases where the website clearly indicates that any duplication of the information on this site is prohibited, since the copyright holder's will is quite clear.

## **2. Secondhand use of messages written on an internet bulletin board**

### **(1) Are the messages on an internet bulletin board copyrighted works? (Whether or not they are protected by Copyright Law)**

Whether certain information is copyrighted work, including a message on an internet bulletin board, shall be determined in the same way as ordinary copyrighted works. Some argue that for a message on an internet bulletin board to be considered 'creative', it must be more highly original compared with other ordinary types of messages. However, such a narrow interpretation seems too restrictive. Rather, a simple revelation of the writer's personal character is enough. Note as well that it is not sufficient to argue that the messages on an internet bulletin board are outside the scope of copyright because they are commonly transmitted on a no-name basis<sup>32</sup>.

Therefore, the act of quoting such messages from an internet bulletin board in a newspaper, magazine or other publication, or of selling and distributing such information after recording them on electromagnetic media such as a CD or DVD, or of creating a movie based on such messages (hereinafter, collectively referred to as "the act of using copyrighted works") basically infringes copyrights.

Nevertheless, the writers of messages on an internet message board accessed by the public are by their nature deemed as implicitly permitting the operator of such board to transmit the contents to the public through the internet, especially if the transmission falls under the situation aforementioned in 1.

On the other hand, in regards to other ways of using messages on internet bulletin boards, it is difficult to argue that the writers of such messages are deemed to have agreed to any secondhand use whether explicitly or implicitly, or waived his/her copyrights simply because he/she wrote such messages on an internet bulletin board.

Note as well that where the messages are not regarded as a copyrighted work, "the act of using copyrighted works" will never infringe any copyright of the users of the board.

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<sup>32</sup> For details, see 'Hotel Jankeys Case' ( Judgment of the Tokyo High Court dated 29 October, 2002)

**(2) Where the internet bulletin board indicates the terms concerning the secondhand use of messages**

What if the operator etc, of the bulletin board provides the terms concerning the secondhand use of messages (hereinafter, “Terms of Secondhand Use”) on the website?

The same principle as aforementioned in PART 1.1. (2) “Effectiveness of the Terms of Use” seems to apply, but some special consideration is necessary.

With regards to auctioning or brokering, or information services on the internet, normal users at least understand consciously that they enter into a transaction whereby they must pay some consideration to obtain certain commodities or items of information.

Furthermore, when it comes to an auctioning or brokering service on the website, it is difficult as a practical matter to display all the terms in detail in a conspicuous way, since the contents of such terms include various conditions for transactions that will be inevitably long and complex. In contrast to this, the “Terms of Secondhand Use” alone require a much smaller amount of necessary information, and thus can be displayed in a conspicuous way.

**(3) Analysis in detail**

Just as we should be careful not to infringe another’s copyright whenever we simply use copyrighted works, special attention should also be paid to the infringement of moral rights, when the copyrighted work is to be used after modification. This means it is important to obtain permission of the copyright holder to modify copyrighted works, as well as to use them. The clauses concerning permission to use them in the “Terms of Secondhand Use” should be stipulated so that each mode of use such as the publication of or the creation of a movie from the copyrighted works is expressly defined to the maximum extent possible<sup>33</sup>.

Therefore, the user and the operator are deemed to have agreed to the mode of use where the browser is so configured so that the user must, prior to writing his/her messages on the board, present his/her will to agree to the terms of use by clicking on a confirmation screen saying “The operator of this bulletin board holds the right to publish the messages on this board without notification after their modification whenever needed (whether or not to disclose the

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<sup>33</sup> In the case of the assignment of copyright, simply ‘assigning the entire copyright’ allegedly means that the rights stipulated in Article 27 (the right for translation, adaptation) and Article 28 (The original copyright holder’s right for the use of secondhand copyrighted works) of the Copyright Law remain retained by the assigner. Therefore, in order to assign the entire copyright including them, the terms must provide as such expressly.

names of the writers as well as the text of the message is subject to the judgment of the operator). The writers on this board shall entitle the operator to use the messages for publication and discharge the operator from any liability for infringement of copyright and moral rights.”

It is still contentious whether a special agreement for the copyright holder not to exercise any moral rights is effective or not. Even where the user is deemed as having agreed to such Terms of Secondhand Use, the use of messages in a manner normally not permitted by users, in such in a manner that is detrimental to the copyright holder’s reputation and honor, would be outside the scope of the agreement between the operator and the user.

In addition to this, the information necessary for users to determine whether they agree to the Terms of Secondhand Use or not should be, as mentioned in 2 (1) above, indicated at a location easily recognizable for them<sup>34</sup>.

In contrast to this, where the internet bulletin board has a Terms of Secondhand Use not easily recognizable for users, no agreement is deemed to have been executed in the absence of an intention of the user to be bound by such terms.

More specifically,

(A) The contents of the Terms of Secondhand Use are quite clear and measures are taken to confirm it.

#### Example of Confirmation Measures

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<sup>34</sup> It is normally difficult to argue that the copyright holder has agreed also to ‘the acts infringing moral rights of the copyright holder’ as defined in Article 113, Paragraph 6 of the Copyright Law.

Bulletin Board for [\*\*\*]  
 [Terms of Secondhand Use]  
 The operator of this bulletin board holds the right to publish the messages on this board without notification after their modification when needed (whether or not to disclose the name of writers is subject to the operator's judgment). The user of this board agrees to waive his/her copyright and moral rights in case of publication of the messages written here on this board by the operator etc, of the board.

**AGREE AND WRITE**

Date Message.....  
 Date Message.....  
 Date Message.....

→→→→→→→→  
 Click **AGREE**

<Message Board>

In this case (see the Example above), generally an agreement is considered to be valid. The purpose for which the messages on the bulletin board are used must be expressly stated in the Terms of Secondhand Use to enable potential users to determine whether they agree to Terms of Secondhand Use or not.

(B) Where the contents of the Terms of Secondhand Use are quite clear and easily recognizable

[Example 1]

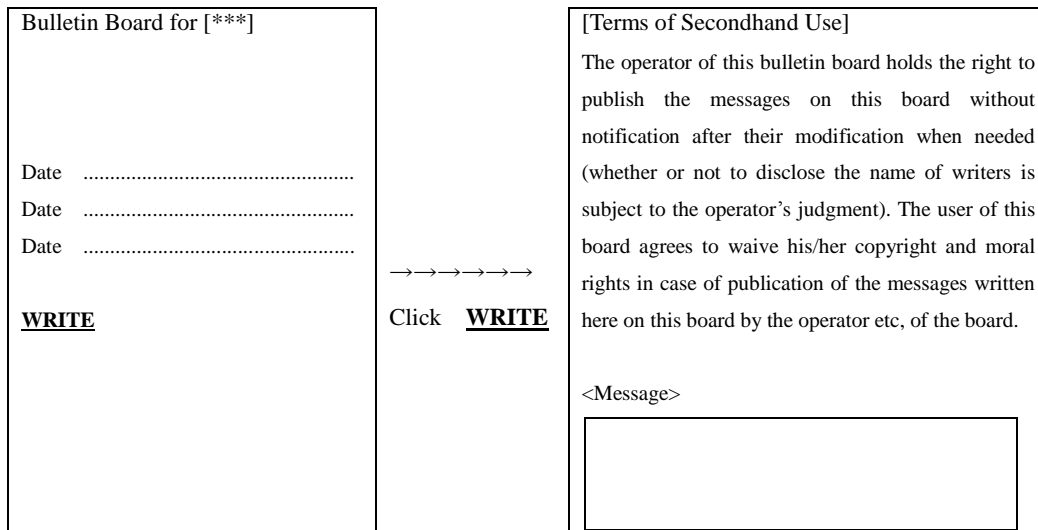
Bulletin Board for [\*\*\*]  
 [Terms of Secondhand Use]  
 The operator of this bulletin board holds the right to publish the messages on this board without notification after their modification when needed (whether or not to disclose the name of writers is subject to the operator's judgment). The user of this board agrees to waive his/her copyright and moral rights in case of publication of the messages written here on this board by the operator etc, of the board.

**AGREE AND WRITE**

Date .....  
 Date .....  
 Date .....

<Message>

[Example 2]



If the Terms of Secondhand Use are indicated at a location easily identifiable on the browser, and include sufficient information necessary for potential users to determine whether they agree or not, such as providing the purpose for which the messages will be used (see the two examples above), the act of writing messages on the board by such users shall be considered acceptance of the offer to use the bulletin board in the manner specified in the Terms of Secondhand Use. In this situation, the agreement is normally deemed as valid.

For such agreement to be most likely to be valid, the information to be disclosed should not be too large in quantity, and the screen should be configured so that the Terms of Secondhand Use appear on the website page itself (rather than only being accessible by clicking on a link to another page), and those terms should never fail to appear whenever the webpage is accessed.

(C) Where the contents of Terms of Secondhand Use are not clear

The agreement shall not be considered valid.

(D) Where the contents of Terms of Secondhand Use are quite clear, but not easily identifiable.

It is likely that the agreement shall be considered invalid.

Cases where the Terms of Secondhand Use are not easily identifiable for the users

- The users reach the Terms of Secondhand Use only after moving from one website to another repeatedly with the aid of a 'link'
- The location of the Terms of Secondhand Use is at the edge of the browser.

Where the user agreed to the Terms of Secondhand Use by mistake without gross negligence (for example due to miscomprehension of the Terms of Secondhand Use), even if an agreement has been concluded, such a writer of messages on the bulletin board is entitled to claim that such agreement is void.

## (11) Thumbnail Image and Copyrights

[Issue]

In regard to the thumbnail image used for a link button or an image retriever, if a person displays copyrighted images in thumbnails, will he/she be liable for infringement of copyrights in some cases?

[Approach]

Where a person displays thumbnail images where the graphic mode and the size of an image is reduced to such an extent that the characteristic features of the original image can no longer be directly perceived, he/she may not be liable for any infringement of copyrights. However, in the case that the characteristic features of the original image can be perceived when viewing its thumbnail image, he/she may be liable for infringement of copyrights.

[Explanations]

### 1. Copyright

#### (1) Problem Identification

The literal meaning of the word *thumbnail* means "the nail of the thumb." The term was originally used to describe a reduced-size sample of a page to convey the overall image of a completed printed material. The term thumbnail has since been used in computer terminology to describe an image of which size and graphic mode is reduced so that a number of images appear like a list on the browser, enabling the user to confirm the contents of a file before opening it in a computer. In particular, since the increase in popularity in internet use, a thumbnail image of reduced size and graphic quality often appear first, and the image of the original file size appears when they are clicked, as opening an image with heavy data is time-consuming.

The thumbnailed images of other websites (as distinguished from banners or text) are used as link buttons, which, when clicked provides a link to the website. This type of thumbnail image is called a thumbnail link.

While the thumbnail image is widely used on the internet such as where the thumbnail images are shown for image retrieving (where the thumbnail image is in itself preserved in the cache of the search engine), or where the image data of the website which utilizes a domain is



shown in a form of a thumbnail image in whois database<sup>76</sup> for domain names, disputes involving the use of thumbnail images<sup>77</sup> do in fact arise.

## **(2) Detailed analysis**

We will analyze cases where a copyrighted work is shown in the form of a thumbnail image, and the copyrighted work appears when the thumbnail image is clicked.

It is necessary to note that the features of a thumbnail consist of (i) a reduced graphic mode and size, and that this is (ii) quite often used to achieve greater accessibility to the original file image by means of a link connecting the thumbnail image to the original file image.

More specifically, the method of creating a thumbnail image consists of the following: Firstly, (i) the copyrighted work that is intended to be thumbnailed is downloaded in one's own computer, (ii) a reduced image data (thumbnail image) of this copyrighted work is created, (iii) the thumbnail image is uploaded onto the server to which the link originates<sup>78</sup>, (iv) and a link is put from the thumbnail as a link button to the image appearing in the linked web page. The second method would be to reduce the size of the image by putting a link to the image on another web page.

In this section, we will discuss the acts of (i) through (iii) comprising of the issues concerning the thumbnail image itself.

- (i) The act of downloading the copyrighted material intended to be thumbnailed onto ones own computer

The act of downloading a copyrighted work from the internet onto a privately-owned computer falls under the duplication (Article 2, Paragraph 1, Item 15 of the Copyright Law). We may reasonably consider this as referred to as "The use of information on the internet".<sup>79</sup>

- (ii) The act of creating a thumbnail image by reducing and displaying another person's copyrighted work

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<sup>77</sup> See the following court precedents in U.S. Kelly v. Arriba Soft Corp 336 F. 3d 811 (9th Cir.2003), and Perfect 10 v. Google, Inc. 416 F. Supp.2d 828 (C.D. Cal. 2006)

<sup>78</sup> There are cases where by means of an application available on the server, the thumbnailed image is created after the original image is uploaded. We will not specifically discuss these cases as a similar approach would be used.

<sup>79</sup> However, according to the interlocutory judgment of the File Rogue Case (Judgment of January 29, 2003 of the Tokyo District Court), where the initial purpose of duplication through was the public transmission of a copyrighted work, this duplication will constitute an infringement of the diplication rights (the judgment of appeal, Judgment of March 31, 2005 of Tokyo High Court, still supports this view).

a) Duplication rights

When a thumbnail image is created, the graphic mode and the size of the original image data are reduced and a new image is created. We shall discuss whether this act falls under the "duplication" under the Copyright Law.<sup>80</sup>

Meanwhile, a copyrighted work is considered to have been duplicated only when the characteristic features of the original copyrighted work can be directly perceived from the duplicated work.<sup>81</sup>

In this regard, as stated above, a thumbnail image is an image created by reducing the graphic mode and size of the original image. As a result, the characteristic features of the original copyrighted work may not be directly perceived from the thumbnailed image.<sup>82</sup> For example, where the delicate color tone is an essential part of an image, if the reduction of graphic code impairs and simplifies the color tone, then such thumbnail image would not be considered as a duplicated work<sup>83</sup>.

On the other hand, if it is still possible to directly perceive the characteristic features of the original copyrighted work from the duplicated work despite the reduction of its graphic mode and size, then the creation of its thumbnail image will constitute an infringement of duplication rights.

b) Right of Integrity

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<sup>80</sup> Thumbnails may be compared to an "adaptation," where creativity is considered as an essential element because it is an act of creating a secondary copyrighted work. Alternatively, the act of creating a thumbnail image which simply involves mechanically reduced graphic mode and size are not likely regarded as involving such creativity. However, some argue that "It is meaningless, in discussing the elements that constitute the infringement of copyrights, to make a distinction between a duplication and a secondary copyrighted work" ("Overview on Copyright Law 2nd Edition" by Yoshiyuki Tamura, p.47). In fact, many court precedents discuss comprehensively "whether the right of duplication or of adaptation is infringed" without analyzing whether a secondary copyrighted work is creative or not. There would be little necessity to discuss whether the infringement constitutes a duplication or to an adaptation. Therefore, here our analysis shall be made on the assumption that the infringement constitutes the duplication.

<sup>81</sup> The Supreme Court Judgment of September 7, 1978 for the Case of One Rainy Night in Tokyo states, "The duplication of a copyrighted material means the act of reproducing a work based on its original, from which the contents and styles of the original work can be perceived."

<sup>82</sup> In this regard, there is a court precedent where, the court ruled that a small image of a calligraphy work appearing in a photo shall not constitute an infringement of duplication rights, or adaptation rights or the right of integrity (Tokyo High Court Judgment of February 18, 2002 for the Case of Setsugetsuka). For details, see the section "Disclosure of Photo or Image in which General Public Appears" herein.

<sup>83</sup> See p.209 of "Annotation to the Copyright Law 5th Edition" by Moriyuki Kado.

With regard to the right of integrity, whether a copyrighted work was altered "against the will" of the right holder is important (Article 20 of the Copyright Law).

As discussed in a) above, if the characteristic features of the original copyrighted work cannot be directly perceived from the thumbnail image, the creation of the thumbnail image will not be considered as an act of utilizing, therefore, there will not be any infringement of the right of integrity.

On the other hand, where the characteristic features of the original copyrighted work could be directly perceived from the thumbnail image, if the graphic mode and size of the original image are reduced against the will of the copyright holder, then the creation of such thumbnail image will constitute an infringement of the right of integrity.

(iii) The act of uploading the thumbnail image on the server

As discussed in (ii) above, if the characteristic features of the original copyrighted work cannot be perceived directly from the thumbnail image, then the act of creating the thumbnail image is not an act of utilizing the original copyrighted work. On this basis the act of uploading the thumbnail image onto the server would pose no problems under the Copyright Law.

On the other hand, where the characteristic features of the original copyrighted work can be directly perceived from the thumbnail image, then the act of recording the thumbnail image in the server that is connected to the internet would fall under an act of "making transmittable" (Article 2, Paragraph 1, Item 9-5 of the same law)<sup>84</sup>. Furthermore, the act of sending the thumbnail image automatically to the users who accessed the server falls under an act of "automatic transmission to the public" (see the same paragraph, Item 9-4).

**(2) Detailed analysis**

As mentioned above, the act of creating a thumbnail image of another person's copyrighted work and utilizing this on the internet would pose no problems under the Copyright Law. By contrast, if the characteristic features of the original copyrighted work could not be perceived directly from it, but this would pose certain problems under the Copyright Law.

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<sup>84</sup> The act of accumulating thumbnail images on the server will generally be considered as a duplication.

On this basis, we will discuss whether there are cases where the creation of thumbnail images from which the characteristic features of the original copyrighted work can be perceived will not be regarded as an infringement of copyrights or their moral rights (infringement of the right of integrity).

(i) The act of uploading the thumbnail image onto the server

As referred to in the "The use of information on the internet", if the right holder publicly discloses a certain image on the internet, he/she will be considered to have allowed all the people that access the site to see the image freely, because he/she posted the information accessible to anyone free of charge.

When it comes to the act of creating a thumbnail image from such image and utilizing it, the copyright holder may, depending on the case, be considered as having given implicit consent for the image's use. However, it will depend on how the image will be used to what extent the copyright holder will be considered to have permitted usage of the image for purposes beyond simple viewing.

(ii) The use of photos of products by an affiliate

In regard to an affiliate, where a thumbnail image of a photo of a product is used for a link button from which a link is put to the web page of an on-line shop, the on-line shop is considered to have disclosed the photo of the product in order for the affiliate to utilize it. Therefore, the on-line shop will be regarded as given prior consent to the creation of the thumbnail image.

However, it is unlikely that the on-line shop should be regarded as having given consent if the thumbnail image of the product is accompanied by critical comments on the product. Once the right holder disclosed his/her copyrighted work on the internet with the intention of allowing its use, the right holder may reasonably expect some critical comments. On this basis, such critical comments will be considered as being within the scope of the right holder's permission.

Furthermore, even where the thumbnailed image of a product is used by those who have no contractual relation such as affiliate with the right holder, such critical comments on the product may be approved as an act of "reference" (Article 32, Paragraph 1 of the Copyright Law).

(12) Legal matters involved in setting up a link to another person's website

[Issue]

Will the act of setting up a link to another person's website without the permission of the operator of the site result in legal liability?

[Examples]

1. Where the operator of an adult-only website that contain obscene images sets up a link at the top of the website for shops managed by women or of certain individuals without their permission.
2. Where an organized anti-social group sets up a link on the websites of other reputable companies without their permission and falsely represents that they are affiliated with them.
3. Where a person sets up a link to the website of a famous company without its permission with the intention to gain profits by misleading people into believing that the individual's personal website belongs to is part of that company's affiliates (for example, by using misleading words such as "Click here for information on related companies"); or where the individual set up the link on unrelated companies and misrepresenting itself as their affiliate or agent; or where the unrelated individual set up a similar link by misrepresenting itself as a person affiliated with such famous company.
4. Where a person sets up an 'Image Link' on the logo mark of an enterprise to his/her own website using the method of 'Inline Link' and thus takes advantage of the sales and services derived from the customers of the enterprise by misrepresenting that his/her website belonged to or is affiliated with the enterprise.

[Approach]

It is allowed, in principle, for any third party to use the data disclosed to the public on the internet free of charge (in other words, where access to such data is not limited to specified members), unless such use constitutes an infringement of copyright or other rights. However, such third party may bear tort liability under special circumstances such as that the use of information in the linked website aims at making illegal personal profits or at causing damage to the operator of the linked website.

[Explanation]

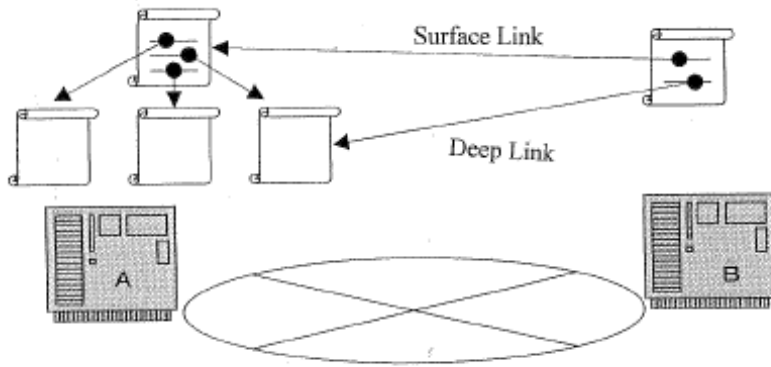
## **1. Basic structure of display on the website**

First, we examine the meaning of browsing a website through WWW. Generally, each website consists of plural files, including images (such as GIF files and JPG files). These files are shown on the browser of each terminal according to the layout defined in an HTML file. When a user accesses and browses a website page, the files that compose the website are transmitted to the user's terminal through the internet. On the other hand, the HTML file is read out in the user's terminal, and the files that compose the website are extracted one after another according to the commands in the HTML file. The contents included in each file are shown in the size and location as prescribed on the browser. Every page on the website composed of the plural files is reproduced on the browser of each terminal through this process.

Based on the above description, we now examine the meaning of "setting up a link." When a user surfs the web from one site to another with the aid of a link, only the URL of the linked page is described in the HTML file composing the website from which the user clicked on the link (hereinafter, 'linking page' or 'linking website'); the contents of the linked page, such as images, are not transmitted or reproduced. The HTML file in which the URL of the linked page is written is transmitted from the linking page, and certain files in the linked page is transmitted to the user's terminal, so that such file is read out and reproduced on it. There are two systems for displaying the linked page; one of them requires the user to click a link button; the other enables the contents of the linked page to be automatically displayed together with those of the linking page. These two systems may have different legal significance. Therefore, to examine this issue comprehensively, it is necessary to analyze the legal significance of the concepts of 'transmission' and 'reproduction' of the contents of the linked page.

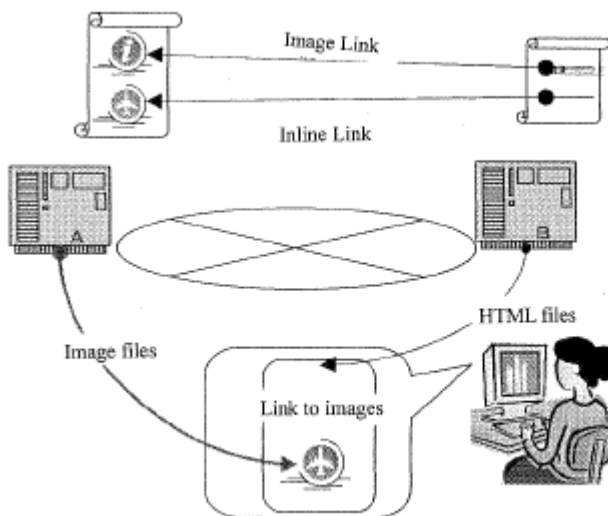
## **2. Methods of setting up a link**

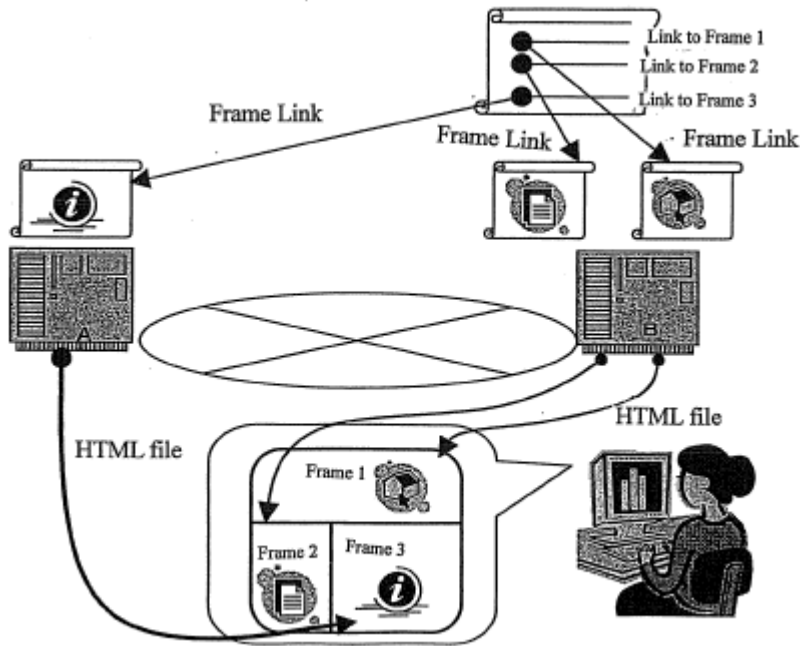
There are various methods of setting up a link. The terms used in this section will be defined as follows.



“Surface Link” means the link set up by an ordinary method to the home page of another website. For the purpose of this document, the link set up by an “ordinary method” means the type of a linked page where, by clicking the URL displayed on the linking page, the user’s connection to the linking page will be cut at the moment such user is connected to the linked page.

“Deep Link” means the link set up by an ordinary method to a website that is not found on the home page of the linking page but on another page within the website.





“Image Link” means the link set up only to a specific image in the linked page.

“Inline Link” means the link where, every time the linking page is opened, the descriptions or the files composing the linked page are automatically transmitted to the user’s terminal, followed by subsequent and automatic appearance of the linked page on the user’s terminal.

“Frame Link” means, where the browser of the linking page is divided into several frames, the link set up from each frame on the browser to another website.

### 3. Legal liabilities arising from setting up a link to another website

#### (1) Tort liability

Where a link set up to another person’s website causes damage to the operator of the linked page, such as to the persons honor, reputation, so-called "name rights" ("*shimei ken*" in Japanese)<sup>28</sup> in the case of false remarks by misrepresenting another person's name without

<sup>28</sup> In one of the precedents a person's right to have his/her name pronounced correctly was disputed in the context of "name rights". The Supreme Court ruled that "a person's name shall be viewed as forming part of his/her moral rights because it not only distinguishes an individual from other persons in our society but also symbolizes his/her identity and personality; and therefore serves as basis for being respected as an individual.". Thus "a person's interest to having his/her name called exactly shall be protected under the tort law." (Supreme Court, February 16, 1988, petty bench III, NHK Japanese Name Case, p.27 of *Minshu* vol. 42-2). In another case the Supreme Court further ruled, with reference to the preceding case, that a person is entitled to seek an injunction against infringement of his/her "name rights": "A person has the right not to have his/her name used by another person against his/her will. Therefore, a person whose name was unjustifiably used by another person is entitled to seek compensation for damages and/or



his/her authorization etc, due to misidentification of the relationship between the linked page and the linking page, the person may bear tort liability under the Civil Code (in addition to criminal liability for libel or defamation under the Criminal Code (Law No. 45 of 1907, "*keihou*" in Japanese)). This matter itself is not peculiar to setting up a link itself. Rather, it is simply a sort of illegal act committed by means of a link on the website. Therefore, whether or not a person who sets up a link bears liability should be judged according to the general interpretation of relevant laws.

Any third party is, in principle, allowed to use the data disclosed to the public on the internet free of charge (in other words, where the access to such data is not limited to specified members), unless such use constitutes an infringement of copyright or other rights. However, such third party may bear tort liability under special circumstances such as where the use of information in the linked website aims at making illegal personal profits or at causing damage to the linked website<sup>29</sup>.

## (2) Unfair Competition Prevention Act

We now discuss whether setting up a link to another website may cause problems relating to unfair competition under the Unfair Competition Prevention Act<sup>30</sup>.

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to claim injunctions to eliminate actual infringements and prevent potential infringements." (Supreme Court, January 20, 2006, petty bench II, Tenri-kyo Case, p.137 of *Minshu* vol. 60-1)

<sup>29</sup> A person (the "Defendant") repeatedly created links to some newspaper articles containing major commercial headlines without the permission of the newspaper company. Then, he posted illegal copies of such newspaper articles and an index thereto on his website. Furthermore, the Defendant not only converted them for personal use but also distributed the newspaper articles indexed via a link to 20,000 registered users of his website so that they can access it on the website. In a suit seeking compensation for damages against the Defendant, the court admitted the claim on the ground that the Defendant illegally competed with the newspaper company in a socially unacceptable manner (*Yomiuri on-line case*, judgment of High Court (Intellectual Properties Division), October 6, 2005). The test utilized for determination of torts derived from the judgment of the first instance of this case rendered by Tokyo District Court on March 24, 2004 will serve as a good reference. However, under what specific circumstances such act is considered as a tort needs further discussion and is open to court's determination in the future.

<sup>30</sup> It is an "unfair competition" to conduct commercial activities by using a "product identification" (i.e. using a name connected with a person's business, trade name, trademark, mark, container or package of goods, or any other indication used for specifying goods or business) well-known to customers which is identical with, or similar to, that of another person's, and thereby misleading customers to misunderstand that such commercial activities are conducted by or somewhat connected such another person's activities (Article 2 Paragraph 1 Item 1 of the Unfair Competition Prevention Act). In addition, where the trademark etc. of another person is famous, it constitutes an unfair competition if a person utilizes such another person's name as if it were his/her own product identification, even if the customers are not misled (Article 2 Paragraph 1 Item 2

If an ordinary method of setting up a link such as a ‘Surface Link’ or ‘Deep Link’ is employed, such act is very unlikely to fall within the definition of unfair competition. It should also be taken into consideration here whether such link is regarded as the use of another person’s product identification (*shohin-tou-hyoji*), or as using it for representing his/her own product identification. In this regard, the information in the linked website is displayed only when the user operates the computer.

In contrast to this, where the method of ‘Inline Link’ or “Frame Link” is employed to set up a link, such link may fall within the definition of unfair competition, if the product identification of the operator of the linked page is configured so that users are misled into confusing the linking page with the linked page, or if a well-known product identification is used as if it were the product identification of the operator of the linking page.

In addition, the disclosure of false information via a link to an unauthorized website, which is detrimental to a competitor's business, may also constitute an unfair competition<sup>31</sup>.

### **(3) Trademark Law**

In regard to the Trademark Law, the act of setting up a link by an ordinary method such as ‘Surface Link’ or ‘Deep Link’ itself is not regarded as an act of using another company’s trademark for indicating the source of information, even if such trademark appears in the linked website. So, such act is in principle unlikely to be considered as an infringement of trademark right. However, even where such an ordinary method is employed, for example, if the linked company’s trademark is used for the link button without permission of the trademark right holder, the fact of using the trademark, not the act of setting up the link itself, may be regarded as an infringement of the trademark right, depending on the mode of use.

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of the same). Further, the dissemination of false information detrimental to the reputation of another person's business may also constitute an unfair competition (Article 2 Paragraph 1 Item 14 of the same).

<sup>31</sup> In a case where the Plaintiffs (the Company (party P1) and its director (party P2)) filed a claim for compensation of damages etc. against the defendant (a Chinese company (party D1) and its agent in Japan (party D2)) on the ground that the D1, which was P1's competitor, indicated on D1's Japanese website as if P1 were an Japanese agent of the D1 and a link was set from D1's website to P1's website. Plaintiff alleged that the aforementioned acts committed by D1 and D2 disparaged P1's reputation and therefore constitute a joint tort. Further, such acts also amounts to unfair competition against P1 as defined in Article 2 Paragraph 1 Item 14 of the Unfair Competition Prevention Act (the "UCPA"). The court partially accepted the Plaintiffs' claim on the ground that D2 had at least provided data and materials for creating D1's website and D2 was also involved not only in creating such website but also in misrepresenting P1 in D1's website, thereby disseminating false information detrimental to the P1's reputation as referred to in Article 2 Paragraph 1 Item 14 of the ULPA. It was held that D1 and D2 are jointly liable to P2 for libel, defamation and infringement of name rights (Osaka District Court, July 26, 2007).

By contrast, where an 'Inline Link' or 'Frame Link' is employed, setting up a linked website may be regarded as the "use" under the Trademark Law, especially if it appears to the website users that the linking website is the origin of another person's trademark appearing in the linked website<sup>32</sup>. Note that, if such trademark is a trademark of the "designated products" ("*shitei shouhin*" in Japanese) or "designated services" ("*shitei ekimu*" in Japanese), setting up a link to a website indicating such trademark may constitute an infringement of trademark.

#### (4) Copyrights Law

We will herein discuss legal issues under the Copyrights Law arising from a link set up to another person's website, where the contents of such website is by nature a copyrighted product.

The user of a website gains access to the linked website by clicking the relevant URL specified in the linking website. In this regard, the data contained in the linked website will be transmitted to the user's computer, while no data will be transmitted to or accumulated in the linking website. Since the act of setting up a link does not lead to public transmission or reproduction, there will not be an infringement of reproduction rights or public transmission rights<sup>33</sup>. Therefore, we may reasonably conclude that the act of setting up a link in itself, whether it is in the form of 'Surface Link', 'Deep Link', 'Image Link', 'Frame Link' or 'Inline Link', does not result in the infringement of copyrights.

However, given the complexity of links to another website, the operator of a website may find certain types of link undesirable, considering its appearance to the users of the linked website. For example, where the link is so configured that a viewer of the linked website and/or copyrighted contents therein may mistake them for the linking website and/or copyrighted contents therein, such link may constitute an infringement of copyright holder's moral rights under the Copyright Law<sup>34</sup>. Further, if a certain link is set up from another website in a

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<sup>32</sup> For example, a link is set up in such manner that the trademark appearing in the linked website, which specifies the origin of another person's products and services etc., will be mistaken for the trademark of the products and services provided by the operator of the linking website. In this case, considering that the purpose of the Trademark Law is to prevent misrepresentation as to the origin of products and services, setting up such a link may reasonably fall under the scope of "use" (Article 2, Paragraph 3, Items 7 and 8 of the Trademark Law, "*shiyou*" in Japanese).

<sup>33</sup> See p.216 of the "Copyright Law" ("*chosakuken hou*" in Japanese) written by Nobuhiro Nakayama

<sup>34</sup> Some learned academics argue that such a web link is a matter of copyright holder's *moral rights* (p.216 of the "Copyright Law ("*Chosaku-ken-hou*" in Japanese)" written by Nobuhiro Nakayama, p.160 of "Legal Affairs Concerning the Website ("*internet no houritsu jithimu (shin-ban)*" in Japanese)" written by Hisamichi Okamura and Takeshi Kondo).

manner detrimental to the copyright holder's reputation, such link may fall under the infringement of moral rights (Article 113 Paragraph 6 of the Copyright Law)<sup>35</sup>.

## (5) Summary

Note that the consistent and logical legal definition of 'link' itself remains to be standardized. Now that numerous disputes are arising from unauthorized use of links, careful consideration is advised whenever you set up a link to any website explicitly saying, "Unauthorized Link Strictly Forbidden".

## 4. Analysis of Specific Examples

As for Examples 1 & 2, the use of a link is likely to be considered as an unlawful act, because the links in these cases cause damage to the honor and reputation of the operator of the linked

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In the context of an image link and frame link, some academics refer to the potential infringement of rights in preserving the integrity and of indication of author's name (see p.121- of "Legal Issues on IT (*"IT no houritsu soudan"* in Japanese)" written by TMI Law Office and p.132- of "Daily Legal Issues vol.20 (*"kurashi no houritsu soudan No.20"* in Japanese)"), while some other theories argue that the problem of image link and frame link may consist in the infringement of public transmission rights. (<http://civilpro.law.kansai-u.ac.jp/kurita/copyright/article2.html#T2> written by Takashi Kurita)

In addition, in the case of a frame link where the linked website expressly bars misrepresentation by use of a frame, some theories affirm the existence of an infringement of public transmission rights (See p. 10 of October 1997 issue of "Copyright" commented by Yoshiyuki Miyashita on "Copyrights and Cyberspace (*"cyberspace ni okeru chosaku-ken mondai ni tsuite"* in Japanese))

Other theories argue public transmission rights and copyright holder's moral rights such as rights of preserving the integrity and of indication of author's name separately, depending on the method of setting up a link (see p.243- and p.250 of "Information, Order, Network, Hokkaido University Library III (*"Joho, Chitsujo, Network, Hokkaido Daigaku Library 3"* in Japanese)" by Yoshiyuki Tamura).

Where a person facilitates or assists an infringement of copyrights by setting up a link to a website infringing another person's copyrights, some publications refer to the infringement of copyrights (see p.36- of "Internet Law Version 4 (*"dai-4-ban, internet hou"* in Japanese)" by Haruyasu Uchida and Tsunemichi Yokoyama and p.243- of "Information, Order, Network, Hokkaido University Library III (*"Joho, Chitsujo, Network, Hokkaido Daigaku Library 3"* in Japanese)" by Yoshiyuki Tamura).

At present, there are various views on the infringement of public transmission rights, rights of preserving the integrity and of indication of author's name. In addition, there is no consistent explanation for those extreme cases by the Japanese legal scholars. Therefore, in-depth discussion of specific cases of infringement would remain necessary in the future (Committee on Restriction of Rights Regarding Copyright Law (*"chosaku-ken-hou no kenri seigen kitei wo meguru shomondai kenri seigen iinkai"* in Japanese) and see p.12 and p.42 of "Analysis Conducted by Copyright Research Institute (*"chosaku-ken kenkyu sho kenkyu zousho"* in Japanese))).

<sup>35</sup> See p.216 of the "Copyright Law" (*"chosakuken hou"* in Japanese) written by Nobuhiro Nakayama.

page. Therefore, the operator of the linked website may be entitled to claim compensation for damages based on tort liability in civil procedures. In addition, such use of link may also constitute a criminal offense and chargeable for libel or defamation. Furthermore, if the link is set up in such a manner that the reputation of the author is damaged, such link may be held as an infringement of moral rights (Article 113 Paragraph 6 of the Copyright Law)

As for Example 3, where such misleading descriptions as "Click here for information on related companies" or "The linked enterprise is our affiliated agent" or "This person is our affiliate" and the name of the company operating the linked page will be indicated on the linking page, these descriptions may give rise to tort liability on the ground of infringement of moral rights or name rights or defamation if these misleading descriptions are highly likely to be aimed at making illegal profits or causing damage to the operator of the linked page.

Furthermore, where a link is set up to a competing company, the indication of false information harmful to the reputation of such company's business activities may constitute an unfair competition.

As for Example 4, where an 'Inline link' is set up only to a logo mark, only the product identification of the linked page is indicated on the linking page. Therefore, if the well-known logo mark is used in such a manner that website users tend to be misled into believing that the linking page belongs to an affiliate of the operator of the linked page, or if another person's well-known logo mark is used as if it belonged to his/her enterprise, such use of the logo mark may be regarded as an act of unfair competition.

In addition, where the logo mark is a registered trademark of somebody else, the use of such registered trademark on his/her personal site for identification of its specified products or services may be regarded as an infringement of trademark right, depending on the mode of such use.

### (13) Use of Other Persons' Copyright Works in E-Learning

[Issue]

What legal responsibilities do the schools or service Vendors have in regard to copyrights when providing school lessons and/or staff trainings through remote education by using network or when the remote education service Vendors provide lessons and/or trainings to schools or companies for value?

[Approach]

When using the copyrighted work of a third party in e-learning, permission from the copyright owner must be obtained in principle.

However, the use of any copyrighted work in the course of lessons by schools or other nonprofit-oriented educational institutions which satisfy certain requirement, such copyrighted work may be transmitted to the students located in remote districts for studying purpose by using the Internet or other network, without permission from the copyright owner. In order for such public transmission without permission to be approved, the transmitter needs to confirm that the copyrighted work is already made public, that the image of the actual lessons (main site) is aired live at the same time at a place other than that where such lessons are given (secondary site) for students who take lessons and that the transmission is limited to those taking classes at such educational institutions.

By satisfying certain requirements, the copyrighted work of exam questions for examination using the network may be transmitted publicly without permission from the copyright owner. In order for such public transmission without permission to be approved, the transmitter needs to confirm that the copyrighted work is already made public and that it is disclosed to an extent necessary for the exam, and may become liable to compensate the copyright owner if it is used for profit-oriented purpose.

As described above, the permission of the copyright owner must be obtained, in principle, in order to use the copyrighted work of such third party relating to e-learning, however, such permission is not required under certain circumstances permitted by law. In such case, however, the above requirements prescribed by law need to be satisfied (public transmission of simultaneous reporting of lessons and exam questions are considered mainly for e-learning. Note, however, that it is under limited conditions that the exceptional provisions concerning the public transmissions of educational materials used in the simultaneous reporting of classes and of exam questions are applicable to those who conduct the e-learning business for profit. In other words, any public transmission of educational materials used in the simultaneous reporting of lessons is not permitted if it is used for profit purpose and requires the permission

of the copyright owner as it is in the first place. Also the public transmission of exam questions is legal, however the transmitter is still liable to pay compensation to the copyright owner.<sup>85</sup>

Where a public transmission of educational materials without obtaining the permission is legal

- Materials (copyrighted work of a third party) are distributed in the school class room (main site) and are transmitted to provide such materials to the students who are taking such class through the simultaneous reporting of such class at secondary site located at remote place.

Where a public transmission of educational materials is illegal regardless of whether permission has been obtained

- In a company, the materials (copyrighted work of a third party) which are distributed at staff training sessions are uploaded to the web server for access by the employees of the company who are attending such session through the simultaneous reporting of such session at a remote location (which will be deemed illegal regardless of whether permission for copy and/or distribution of the materials is obtained).
- Materials (copyrighted work of a third party) distributed in a school class room are transmitted to the students who were absent from the class so that they can review them later (which will be deemed illegal regardless of whether permission to copy and/or distribute the materials is obtained).

Where a public transmission of exam questions without obtaining the permission is legal

- E-learning Vendor posts the copyrighted work of exam questions already made public on its website and transmits to the test-taker who enters its ID and/or password.

Where a public transmission of exam questions without obtaining the permission is illegal

- E-learning Vendor posts the copyrighted work of exam questions already made public on its website and transmits to the test-taker who enters its ID and/or password.

[Explanations]

**1. Utilization of internet in education**

The copyrighted works of third parties have been used as materials in many educational scenes. The text of novels and/or newspaper articles or images of pictures and/or paintings have traditionally been used as materials. In remote education utilizing networks (i.e.

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85 We should pay attention to the liabilities related to personal information as well as copyrights in implementing the E-learning. If a school or an E-learning Vendor managing personal information such as students' work performance leaks such information in a form where each individual may be identified (not in the form of statistics), such school or the E-learning Vendor may be liable for a contractual breach (Article 415 of the Civil Code) or for an unlawful act (Article 709 of the Civil Code). In addition, the provisions on the obligations under the Act on Protection of Personal Information are applicable to the school or E-learning Vendor holding certain amount of personal information in the form of a database (For details regarding the handling of personal information, see the "guideline concerning the Act on Protection of Personal Information relating to economy and industry" ([http://www.meti.go.jp/policy/it\\_policy/privacy/kojin\\_gadelane.htm](http://www.meti.go.jp/policy/it_policy/privacy/kojin_gadelane.htm)) and other guidelines published by other ministries (<http://www5.cao.go.jp/seikatsu/kojin/gaidorainkentou.html>))

e-learning), the range for use of copyrighted works of a third party has further extended by the addition of programmer, narration and even music media, as a result of digitalization of the materials and/or the multimedia content of such materials.

It is a fundamental rule to obtain the license or permission of the copyright owner for the use of copyrighted work of a third party. However, there are several exceptions under the Copyright Law in light of the significance of the use of copyrighted work of a third party in education. A 2003 amendment to the Copyright Law focused on the increase in usage of the internet in education and has expanded the range of exceptions.

## **2. Public transmission of materials during simultaneous teaching of a class**

The public transmission (including making transmittable in the case of interactive transmission; the same shall apply hereinafter) during the simultaneous teaching of a class without permission is permitted under Paragraph (2), Article 35 of the Copyright Law, which was newly created by the 2003 amendment, subject to the following conditions<sup>86</sup>:

- that the transmitter is nonprofit-oriented educational institution;
- that the transmission is made only to those attending the classes at such educational institution;
- that the transmission is made to the individuals at secondary site who are simultaneously participating in the ongoing classes at the main site;
- that the transmission is made for the delivery of materials which are distributed at the main site;
- that it is a transmission of copyrighted work which has already been made public; and
- that the transmission does not unreasonably prejudice the interests of the copyright owner in light of the nature and the purpose of the work as well as the form of the transmission.

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<sup>86</sup> <Copyright Law>  
Article 35 Paragraph 2

In the case of the exploitation of a work already made public, by offering or making public the original or copies of such work in the course of lessons in educational institutions mentioned in the preceding paragraph to those who take lessons directly, or in the case of the exploitation of such work by publicly performing, presenting or reciting it in accordance with the provision of Paragraph (1), Article 38 in the course of such lessons, it shall be permissible to make the public transmission (including making transmittable in the case of interactive transmission) of such work intended for reception by those who take lessons simultaneously at a location different from the place where such lessons are given; provided, however, that such transmission does not unreasonably prejudice the interests of the copyright owner in the light of the nature and the purpose of the work as well as the form of the transmission.



In the first place, only the nonprofit-oriented educational institutions, such as schools or community centers are the subject entities, while the private profit-oriented e-learning Vendors are not. E-learning Vendors need to obtain permission for public transmissions in class instructions from the copyright owner. The permission for the distribution of materials in the actual classroom does not apply to the public transmission thereof.

Also, exceptions are applicable only to simultaneous teaching. In addition, the permission of the copyright owner is required if such lecture is to be kept on the web server for later access.

### **3. Public transmission of exam questions**

The public transmission of exam questions without permission is permitted under Article 36 of the Copyright Law following the 2003 amendment, subject to the following conditions<sup>87</sup>:

- to pay compensation to the copyright owner if it is used for profit purposes;
- to ensure that the use is within the extent necessary for the purpose of exam;
- to ensure that the copyrighted work is already made public; and
- that the transmission does not unreasonably prejudice the interests of the copyright owner in light of the nature and the purpose of work as well as the form of the transmission.

The private e-learning Vendors having profit-oriented purposes may use public transmissions without permission if they are used to communicate exam questions. As a result, however, such Vendors will be responsible to pay compensation. Also, a trial exam which collects an examination fee is a typical example of profit-making for which the Vendor will be responsible to pay compensation.

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<sup>87</sup> <Copyright Law>

Article 36

It shall be permissible to reproduce or to make a public transmission (excluding the broadcasting or wire diffusion, and including making transmittable in the case of interactive transmission; the same shall apply in next paragraph) of, a work already made public as questions for an entrance examination or other examinations of knowledge or skill, or such examination for a license, to the extent deemed necessary for such purpose; provided, however, that such transmission does not unreasonably prejudice the interests of the copyright owner in light of the nature and the purpose of the work as well as the form of the transmission.