

The Rise of the Code of Conduct in Japan: Legal Analysis and Prospect

By

Koji Ishikawa

Associate, Latham Tokyo Law Office/Latham & Watkins LLP
Visiting Researcher, Peking University School of Law (from August 2004)
LL.M. 2004, New York University School of Law
LL.B. 1993, Waseda University

Email: Koji.Ishikawa@LW.com
Current address: 57 Hobart Avenue, Summit, NJ 07901-2808
Tel 908 598 1579
Permanent address: Latham & Watkins LLP, Tokyo office
32nd floor, Marunouchi Bldg., 2-4-1 Marunouchi
Chiyoda-ku, Tokyo 100-6332, Japan
Tel +81 3 6212 7800 Fax +81 3 6212 7801

Abstract

A code of conduct is a set of rules adopted by transnational corporations (“TNCs”) to regulate mainly working conditions and the management of contract factories. TNCs adopted codes of conduct to cope with the rising criticisms from the public in late 1980s and 1990s about unfair labor practices in contract factories in Third World countries. As the globalization of the economy progressed, like American TNCs, Japanese TNCs also transferred their production bases to developing countries like China, Vietnam, Malaysia and Indonesia in search of low wage labor. The development of a code of conduct in Japan is, however, quite different from that of American TNCs, and is very domestic and, in a sense, very “Japanese.” The purpose of this Note is to analyze, from a legal point of view, the development of Japanese codes of conduct and legal risks under Japanese law concerning unfair labor practices in foreign contract factories. Finally, this Note hypothesizes about the direction of the evolution of Japanese codes of conduct.

The Rise of the Code of Conduct in Japan: Legal Analysis and Prospect

Koji Ishikawa

Introduction

A code of conduct is a set of rules adopted by transnational corporations (“TNCs”)¹ to regulate mainly working conditions and the management of contract factories. TNCs adopted codes of conduct to cope with the rising criticisms from the public in late 1980s and 1990s about unfair labor practices in contract factories in Third World countries. Among the many stories that the media reported at that time, low wages in Nike’s contract factories in Indonesia² and “sweatshops” in Saipan, the Northern Mariana Islands, for the U.S. mainland apparel industry³ would be the two most watched cases and fresh in our memory.

Like American TNCs, as the globalization of the economy progressed, Japanese corporations also transferred their production bases to foreign countries like China, Vietnam, Malaysia and Indonesia in search of low wage labor. The development of a code of conduct in

¹ Among many terms to refer to corporations that operate in several countries such as “transnational corporations (TNCs),” “multinational corporations (MNCs)” and “multinational enterprises (MNEs),” in this note “transnational corporations (TNCs)” will be used based upon the “U.N. Code of Conduct for Transnational Corporations” discussed below. *See, generally*, David Weissbrodt & Muria Kruger, *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights*, 97 AM. J. INT’L L. 901, 907 (2003).

² *See, e.g.*, Edward A. Gargan, *International Business: An Indonesian Asset Is Also a Liability; Low Wages Woo Foreign Business, But the Price Is Worker Poverty*, N.Y. Times, Mar. 16, 1996, at 35.

³ *See, e.g.*, Jeff Wong, *Top U.S. Companies Being Sued for “America’s Worst Sweatshop”*, The Associated Press, Jan. 14, 1999.

Japan is, however, quite different from that of American TNCs, and is very domestic and, in a sense, very “Japanese.”

The purpose of this note is to analyze from a legal point of view the development of Japanese codes of conduct, and to hypothesize about the direction of its evolution. Before analyzing Japanese codes of conduct, Part I briefly describes the development of codes of conduct in the international community and the efforts made there by public and private initiatives. Part II discusses legal risks under Japanese law concerning unfair labor practices in foreign contract factories. Next, Part III describes two recent corporate scandals that drove Japanese corporations to the adoption of codes of conduct, and discusses the development of Japanese codes of conduct. Finally, Part IV analyzes the legal effect under Japanese law of the adoption of a code of conduct, and hypothesizes about its future.

I. Brief History of the Development of Codes of Conduct in the International Community

Roughly speaking, codes of conduct in the international community have been developed by three parties, which are international organizations like the United Nations, TNCs, and other third parties such as non-governmental organizations. Before discussing the development of codes of conduct in Japan, a brief survey of those in the international community would be helpful in understanding the uniqueness of Japanese codes of conduct.

A. Code of Conduct by International Organizations

As the globalization of the economy progressed, TNCs were motivated by economic reasons to transfer their production bases to developing countries, such as Latin American countries and South East Asian countries, for low wage labor and less employee's rights protection. Simultaneously, however, the international community increased criticism of TNCs' behavior in the host countries⁴, and various organizations, from governmental to non-governmental, have drafted guidelines to control TNCs' business conduct.

U.N. Code. Among the many efforts to create norms to regulate the business conduct of TNCs by international organizations, the United Nations' "Code of Conduct for Transnational Corporations" in 1974 ("U.N. Code")⁵ will be mentioned first. The U.N. Code had been under development since 1974, when the Economic and Social Council of the U.N. established a commission on TNCs. The commission was directed to study the role of TNCs in the international economy and to draft a code of conduct for them⁶, which later became the U.N. Code. The U.N. Code consists of 71 articles, but the wording is somewhat generic⁷ and no

⁴ One of the most illustrative cases would be the involvement of International Telephone and Telegraph Corporation, an American TNC, in the 1974 coup d'état in Chile, which overthrew then President Salvador Allende. David Binder (non-titled column), N. Y. Times, Feb. 28, 1974, at 14.

⁵ The final draft of the U.N. Code is attached to Economic and Social Council, 2d Sess., Agenda Item 7(d), at 1, U.N. Doc. E/1990/94 (1990).

⁶ *Review of the U.N. Code of Conduct for Transnational Corporations, Hearings Before the House Comm. on Foreign Affairs, Subcomm. on Human Rights and International Organizations*, 100th Cong. May 7, 1987, at 3 (statement of Hon. Alan Keyes, Assistant Secretary of State) [hereinafter *Hearings*].

⁷ Lance Compa & Tashia Hinchliffe-Darricarrère, *Doing Business in China and Latin America: Development in Comparative and International Labor Law*, 33 COLUM. J. TRANSNAT'L L. 663, 669 (1995).

concrete burden is imposed on TNCs. For example, Article 14 regarding human rights reads “[t]ransnational corporations shall respect human rights and fundamental freedoms in the countries in which they operate.” The U.N. Code, however, met strong oppositions from industrialized countries, especially the United States⁸, and was never officially adopted.

Global Compact. The U.N.’s other major effort after the U.N. Code was the Global Compact. The Global Compact was first addressed by U.N. Secretary-General Kofi Annan at the World Economic Forum on January 13, 1999⁹. He appealed to business leaders in attendance from all over the world to join an international initiative, the Global Compact, to promote human rights, improve labor conditions, and protect the environment. The Global Compact’s operational phase was officially launched at U.N. Headquarters in New York on July 26, 2000¹⁰. Although major U.N. agencies and TNCs expressed support for the Global Compact, it faced criticism from member state governments, especially the United States, the business community and even academics, and has not accomplished the major success that was expected when it was launched¹¹.

OECD’s Guidelines. In addition to the two U.N. major efforts noted above, “Guidelines for Multinational Enterprises” drafted by the Organization for Economic Corporation and

⁸ *Hearings, supra* note 6, at 4.

⁹ Global Compact web site. Available at <http://www.unglobalcompact.org/Portal> (last visited on Apr. 20, 2004).

¹⁰ *Id.*

¹¹ See, e.g., S. PRAKASH SETHI, SETTING GLOBAL STANDARDS, 115 (2003) (hereinafter *Sethi*); William H. Meyer & Boyka Stefanova, *Human Rights, the UN Global Compact, and Global Governance*, 34 CORNELL INT’L L.J. 501, 504 (2001).

Development (“OECD”) in 1976 (revised in 2000)¹² (“OECD Guidelines”) should be mentioned here. The OECD’s Guidelines are recommendations by the governments of thirty OECD member countries¹³. The OECD Guidelines are voluntary principles consisting of three parts: Part I The OECD Guidelines for Multinational Enterprises; Part II Implementation Procedures of the OECD Guidelines for Multinational Enterprises; and Part III Commentaries. They provide norms for a wide variety of areas such as employment, industrial relations, human rights, environment, disclosure, competition, taxation, and science and technology. One thing unique in the OECD Guidelines is that they have a complaint procedure for workers and trade unions¹⁴.

ILO Code. The International Labor Organization (“ILO”) also drafted a code of conduct entitled “Tripartite Declaration of Principles Concerning Multinational Enterprises of Social Policy”¹⁵ (“ILO Code”). The scope of the ILO Code is wider than the OECD Guidelines and covers job creation, investment in the local economy and subcontracting, etc.

¹² Available at http://www.oecd.org/findDocument/0,2350,en_2649_34889_1_119820_1_1_1,00.html (last visited on Apr. 20, 2004). For the revision in 2000, *see, generally*, OECD, *Review of the OECD Guidelines for Multinational Enterprises – Framework for Review* (May 21, 1999), available at http://www.oecd.org/document/29/0,2340,en_2649_34889_2439005_1_1_1_1,00.html (last visited on Apr. 20, 2004)

¹³ Eight non-member countries also expressed their endorsements for the OECD Guidelines. These countries are Argentina, Brazil, Chile, Estonia, Israel, Latvia, Lithuania and Slovenia.

¹⁴ OECD Guidelines, Part II Implementation Procedures of the OECD Guidelines for Multinational Enterprises; *Supra* note 7, at 671.

¹⁵ Available at <http://www.ilo.org/public/english/standards/norm/sources/mne.htm> (last visited on Apr. 20, 2004).

Both the OECD Guidelines and the ILO Code lack a penal or enforcement system for violations thereof, which leaves some question as to their actual influence¹⁶.

B. Code of Conduct by Private Initiatives

Side by side with the efforts by international organizations, TNCs themselves had started creating certain norms in the 1970s to regulate themselves, in response to increased criticism. Surveying these private initiatives, the Sullivan Statement of Principles¹⁷ concerning business with South Africa in the apartheid era, Levi-Strauss's Terms of Engagement and Guidelines¹⁸, and Nike's Code of Conduct¹⁹ are worth mentioning here. Levi-Strauss's Terms of Engagement and Guidelines are said to be the first code of conduct by TNCs, and Nike's Code of Conduct

¹⁶ Douglass Cassel, *Corporate Initiatives: A Second Human Rights Revolution?*, 19 FORDHAM INT'L L.J. 1963, 1970 (1996); Joshua P. Eaton, *The Nigerian Tragedy, Environmental Regulation of Transnational Corporations, and the Human Right to a Healthy Environment*, 15 B.U. INT'L L.J. 261, 273 (1997); Christopher R. Coxson, *The 1998 ILO Declaration of Fundamental Principles and Rights at Work: Promoting Labor Law Reforms Through the ILO as an Alternative To Imposing Coercive Trade Sanctions*, 17 DICK. J. INT'L L. 469, 478-481 (1999); Jane C. Hong, *Enforcement of Corporate Codes of Conduct: Finding a Private Right of Action for International Laborers Against MNCs for Labor Rights Violations*, 19 WIS. INT'L L.J. 41, 48 (2000); Elisa Westfield, *Globalization, Governance, and Multinational Enterprise Responsibility: Corporate Codes of Conduct in the 21st Century*, 42 VA. J. INT'L L. 1075, 1091 (2002).

¹⁷ Leon H. Sullivan, *Sullivan Principles for U.S. Corporations Operating in South Africa*, reprinted in 24 I.L.M. 1496 (1985).

¹⁸ Available at <http://www.levistrauss.com/responsibility/conduct/guidelines.htm> (last visited Apr. 20, 2004).

¹⁹ Available at <http://www.nike.com/nikebiz/gc/mp/pdf/English.pdf> (last visited on Apr. 20, 2004).

was in part a response to criticism²⁰ of Nike's unfair labor practices, such as child labor, in its Indonesian contract factories.

The Sullivan Statement of Principles. The Sullivan Statement of Principles was a set of principles advocated in 1976 by Leon H. Sullivan, a pastor of the Zion Baptist Church and a member of General Motor's board of directors. It focused on regulating American TNCs doing business in South Africa during the apartheid era²¹. Initially twelve major American TNCs expressed their support for the principles. The Sullivan Statement of Principles consists of six principles dealing with anti-discrimination (Principle I), fair employment practice (Principle II), equal payment (Principle III), job training program (Principle IV), promotion of non-white management (Principle V) and improvement of the quality of life outside the workplace (Principle VI)²². The principles themselves do not have penal provision for violations thereof. However, Arthur D. Little, Inc., a reputable consulting firm, undertook to oversee the function of the principles and to assess the progress made by the signatory companies²³. The Sullivan Statement of Principles, however, is not thought to have been a great success and it is said to have failed to deliver fully on its promise and potential²⁴.

²⁰ Among the literature and media coverage, "The Big One" (1999), a movie directed by American filmmaker, Michael Moore, would be a good example of the Nike criticism. In this movie, Michael Moore discussed with Philip H. Knight, President and CEO of Nike, child labor in Nike's contract factories in Indonesia.

²¹ *Supra* note 11, *Sethi*, at 95.

²² *Supra* note 17.

²³ *Supra* note 11, *Sethi*, at 104.

²⁴ *Id.* at 109. *Supra* note 7, at 666.

Levi-Strauss's Terms of Engagement and Guidelines. Levis-Strauss's "Business Partner Terms of Engagement and Guidelines for Country Selection" ("Levi-Strauss Code") that was adopted in 1991 is believed to be the first code of conduct among TNCs²⁵. The Levi-Strauss Code consists of five major aspects: ethical standards, legal requirements, environmental requirements, community involvement and employment standards. The employment standards cover child labor, prison labor/forced labor, disciplinary practices, working hours, wages and benefits, freedom of association, discrimination, health and safety²⁶. One unique element here would be the respect for freedom of association, which is not included in Nike's code of conduct, which is explained below.

Nike's Code of Conduct. Nike's Code of Conduct ("Nike Code") was established in 1992 in response to criticism about its unfair labor practices, such as child labor, in Nike's Indonesian contract factories²⁷. The code consists of a preamble and six sections, covering forced labor, child labor, compensation, benefits, hours of work/overtime, environment/safety/health, and documentation and inspection²⁸. Unlike Levi-Strauss's Code and

²⁵ Robert J. Liubicic, *Corporate Codes of Conduct and Product Labeling Schemes: The Limits and Possibilities of Promoting International Labor Rights Through Private Initiatives*, 30 LAW & POL'Y INT'L BUS. 111, 128 (1998). *See, also*, Levi Strauss's web site at <http://www.levistrauss.com/responsibility/index.htm> (claiming that "[i]n 1991, we became the first worldwide company to establish a comprehensive ethical code of conduct for manufacturing and finishing contractors working with the company") (last visited on Apr. 20, 2004).

²⁶ *Supra* note 18.

²⁷ The actual businesses of Nike are designing and marketing of sports gears. Nike does not own a manufacturing factory and outsources its production to foreign contract factories. *See, generally, supra* note 11, *Sethi*, at 152.

²⁸ *Supra* note 19.

Gap Inc.'s, Code of Vendor Conduct²⁹, the Nike Code does not mention freedom of association for the workers. Although the contents are standard and there is nothing special therein, a distinctive feature of the Nike Code, or more precisely, the enforcement of the Nike Code is its monitoring and checking system. Nike established a Labor Practices Department in 1996 to check whether the performance of Nike's contractors meets the Nike Code. In addition, Nike hired Ernst & Young, one of the big four accounting firms, to independently monitor pay records, overtime compensation requirements and other local law compliance³⁰.

The motives of the adoption of codes of conduct by TNCs, such as Levi-Strauss and Nike, might vary. Some might have not originated from a purity of heart to care for the workers in the foreign contract factories³¹. It would be undeniable, however, that these codes heightened the standards and were a driving force to improve the awareness of the management of TNCs and foreign contract factories, and, possibly, improved working conditions³².

²⁹ Available at http://www.gapinc.com/social_resp/ifpr/op&p/code_of_vendor_conduct.pdf (last visited on Apr. 20, 2004).

³⁰ See, generally, Ryan P. Toftoy, *Now Playing: Corporate Code of Conduct in the Global Theater. Is Nike Just Doing It?*, 15 ARIZ. J. INT'L & COMP. L. 905, 923.

³¹ Sol Picciotto, *Rights, Responsibilities and Regulation of International Business*, 42 COLUM. J. TRANSNAT'L L. 131, 139 (2003).

³² Claire Moore Dickerson, *Human Rights: The Emerging Norm of Corporate Social Responsibility*, 76 TUL. L. REV. 1431, 1437 (2002).

II. Legal Risks under Japanese Law Arising from Unfair Labor Practices in

A Foreign Contract Factory

Although Japan became the second largest economy in the 1970s, fortunately or unfortunately, Japan has had nothing to do with the international efforts mentioned above to regulate TNCs' business conduct in developing countries. Japan was neither a wrongdoer (at least directly) nor a victim of TNCs malfeasance, and was just out of the loop as usual.

There seemed to be three major reasons behind this history. Firstly, since the end of World War II, there has been actually no report of serious unfair labor practice, such as child labor, indentured labor or slave labor, in Japan. This is mainly because of the Japanese immigration policy³³ that prohibits, in principle, immigration of simple labor³⁴. Secondly, there has been no report of serious unfair labor practices in the foreign contract factories of Japanese corporations³⁵. Thirdly, there is little legal risk to which Japanese corporations are exposed

³³ Shutsunyūkoku kanri oyobi nanmin nintei hō [Immigration Control and Refugee Recognition Law] (Cabinet Order No. 319 of October 4, 1951; last revised on June 4, 2003), Article 7(1)(ii) and Annex 1-2; Shutsunyūkoku kanri oyobi nanmin nintei hō dai nanajō daiikkō dainigō no kijyun wo sadameru shōrei [Ministerial Order Providing Standards of Article 7(1)(ii) of Immigration Control and Refugee Recognition Law] (Ministry of Justice Order No. 16 of May 24, 1990; last revised on Feb. 27, 2004). The law and ministerial order, in principle, allow only foreign workers who have an expertise, such as a corporate executive, professor, banker, lawyer or scientist, to work in Japan.

³⁴ Before World War II, however, Japan also had a history of child labor and indentured labor, which were sometimes deemed legal at that time. A typical case was that, in a lean year, tenant farmers in the Tohoku region (northern Japan) would send, or sometimes sell, their children to factories as workers or to wealthy families as domestic help.

³⁵ There is one widely reported case that an American subsidiary of Mitsubishi Motors Corporation was sued by the U.S. Equal Employment Opportunity Commission for sexual harassment in a factory located in America. See Nihon Keizai Shimbun [Nikkei Newspaper] (morning edition), Apr. 24, 1996, at 13. This

under Japanese law, relating to serious unfair labor practices in their foreign contract factories. Although there are several laws possibly applicable to such issues as follows, each of them has difficulty in its application and cannot have a direct impact on Japanese corporations.

A. Observation of Treaties under the Japanese Constitution

The Constitution of Japan³⁶ provides for the observation of treaties and established international law. Article 98(2) states “[t]he treaties concluded by Japan and established laws of nations shall be faithfully observed.”³⁷ This obligation, however, is only applicable to the Japanese government and not to Japanese citizens and corporations, because the subject of this obligation is the Japanese government. Therefore, even in cases where the conduct of a Japanese citizen or corporation in a foreign country is contrary to “[t]he treaties concluded by Japan and established laws of nations,” Article 98(2) of the Constitution does not provide victims of such conduct with a cause of action before the Japanese courts.

case was, however, between two developed countries so that the context is different from cases to which the codes of conduct discussed in this note are applied.

³⁶ Nihonkoku Kenpō, [The Constitution of Japan]. Official English translation is available at http://www.kantei.go.jp/foreign/constitution_and_government_of_japan/constitution_e.html (last visited on Apr. 20, 2004).

³⁷ It is the established view among scholars that, based on Article 98(2) of the Constitution, treaties, conventions, compacts and other international agreements are given precedence over national laws of Japan. The argument among scholars whether superiority between the Constitution and treaties, conventions, compacts and other international agreements is not settled yet. *See*, KŌJI SATO, KENPŌ [CONSTITUTIONAL LAW] 30 (3d ed. 1995) (1981). The Supreme Court held, however, that treaties, conventions, compacts and other international agreements can be a violation of the Constitution. *See*, Sunagawa case, 13 KEISHŪ [Supreme Court Criminal Case Reporter] 3225 (Sup. Ct. Dec. 16, 1959). The main issue in the Sunagawa case was the constitutionality of the Japan-U.S. Security Treaty. The Supreme Court held that the Japan-U.S. Security Treaty was constitutional.

B. Product Liability Claim

Under the Product Liability Law³⁸, importers shall be liable for damages caused by defects in imported products. Article 3 of the law provides as follows (note: by Article 2(3)(i), “importer” is included in the definition of “manufacturer, etc.” below):

Article 3 (Product Liability)

The manufacturer, etc. shall be liable for damages caused by the injury, when he injured someone's life, body or property by the defect in his delivered product which he manufactured, processed, imported or put the representation of name, etc. as described in subsection 2 or 3 of section 3 of Article 2. However, the manufacturer, etc. is not liable when only the defective product itself is damaged.

If there is a defect in an imported product and a consumer suffered damages thereby, the consumer can sue the importer for the damages caused by the defective imported product. Product Liability Law defines “defect” as “lack of safety that the product ordinarily should provide, taking into account the nature of the product, the ordinarily foreseeable manner of use of the product, the time when the manufacturer, etc. delivered the product, and other circumstances concerning the product.”³⁹ Thus, “defect” under the Product Liability Law is limited to defects in product safety that might harm consumers, and does not include so called “social quality” such as the fact that the product was produced without child labor or forced

³⁸ Seizōbutsu Sekinin Hō [Product Liability Law], Law No. 85 of July 1, 1994. Tentative English translation by the Japanese government is available at <http://www.consumer.go.jp/e/pla/index.html> (last visited on Apr. 20, 2004).

³⁹ Article 2(2) of the Product Liability Law.

labor, etc.⁴⁰. Therefore, in cases where imported products that were produced by child labor or forced labor, etc. in foreign contract factories caused injury to a Japanese consumer, the Product Liability Law does not provide the consumer with a cause of action before the Japanese courts, as long as the product is free from defects in its safety.

C. Tort Claim

Under Japanese law, if the tortfeasor is a Japanese citizen or a corporation incorporated under Japanese law, victims of the tort in a foreign country can sue the tortfeasor in both Japanese court⁴¹ and the court of the country where the tort was done⁴². This theory is, however, applicable only to cases in which a Japanese citizen or corporation is directly involved in the case; in other words, in cases where tort, namely, unfair labor practice in our context, was done solely by a foreign contract factory, Japanese law does not provide jurisdiction over the Japanese party behind the contract factory. Workers in foreign contract factories, therefore, have to prove that the Japanese party is the real tortfeasor or joint tortfeasor and there is a reasonable causation between the act of the Japanese party behind the contract factory and the damages the victims suffered. This proof would be very difficult in a typical contract relation between a Japanese party and its foreign contract factory.

⁴⁰ Economy Planning Agency Consumer Affairs 1st Section, Chikujyō kaisetsu seizōbutsu sekinin hō [Annotated Product Liability Law] 65 (1995).

⁴¹ Article 709 of Minpō [Civil Code], Law No. 89 of Apr. 27, 1896 (last revised on Aug. 1, 2003); Article 4(1) of Minji Soshōhō [Code of Civil Procedure], Law No. 109 of June 26, 1996 (last revised on July 25, 2003). See Malaysian Airline case, 35 MINSHŪ [Supreme Court Civil Case Reporter] 1224 (Sup. Ct. Oct. 16, 1980).

⁴² Hiroshi Sano, *Fuhō kōichi no kankatsuken* [Jurisdiction Over International Tort], in SHIN SAIBAN JITSUMU TAIKEI VOL. 3 KOKUSAI MINJI SOSHOHŌ (ZAIANHŌ KANKEI) [New Court Practice Collection Vol. 3 International Civil Procedure Law] 91 (Akira Takakuwa & Masato Dōgauchi eds., 2002).

Also, even if workers in foreign contract factories could prove that the real tortfeasor is the Japanese party and thereby established a jurisdiction over the Japanese party before a Japanese court, the Japanese court still reserves the right to deny the jurisdiction for the reason that having the case in Japan does not stand to reason⁴³. A recent Supreme Court case also held that, if the court recognizes a circumstance in which having the case before a Japanese court is contrary to the ideas of fairness, adequacy and promptness of court procedure, the Japanese court does not have jurisdiction over such an international litigation⁴⁴. Based upon this tendency of the Supreme Court, if one or both parties are located in a foreign country, and the tort occurred there, it is very likely that the Japanese court would deny the jurisdiction over that matter. Accordingly, a tort claim by workers in foreign contract factories against the Japanese corporation behind their employers cannot help but give concrete and imminent pressure on Japanese corporations and their directors.

D. Director's Fiduciary Duty

The legal risk relating to unfair labor practices in foreign contract factories might be realized from inside of the corporation, rather than from outside pressure such as treaties, product liability or tort claim. The Commercial Code of Japan⁴⁵ provides for the fiduciary duty of directors^{46,47}. Based on this fiduciary duty, directors shall be responsible for constructing a risk

⁴³ Malaysian Airline case, *supra* note 41, at 1226.

⁴⁴ 51 MINSHŪ [Supreme Court Civil Case Reporter] 4055, 4059 (Sup. Ct., Nov. 11, 1997).

⁴⁵ SHOHŌ [Commercial Code], Law No. 48 of Mar. 9, 1899 (last revised on Aug. 1, 2003).

⁴⁶ Article 254(3) of the Commercial Code; Article 644 of the Civil Code. So-called corporate law is provided as a part of the Commercial Code.

⁴⁷ Under Japanese corporate law, fiduciary duty does not clearly branch into duty of care and duty of loyalty. Especially, duty of loyalty is not recognized as an independent duty of directors. The term

control system corresponding to the scale and characteristics of the business.⁴⁸ If a director of Japanese corporation realized that an unfair labor practice occurs in a foreign contract factory and that it attracts media attention and is reported widely and thereby the reputation or business of the corporation is damaged, the director might be liable for such damages because of a violation of his fiduciary duty and could be sued in a shareholders representative suit. Although there seems to be no such case in Japan so far⁴⁹, the required level of the fiduciary duty is heightened as the complexity and specialization in society progresses⁵⁰. Also, the consciousness of the general public regarding international human rights is also improved. The above scenario is now more realistic under current circumstances than it was in the past.

“fiduciary duty” (*zenkan chūi gimu*) is used to refer to both duty of care and duty of loyalty. See generally, SHINPAN CHŪSHAKU KAISHA HŌ VOL. 6, KABUSHIKI KAISHA NO KIKAN (2) §§254~280 [NEW EDITION ANNOTATED CORPORATE LAW VOL. 6, ORGANS OF JOINT STOCK CORPORATION(2) §§254~280] 28 (Katsuro Ueyanagi et al. eds., Revised edition 1987)

⁴⁸ Daiwa Bank shareholders representative suit, 1721 Hanrei Jihō 3, 32 (Osaka District Court, Sep. 20, 2000). Daiwa Bank suffered a loss of about \$1.1 billion due to off-the-book transactions of U.S. treasury bill for 11 years by an executive vice president of the New York branch. Daiwa Bank had to withdraw from the U.S. market because of this scandal.

⁴⁹ There is no official online database covering all published cases in Japan. There are, however, several private vendors providing online database in Japan, like Westlaw or Lexis.

⁵⁰ SHINPAN CHŪSHAKU MINPŌ VOL. 16, SAIKEN (2) §§623~666 [NEW EDITION ANNOTATED CIVIL CODE VOL. 16, CREDITOR’S RIGHTS (2) §§623~666] 224 (Tōru Ikuyo & Toshio Hironaka ed., Revised edition 1989).

III. Code of Conduct of Japanese Corporations

A. Code of Conduct for Quality Control

Despite the relatively low legal risk as discussed above, Japanese corporations are becoming more conscious of the importance of the control of contract factories. The motive for the adoption of a code of conduct is, however, quite different from that of TNCs, and is very domestic or “Japanese”: it is for quality control of products in domestic contract factories, not for preventing unfair labor practices in foreign contract factories. The followings are two illustrative cases that drove Japanese corporations to considering a code of conduct.

1. Sony Playstation Case⁵¹

In Fall 2001, cadmium exceeding the environmental standard was found in connection cables of the Playstation 2, Sony’s consumer video game console, in Holland. As a result, Sony had to recall the Playstation 2 from the European market and temporarily suspend shipments. The connection cable was procured from a Sony’s contract factory in China, and Sony realized from this case that legal compliance in a foreign contract factory could affect Sony’s reputation. One Sony manager said “so-called ‘source management’ became crucial.”⁵² In response to this case, Sony conducted onsite audits in 4,500 contract factories and checked whether the contract

⁵¹ *Europe and America Go Ahead in Corporate Social Responsibility – Onsite Audit in Contract Factories*, Nihon Keizai Shimbun [Nikkei Newspaper], Aug. 3, 2003 (morning edition), at 29.

“Shimbun” in Japanese means “newspaper.”

⁵² *The Economy Has Changed (2) – Customer Has Changed: Selling Reliance and Building New Affiliation*, Nihon Keizai Shimbun [Nikkei Newspaper], May 16, 2003 (morning edition), at 1.

factories complied with local environmental and other regulations, including protection of human rights.

2. Prima Meat Packers Case⁵³

Prima Meat Packers, Ltd. (“Prima”), the second largest meat packer in Japan, is a major manufacturer of a bacon product that is one of the private brands of Aeon Co., Ltd., the second largest supermarket chain in Japan. Prima used albumin in the bacon product, which was prohibited under its contract with Aeon, without notifying Aeon. Albumin is an allergenic material and required to be labeled on the product by the Food Sanitation Law⁵⁴. Aeon did not label the use of albumin on the product because Prima had not notified Aeon thereof, which constituted a violation of the Food Sanitation Law by Prima. Since the bacon products were sold as an Aeon private brand product, Aeon was also exposed to a legal risk of consumer claims if the albumin caused an allergic reaction in any consumer who ate Aeon’s products. In response to Prima’s prohibited use of albumin, Aeon indicted Prima for a violation of the Food Sanitation

⁵³ *Aeon Withdraws Prima Meat Packer’s Products: Use of Prohibited Material Under Contract*, Nihon Keizai Shimbun [Nikkei Newspaper], Feb. 2, 2003 (morning edition), at 35; *Prima Meat Packers Conceded the Use of Prohibited Material in Bacon Product – Reexamine All Products*, Nihon Keizai Shimbun [Nikkei Newspaper], Feb. 3, 2003 (morning edition), at 13.

⁵⁴ Law No. 233 of Feb. 24, 1947 (last revised on May 30, 2003). Article 19.

Law⁵⁵, which was extremely exceptional in a Japanese corporate culture that tends to avoid legal disputes as much as possible⁵⁶.

B. The Three Generations of Japanese Codes of Conduct

After a series of quality control problems in contract factories that significantly affected corporate brands and consumer credibility, Japanese corporations started paying more attention to checking the management and operation of contract factories through a code of conduct. Unfortunately, there is no official and unofficial data showing the number of Japanese corporations that adopted a code of conduct applicable to its contract factories. As far as the author was able to research, three public corporations, Prima, Bandai Co., Ltd., a major toy manufacture, and Aeon adopted a code of conduct. The codes of conduct of Prima and Aeon are posted on their web sites, but Bandai does not make its code of conduct available publicly⁵⁷.

In contrast to codes of conduct of TNCs that focus on preventing unfair labor practices in foreign contract factories, the Japanese codes of conduct have originated with a focus on regulating much broader aspects and have not paid specific attention to the prevention of unfair labor practices in foreign contract factories. Subject to its scope and legal nature, the

⁵⁵ *Aeon Indicted Prima Meat Packers for Use of Prohibited Material*, Nihon Keizai Shimbun [Nikkei Newspaper], Feb. 4, 2003 (morning edition), at 39. After receiving the indictment by Aeon, the Metropolitan Police Department searched the headquarter of Prima and heard from Prima employees as witnesses. The formal criminal procedure, however, was not commenced.

⁵⁶ *Prima Meat Packers Problem Creates a Sensation Among Contract Factories*, Nikkei Sangyo Shimbun [Nikkei Industry Newspaper], Oct. 1, 2003, at 21. Some contractors said that they “never heard of such indictment” and sympathized with Prima.

⁵⁷ The author requested Bandai to disclose the code of conduct, but they refused. E-mail dated Feb. 23, 2004 from Bandai Customer Center to the author (on file with the author).

development of the Japanese codes of conduct can be classified as the following three generations.

The First Generation

- Abstract and spiritual (does not create any legal rights or duties)
- Unilateral expression of policy (counter signature by the contract factory is not required)
- No reference to unfair labor practices and human rights

The Second Generation

- Abstract and spiritual (does not create any legal rights or duties between the corporation and the contract factory)
- Unilateral expression of policy (counter signature by the contract factory is not required)
- Some reference to unfair labor practices or human rights or both

The Third Generation

- Concrete and detailed (creates legal rights and duties between the corporation and the contract factory)
- Legal nature is an agreement (counter signature by the contract factory is required)
- Specifically focusing on the prevention of unfair labor practices or protection of human rights or both

As seen above, it can be noted that there are three movements in the development from the first generation to the third generation: from abstract and spiritual wordings to concrete and detailed ones; from an unilateral expression of policy to a bilateral legal agreement; and the broad scope of application to focusing on labor practices or human rights or both.

In the light of this classification, Prima's code of conduct is an example of the first generation, and Aeon's code of conduct can be classified in the second generation. There is no Japanese code of conduct that can be classified in the third generation so far. In 2002, Wal-Mart Stores, Inc., which has a more advanced code of conduct that can be classified as the third generation in Japan, acquired The Seiyu, Ltd., Japan's fourth largest supermarket chain⁵⁸. Through this acquisition, it is expected that the so-called third generation code of conduct will penetrate into the Japanese business community.

C. Prima Meat Packers, Ltd. Code of Conduct⁵⁹

Prima's code of conduct consists of nine relatively spiritual and abstract principles as follows⁶⁰:

Preamble The highest priority of Prima Meat Packers is to contribute to society, and we shall be always thankful to our customers and devote ourselves to food production.

⁵⁸ *Wal-Mart acquires Seiyu*, Nihon Keizai Shimbun [Nikkei Newspaper], Mar. 15, 2002 (morning edition), at 1.

⁵⁹ Japanese version is available at <http://www.primaham.co.jp/company/kihan.htm> (last visited on Apr. 20, 2004).

⁶⁰ English translation by the author.

We, as an economic entity, pursue profits through fair competition, but, at the same time, we shall make our best effortsto be a usefulpresence in society.

Our management and employees shall fully understand the above spirits, and, based on the following nine principles, shall observe national and international laws, international rules and their spirits, and shall behave with common sense.

Principle I Being honest and being faithful to basics shall be the principle in every aspects of corporate activities, and law and internal rule, etc. shall be observed.

Principle II “Nothing is more important than product and quality” and “service for customers with constant innovation” shall be the principles, and we shall manufacture products with a priority on customer satisfaction and reliance.

Principle III Fair, transparent and free competition shall be observed in business. We shall maintain healthy relations with politics and the government.

Principle IV We shall actively and fairly disclose corporate information, such as operation and business activities, to consumers and shareholders, etc.

Principle V We shall make effortsto protect the environment in business.

Principle VI We shall achieve employees welfare, keep a safe and worker-friendly workplace and respect the dignity and personality of employees.

Principle VII We shall firmly confront antisocial organizations that threaten the order and safety of civil society.

Principle VIII We shall respect the culture and customs in foreign countries, and do business that contributes to local development.

Principle IX Management shall understand that the realization of the spirit of this code of conduct is its role, inform related parties of this code of conduct, prepare internal systems and nurture ethics.

Prima's code of conduct, however, does not specifically focus on controlling contract factories; rather, it is an expression of an unilateral resolution of Prima itself. There is no section therein that deals with labor standards in its contract factories, which can be said to be the core of the codes of conduct adopted by TNCs. Also, Prima's code of conduct does not create legal rights or duties of Prima or its contract factories. Surprisingly, although Prima's code of conduct was established after the albumin scandal, there is no section, except for the highly spiritual and abstract Principle I and Principle II, that details how to implement concretely quality control and legal compliance in both Prima and its contract factories. Generally speaking, Prima's code of conduct is a kind of extension of corporate precepts and very remote from the common understanding of a code of conduct in the international community.

D. Aeon Code of Conduct⁶¹

Aeon's code of conduct, which can be said to be of the second generation, is more specific and closer to the codes of conduct in the international community.

Aeon's code of conduct, established in April 2003, consists of six parts: "Preamble," "The Aeon Code of Conduct Commitment," "Our Promise to Customers," "Aeon and Local Community," "Aeon and Its Business Partners," and "Aeon and Its Shareholders." We can see also here, the same as with Prima's code of conduct, that a code of conduct of a Japanese corporation covers not only contract factories but also very broad areas, such as customer relations and investor relations, which are a quite unique element compared with a TNC's code of conduct.

Among the six parts of Aeon's code of conduct, "Aeon and Its Business Partners" ("Aeon Code") is equivalent to the code of conduct discussed in this note in the context of labor standards in contract factories. The Aeon Code consists of the following preamble and five principles.

Preamble Aeon respects innovative business partners who help the company achieve its objective of "Customer Satisfaction." We strive to work as equals with our business partners, dealing fairly and working for our mutual prosperity.

⁶¹ English version is available at http://www.aeon.info/aboutaeon/aeon_code_of_conduct/en/ (last visited on Apr. 20, 2004).

The term “business partner” refers to all of the partners with whom we conduct business, including those who provide retail products, facilities services, and our retail tenants.

Principle I⁶² At Aeon, we cooperate with our business partners, all of whom are important to us, moving forward together to develop innovative business models that will open the gate to the next era.

We cultivate strong relations with our partners, together pursuing innovative business practices, better products, better services, and our mutual success.

Principle II At Aeon, we clearly document agreements with business partners, and strictly follow the letter of such agreements.

We maintain equality with our business partners, connected through formal agreements. Both parties strictly adhere to all agreed-upon contract provisions.

Principle III At Aeon, we respect business partners whose top priority is safety and customer peace of mind/assurance.

We and all of our business partners share the common goal of “Customer Satisfaction.” If the smallest doubt exists regarding the safety or trust of a

⁶² Original Aeon Code is not numbered. Numbering is done by the author for convenience purposes.

product or service, we work with our business partners to promptly ascertain the nature of the concern and resolve the issuer.

Principle IV At Aeon, we require our business partners to comply with both the letter and spirit of international standards and to practice them fully.

Aeon complies with and respects all generally recognized international standards, including those related to ISO, labor, environmental conservation, and quality management. We also require our business partners to strictly observe these same standards.

Principle V At Aeon, we do not tolerate the acceptance of gifts, money, or special favors from our business partners.

We select business partners based on their ability to offer better products and services at fair price. Individuals do not accept any gifts, money, or special treatment from a business partner designed to secure our business in any situation. All efforts must to forward benefits to the customers.

Compared with the Prima Code, the Aeon Code rises higher than a unilateral expression of corporate policy or mere spirit, and focuses more specifically on relations with business partners. Also, in Principle IV of the Aeon Code, we can see a small sign of the shift from the second generation to the third generation, namely, the shift to getting nearer to a contract.

E. Comparison of Codes of Conduct

Although the Aeon Code is one of the most advanced codes of conduct among Japanese corporations, there are still some gap between TNCs’ codes of conduct and the Aeon Code. Wal-Mart, for instance, has a similar business structure to Aeon, but its code of conduct, titled “Standards for Suppliers”⁶³ (“Wal-Mart Code”) applicable to Wal-Mart’s suppliers, is more concrete and detailed than the Aeon Code. The following chart shows a comparison between the Wal-Mart Code and the Aeon Code.

		Aeon	Wal-Mart
1	Legal nature	Unilateral expression of policy on supplier	Agreement between Wal-Mart and supplier
2	Scope of application	Business relation between Aeon and its all business partners including suppliers	Business relation between Wal-Mart and suppliers
3	Compliance with applicable laws	Abstractly mentioned	Concretely mentioned
4	Employee compensation	Very abstract reference in Principle IV: “At Aeon, we require our business partners to comply with both the letter and spirit of international standards and to practice them fully. Aeon complies with and respects all generally	Concretely mentioned
5	Hours of labor		Concretely mentioned
6	Forced labor		Concretely mentioned
7	Prison labor		Concretely mentioned
8	Child labor		Concretely mentioned
9	Discrimination/Human rights		Concretely mentioned
10	Workplace environment		Concretely mentioned

⁶³ Available at <http://www.walmartstores.com/Files/SupplierStandardsdoc.pdf> (last visited on Apr. 20,2004).

11	Concern for the environment	recognized international standards, including those related to ISO, labor, environmental conservation, and quality management. We also require our business partners to strictly observe these same standards.”	Concretely mentioned
12	Right of inspection	Not mentioned	Concretely mentioned
13	Right of unannounced factory inspection	Not mentioned	Concretely mentioned
14	Termination of business relation	Not mentioned	Concretely mentioned
15	Confidentiality	Not mentioned	Concretely mentioned
16	Gift and gratuity from supplier	Clearly prohibited	Clearly prohibited
17	Disclosure of the code of conduct to employees of contract factory	Not mentioned	Disclosed to employees in local language
18	Violation reporting system	Not mentioned	Concretely mentioned
19	Counter signature by supplier	Not required	Required

Among the many differences between the two codes, the most significant one is whether it creates legal rights and duties of the parties. Each section in the Wal-Mart Code begins with “[s]upplier shall” and it provides a penalty for a violation of the code by the supplier. To the contrary, there is no “shall” in the Aeon Code but rather, it says “respect” and “cooperate.” Only

Principle IV in the Aeon Code says “we require our business partners to comply.” There is, however, no penalty in the Aeon Code for violations of Principle IV by the supplier.

IV. Legal Analysis of a Japanese Code of Conduct and Its Prospect

As discussed in Part II, the legal risk under Japanese law arising from unfair labor practices in a foreign contract factory is low. Causes of action before a Japanese court, such as a violation of international law, tort or product liability, are remote for proceeding to a substantive court procedure. Accordingly, directors of Japanese corporations are not exposed to substantial legal risks related thereto, and have not needed to pay attention to those issues.

Among the many possible, but sometimes remote, causes of action before a Japanese court concerning unfair labor practices in a foreign contract factory, a director’s fiduciary duty would be the most viable one. A recent shareholder representative case in the Osaka District Court held that directors shall be responsible for constructing a risk control system corresponding to the scale and characteristics of business⁶⁴:

“...for healthy operation, it is indispensable to have a clear grasp and control of various risks, namely risk control, arising from the type and nature of the business, such as credit risk, market risk, liquidity risk, office work risk, system risk, etc., and a risk control system (so-called internal control system) corresponding to the scale and characteristics of the business of the corporation is required. As a board resolution is required for

⁶⁴ *Supra* note 48. Among many shareholders representative suits, the Osaka District Court Judgment is the latest one that explains the details of an “internal control system.”

important business execution (Article 260(2) of the Commercial Code), the general principles of a risk control system, which are fundamental to the operation, shall be decided at a board meeting, and the representative director and director in charge shall decide, based on the general principles, the details of the risk control system of each department. In this context, directors, as a member of the board or the representative director or director in charge, shall be responsible to establish a risk control system and to monitor the performance of the representative director and director in charge, and this shall be also one element of the director's duty of care and duty of loyalty⁶⁵ ...” (“Osaka District Court Judgment)⁶⁶ (underline added by the author).

It is not very clear whether the term “internal control system” in the Osaka District Court Judgment includes a code of conduct applicable to contract factories. However, considering the two facts that the Aeon Code was adopted in April 2003, three years after the Osaka District Court Judgment, and there has been no court case dealing with a code of conduct and a director's fiduciary duty so far, it might be too much to say that the judges of the Osaka District Court Judgment wrote “internal control system” with the intention to include or pay some attention to a code of conduct applicable to contract factories.

The situation, however, has changed since the Osaka District Court Judgment in 2000. There were many corporate scandals other than the Playstation case (2001) and the Prima Meat Packer case (2003) that have harmed consumer credibility and thereby financially damaged corporations. Nippon Foods, Inc. and Yukiijirushi Foods, Co., Ltd. would be the two most

⁶⁵ See, *supra* note 47.

⁶⁶ *Supra* note 48. English translation by the author. Japanese courts do not provide English translation of judgments, decisions and orders.

illustrative cases after the Osaka District Court Judgment. There was an outbreak of Bovine Spongiform Encephalopathy (“BSE”), or mad cow disease, in Japan in 2001, and, to save the beef industry, the Japanese government started a purchase program under which the government purchases domestic beef from beef processors. The purchase program covered only domestic beef because BSE was confirmed only in domestic beef at that time⁶⁷. Two major beef processors, Nippon Foods, Inc., and Yukijirushi Foods, Co., Ltd., misused the government’s purchase program. They camouflaged foreign beef as domestic beef so that their beef could be purchased by the government. After these deceptions came to light, Nippon Foods and Yukijirushi Foods, together with their parent corporations, suffered significant business and financial losses⁶⁸. Further, because of sever criticism from consumers, Yukijirushi Foods, then a public corporation listed on the Tokyo Stock Exchange, had to go into bankrupt only three months after the deception was discovered⁶⁹.

The above cases fully show that Japan has entered a new era in which consumer credibility possesses the power of life and death over corporations. Corresponding to the new era, it is reasonably expected that a director’s fiduciary duty should also be heightened and expanded⁷⁰. In fact, after the series of corporate scandals in the meat industry including the Prima case, Japanese corporations became more conscious of quality control in contract factories and, like Aeon, rapidly moved to adopt a code of conduct because of the fear of losing consumer credibility. This movement indicates that, in the new era after the corporate scandals in the meat

⁶⁷ Nihon Keizai Shimbun [Nikkei Newspaper] (morning edition), Aug. 7, 2002, at 35.

⁶⁸ Nihon Keizai Shimbun [Nikkei Newspaper] (morning edition), Aug. 13, 2002, at 9.

⁶⁹ Nihon Keizai Shimbun [Nikkei Newspaper] (morning edition), May 1, 2002, at 13.

⁷⁰ *Supra* note 50, at 226.

industry, adopting a code of conduct to control contract factories is included in a director's fiduciary duty, or, at least, directors have started thinking that they might be liable for a violation of this fiduciary duty if they do not adopt a code of conduct to prevent such scandals.

Amplifying this tendency, after one corporation was criticized for its unfair labor practice in its foreign contract factories, it would be undeniable that adopting a code of conduct to prevent unfair labor practices in foreign contract factories should be included in a director's fiduciary duty, or, at least, directors should start thinking that they might be liable for a violation of this fiduciary duty if they do not adopt a relevant code of conduct.

We can assume further a shareholder representative suit that pursues a violation of a director's fiduciary duty in connection with a code of conduct and an unfair labor practice in foreign contract factories. Can adopting a code of conduct be a defense against a claim for a violation of a director's fiduciary duty? Probably not, if such a code of conduct is in the second generation in Japan. Although the Osaka District Court Judgment is not perfectly clear on this point, it is not impossible to read that the Osaka District Court Judgment held implicitly that a director's fiduciary duty is deemed fully performed when an internal control system is established, performed and monitored. Amplifying this thought, a director's fiduciary duty is fully performed when a code of conduct is established, performed and monitored. As a result, the Japanese code of conduct has to evolve from the second generation to the third generation and to enhance its characteristics as a contract. Otherwise, it will not be able to assure the performance and monitoring of foreign contract factories.

Conclusion

The codes of conduct of Japanese corporations have originated from a series of corporate scandals relating to the quality control of products. It might sound very “Japanese” and probably shares its root with “*kaizen*”, Toyota’s famous way of improving the quality of products.

It is not believable, however, that Japanese corporations do not have anything to do with unfair labor practices in foreign contract factories for which TNCs are criticized. For example, according to a statistics of the Japan External Trade Organization, a governmental corporation to promote import and export, in 2003 China was the largest exporter for Japan, and Indonesia was the fourth. The shares and volumes were 21.9%, approximately US\$75.1 billion, and 15.4%, approximately US\$16.4 billion, respectively⁷¹. No one can guarantee that contract factories in these countries manufacturing products for U.S. corporations do not manufacture the same products for Japanese corporations.

As discussed in Part IV, a director’s fiduciary duty has changed with the change of society. In an era in which consumers became more conscious of unfair labor practices in foreign contract factories, a director’s fiduciary duty also will have to cover such concerns to protect the corporation. The code of conduct of Japanese corporations will evolve by the interaction between law and society. Consumers’ consciousness of international human rights was heightened as the globalization of the economy progressed. Probably, the next turn to heighten the consciousness will be on the corporation side.

End

⁷¹ Available at <http://www.jetro.go.jp/ec/j/trade> (last visited on Apr. 20, 2004).